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AN EMPIRICAL EVALUATION OF THE ADVANCE PRICING AGREEMENT
PROCESS IN THE UK

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Submitted in fulfilment of the requirements for the Degree of Doctor of Philosophy in

Accounting and Finance

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ABSTRACT

Tax planning and compliance in transfer pricing are sensitive issues that potentially affect the level of world trade. Advance pricing agreements (APAs) are intended to prevent disputes between fiscal authorities and multinational enterprises (MNEs) but to date the benefits and costs of applying for an APA are under-specified.

From a theoretical perspective, foreign direct investment (FDI) theories tend to provide strong support for the view that MNEs utilize international transfer pricing (ITP) as a means of ensuring the exploitation of FDI market imperfections. MNEs, however, presently find it difficult to achieve this objective given the need for them to demonstrate compliance with the arm's length principle (ALP) in their transfer pricing operations. The APA serves as one obvious avenue to overcome this tension. Normally, an APA is formally initiated by a taxpayer and requires negotiations between the taxpayer, one or more related-party entities, and the tax administration(s) of one or more nation states. Given the critical need for MNEs to manage their transfer pricing risk in modern times, the APA programme should have been popular with many MNE taxpayers. However, recent statistics showed that this is not the case, especially in the UK where Her Majesty's Revenue & Customs (HMRC) have operated the APA programme since 1999.

Some researchers have attempted to examine the reasons for the non-popularity of the APA programme. This study, however, goes beyond the traditional mono-method approach usually adopted by such authors. This study adopts a mixed-method methodological choice to examine the APA process. A sample of MNEs based in the UK was investigated and also their reasons for applying or not applying for an APA, particularly with HMRC in the UK. Together with the uniqueness of the methodological approach adopted, the study provides a clearer lens through which the topic of APAs can be explored and understood better. The study uncovers the confusion faced by MNEs in understanding the role being played by fiscal authorities in relation to the APA process. MNEs also face uncertainties in distinguishing between the benefits of an APA when compared with the cost of undergoing a transfer pricing audit as typically conducted by HMRC. The study concludes that three key themes (i.e., Cost and Benefit of an APA, Clarification of APA Guidelines and Generic APA Process) are critical to the MNEs' decision on whether or not to apply for APAs. There is a need to address these issues in order to improve the UK APA process in general.

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AUTHOR'S DECLARATION

I declare that, except where explicit reference is made to the contribution of others, that this dissertation is the result of my own work and has not been submitted for any other degree at the University of Glasgow or any other institution.

Signature _____

Printed name Oluwaseun Olanrewaju Avoseh (0600876)

CHAPTER 1: INTRODUCTION

1.1 International Transfer Pricing (ITP)

Over the past 50 years, the field of transfer pricing (TP) has witnessed a recognisable level of empirical and theoretical focus (domestic and international) both in academic and professional research if taken in its broadest sense. The evolving importance of transfer pricing, however, can arguably be said to be of more prominence within the last 15 to 20 years. Specifically, the increase in the level of interest is reflected in both the intensive theoretical and empirical research conducted on this topic, as well as the significant position the issue of ITP has taken in events of international taxation during these periods.

The works of Borkowski (1992a, 1992b, 1997a), Leitch and Barret (1992), Emmanuel and Mehafdi (1994), Cravens and Shearon (1996), Cravens (1997) and that of Cools and Emmanuel (2007), are only but a few of the academic studies that depict the complexity and the important nature of the transfer pricing issue in modern day multinational businesses.

Aside from this, the increase recorded in the number of businesses establishing multinational networks around these periods is also noted to have triggered an increasing alertness of tax authorities to the risk associated with income shifting. The US Internal Revenue Service (IRS), in the 1990s, led the way in the move to tighten transfer pricing related legislation and this, as of today, has become a common feature of most major and minor economies which have developed transfer pricing rules for their countries in order to handle the challenges of transfer pricing. However, many of these jurisdictions (including Australia, Canada, Japan, Mexico, the United Kingdom and the United States of America) allow companies to mitigate the risk associated with significant adjustments and penalties by entering into an Advance Pricing Agreement (APA) with the tax authority whereby agreed upon arm's length prices for related party transactions are established. In international transfer pricing (ITP), the APA process is designed to produce a formal agreement between taxpayers and revenue authorities in order to prevent uncertain consequences of changes in transfer price methods applied and fiscal regulation changes. The introduction of the APA programme as an administrative response to the difficulties with current transfer pricing tax regime is generally seen as a positive approach towards solving the transfer pricing problem of determining an arm's length price. This research study aligns with this positive notion of the process by proposing that the

APA process should have been more popular with multinational enterprises (MNEs), given the tension that these companies are bound to experience in their bid to comply with the arm's length principle. Together with the recent developments within the global economy which create an increasing challenge for MNEs in their efforts to comply with the arm's length principle, the tension should derive further from the juxtaposition of the theories of foreign direct investments (FDI) and the fiscal provisions in relation to the application of an arm's length principle for transfer pricing tax purposes. Given this concern, the lack of popularity of the APA process in the UK especially showcases an important need to reflect better the primary operational realities of MNEs in APA operations and policies.

1.2 The Research Problem

The main objective of this research study is to contribute towards a greater understanding of the rationales behind the attitudes of MNEs towards the UK APA process. By ascertaining on an empirical basis the underlying rationales for applying/not applying for the APA programme by MNEs, the researcher hopes to investigate how much of the generally established reasons/rationales (in extant academic and professional literature) for making APA applications actually hold true, among other practical ones. This investigation is further extended through an attempt to establish a user-oriented evaluation of the APA process from the MNE perspective by identifying the perceptions of the MNEs about the current UK APA process and matching this, where necessary, with the views of Her Majesty's Revenue & Customs (HMRC) in the UK.

1.3 Research Methodology

The study adopts a mixed-method methodological choice and a combination of deductive and inductive approaches to examine the research question. The mixed-method research methodological choice involves the use of both quantitative and qualitative techniques and procedure of analysis in a simple and sequential pattern (Saunders et al., 2012). The initial choice includes a largely closed questionnaire which was administered by post to the tax/transfer pricing directors of a sample of MNEs based in the UK. The analysis of the responses from the survey produces six themes which are in line with the central research question for this study. These include that of: Cost and benefits of an APA to MNEs; Transfer pricing (TP) audit experience relationship with APA applications by MNEs; Alternative dispute resolution (ADR) methods available to MNEs; Complexity of MNEs' TP cases; Risk

assessment; and Volume and size of MNEs' cross-border transactions. The six themes guide the development of the protocol for the second methodological choice, i.e., semi-structured interviews. With the interviews, the study explores further an in-depth analysis of issues that were evident under the six themes from the questionnaire. A combination of deductive and inductive approaches (i.e., hybrid approach) is used to analyze the interview transcripts and this throws up four new inductive themes of: Tax regime differences; Clarification of APA Guidelines; Generic APA options; and Distrust and secrecy. Following these interviews, a cross-section of TP/APA experts is consulted via a confirmatory Delphi study. This represents the third methodological choice in this project. The over-arching theme that emerges from the Delphi exercise is that of 'HMRC's facilitating role in terms of take-up of the APA'. The triangulation and sequence of data sources that is followed helps to demonstrate rigour and provides proper validity checks against inherent problems of common method bias/variance (CMV) as identified by Podsakoff et al. (2003).

1.4 Layout of the Thesis

The remainder of the thesis is as given below.

Chapter 2 presents the background discussion on the topic of APAs. Initially, the definition and significance of international transfer pricing is explained and the challenges that MNEs face in complying with the arm's length principle are discussed. The second part of this chapter justifies the need to address the central research question which is examined in this study. It also introduces the concept of APA, its purpose, objectives and structure as operated by HMRC in the UK. The general principles of the APA process are also discussed.

Chapter 3 reviews the empirical literature relating to international transfer pricing, income shifting evidence and advance pricing agreements (APAs). Consideration is initially given to the general theoretical influences that underlie the significance of international transfer pricing. After this, evidence of the previous empirical studies in the area of advance pricing agreement is used to identify the gap in the literature which justifies the research question.

Chapter 4 explains the researcher's beliefs and assumptions about the world and knowledge which is consistent with the pragmatist's position. This paradigm guides the researcher's choice of research methodologies which are appropriate to the study of APAs. The chapter

also describes in detail the methodological steps which are followed in carrying out this research and how the three different methodological choices made are connected in a triangulation of data sources.

Chapter 5 describes the data collected and what was done with the data. The mixed-method approach which is adopted to analyse the multiple data obtained is presented in a sequential order and how the themes for discussion are generated is showcased in detail.

Chapter 6 presents the findings of the study. The themes of relevance are presented and the connection between these themes is displayed. The theoretical and policy implications of the dominant themes are also discussed.

Chapter 7 concludes the research by looking at the practical relevance of the study. A review of the strengths and limitations of the study is also undertaken and contributions made by this study are clearly articulated. Also, suggestions for future research are presented.

CHAPTER 2: THE IMPORTANCE OF ADVANCE PRICING AGREEMENTS (APAS)

2.1 Introduction

The APA process is made necessary from the different difficulties associated with transfer pricing especially where there are considerable problems in establishing the manner by which the arm's length principle should be applied and the resultant implications of double taxation. Such difficulty makes for the existence of two opposing interest and, in a bid to address the two opposing interests of both parties (i.e., MNEs and tax authorities), a procedural programme involving mutual agreement between taxpayer and tax authority (authorities) is devised. These agreements, known as Advance Pricing Agreements or simply as APAs, are agreements whereby the future transfer pricing methodology to be used to determine the arm's length price is agreed by the taxpayer and the relevant tax authority or authorities. It is a procedural mechanism designed to resolve the uncertainties of tax laws surrounding related party transactions and cross border businesses. This chapter initially discusses the general background of international transfer pricing (ITP) and the developments that bring about the importance of APAs. The second part of the chapter discusses the general workings, process and administrative procedure of the APA programme.

2.2 International Transfer Pricing (Definition)

Willendorf (2010) defined the term 'transfer pricing' as the prices in transactions between associated enterprises. A more extensive coverage of what this term relates to is given in the explanation of Borkowski (1997b). Borkowski explained that transfer pricing is a strategy for pricing goods and intangible services transferred between parent and subsidiaries, or between subsidiaries, to maximize profits, minimize taxes, maintain goal congruence, and/or evaluate managerial performance. She further stated that these transfers may be between domestic entities or involve cross-border transactions (i.e., international transfer pricing (ITP) and that it is only international transfer pricing activity that lends itself to potential cross-border income shifting and tax reallocation to the multinational corporation's (MNCs) advantage (p. 322). This highlights the fact that the issue of transfer pricing, especially the tax aspect, is more pervasive and complicated at the MNE level. Willendorf (2010, p. 3) stated that 'The tax law problems derived from transfer pricing relate in particular to diminishing the tax base for individual associated enterprises, the international allocation of the tax base, enforcement of the law and international double taxation'. Most of the issues highlighted by Willendorf above

typically feature when cross border businesses take place. It is therefore easy to understand why tax authorities will want to look at the transfer pricing issue mainly from the international business perspective. In explaining the term 'transfer pricing', HMRC, for example, consider transfer pricing as an issue that mainly arises in cross border transactions between two entities that are part of the same group (HMRC International Tax Manual, INTM412000). To HMRC, transfer pricing does not have any formal definition but it can be characterized as the terms and conditions under which two persons enter into a transaction. However, transfer pricing problems are not limited to company transactions. For example, a transaction between an individual and an overseas company he/she controls can also be manipulated through the transfer price.

Consequently, we can consider having a transfer pricing (TP) situation whenever two related companies/entities/individuals trade with one another. By this, the price negotiated between the two is typically referred to as a transfer price. Considered differently from a multinational perspective, international transfer pricing (ITP) can be considered as a profit allocation activity for tax and other purposes between parts of a multinational corporate group. This latter definition is tenable on the basis of the argument that when undertaking transfers between different parts of one entity, the transaction (whether it is for the sale of goods, services or intellectual property) can be priced in such a way so as to move income from a high tax jurisdiction to a low tax jurisdiction. This practice is regarded as transfer price manipulation or aggressive tax planning.

2.3 Importance of International Transfer Pricing (ITP)

The above discussion helps to underline the fact that transfer pricing issues are mainly of concern when cross border transactions are involved between two or more entities that are part of the same multinational group. Following this, a clearer way of indicating the significance of international transfer pricing is to highlight the facts from publications by the Organization for Economic Cooperation and Development (OECD). The OECD report revealed that more 60% of world trade takes place within MNEs (OECD, 1996). This shows that MNEs play a key role in the globalized economy of today. According to the World Investment Report (2007), there are about 78,000 MNEs in the world, with about 778,000 foreign subsidiaries. Among the 100 biggest MNEs outside the financial sector, 23 are based in the United States of America, there are 13 in each of France, Germany and the United Kingdom, Japan has 9, while the home

states of the remaining 29 MNEs are spread over several countries. Although these figures are not taken as absolutely certain, subsequent OECD announcements and publications have continued to reiterate the fact that internal trade between associated enterprises of MNEs is large and growing. Willendorf (2010) noted the following.

‘The globalization of the economy has led both to an increase in world trade and in foreign direct investment. The driving force behind this has been, in particular, developments in telecommunications and information technology, falling transport costs, deregulation of financial transactions and the integration of financial markets, as well as the growth of new market economies in Asia and Eastern Europe. Economic integration has led to structural changes in the world trade. Major differences in wage levels between different countries have caused an international division of labour, as can be seen in a switch of imports of goods from high-cost countries to low-cost countries. A greater division of the production process has led to increased trade in semi-finished products, and a marked increase in trade-in-services. There has also been an increase in the mobility of production factors. These developments have also contributed to a greater centralization of the management of MNEs, cutting across national boundaries and corporate entities’ (p. 4).

The development of MNE activities in relation to this globalization trend does have implications for transfer pricing. Chan and Lo (2004) noted that increased globalization has made transfer pricing increasingly challenging for multinational corporations in planning and implementing their global operations. If we situate this assertion within the multinational enterprise theory from which we understand that the strategic selection of transfer prices can maximize global tax savings, minimize operating risks and circumvent restrictions imposed by host governments, then the significance of this present challenge posed by the international transfer pricing issue can be digested better. It is therefore no longer surprising that transfer pricing is ranked as one of the most important issues/topics in contemporary international accounting and tax matters both by accounting educators as well as by tax directors (see Sands and Pragasam, 1997; Ernst & Young’s Global Transfer Pricing Survey, 1995-2010).

2.3.1 Implications of Globalization for Transfer Pricing

Zhang (2012) noted that the prosperity of international business inevitably leads to the formation of the multinational enterprises (MNEs) that are engaged in various cross-border commercial transactions for the profit-seeking purpose. However, the emergence of MNEs and the subsequent globalization of business trade is a development that increased the alertness of tax authorities to the issue of transfer pricing. Right from the 1970s and 1980s when records show an increasing number of multinationals establishing multinational networks, tax authorities have increasingly felt exposed to the risk of profit shifting, whether this is intentional or not on the part of the MNEs. Greater tightening of transfer pricing regulations started with the US Internal Revenue Service in the early 1990s and this has subsequently spread widely to other countries which subsequently have implemented transfer pricing legislations. This way, increased enforcement of strong transfer pricing regimes has been adopted to protect tax revenues. Zhang (2012) noted that in order to ensure tax compliance and keep tax avoidance within limits, different tax regimes, apart from having enacted tax avoidance rules such as anti-deferral measures, are carefully watching the transfer pricing practices of multinationals. So far, over 60 countries worldwide have adopted the arm's length principle to regulate the transfer pricing, which makes multinationals to rely on APAs to manage their global supply chains (p. 19). Countries like Japan, Canada, Germany, France and the United Kingdom are some of the earlier countries, after the USA, to focus more on transfer pricing issues. The recognition that multinationals apportion group income amongst the various members of their controlled groups around the world through transfer pricing, triggers tax authorities' interest, since these transfer pricing policies serve as the basis for establishing the level of taxable income in their respective countries. However, these different transfer pricing enforcement efforts by tax authorities make MNEs more exposed to transfer pricing disputes and double taxation. Some of the high profile cases that are witnessed in recent years include that of the '*GlaxoSmithKline Holdings (Americas) Inc. v. Commissioner of the IRS*'. This is a case involving two tax authorities (i.e., US Internal Revenue Service (IRS) and HMRC) who were not willing to accept each other's position even though no abusive position is perceived against each other. In the end, additional US tax in excess of \$3 billion was reportedly incurred by GSK (Green, 2008). Another notable case is that of '*Yukos Universal Limited (Isle of Man) v. The Russian Federation*'. Yukos is a Russian energy company. It was reported that the demands of the Russian government for extra tax arising from alleged tax evasion and abusive transfer pricing bankrupted the company (Green,

2008). More recently, the long running battle between DSG International (owner of Dixons) and HMRC in the UK i.e., '*DSG Retail Limited and Others v. HMRC*', over transfer pricing arrangements was settled with an agreement that the company owed the tax authority £52.7 million (Clayson and Beeton, 2010). These are just a few of the resource consuming disputes that MNEs frequently face with tax authorities around the globe.¹

On the back of the increasing trends in transfer pricing disputes that are being witnessed across the globe, especially with the involvement of the USA and many of its trading partners, the demand for a universally acceptable principle was triggered. Consequently, the Organization for Economic Corporation and Development (OECD) attempted to mediate these conflicts by publishing the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations in July 1995 (the OECD Guidelines).² These Guidelines discuss the application of the arm's length principle (ALP) in determining the transfer pricing between related parties. The OECD is a forum in which governments work together to address economic, social and environmental challenges of interdependence and globalization as well as a provider of comparative data, analysis and forecasts to underpin multilateral co-operation. The forum's recommendation of the arm's length principle is based on the members' endorsement of the concept of separate entity as the underlying basis for allocating tax rights between countries. Thus, each part of the multinational entity is treated as a separate part of the economic entity (whether it is a branch or a subsidiary) and a price is substituted for taxation purposes that would have been used in the transaction had it been with an unrelated third party rather than a related party within the same multinational entity. These Guidelines represent a consensus among 25 OECD member countries on the approach to international transfer pricing issues.

2.3.2 The Arm's Length Principle (ALP)

According to the arm's length principle (ALP), MNEs are expected to carry out controlled transactions at arm's length prices. Green (2008) expatiated on this principle and described the ALP as the standard used to evaluate whether the commercial and financial arrangements such

¹ See 'Recent International Case Law on Transfer Pricing', Nishith Desai, International Fiscal Association-Indian Branch Publication (2002) for some more select international TP Cases.

² The current TP Guidelines i.e., TP Guidelines (2010), represent the first substantial revision of these Guidelines since they were first issued in 1995. The 2010 version of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations was approved by the OECD Council on 22 July 2010.

as prices and conditions of tangible and intangible property transfers and service provision between related parties ('controlled transactions') are equivalent to the financial arrangements of tangible and intangible transactions and service provisions between unrelated parties ('uncontrolled transactions') determined under external market forces (p. 11). From the point of view of taxation policy the choice of the arm's length principle is justified by the fact that it contributes to tax equality and neutrality between associated enterprises and independent enterprises (Wittendorff, 2010). Thus, the OECD Guidelines in relation to transfer pricing tax primarily focus on whether MNEs' controlled transactions have been established in manners that are consistent with the arm's length principle. In the OECD TP Guidelines, the ALP is supplemented with rules and methods which are intended to create a uniform international legal approach, across national boundaries and different legal traditions.³ Although it is generally considered that the OECD Guidelines act as a political mediator among the transfer pricing regimes of the OECD member countries, such efforts, however, are generally respected by the OECD member countries and many of the non-OECD member countries particularly in relation to the definition and interpretation of the arm's length principle under the Guidelines.

The application of the arm's length principle, however, requires that judgement be exercised to determine the comparability of transactions so that accurate adjustments can be made to reflect differences (Adams and Coombes, 2003). Often, a range of data (the arm's length range) will need to be used, and judgement will be required to establish where, within this range, the circumstances of the transaction are best reflected. Thus, the issue of 'comparability' is at the heart of the arm's length principle. In determining comparability and making adjustments to data, the OECD Guidelines (2010) indicate that a number of general factors should be taken into consideration.⁴ These factors are summarised as given below.

- **Characteristics of the property and services:** for example, the quality, volume, and reliability of goods, the nature and extent of services, and in the case of intangible property, the nature of the property, the form of the transaction, and the anticipated level of profitability.

³ The OECD Guidelines (2010, Chapters I - III) provide a detailed description of transfer pricing methods and analysis that could apply the arm's length principle in actual controlled transactions.

⁴ These factors were originally explained in the previous OECD Guidelines i.e., TP Guidelines (1995) and have also been maintained in the revised Guidelines i.e., TP Guidelines (2010).

- **Functional analysis:** compensation paid between third parties usually reflects the functions performed and risks assumed by each party to the transaction. In order to work out whether third party and intra-group transactions are comparable, a functional analysis is needed, the purpose of which is to identify and compare economically significant activities and responsibilities taken on by the third party and associated enterprises. The same analysis should cover risk, since reward is ultimately linked to risk, and in broad terms the more limited the exposure to risk, the more limited will be the reward (though this limited reward is likely to be steadier than the fluctuating returns associated with the assumption of more and higher risk).
- **Contractual terms:** an analysis of contractual terms is really part of the function and risk analysis outlined above. Where there is no contract or other written agreement, terms can be inferred from the behaviour of the parties and general principles. Where there is a written contract, it is important that there is a good match between what the contract says and how the parties behave in practice.
- **Economic circumstances:** by which the Guidelines mean market conditions. These include geographical location of market, size, competition, availability of alternatives, government regulation, cost of labour and land and so forth. Differences in any of this will put a dent on comparability.
- **Business strategies:** businesses will very likely approach their market in different ways, with varying degrees, for example, of innovation and risk taking. The adoption of a market penetration scheme can also have a dramatic effect on a transfer price. Contentions that an MNE is following a market penetration strategy should be carefully thought out as tax authorities usually regard them with a degree of scepticism. Market penetration strategies will always involve one or more parties taking something of a ‘hit’ in early years in the expectation of profits later. Hence, the contract and other evidence of the parties’ relationship must be consistent with this. Cases have been found where a distributor agrees to incur marketing expenditure on such a scale that it cannot make a profit during the lifetime of the contract. Credible projections of growing profits over a reasonable timescale will be required, as will evidence of lower end prices and/or higher marketing spend and effort (OECD Guidelines, 2010, pp. 10 – 16).

The above, however, illuminates the point that satisfying the arm's length principle by establishing true comparability may not be as straightforward an issue as it may seem. Specifically, the functional analysis requirement seeks to 'identify and compare the economically significant activities and responsibilities undertaken or to be undertaken by the independent and associated enterprise, e.g., design, manufacturing, assembly, research and development, servicing, purchasing, distribution, marketing, advertising, financing and management' (OECD, 2010, par. 1.43). As a result, tax authorities therefore, pay close attention to situations where there have been substantial distortions to the arm's length principle, which have resulted in shifting income.

These distortions to the arm's length principle could be brought about by factors that both have to do with tax and non-tax considerations. Fujimori (2008) noted that setting a price for tax purposes is still the single most important factor which distorts the arm's length principle, resulting in transfer pricing issues. He also explained that the evidence of hard bargaining alone is not sufficient to establish that transactions are at arm's length. Therefore, factors other than tax considerations may also distort the arm's length conditions of commercial and financial arrangements established between related companies.

One of these is related to the fact that autonomous local managers involved in related parties' transactions within an MNE may, when interested in establishing good profit records, seek to establish inter-company prices that would reduce the profits of their counterpart. Therefore, the relationship between the two parties may influence the outcome of bargaining. Additionally, management decisions within MNE entities may also distort the arm's length principle. This could be the case where there is a dire need to generate cash flows or need to show high profitability at the parent company entity level owing to external pressure from public shareholders. Also, the pressure from conflicting governmental policies and actions in various jurisdictions where operations are carried out is something to which multinational companies are subjected. Other pertinent issues such as transfer pricing enforcements, overseas remittance restrictions, foreign exchange controls, anti-dumping policies, etc., are some of the factors that may influence the application of the arm's length principle.

Consequently, it can be seen that the application of the arm's length principle is not always a straightforward and easy rule to adopt in practice, especially because of the fact-specific

nature of controlled transactions. Wittendorff (2010) noted that although the arm's length principle is laid down as the norm for income allocation in national and international law, tax law problems associated with the allocation of profits between associated enterprises has not been solved yet. He further argued that MNEs still have to live with the high compliance costs and the risk of double taxation, even when they do their best to comply with the arm's length principle (p. 11). Nevertheless, the OECD members and to a large extent, non-members, recognize that the arm's length principle provides the closest approximation to the workings of the open market in cases where tangible and intangible properties and services are transferred between associated enterprises.

2.3.3 Application of the Arm's Length Principle (ALP)

The transfer pricing regimes in many of the countries around the globe follow the universally approved arm's length principle. The Guidelines and regulations (many of which are in line with the OECD Guidelines) provided by these bodies require MNEs to cope with the ability to demonstrate compliance with the arm's length principle through functional analysis, especially with respect to the most advantageous position that can be robustly defended. As discussed in Section 2.3.2, the arm's length principle of transfer pricing states that the amount charged by one related party to another for a given product must be the same as if the parties were not related. An arm's length price for a transaction is therefore what the price of that transaction would be on the open market. The OECD and its member countries take this price as the international transfer pricing standard that should be used for tax purposes by MNE groups and tax administrations. The justification of this arm's length transfer price, however, and the methodology through which the price is derived largely relies on the provision of acceptable comparison as part of the comparability analysis for the relevant transaction. By definition, a comparison implies examining two terms: the controlled transaction under review and the uncontrolled transactions that are regarded as potentially comparable (OECD 2010, p. 107). According to the Guidelines, a comparable uncontrolled transaction is a transaction between two independent parties that is comparable with the controlled transaction under examination. It can be either a comparable transaction between one party to the controlled transaction and an independent party ('internal comparable') or between two independent enterprises, neither of which is a party to the controlled transaction ('external comparable') (p. 115). This should be used by a taxpayer to support its transfer pricing policy or by a tax administration as the basis for a transfer pricing adjustment. Accordingly, in ascertaining compliance with this

directive, tax authorities endeavour to examine MNEs' intra-group arrangements in order to ensure that transfer price manipulation is not occurring, or that an incorrect transfer price is not being used, resulting in the under-payment of tax. Any serious disagreements by a country's tax authority in this area as regard the transfer pricing policies of an MNE may simply lead to its (i.e., tax authority's) imposition of that which it believes reflects better the amount of taxable income that ought to reside in its country. Consequently, a real issue for corporate taxpayers here is that the same MNE is likely to have already paid tax on the same income in another country or countries, thereby presenting a significant problem of double taxation and the risk of transfer pricing disputes to the MNEs.

The OECD acknowledges that there are such practical difficulties in applying the arm's length principle especially because the application of the principle has always been subject to the local authority's interpretation, which could be influenced by the economic conditions and the policies of each government. Therefore, in order to increase the consistency when applying the arm's length principle, and thus to reduce disputes between countries, the organization also provides transfer pricing methodologies to further substantiate the principle. The OECD Guidelines define transfer pricing methodologies that could best estimate a price consistent with the arm's length principle. Thus, the Guidelines provide approaches to achieve a reliable result under any of the OECD approved methods.⁵ The Guidelines and the transfer pricing regulations of most OECD members, and also an increasing number of non-member countries, require that the economically relevant characteristics of the situation being compared must be sufficiently similar to apply these methods, because companies generally consider economic differences between alternatives in an uncontrolled situation. The similarity in the characteristics of the property or services transferred will matter most, but as already discussed in the previous section, other relevant characteristics of the situations, such as the functions performed and the risks assumed by the parties, the contractual terms, the economic circumstances of the parties, and the business strategies pursued by the parties, should also be taken into account.

⁵ The OECD Guidelines (2010, Chapter II) distinguish between five transfer pricing methods, which are termed either traditional transaction methods or transactional profit methods. The Comparable Uncontrolled Price (CUP) method, the Resale Price method, and the Cost Plus method are referred to as traditional transaction methods. The Transactional Net Margin method and the Profit Split method are considered as transactional profit methods.

2.3.4 Challenges of MNEs in Applying the Arm's Length Principle (ALP)

Despite the OECD's efforts to create a harmonised principle as the basis for enforcing the transfer pricing regime, MNEs still find themselves in the middle of aggressive fight for tax revenues between countries. Although the harmonised standard of the ALP is globally respected, the failure to coordinate interpretation of this principle among jurisdictions can significantly exacerbate a transfer pricing exposure because of its inherently fact-specific nature. Markham (2012) argued that the twenty-first century era of global tax enforcement and administration has increased the TP exposure experienced by MNEs because there remains a large degree of divergence between the approaches adopted to transfer pricing among revenue authorities around the world. She noted further that transfer pricing rules, acceptable methodologies and interpretations of the arm's length principle and how it is to be applied in practice still differ from country to country (p. 9). Additionally, MNEs may not only face difficulties in identifying comparable uncontrolled transactions that will provide an acceptable benchmark of an arm's length, but may also have to deal with the revenue authorities that continue to use secret comparables to evaluate this price, regardless of the inequities of this practice. The implication of this is that MNEs will continue to face uncertainty from country to country as to whether or not their transfer prices comply with the arm's length principle, and what the extent of any adjustment will be.

The extent of this uncertainty is significantly heightened by subsequent developments within the global economy which increased tax authorities' attention towards the issue of transfer pricing in cross border businesses. These developments make it even more difficult for multinationals to apply the arm's length principle as required by fiscal regulations. The developments have to do with many of the different economic, fiscal and accounting issues that emerged during the first decade of the twenty first century and these have to make transfer pricing a top priority concern for all multinational enterprises (MNEs), regardless of the type of industry of transactions they engage in (Markham, 2012). As already mentioned above (Section 2.3), the topic of transfer pricing has, during this period, been consistently ranked as one of the most important issues in contemporary international accounting and tax matters (see Sands and Pragasam, 1997; Ernst & Young's Global Transfer Pricing Survey, 1995-2010).

According to Markham (2012), the global economic developments have to do with the economic uncertainty (described as the global financial crisis) which marred the last quarter of

the decade on an international scale. During this period, some countries (e.g., Portugal, Spain, Italy etc.) were threatened by potential national bankruptcy while others actually went bankrupt (e.g., Iceland). The global financial crises resulted in a contraction in foreign direct investments (FDI) and tax authorities around the world therefore had to focus more on transfer pricing enforcement, especially for cross-border transactions, as a source of additional revenue. Markham noted that ‘transfer pricing regulations are becoming a worldwide phenomenon. In 1994 only two of the world’s major economies had effective documentation rules: the United States of America and Australia. By 2003, 27 countries had introduced specific legislation or regulations regarding transfer pricing documentation’ (p. 5). The impact of this focus on cross-border transactions by revenue authorities has therefore created a volatile and uncertain operating environment for MNEs. Hence, as MNEs continue to change their organizational and business structures in order to survive the residual effects of the global financial crisis, the longer supply chains associated with this effort have multiplied the number and frequency of cross-border transactions, with a concomitant increase in transfer prices that must be determined, documented and defended (p. 12).

On the other hand, the global fiscal developments were more triggered by the consequences of the economic developments described above. Markham (2012) explained that following the rising national treasury deficits experienced by the world’s largest economies, governments face mounting pressure to rigorously enforce their transfer pricing regulations and maximize their tax revenue base. Tax administrations have therefore, been taking an increasingly aggressive approach in order to secure their ‘fair share’ of the global tax revenue generated by MNE profits. These efforts have also been aided by different initiatives of the OECD to bring about increased collaboration between tax authorities in order to ensure tax transparency and compliance. Some of these initiatives include the establishment of the OECD Forum on Tax Administration (FTA)⁶ and the Global Forum on Transparency and Exchange of Information for Tax Purposes.⁷ However, despite these initiatives and collaborations, there still exists a

⁶ ‘The OECD Forum on Tax Administration (FTA) was established by the Committee on Fiscal Affairs in 2002 to promote cooperation between revenue bodies and to develop good tax administration practices. This Forum brings together tax commissioners from 40 countries to “find ways in which national tax systems (can) interact ...neither to create double taxation or double non-taxation”’ (Markham, 2012, p. 7).

⁷ The Global Forum on Transparency and Exchange of Information for Tax Purposes was established by OECD member countries and some participating members in 2000 and presently represents the largest tax group in the world. The Global Forum is made up of 105 member jurisdictions and aim to ensure a global level playing field for transparency and exchange of information for tax purposes (Markham, 2012, p. 8).

large degree of divergence between tax authorities in their approach towards transfer pricing tax enforcement. Markham explained that these differences present MNEs with the challenge of identifying comparable uncontrolled transactions that will provide an acceptable benchmark of an arm's length price. MNEs also now need to consider whether a particular jurisdiction looks at form or substance in its transfer pricing rules and regulations (p. 9). With this increasing challenge experienced by MNEs in their effort to comply with the arm's length principle, revenue authorities therefore have the ability to exploit transfer pricing as a 'soft target', with a key incentive being the potential to produce very large increases in tax revenues (Markham, 2012). Many countries such as Australia, the United States of America, Japan, Canada and the United Kingdom, have therefore all increased the incidence of transfer pricing penalty assessments.

The third aspect of developments that increased the level of uncertainties associated with transfer pricing tax compliance is related to the global accounting environment. Following the accounting scandals generated by MNEs such as Enron and WorldCom, MNEs were compelled to adopt a greater degree of transparency in their tax and transfer pricing provisions reporting. In order to ensure this, countries such as Canada and Japan adopted accounting reforms similar to the United States enactment of the *Sarbanes-Oxley Act* (SOX) in 2002⁸. Section 404 of this Act 'requires the documentation of a company's transfer pricing policies along with their processes of resolving transfer pricing issues, adequately guarding against any potential risk exposure' (Markham, 2012, p. 14). The burden on MNEs in relation to transfer pricing was further increased when the United States Financial Accounting Standards Board (FASB) introduced Financial Interpretation No 48 *Accounting for Uncertainty in Income Taxes* (FIN 48) in June 2006, interpreting Statement of Financial Accounting Standards No. 109 *Accounting for Income Taxes* (FAS 109). With FIN 48, MNEs are required to account for uncertain tax positions, including recognition and measurement of their financial statement effects, and also document the recognition of their tax position once this falls within a minimum threshold. Markham (2012) however, explained that FIN 48 does not only affect United States MNEs, but will also have an effect on foreign MNEs in countries that have decided to adopt the International Financial Reporting Standards (IFRS), as since 2002 there has been a convergence project between the FASB and the International Accounting Standard

⁸ Also known as the *Public Company Accounting Reform and Investor Protection Act of 2002*.

Board (IASB) following the signing of the Norwalk Agreement in October 2002 (p. 14). The third accounting development noted by Markham is the release by the IRS of the final Schedule UTP *Uncertain Tax Position Statement* and related instructions requiring that certain large business taxpayers (with assets exceeding USD 100 million) report their uncertain positions (UTPs) on their annual business tax returns, beginning with the 2010 tax year (p. 14). However, taxpayers with assets USD 50 million or more are also required to file beginning in 2012 and taxpayers with USD 10 million or more are to begin filing in 2014. In relation to this, the Schedule requires a description of each uncertain tax position providing sufficient detail for the IRS to determine the nature of the issue, as well as the disclosure of the maximum United States federal income tax liability attributable to each uncertain tax position in the event that the position was disallowed entirely. Here, the transfer pricing tax positions are reported in a separate category from all other positions. Accordingly, it was reported that transfer pricing was one of the three issues topping the list of disclosures of uncertain tax positions in the first round of submissions, along with the research credit and business expenses (Bennet, 2011 cited in Markham, 2012, p. 15). This shows that MNEs will struggle to comply with the new reporting requirements especially because of their international issues and transactions which include transfer pricing. All of the above developments in relation to financial reporting i.e., the SOX, FIN 48 and the UTP Schedule have therefore continued to have global effects in relation to the increasing uncertainty that has been introduced into the transfer pricing arena.

These apparent tension faced by MNEs within their international transfer pricing operations usually brings about TP disagreements between MNE taxpayers and tax authorities. Many of such disagreements have led to time consuming TP disputes associated with large expenditure of both human and financial resources (see section 2.3.1 above). Moreover, MNEs now find themselves in an unprecedented position of needing more certainty and less risk. As Markham puts it that:

‘the cumulative effect of the unprecedented pressures on MNEs to comply with a daunting array of rules concerning documentation of transactions, disclosure of financial information, transparency of tax issues, analyses of tax reserves, and reasoned conclusions regarding tax exposures in a global economy where national revenue authorities are simultaneously adopting new multilateral initiatives to

exchange information about taxpayers while aggressively pursuing transfer pricing enforcement through an increase in audits, disputes, tax adjustments, transfer pricing penalties and litigation is that transfer pricing risk management and the pursuit of transfer pricing certainty have assumed a priority role' (p. 17).

However, fiscal authorities are not unaware of this tension and the trouble that MNEs are likely to face in their bid to satisfy the requirements of the arm's length principle. In a bid to address the two opposing interests of both parties, most countries' tax authorities have domestic appeal procedures that MNEs can follow whenever they are faced with transfer pricing disagreements. MNE taxpayers generally have three options when it comes to managing and resolving transfer pricing disputes and eliminating potential double taxation with tax authorities. These include: Competent Authority relief via Mutual Agreement Procedure (MAP)⁹ provisions of the relevant double tax treaty; litigation; or advance pricing agreements (APAs). While MAPs between competent authorities and arbitration procedures may provide some assistance in securing international economic relationships, the only process whereby international transfer pricing issues, and especially the potential for double taxation, can be addressed on a prospective basis is the APA process (Markham, 2012, p. 17). As noted already, it is the latter option, i.e., APAs, that constitutes the primary focus of this research project.

⁹ 'The mutual agreement procedure is a well-established means through which tax administrations consult to resolve disputes regarding the application of double tax conventions. This procedure, described and authorised by article 25 of the OECD Model Tax Convention, can be used to eliminate double taxation that could arise from a transfer pricing adjustment' (OECD Guidelines, 2010, p. 139). According to the OECD Manual on Effective Mutual Agreement Procedures (MEMAP), February, 2007), 'the MAP article (Article 25 (Mutual Agreement Procedure) of the OECD Model Tax Convention) usually sets out three general areas where two states endeavour to resolve their differences. The first area, covered by paragraphs 1 and 2 of the OECD Model Tax Convention's MAP article, applies to situations where a taxpayer believes that the actions of one or both of the contracting states have resulted or will result for him in "taxation not in accordance with the provisions of the Convention". This area is the most commonly used and most often referred to part of the MAP article since it deals with most international taxation disputes under tax treaties. The taxpayer may request MAP assistance in these instances of taxation contrary to a convention, which in most cases involve double taxation. Historically the majority of these cases have been issues of transfer pricing where associated companies of a multinational enterprise group incurred economic double taxation due to an adjustment to their income from intra-group transactions by one or more tax administrations' (p. 9). The Manual, however, explained that enterprises also request this kind of MAP assistance for non-transfer pricing cases, including disputes over such issues as the existence of a permanent establishment, the amount of profits attributable to a permanent establishment, or the application of a tax convention's withholding tax provisions to their income. The other two areas, usually mentioned in a provision corresponding to Article 25(3) of the OECD Model Tax Convention, involve questions of 'interpretation or application of the Convention' and the elimination of double taxation in cases not otherwise provided for in a convention (OECD Manual on Effective Mutual Agreement Procedures (MEMAP), February, 2007, p. 10).

The APA is a procedural programme involving mutual agreement between a taxpayer and tax authority/authorities. These agreements are an agreement whereby the future transfer pricing methodology to be used to determine the arm's length price is agreed to by the taxpayer and the relevant tax authority or authorities. It is a procedural mechanism designed to resolve the uncertainties surrounding both domestic and cross-border related transactions. According to the OECD Guidelines (2010):

‘an advance pricing arrangement (APA) is an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g., method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time. An APA is formally initiated by a taxpayer and requires negotiations between the taxpayer, one or more associated enterprises, and one or more tax administrations’ (p. 168).

Essentially, a commonly noted objective and advantage of APAs is their usefulness in conferring greater certainty in respect to the tax liability of MNEs for their transfer pricing arrangements. Vögele and Brem (2003) noted that APAs facilitate legal certainty for the taxpayer because they: ‘determine the appropriate TPM (Transfer Pricing Methodology) for the specific circumstances of the taxpayer; resolve adversarial transfer pricing disputes with the tax authorities; and avoid potential double taxation’ (p. 35). However, Damon (2005) argued that the benefit of greater certainty through APAs is not without qualification. There is the argument that the APA's relatively limited openness to scrutiny, and its multi-faceted relevance in areas such as cross-border financial transactions, inter-governmental relations, high information cost for regulations, as well as its serious risks to all parties from uncertainties, all make it relevant for the process to be subjected to some critical analysis (Ring, 2000). This is despite the acknowledgement that the advent of the programme by tax authorities across the world had, in its innovative form and intended flexibility, helped to justify the championing of macro-economic administrative theories which advocate discretion, flexibility and experimentation. Nevertheless, the design of the APA programme to produce a formal agreement between taxpayers and revenue authorities largely helps to create some feelings of certainty among participating MNEs in the areas of changes in transfer price methods being applied and fiscal regulation changes. Accordingly, it is a common

acknowledgement that the process is assisting in producing a positive solution to the problem of transfer pricing in some countries (among others) including Australia, Canada, Japan, Mexico, the United Kingdom, and the United States of America (Deloitte, 2011).

The expectation, therefore, and acknowledgement that the process helps to give assistance to MNEs in handling the opposing tension that they face in their TP operations should make the programme very popular with the MNEs around the globe. Although TP regulated economies such as the USA, Australia and Canada cannot be considered here, the case of the UK is of much concern. The low uptake of the APA programme in the UK (see Appendix 1) showcases an important need to reflect better the primary realities of multinationals in APA operations and policies. It is reported that around 50-60 cases are currently in the UK's APA programme and that around 20 will be added annually with a similar number to be dropped from the process (Clayson and Beeton, 2010). This obviously constitutes a very low figure when put in context of the amount and magnitude of cross-border transfer pricing cases in terms of enquiries, adjustments and penalties occurring in the UK economy (see Hansard, UK House of Commons Debates, 2006, 2008 and 2010 cited in Sikka and Wilmott, 2010). The intention of the APA process as contained in the HMRC Statement of Practice (SP3/99) which has now been replaced by HMRC Statement of Practice SP2/10 is to promote cooperation and open discussion. This is considered as a healthy move not only towards achieving the desired improvement in multinational taxation but also as a desirable catalyst in promoting smoother cross-border business operations in the global market.

With this in mind, the aim of this study is to identify empirically the significant reasons for applying/not applying for the APA process by investigating the underlying motive of a sample of MNEs in the UK. Hence, the relevant central research question: '*Why do MNEs apply/do not apply for Advance Pricing Agreements in the UK?*' should provide a clear lens through which the attitudes and potential attitudes towards the APA tax process can be viewed and also, the significant implications of this for both domestic and cross-border internal transactions can be examined.

2.4 The Advance Pricing Agreement (APA) Programme

The APA process comes about as a result of the different difficulties associated with transfer pricing especially where there are considerable problems in establishing the manner by which

the arm's length principle should be applied and the resultant implications of double taxation. Such difficulties make for the existence of two opposing interest and, in a bid to address the two opposing interests of both parties (i.e., MNEs and tax authorities), the APA programme is devised as a procedural process involving mutual agreements between a taxpayer and tax authority (authorities). These agreements are contracts, usually for multiple years, between a taxpayer and at least one tax authority specifying the pricing method that the taxpayer will apply to its related-company transactions.

2.4.1 The purpose of the APA

While transfer pricing problems are also associated with the burdensome process of compiling transfer pricing documents and the review process undertaken by the revenue authorities, an APA is meant to resolve definite or potential transfer pricing differences in an ethical, accommodating approach, and may be used as a substitute to the conventional review process. Harden and Biggart (2004) explained that the focus of an APA is on arm's length prices, returns and methods that multinationals will use during a specified future period. Generally, the APA procedure is not in any way affected by the nomenclature associated with it in different countries (Borkowski, 2000). Hence, whether it is referred to as Advance Pricing Agreement as in the USA, or Advance Pricing Arrangements as previously called in the UK, or Pre-confirmation Agreements as adopted in Japan, APAs typically allow an MNE to negotiate an understanding with one or more tax authorities that approves a transfer pricing methodology for a given term, resolving the uncertainty about its acceptability and reducing audit risk (Borkowski, 2000).

2.4.2 Definition of an APA

Although most APA processes around the world roughly follow the US Internal Revenue Service (IRS) process (being arguably the most detailed transfer pricing regime in place), the OECD Guidelines, nevertheless, serve as the most widely referenced guide for the adoption of the APA in many countries. The definition of an APA as given in the Guidelines is already described in Section 2.3.4 above. However, for the sake of emphasis, this is restated below:

‘an advance pricing arrangement (APA) is an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g., method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the

determination of the transfer pricing for those transactions over a fixed period of time. An APA is formally initiated by a taxpayer and requires negotiations between the taxpayer, one or more associated enterprises, and one or more tax administrations' (OECD TP Guidelines, 2010, p. 168).

2.4.3 Concept of an APA

The APA is normally regarded as very important in that it helps to stipulate to the taxpayer, a precise transfer pricing mechanism over a period of time. When the terms of the agreement are complied with, APAs provide assurance that the treatment in accordance with the agreement of those transfer pricing issues will be accepted by both the tax authority (authorities) and the business involved for the period covered by the agreements. It is noteworthy that APAs, in some ways, differ from private rulings which some tax administrations issue to taxpayers. An APA generally deals with factual issues and methodology, whereas more traditional private rulings tend to be limited to addressing questions of a legal nature based on facts presented by taxpayers. Also, an APA usually covers several transactions, several types of transactions on a continuing basis, or all of a taxpayer's international related party transactions for a given period of time. On the other hand, a private ruling request is usually binding only for a particular transaction.

2.4.4 Objectives of an APA

A key objective of an APA is the elimination of potential double taxation (OECD, 2010). In line with this objective, Brem (2005) explained that APAs are intended to supplement the traditional administrative, judicial, and treaty mechanisms for resolving transfer pricing issues. However, he listed the following as the main objectives of the APA process:

- to facilitate principled, practical and cooperative negotiations;
- to resolve transfer pricing issues expeditiously and prospectively;
- to use the resources of the taxpayer and the tax administration more efficiently; and
- to provide a measure of predictability for the taxpayer (p. 7).

2.4.5 Forms of APAs

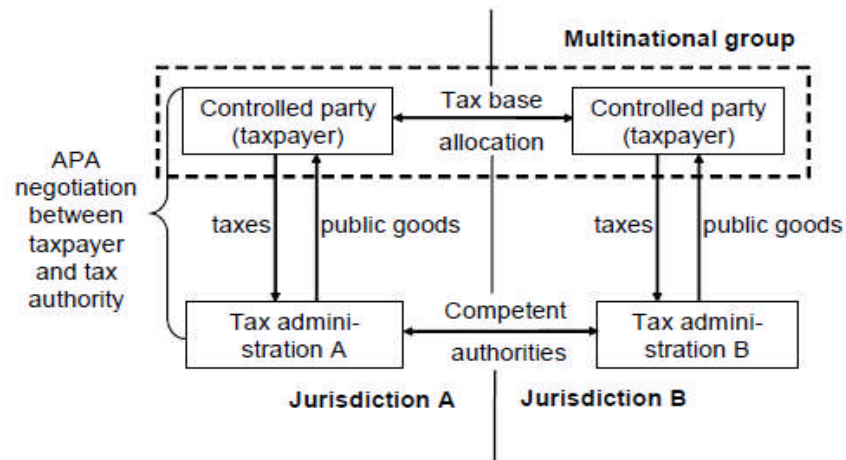
An APA can either be unilateral, bilateral or even multilateral. Borkowski (2008) noted that both bilateral and multilateral agreements are more easily negotiated with tax authorities that have existing tax treaties. This way, APAs can be seen as a primary way of ending an international dispute before it even begins (Adams and Coombes, 2003).

2.4.5.1 Bilateral/Multilateral APA

A bilateral/multilateral APA is an agreement between an MNE and two or more tax authorities. It is basically an agreement where two or more countries agree on the pricing methodology to be used. Thus, it provides a guarantee that the method used in transfer pricing issues will be accepted by tax authorities of both countries and thus ensures that the arrangement will be able to reduce the risk of double taxation, is impartial to all tax authorities and taxpayers involved and also provides greater certainty to the taxpayer concerned (Brem, 2005). In addition, the bilateral APA broadly covers forward agreements between associated parties in two separate countries and the tax authorities in those countries as well. In this way, it can be said that bilateral and multilateral APAs provide transfer pricing protection for all countries involved in the agreement. These agreements are, however, initiated at the request of the taxpayer and they are presently made available in a growing number of jurisdictions. For some countries, APAs can only be concluded with the competent authority of a treaty partner under mutual agreement procedures (MAP) because domestic provisions in such countries do not permit the tax authority to enter into binding agreements directly with the taxpayer. Therefore, in a bilateral or multilateral APA, the contractual arrangement between the jurisdictions is governed by the MAP, if the relevant double tax treaty between these countries provides for that. The number of parties involved in an APA is not definite but subject to the APA in question. Vögele and Brem (2003) illustrated the basic structure of a bilateral APA in the diagram below.

For a successful bilateral APA agreement to be in place, the cooperation of the associated enterprise is fundamental to a successful APA negotiation. For example, the associated enterprise normally would be expected to provide the tax authorities with the methodology that they consider most reasonable under the particular facts and circumstances.

Figure 2-1 Basic Structure of Bilateral APAs



Source: Vögele and Brem (2003, p. 35)

The information that supports the fairness of the proposal should be submitted, which will include data relating to the industry, markets and countries covered by the arrangements. In addition, the associated enterprise may identify uncontrolled prices that are comparable or similar to the associated enterprise's business in terms of the economic activities performed and the transfer pricing conditions, e.g., economic costs and risks incurred, etc., and perform a functional analysis (OECD 2001, Par. 4.134).

2.4.5.2 Unilateral APA

A unilateral APA exists where the tax authority and the taxpayer in its jurisdiction institute an agreement not including the participation of the other interested tax authority. Where a unilateral APA is agreed, the tax liability of the associated enterprise in another tax jurisdiction may be affected, i.e., possibilities of double taxation may result in respect of transfer pricing issues attended to by the use of a unilateral APA. However, where unilateral APAs have been agreed, the tax authority of the other country is normally notified about the arrangements so as to be able to consider whether a bilateral arrangement may be permitted.

2.4.6 Benefits of an APA

The APA process is always touted as highly beneficial to both the MNE and the agreeing tax authority. Because the process deals with real time issues, including highly integrated

operations and novel situations, there are many positive declarations from taxpayers who benefited from the APA programme as well as tax authorities who participate in it.

2.4.6.1 Benefits to the Taxpayer

Many APA studies identify a number of substantial benefits to taxpayers when they enter into an APA agreement. These benefits are, in many cases, the MNEs' motivations to seek an APA. Such motivations among others are outlined in the Table 2-1 below.

2.4.6.2 Benefits to the Tax Authority

- Once an APA agreement is reached, the tax authority would have already acquired as much information as possible from the taxpayer, and as such fewer resources will be required for any subsequent examination of the taxpayer's return.

Table 2-1 APA Benefits to the Taxpayer

Benefits/Motivations associated with an APA	Sources:
<ul style="list-style-type: none"> - Avoidance of general transfer pricing uncertainties - Avoidance of financial reporting uncertainties - Avoidance of TP examinations - Avoidance of exposure to double tax and penalties - Development of a representative arm's length outcome on a fact pattern repeated in other countries - Simplicity of transfer pricing method chosen - Relative speed of an APA over an audit - Time and cost savings - TP audit risk reduction strategy - Non-hostile collaboration between the MNE and tax authority - Safe harbour guarantee against TP penalties and adjustments - APA roll back advantages - Options for extensions of the APA - Resolution of an open tax authority's transfer pricing regulation - Rehabilitation of the MNE's relationship with the tax authority - MNE's involvement in competent authority negotiations 	<ul style="list-style-type: none"> - <i>Canale and Wrappe (2008)</i> - <i>Ernst and Young (1995; 2003; 2007/ 2008)</i> - <i>Borkowski (1993; 1996b; 2000)</i> - <i>Harden and Biggart (2004)</i> - <i>Markham (2005)</i>

- Harden and Biggart (2004) also noted that an APA presents an opportunity for tax authorities in the sense that the work that would otherwise have to be undertaken via the audit process is done now, and can be used in other fora, reviews or audits. Moreover, the tax authority will be in a position to divert other transfer pricing personnel and other important staff members where they are most needed. The existence of an APA, therefore, positively affects the amount of resources devoted to compliance.
- Much benefit could be gained as a result of the accommodating manner under which an APA can be negotiated. It may help tax authorities to gain insight into intricate international transactions and thus improve awareness of and insight into such transactions. A successful APA programme therefore presents an opportunity for tax authorities to concentrate on other complex areas of tax.

2.4.7 APA Shortcomings

Obviously, irrespective of how much benefit is associated with the APA process, the programme possesses its own shortcomings, as might be expected. These include some of the following.

- Chapter 4 of the OECD Guidelines (2010) stated that unilateral APAs may present considerable inconveniences for tax authorities and taxpayers alike.¹⁰ Together with this, an APA may put a strain on the transfer pricing resources of tax authorities. The envisaged balance between enforcement and compliance may be severely affected as the APA programme tends to need highly skilled resources and other specialist staff. These demands may not coincide with the resource (human and financial) planning of the tax authority, thereby making it difficult to process efficiently both the APA programme and other equally important work. Renewing an APA, however, is likely to be less time consuming than the process of initiating one. The eventual result is that scarcity of the resources may hinder the number of requests that can be attended to by both the tax authority and the

¹⁰ Section 4.147 stated that 'From the point of view of other tax administrations, problems arise because they may disagree with the APA's conclusion. From the point of view of the associated enterprises involved, one problem is the possible effect on the behaviour of the associated enterprise. Unlike bilateral or multilateral APAs, the use of unilateral APAs may not lead to an increased level of certainty for the taxpayer involved and a reduction in economic or juridical double taxation for the MNE group' (p. 174).

taxpayer and in certain circumstances it may mean only large companies will receive preference.

- From the standpoint of the associated enterprise concerned, one problem is the possible effect on the behaviour of other associated enterprises. If the taxpayer accepts an arrangement that over-allocates income to the country making the APA in order to avoid lengthy and expensive transfer pricing enquiries or excessive penalties, the administrative burden shifts from the country providing the APA to other tax jurisdictions. Taxpayers may therefore be less interested in the APA programme for these reasons.
- Also, the length of time associated with agreeing a bilateral or multilateral APA can create inefficiencies and significantly augment the cost of the APA programme. In some cases however, only large companies can afford to use the APA programme since it will require the expertise of an independent consultant and such expertise is normally expensive. Therefore, an APA programme may be seen as only feasible for large multinationals.
- The APA processes may become unnecessarily burdensome for the taxpayer owing to the bulk of information that may be needed. Should the request become arduous, it may hinder further requests from related companies, thereby jeopardizing the whole process.

2.4.8 The APA Process

2.4.8.1 Introduction

The APA has actually been in official use since 1985 when the Japanese National Tax Agency (NTA) negotiated its first agreement. The US IRS, however, led the way here by instituting a formal APA programme in 1991. Following this, the OECD introduced the idea in general terms in its 1995 Transfer Pricing Guidelines covering two basic sections - one covering the administrative approaches to APA and the second covering the conduct of APAs under MAP (i.e., Mutual Agreement Procedure set out under article 25 of the OECD model, explaining the procedure under which tax authorities can resolve double taxation disputes). Nevertheless, an APA only guarantees that the use of the agreed upon transfer pricing method will not trigger an audit. It does not guarantee that the MNE will not be audited for other aspects of its transfer pricing activity (Borkowski, 2008).

2.4.8.2 Legal Framework of the APA Process

Within the legal framework of an APA, many jurisdictions have had, for some time now, procedures (e.g., rulings) which enable taxpayers to obtain some degree of certainty regarding how the law will be applied in a given set of circumstances. The legal consequences of the proposed action are determined in advance, based on assumptions, i.e., critical assumptions, about the factual basis. Countries around the world have increased their investment in the APA process in recent years, and the number of taxpayers applying for such programmes worldwide appears to be on the increase. For example, the US IRS has consistently reported an increase in the number of APA applications received, from 15 applications in the 1991 fiscal year to 144 APA application submissions during the fiscal year 2010. The cumulative total number of APA executed by the IRS as at the end of 2010 fiscal year stands at 973 agreements (Internal Revenue Service - Announcements and Reports Concerning Advance Pricing Agreements, 2000; 2011). In many jurisdictions, however, APAs are not usually specifically legislated for, but a formal 'APA programme' may be in place. There are now more countries incorporating APA provisions either into their domestic law or through some form of formal programme (see Ernst & Young 2010 Global Transfer Pricing Survey). The fact that a taxpayer may be under a TP audit or examination by a tax authority should not generally prevent the taxpayer from requesting an APA in respect of prospective transactions. While APA procedures are separate from TP audits or examinations, the process is also typically resolved differently from other administrative processes such as the MAP. Audit or examination activities would not normally be suspended by tax authorities while an APA is being considered, unless it is agreed by all parties that the audit or examination be held in abeyance because the obtaining of the APA would assist in resolving the audit or examination. MNEs argue sometimes that the different sets of rules governing the various APA procedures in different countries are time consuming to deal with. As a result, the absence of a common approach among tax administrations and the inherent subjectivity of transfer pricing can make it difficult for an agreement to be reached. This is also because the differences in approach can lead to contentious negotiations that ultimately fail to produce an APA, become too costly for the parties involved and eventually fail to eliminate double taxation.

2.4.8.3 General Principle of the APA Process

Generally, the request for an APA follows procedures that are spelt out by the country in question. For example, the US APA process can be broken into five phases namely:

application; due diligence; analysis; discussion and agreement; and drafting, review and execution. However, given the focus of this research project, attention is given to the UK APA process and the required procedures that are involved.

2.4.8.3.1 The UK APA Process

HMRC in the UK do have within a statutory framework, an APA programme which has been in place since 1999. Before this period, APAs are agreed using the mutual agreement procedure of the relevant treaty. The related legislation for their APA process, formerly found at *Section 85, Finance Act 1999*, is now rewritten as part of the UK's Tax Law Rewrite Project and this presently appears at *Sections 218-230 of the Taxation (International and Other Provisions) Act 2010 (TIOPA 2010)*. Also in place is a new HMRC Statement of Practice (SoP) SP2/10 which HMRC issued to provide guidance on how they interpret the new APA legislation and apply it in practice.

According to the HMRC International Manual (INTM422040), an APA may be requested by:

- any UK business, including a partnership, with transactions to which the provisions of Part 4 of TIOPA 2010 apply (the UK transfer pricing rules);
- any non-resident trading in the UK through a permanent establishment; and
- any UK resident trading through a permanent establishment outside the UK.

HMRC maintain that every APA request will be considered, but generally, they look for cases where the transfer pricing issues are complex rather than straightforward (complex means there is doubt as to how the arm's length standard should be applied - HMRC Statement of Practice - SP 2/10 (par. 14). HMRC also look for situations where, without an APA, there is a high likelihood of double taxation or where the taxpayer seeks to implement a method closely tailored to its own particular circumstances. The UK APA process, under its framework, passes through the following stages.

(a) Pre-filing Conferences

Under the UK framework, the initial contact regarding an APA is referred to as the 'Expression of Interest' process. HMRC strongly recommend that an interested party contact

them first to discuss informally its plans before submitting a formal application. The ‘Expression of Interest’ process is intended to ensure that the resources of a business are not wasted on an unsuitable application. It also gives HMRC an opportunity to outline a realistic anticipated timetable for agreeing an APA, or to discuss other practical process issues with the business. The ‘Expression of Interest’ presentation or meeting should generally cover:

- the nature of the transfer pricing issues intended to be covered by an APA;
- details of the tax residence of the parties involved and the importance to the wider business of the transactions intended to be covered;
- if already decided upon, a description of the proposed transfer pricing methodology (TPM) by which prices are to be set or tested; and
- an indication of the nature of any current transfer pricing inquiries, competent authority claims and any other relevant issues that the business is aware of in the context of the suggested APA.

If, after preliminary discussions, HMRC do not believe that the application should be admitted into the UK APA programme, they will advise the business of the reasons why HMRC take that view. Typically, this will be connected to the perceived complexity or difficulties of setting pricing in conformity with the arm’s length principle. While such a view will often be provided at the end of the ‘Expression of Interest’ meeting, the business will, however, have the opportunity to make further representations.

(b) Formal APA Request

A formal application is submitted if, after the ‘Expression of Interest’ process, HMRC indicate that they are willing to accept the APA proposal into the programme and the business wishes to proceed. The formal application will generally be accompanied with the following information:

- the identification of the parties and recent accounts (generally for the previous three years);
- a description of the transfer pricing issues proposed to be covered in the APA and analysis of the functions and risks of the parties and actual and projected financial data of the parties in relation to the issues;

- a description of the worldwide organizational structure, ownership and business operations of the group to which the company in question belongs, the place or places where such operations are conducted and all the major categories of transaction flows of the parties to whom the APA is intended to apply;
- a description of the records that will be maintained to support the TPM proposed for adoption in the APA and the information that is proposed to be supplied each year to demonstrate that the tax return conforms to the terms of the APA;
- a description of any current tax inquiries or competent authority claims that are relevant to the issues covered by the proposed APA;
- the chargeable periods to be covered by the APA;
- the identification of assumptions made in developing the proposed TPM that are critical to the reliability of its application under the arm's length standard; and
- where appropriate, a request for a competent authority's assistance in reaching a bilateral or multilateral APA (Ernst & Young Guide to Advance Pricing Agreements, 2012).

(c) Evaluation and Negotiation

Once a formal application is received, HMRC evaluate its contents and will request clarification or additional information from the business, as required. The examination of the application is generally a cooperative process in which the transfer pricing issues are discussed openly. Moreover, access to relevant supporting information and documentation should be provided to HMRC during this evaluation phase. Lack of cooperation may result in the refusal of HMRC to further consider the APA application. The agreement between HMRC and the business will be made subject to its terms being observed. The terms will include the following.

- a commitment from the business to demonstrate adherence to the agreed method for dealing with the transfer pricing issues during the term of the APA in the form of a regular compliance report (an annual report).
- the identification of critical assumptions bearing materially on the reliability of the method and which, if subject to change, may render the agreement invalid.

HMRC aim to complete the APA process within 18 to 21 months from the date of the formal submission.

(d) The APA Annual Report

An APA annual report is a requirement of the agreement between HMRC and the taxpayer. The annual report is generally submitted with the business's tax return. The particular requirements of each report are set forth in the finalized APA agreement and focus narrowly on the issue covered by the APA. The broad intention is that the annual report should demonstrate whether the business has complied with the terms and conditions of the APA.

2.4.8.3.2 Nullifying and Revoking APAs and Penalties

According to *TIOPA (2010, section 225)*, an APA may be revoked by HMRC in accordance with its terms where the business does not comply with the terms and conditions of the agreement, or where the identified critical assumptions cease to be valid. In practice, when considering nullifying or cancelling a bilateral APA, HMRC will consult with the business and with the competent authority of the treaty partner involved. In some cases, a change in the agreement may be possible (SP2/10, Par. 44). Paragraph 45 of the SP2/10 further states that where false or misleading information is supplied fraudulently or negligently, in connection with an application for, or in the process of monitoring, an APA, penalties may be applied, and the APA may be nullified. However, the business has the right to appeal against the amount of any additions to profits arising as a result of the revocation or cancellation of an APA.

2.4.8.3.3 Revising and Renewing APAs

In relation to the revision and renewal of an APA with HMRC in the UK, Statement of Practice (SP2/10), which replaces the old Statement of Practice (SP3/99), stipulates the following.

- In some cases the APA may provide for modification of its terms in specific circumstances. For example, a particular agreement may provide that where there is a change which makes the agreed methodology difficult to apply, but which does not go as far as to invalidate a critical assumption, the agreement may be modified with the consent of the parties to resolve that difficulty. In such cases the APA may be revised in accordance with *Section 225, TIOPA*

2010 after consultations between the business and HMRC and, in the case of bilateral agreements, the competent authority of the other country involved (SP2/10; Par.47).

- The business may request renewal of an APA, ideally not later than six months before the expiry of its current term, but HMRC will not rule as out of time requests made before the end of the first chargeable period affected by the renewal or, in the case of bilateral cases, later, if the other tax authority is prepared to allow further time. The renewal application should expressly consider any changes or anticipated changes in facts and circumstances since the existing agreement was reached, whether any amendments are required to the agreement on renewal as a result, and should demonstrate that the proposed methodology is, or is still, appropriate.

- HMRC will conduct a review of the renewal application, taking into account whatever revisions to the existing APA are necessary and appropriate in the light of any changed facts and circumstances. Where it is agreed that the transfer pricing issues under consideration remain the same and the existing transfer pricing methodology can continue as before but with details updated to ensure continued adherence to the arm's length principle, the agreement will simply be amended and extended for a further term. Where, however, the transfer pricing issues have changed, or a different method is being proposed, the business will be required to make a fresh APA application. A fresh application may also be necessary in a bilateral context where the processes of the other tax authority require that (SP2/10, Par. 49).

In general, the differing transfer pricing agenda of a tax authority is reflected in the way it conducts its APA process. While the procedures outlined above describe HMRC's UK APA process, other revenue authorities, such as the US IRS and the Australian Tax Office, maintain a noticeably divergent approach towards their APA programme. Table 2-2 below is used to give some brief comparisons of the APA process in the UK, USA and Australia. The information summarised in this table is as made available publicly for the APA process as operated by each of the relevant tax authority.

Table 2-2 Comparison of the APA Process in the UK, USA and Australia

	UK	USA	Australia
APA Legislation	<i>Section 218-230 of the Taxation (International and Other Provisions) Act 2010 (TIOPA 2010)</i>	<i>Rev. Proc. 2006-9</i>	<i>Practice Statement Law Administration PS LA 2011/1¹¹</i>
Nomenclature	Advance Pricing Agreement (APA)	Advance Pricing Agreement (APA)	Advance Pricing Arrangement (APA)
Year of Establishment	1999	1991	1995
APA User fee	No user fee	\$10,000- \$50,000	No user fee
APA Application Phases	(1) Expression of interest (2) Formal submission of APA application (3) Evaluation of proposed methodology and critical assumption (4) Drawing up agreements (5) Annual report	(1) Application (2) Due diligence (3) Analysis (4) Discussion and agreement (5) Drafting, review, and execution	(1) Pre-Lodgement (2) Lodgement of formal application (3) Analysis/Evaluation (4) Negotiation/ Agreement (5) Conclusion
Approach to APA Application	Complex transactions vs. Non-complex transaction	Strategic transactions vs. Non-strategic Transactions	Simplified transactions vs. Standard transactions vs. - Complex transactions

Despite the differences identified between the processes as operated by the three tax administrations, a most noticeable and key area of divergence among these authorities is in the attitudes that they maintain when evaluating APA applications by MNE taxpayers. With the Australian Tax Office, all MNEs are encouraged to consider and submit applications for APAs, i.e., universal APA applications are encouraged as a means of mitigating transfer pricing risks. On the other hand, the US IRS will consider and accept APA applications into its process upon the due payment of the necessary application fees by the MNE applicant. Any necessary evaluation can then be carried out after the applications have been advanced into the procedural stages of the process. However, HMRC in the UK will typically determine whether or not an APA application will be allowed into their process based on a ‘complexity’ threshold. In other words, consideration is generally given to cases where the transfer pricing

¹¹ Replaces *Taxation Ruling (TR) 95/23* on 17/3/2011.

issues are complex rather than straightforward. In this case, complex means that there is doubt as to how the arm's length standard should be applied. Recent revision of the APA regulations relaxed this threshold by providing that HMRC will also now look for situations where, without an APA, there is a high likelihood of double taxation or where the taxpayer seeks to implement a method closely tailored to its own particular circumstances. These kinds of differing practices and attitudes towards the administration of the APA process abound among the other fiscal authorities as, as mentioned before, each tax authority generally administer its own process based on its transfer pricing agenda.

2.4.9 Use of an APA under Double Taxation Agreements and Mutual Agreement Procedure (MAP)

One main reason why tax authorities are interested in MNEs' transfer pricing policies is because they are the basis for establishing the level of taxable income in their respective countries. Hence, where a tax authority disagrees with an MNE's transfer pricing policy upon audit, it may simply impose one which it believes reflects better the amount of taxable income that ought to reside in its country. The problem, however, is that such an MNE is most likely to have paid tax on the same income in another country or countries, thereby creating a double taxation issue for the MNE. Under this kind of scenario, article 25 of the OECD Model Tax Convention on Income and on Capital sets out what is known as the Mutual Agreement Procedure (MAP). The MAP is a well established means through which tax administrations consult to resolve disputes regarding the application of double tax conventions (Par. 4.29, OECD Guidelines, 2010), i.e., a procedure under which tax authorities can (through their designated competent authorities)¹² resolve double taxation disputes. Many double tax agreements include a MAP article, and therefore provide for the competent authorities of the two countries to consult each other when a taxpayer claims that it is being taxed 'otherwise than in accordance with the convention,¹³ as a result of the actions of one or both of the tax authorities'.

¹² Competent Authorities are officials appointed by the government to undertake inter-jurisdictional dialogue and negotiation on such matters such as exchange of information and the resolution of disputes. In the UK, these individuals work directly within the revenue authority.

¹³ By convention, the researcher is referring to the Associated Enterprises Article of the 1997 OECD Model Tax Convention on Income and on Capital' which explains the general application of the arm's length principle as far as TP is concerned. The chief purpose of this convention is to eliminate double taxation and as such, 'Taxation not in accordance with the convention' effectively means double taxation. OECD has been updating this model on a regular basis. The most recent updates was published in 2010.

APAs are always encouraged to be concluded on a bilateral or multilateral basis because such agreements carry less risk of taxpayers feeling compelled to enter into an APA or to accept a non-arm's length agreement in order to avoid expensive and prolonged enquiries and possible penalties. Bilateral APAs also significantly reduce the chance of any profits either escaping tax altogether or being doubly taxed. Where this (i.e., a bilateral APA) is sought, it is generally considered appropriate to seek this between competent authorities through the MAP of the relevant treaty. In particular, paragraph 4.164 of the Annex to Chapter IV of the 2010 OECD Guidelines states that:

‘Between those countries that use APAs, greater uniformity in APA practices could be beneficial to both tax administrations and taxpayers. Accordingly, the tax administrations of such countries may wish to consider working agreements with the competent authorities for the undertaking of APAs. These agreements may set forth general guidelines and understandings for the reaching of mutual agreement in cases where a taxpayer has requested an APA involving transfer pricing issues’ (p. 179).

This sort of arrangement is relevant especially where the tax authority lacks domestic legislation to conclude binding agreements directly with the taxpayer. In this case, concluding an APA through the mutual agreement procedure may be the only form that can be adopted by such a tax administration.

According to the Annex, APAs under the mutual agreement procedures are referred to as MAP APAs and these basically refer to the bilateral or multilateral APAs which are the main subject of the annex. As noted earlier, MAP APAs are governed by the mutual agreement procedure of the applicable double tax agreement, Article 25 of the OECD Model Tax Convention, and are administered at the discretion of the relevant tax administrations. The Guidelines state that if a taxpayer does not request a MAP APA, then the reason should be reviewed, and wherever possible, tax authorities should encourage the taxpayer to request a MAP APA if the circumstances are suitable. The negotiation of MAP APAs, however, requires the consent of the relevant competent authorities. Sometimes, the taxpayer might voluntarily take the initiative by making simultaneous requests to the competent authorities concerned. However, Article 25 does not oblige the competent authorities to enter into MAP APAs at the request of the taxpayer. Rather, the willingness to enter into MAP APAs will

depend on the particular policy of a country and how it interprets the mutual agreement article of its bilateral treaties. The desire of the taxpayer for certainty of treatment is therefore not, in isolation, sufficient to execute MAP APAs. Nevertheless, other competent authorities apply a less restrictive threshold for entering into MAP APAs, based on their view that any MAP APA process should be encouraged.

2.4.9.1 Process of Execution of MAP APAs

In line with the provisions of the OECD Guidelines (2010), both the taxpayers and the tax authorities are extensively involved in the process of executing the MAP APA. Some considerations identified by the Guidelines in executing this process are as follows.

a) Preliminary discussions between the taxpayer and the tax administration to discuss the type of APA, the extent and type of information required and the scope of any analyses required for the completion of a successful APA ‘kick’ start the process of executing a MAP APA. Based on these discussions, a taxpayer will make a decision whether this route should be pursued or not.

b) If the taxpayer wishes to pursue a MAP APA request, then the second stage is to make a detailed proposal to the relevant tax administration, pursuant to any domestic procedural requirements, e.g., a requirement to file the request with a designated part of the domestic tax administration. For a MAP APA, the purpose of the taxpayer’s proposal is to give the relevant competent authorities all the information needed to evaluate the proposal and to undertake mutual agreement discussions. In certain countries, the taxpayer is able to make the proposal directly to the competent authority, whereas in other cases a copy of the domestic APA proposal can be made available to the other participating jurisdictions.

c) The exact form and content of the MAP APA proposal should be established between the taxpayer and tax administration based on preliminary meetings. The MAP APA proposal may cover all of the transfer pricing issues of a taxpayer (or of the members of a MNE group) or may be more limited, for example to a particular transaction, sets of transactions, product lines or to only some members of a MNE group. Further, the content of the proposal and the extent of the necessary supporting information and documentation will depend on the facts and circumstances of each case and the requirements of the individual participating tax

administrations. It is therefore not considered practicable to list or define exactly what should be provided. The guiding principle, however, should be to provide the information and documentation necessary to explain the facts relevant to the proposed methodology and to demonstrate its application in accordance with the appropriate article of the relevant treaty. The proposal should therefore be consistent with any general guidance given by the Commentary of the OECD Model Tax Convention on the corresponding articles, together with the guidance on the application of the arm's length principle of Article 9 given by the Transfer Pricing Guidelines in cases involving transfer pricing between associated enterprises.

d) The term of an APA is generally negotiated between the competent authorities on a case by case basis. Experience to date has shown that a MAP APA might, on average, last for three to five years.

e) Once a taxpayer's proposal is received by the tax administrations, they should mutually agree on the co-ordination of the review, evaluation and negotiation of the MAP APA. The MAP APA process is broken up into two main stages: (1) fact finding, review and evaluation; and (2) the competent authority discussions. Taxpayers can withdraw from the MAP APA at any time but any late withdrawal is generally discouraged.

f) Once the MAP APA is finally agreed, the participating tax authorities give effect to the same by executing an agreement in their own jurisdiction. The tax administrations should enter into some kind of a confirmation or agreement with their respective taxpayers consistent with the mutual agreement entered into by the participating competent authorities. This agreement would provide the taxpayer with the certainty that the transfer pricing transactions covered by the MAP APA would not be adjusted, so long as the taxpayer complies with the terms and conditions of the mutual agreement, as reflected in the domestic confirmation or agreement, and provided that the taxpayer has not made materially false or misleading statements during the process, including statements made in annual compliance reports. The terms and conditions would include certain assumptions which, if not met, might require an adjustment to be made or the agreement to be reconsidered.

g) The tax administrations and the taxpayer are not bound to apply the methodology agreed upon as part of the MAP APA to tax years ending prior to the first year of the MAP APA (often referred to as 'rolling back').

With the above outlined procedures, the Annex aims to improve the consistency of application of the APAs by providing guidance to tax administrations on how to conduct mutual agreement procedures involving APAs. Additionally, it also provides discussion as to the best ways through which taxpayers (within both OECD and non-OECD member countries) can contribute to the process.

2.4.10 Conclusion

The APA process is designed to take care of many issues related to transfer pricing tax, including that of double taxation, determination of a satisfactory arm's length price, preparation and satisfaction of documentation requirements, etc. The process is usually considered to be an attractive, appropriate and welcoming initiative in resolving transfer pricing issues and giving assurance on tax matters. This chapter underlines how the APA procedure could provide MNE taxpayers with a significant way to reach better assurance in organizing their transfer pricing tax risks and uncertainties. The chapter has discussed the general workings of the APA programme. The process and administration procedure of the APA is also discussed with particular focus given to the UK APA process. Further, the latter section of the chapter discussed the use of the APA as a remedy against double taxation. The section considers arrangement and workings of the APA process within the mutual agreement procedure (MAP) as outlined in the Annex to Chapter IV of the OECD 2010 Guidelines. Although the benefits of the APA process are discussed as identified in the APA literature, it however stands to reason that they far surpass the shortcomings.

CHAPTER 3: LITERATURE REVIEW

3.1 Introduction

There is possibly no single accounting topic that consumes more management time and energy in multi-profit centre companies than the business of establishing acceptable transfer prices (McAulay and Tomkins, 1992). This may be because the issue of transfer pricing and/or international transfer pricing is grappled with from the perspectives of many different disciplines, the most common of which are economics, accounting, international business, law and public policy. While different approaches are being used to examine the issue of transfer pricing and evidence associated with income shifting, it is apparent that the importance of international transfer pricing has increased owing to the ever-growing effect of international taxation on the global economy. As noted in Section 2.3, more than 60% of world trade takes place within multinational enterprises (OECD, 1996). By this, the importance of international transfer pricing becomes very clear. This fact can be related to why the topic of transfer pricing is currently regarded as highly important in contemporary international accounting and tax matters as already shown by several studies (see Sands and Pragasam, 1997; Ernst & Young's Global Transfer Pricing Survey, 1995-2010).

This chapter sets out with a general consideration of the theoretical influences on the organisation of MNE activities. This helps to underline the significance of international transfer pricing. The next section covers a review of transfer pricing literature. After this, the literature on evidence of income shifting by MNEs is examined in line with the challenges faced by MNEs within their transfer pricing operations. This also helps to provide justifications for the under-researched area of Advance Pricing Agreements (APAs). The last part of this chapter thereafter considers evidence from previous empirical studies in the specific area of Advance Pricing Agreements (APAs) in the hope of clarifying the need to examine the research question which is considered in this project.

3.2 Theoretical Influences on the Organization of MNEs

Generally, the two forms of international business that exist overtime are foreign trade and foreign direct investment. Other forms include international licensing, international franchising, contract manufacturing, management contract, and the turkey project. Zhang (2012) contended that it is the prosperity of these different forms of international business that

inevitably leads to the formation of the multinational enterprises (MNEs) that are engaged in various cross-border commercial transactions for profit-seeking purpose.

However, Leitch and Barrett (1992) showed in his work that ‘the theory of MNEs argues that MNEs arise and engage in foreign direct investment (FDI) in order to exploit imperfections in global markets. Although not explicitly motivated by this theory, the transfer-pricing literature is largely in harmony with this ‘exploitation argument’ (p. 84). This assertion therefore indicates that the quest to engage in FDI and other multinational activities that exploit the imperfections in global markets constitutes a significant underlying reason for the important status accorded to international transfer pricing issues by MNEs.

Several theories have been used to explain MNE and FDI activities. These theories try to project why and how MNEs are expected to exploit the comparative advantages that define their existence. Moreover, as MNEs are the main institutional agent of international production, these theories are sometimes synonymously advanced as the general theories of FDI which is the major means by which international production is financed. They include trade theory, theories of industrial location, a theory of the firm, and industrial organization (Dunning and Pearce, 1988). The following section considers some of the main theories relating to MNE activities and FDI.

3.2.1 Theoretical Framework for FDI Activities of MNEs

3.2.1.1 The Eclectic Paradigm Theory of MNEs’ Activities

Although the eclectic approach (Dunning, 1979; 1980; 1981; 1988; 2001)¹⁴ is not accepted by all commentators (Casson, 1985), it remains the most notable systematic framework in which most operational assumptions and theories about MNE activities are regularly situated. Dunning however acknowledged that the eclectic paradigm is not itself another theory but rather an overall analytical framework intended to provide common grounds between theories of international production.¹⁵ His effort is aimed at clarifying the relationship between

¹⁴ Dunning (2001) noted that the origin of the eclectic paradigm can be traced back to the mid-1950s while writing his PhD thesis on US direct investment in British manufacturing industry.

¹⁵ The main theories of international production can be grouped under four headings which constitute four alternative theoretical frameworks. Each of them is basically an approach that shares common theoretical foundations with others. These are: the market power or Hymer theory of the firm; the internalization or Coasian

different levels of analysis and the different questions which theorists of international production are concerned to address (see Cantwell, 2000). Thus, the eclectic approach integrates a number of economic theories to explain why firms conduct foreign production rather than domestic production and export. The theories which shaped Dunning's eclectic paradigm include:

- International capital theory: This was not suitable for explaining FDI because it involves the transfer of other resources in addition to capital (e.g., technology, management skills), and these resources are transferred within the organization rather than externally to an independent organization.
- Industrial organization theory: This has been used to explain why international production takes place based on important ownership advantages (including technology, innovative capacity and product differentiation).
- Location theory: This has been used to explain why a firm produces in a particular country.
- The theory of the firm: This has been extended to international production by applying market failure theory (Coase, 1937; Williamson, 1975) which argues in favour of internalizing markets.

Nevertheless, each of these theories focuses on different ways of exploiting competitive advantages. For example, industrial organization theory does not address where ownership advantages would be exploited and location theory does not address the way in which foreign firms could compete with domestic firms. Therefore, the eclectic approach argues that to overcome the disadvantages of competing with a local firm in its local market (e.g., little specialist knowledge of the local market conditions, additional costs such as transportation costs), a firm engaged in international production must be able to rely on a set of advantages which are not available to the local firms.

The wide acceptability of the eclectic framework is reflected better in the work of Weisfelder (1998) who argued that the eclectic approach is perhaps, the most expressive of the research tradition in international business which has evolved over the past two decades. The approach asserts that the extent, geography and industrial composition of foreign production undertaken

theory of the firm; the macroeconomic developmental approaches; and the analysis of comparative firm growth in competitive international industries.

by MNEs is determined by the interaction of three sets of interdependent variables, which themselves comprise the components of three sub-paradigms (Dunning, 2000). These variables represent key areas of advantages necessary for foreign investment. They are ownership advantages (O), locational advantages (L) and internalization advantages (I) i.e., OLI. Hence, eclectic paradigm approach is otherwise referred to as the OLI framework. Therefore, by combining the different theories, Dunning (1981) argued that:

‘Firms with headquarters in one country will set up and/or expand value adding activities outside their national boundaries whenever:

- a) they perceive that, due to their nationality of ownership or degree of multi-nationality, they possess some kind of competitive advantage over indigenous firms (actual or potential) in the host country;
- b) they find it economic to exploit these advantages themselves, i.e., to internalize their use, rather than sell the rights to do so to host country firms, via an arm’s length transaction (e.g., a technical service agreement or management contract);
- c) they believe that it is in their global interests to produce at least part of the value added from a foreign rather than a home location’ (p. 34).

Expressing the OLI advantages more formally, they comprise:

- Ownership-specific advantages (O): These are the comparative advantages of the enterprises seeking to engage in foreign direct investment which are specific to the ownership of the investing enterprises. They include assets or access to assets that give the MNE an advantage over the local firm (e.g., technology, management and organizational skills, trademarks, etc.). Thus, the greater the competitive advantages of the investing firms, *relative to those of other firms* - and particularly those domiciled in the country in which they are seeking to make their investments - the more they are likely to be able to engage in, or increase, their foreign production, all things being equal.
- Location-specific advantages (L): These involve the extent to which MNEs prefer to locate some or all of their production overseas rather than servicing foreign demand with direct exports (e.g., input and transport costs, comparative productivity, government incentives). They are the locational attractions of alternative countries or regions for undertaking value

adding activities of MNEs. Thus, the more the immobile, natural or created endowments, which firms need to use jointly with their own competitive advantages, favour a presence in a foreign, rather than a domestic, location, the more firms will choose to augment or exploit their O specific advantages by engaging in foreign direct investment. Considering the two sub-paradigms above together, the eclectic paradigm contends that MNEs have competitive or 'ownership' advantages vis-à-vis their major rivals which they utilise in establishing production in sites that are attractive due to their 'location' advantages.

- Internalization advantages (I): The internalization sub-paradigm of the eclectic theory makes a similar proposition as that of the internalization theory of MNEs. It gives a framework of different alternatives within which firms can organize the creation and exploitation of their core competencies (O) in consonance with the locational attractions (L) of different countries or regions. Given that an MNE has certain comparative advantages, should it internalize these advantages (hierarchical structure) or sell them on to other firms using licensing or franchising (market structure)?¹⁶ Each of these organizational structures will have associated transaction costs (e.g., internalization advantages include the protection of technology, quality control, retention of maximum flexibility, maximized returns) but it is argued that internalization allows an MNE to gain the full benefit of the total value added of a product. It can also be argued that the costs associated with the market structure might outweigh those associated with internal purchases and sales. Nevertheless, these internalization advantages arise both from the greater ease with which an integrated firm is able to appropriate a full return on its ownership of distinctive assets (such as its own technology) as well as directly from the coordination of the use of complementary assets, subject to the costs of managing a more complex network (Dunning, 1988). Given this rationalization, the greater the net benefits of internalizing cross-border intermediate product markets, the more likely a firm will prefer to engage in foreign production itself (rather than license the right to do so).

¹⁶ The framework for these alternatives is originally derived from the works of Coase (1937) and Williamson (1975; 1979; 1985).

3.2.1.2 The Transaction Cost Economics Theory/Internalization Theory of Multinational Enterprises

Although arguments abound as to who originally proposed and applied the internalization and the transaction cost economics (TCE) theories to the theory of MNEs,¹⁷ early contributions to these theories include the works of Hymer (1968; 1970; 1972), McManus (1972), Williamson (1975), Buckley and Casson (1976) and Hennart (1977; 1982). Both internalization and TCE theories are similar in the sense that they both see the firm as a response to ‘market failure’.¹⁸ They both submit that profit-seeking firms will internalize operations when by so doing the costs of organizing and transacting business will thereby be lowered (Teece, 1985). However, while internalization emphasizes the advantages and costs associated with internalizing economic activity, TCE focuses on the transactions as the basic unit of analysis thereby having a micro-analytic view. It regards firms, markets, and hybrid mixed modes as alternative governance structures. The selection of one or the other depends on their relative efficiency properties. This will in turn depend on the nature of the transactions and the type of governance structure that is needed. Despite these mild differences, it is argued that ‘without the TCE framework, internalization theories of the multinational enterprise must be considered incomplete; and perhaps even tautological’ (Teece, 1985, pp. 24 – 25).

The TCE theory is an economic institution that is applicable to both domestic institutions as well as MNEs. The major difference in its implication is that with MNEs, there exists the challenge of having to manage across political and cultural barriers (Hennart, 2001). TCE theory looks at the problems of organizing inter-dependencies among individuals. As such, a general argument is that firms do arise when they are the most efficient institution to organize these interdependencies. For MNEs therefore, they are necessitated when agents negotiating these interdependencies are located in different countries and an MNE entity proves to be more efficient than markets and contracts in organizing such interdependencies.

¹⁷ See Horagushi and Toyne (1990), ‘*Setting the records straight: Hymer, Internalization Theory and Transaction Cost Economics*’ for further clarification.

¹⁸ ‘Market failure arises whenever there are impediments to a market transaction which would otherwise increase (social) efficiency. Such a circumstance may arise because tacit knowledge is difficult to codify and teach, and therefore so costly to transfer by market mechanisms that otherwise efficient trade does not take place’ (Love, 1995, p. 401).

These interdependencies usually come about as a result of the imperfections that characterize markets. Market imperfections affect virtually every transaction in some way,¹⁹ generating costs which interfere with trades that rational individuals make, or would make in the absence of the imperfection (DeGennaro, 2005). These market imperfections may be structural, thereby generating pecuniary externalities (Hymer, 1960), which can potentially be internalized by mergers, cartels or collusion. An example of pecuniary externality includes that of competition in the market for final products (Hennart, 2001). On the other hand, traditional literature on externalities shows that markets typically suffer from natural imperfections (which also can potentially be internalized by spot markets, contracts, or MNEs) because they are not perfectly efficient (Dunning and Rugman, 1985). It is this latter type of imperfection that TCE concentrates on. The TCE/internalization theory of MNE argues that when natural market imperfections are high, the expansion of firms across national boundaries may be a more efficient way to internalize the associated non-pecuniary externalities (Buckley and Casson, 1976; Hennart, 1977, 1982; Rugman, 1981). A basic proposition of the transaction cost theory is that natural market imperfections are consequentially associated with the nature of economic agents and these agents are characterised with ‘bounded rationality’ and ‘opportunism’. By this, they do not always know prices and are not always able to measure output (Williamson 1975, 1985). As agents cannot therefore trust one another to be honest, transaction cost theory endeavours to highlight why MNEs organize interdependencies that could also be handled by markets.

This argument of TCE/internalization theory that multinationals exist as an alternative method of organization or control in lieu of markets through which transactions could be organized is in line with the primary reason for the evolution of MNEs. Hennart (2001, p. 133) clarified that the basic argument of transaction cost theory is that ‘the cost of organizing a given transaction varies with the method of organization chosen to organize it and this is because each of the two basic methods of organization (i.e., the price system (market) and hierarchy)

¹⁹ In Teece’s 1985 view, this assertion reflects the starting point for a transaction cost approach to governance and organizational issues in relation to the point made by Coase (1937) that if it were not for transaction costs, all gains to trade would be exhausted and this could take place under any organizational arrangement. This perhaps is consistent with Coase’s earlier paper (Coase, 1937) that the assessment of the net benefits of organizational and governance alternatives must proceed in terms of a comparative analysis of the costs of transacting under the relevant alternatives (p. 405).

experiences different level of cost for each transaction. They experience different cost because they use different methods’.

Buckley and Casson (1976), however, noted that while markets will tend to be relatively more efficient than firms in handling transactions between a large number of buyers and sellers, they (i.e., markets) will be ‘at a comparative disadvantage when transactions are subject to a high degree of uncertainty and when they consist of long-term exchanges of complex and heterogeneous products between a comparatively small number of traders’ (pp. 167 – 168). Thus, a company will expand abroad when it can organize interdependencies with agents located in a different country more efficiently (at lower cost) than markets i.e., obtain greater comparative advantage via hierarchy than from markets.

3.2.1.3 Implications of the FDI theory for International Transfer Pricing (ITP)

The eclectic paradigm as discussed in section 3.2.1.1 states that MNEs do possess ownership advantages over their competitors which they then seek to exploit by locating production in countries with desirable locational advantages. These locational advantages are those which are specific to a country and are especially attractive for foreign investors. However, while such locational advantages may include issues like material sourcing, a good labour market, local markets, etc., cooperative governmental policies especially in the form of tax policies play a major role in this decision making process (Grubert and Mutti, 1991; Wheeler and Mody, 1992; Mudambi, 1995). This is because politically motivated factors such as taxes, duties, quotas and other economic differentials that vary among countries of the world help to contribute in significant measure to the economic and socio-political environment of the MNE (Leitch and Barrett, 1992). Accordingly, the MNE considers the OLI framework in order to operate in a way that maximizes its desired set of objectives. The fact that the paradigmatic contents of this framework vary among regions and countries allows for what is regarded as market imperfections that are exploitable by MNEs to maximize their own objectives. Consistent with this assertion, the internalization/TCE theory additionally, gives a framework of different alternatives within which firms can organize the creation and exploitation of their core competencies (O) in consonance with the locational attractions (L) of different countries or regions.

Therefore, from a FDI viewpoint, MNEs seek to maximize location-specific advantages by taking advantage of government incentives and market imperfections. Therefore, ITP can be used as a mechanism for ensuring that the MNE is able to utilize these market imperfections (Leitch and Barrett, 1992). Dunning (1981) supported the link between ITP and internalization:

‘Government intervention...encourages (MNEs) to internalize existing activities and to engage in new activities which offer the possibility of internalizing gains... Other things being equal, the more internal transactions the company engages in the greater its opportunity for doing this (manipulating transfer prices) - hence, in the case of MNEs, the added impetus to engage in a global strategy and to practice product or process specialization within its organization’ (p. 31).

There does appear to be strong support for the view that ITP is a means for ensuring that FDI market imperfections can be exploited. Although the majority of empirical studies survey the relative importance of a set of factors on the transfer pricing decisions (e.g., Tang and Chan, 1979; Borkowski, 1992a, 1996a; Tang 1993; Cravens and Shearon, 1996; Cravens, 1997; etc.), very few studies either justify how these factors were selected or ground them in terms of market imperfections and FDI theory.

3.3 Overview of the Transfer Pricing Theory

3.3.1 Introduction

According to Hirshleifer (1964), two main shortcomings of both empirical and theoretical transfer pricing studies are that there is limited acknowledgement that transfer prices are actually a by-product of decentralization by organizations and that transfer pricing is a multidisciplinary exercise. Hence, while some empirical studies have surveyed the practice of companies without any consideration of how these companies operate in their internal and external environments, other theoretical studies have disregarded the practicalities of applying transfer prices in the real world.

With particular reference to being a multidisciplinary exercise, Mehafdi (1990) argued that a study of transfer pricing requires the combination of accounting solutions with explanations from marketing, behavioural science (which includes contingency theory and agency theory) and the economics of the firm. Specifically, a definitional framework is necessary to guide investigation. This framework should recognize the particularities and peculiarities of companies. This requires an understanding of the internal (including organizational structure, technology, culture, managerial systems and the people) and external (economic, political and social environments) factors that influence and are influenced by internal transactions.

3.3.2 Transfer Pricing Literature

Following from Mehafdi's (1990) argument, it is therefore not surprising that a wide range of research on the topic of (international) transfer pricing has been carried out from different theoretical perspectives and using different empirical approaches. The transfer pricing theory and literature has been examined under the organizational theory²⁰ (Watson and Baulmer, 1975; Swieringa and Waterhouse, 1982; Eccles, 1985; Ezzamel, 1987; Spicer, 1988; Emmanuel and Mehafdi, 1994; Colbert and Spicer, 1995) as well as from the contingency theory²¹ perspective (Solomons, 1965; Anthony et al., 1984, Al-Eriyani, 1987; Kaplan and Atkinson, 1989; Mehafdi, 1990; Borkowski, 1990; McAulay and Tomkins, 1992). Besides, the issue of transfer pricing and/or international transfer pricing is also grappled with from the perspectives of many different disciplines, the most common of which are economics, accounting, international business, law and public policy. While different approaches are used to examine the transfer pricing issue and evidence of income shifting that is associated with this, two of the more common approaches adopted to transfer pricing research include the managerial approach (Eccles, 1983; Spicer, 1988; Colbert and Spicer, 1995; Cravens, 1997;

²⁰ According to Emmanuel and Mehafdi (1994), the organizational theoretical framework of transfer pricing involve three issues:

- Researchers should have a proper understanding and justification of internal trade;
- Researchers should recognize the variety of objectives that a transfer pricing system is expected to achieve;
- Objectivity must not override human/subjective dimensions - 'hence the need for a multi-disciplinary approach' (p. 148).

²¹ Contingency theory recognizes the claims that some theories are inappropriate to certain circumstances. Otley (1980) argued that 'conflicting results which could not satisfactorily be resolved within a universal framework have been one source of stimulus for the development of contingency formulations' (p. 414). Thus, the theory has been employed by various researchers in an attempt to identify the important contingent variables for transfer pricing.

Elliot and Emmanuel, 2000) and the economic approach²² (Hirshleifer, 1956; Solomons, 1965; Kanodia, 1979; Kaplan, 1982).

However, the relevant transfer pricing studies that are considered for review under this section are as implied from the propositions of the FDI theories discussed above. As explained above, transfer pricing is considered here as useful for internalizing gains within an MNE as well as for capitalizing on market imperfections between different international markets. Accordingly, these theories suggest the use of transfer pricing as a tool of resource allocation within the global operations of MNEs. Also, this indicates the desire of MNEs to always exercise control of those activities that are core to the MNE operations as a means of maximizing their intended objectives. Hence, the following review covers works that relate to transfer pricing as an instrument of resource allocation, strategy, management control and tax optimization.

3.3.2.1 Hirshleifer (1956)

As it is popularly observed, many economic studies of transfer pricing are built on the standard transfer pricing model as proposed by Hirshleifer (1956). Eccles (1985) and Grabski (1985) both noted that Hirshleifer's model was the first formal treatment of transfer pricing from the economics viewpoint. His paper is concerned with the problem of pricing goods and services that are exchanged between some virtually autonomous 'profit centres' within a firm and how these prices should be set in order to induce each of these divisions to act so as to maximize the profit of the firm as a whole.²³ Hirshleifer's model assumed two profit centres, i.e., a manufacturing division - with no external market for its product; and a distribution division - with a competitive external market. Following these assumptions, Hirshleifer (1956) carried out his analysis under different demand conditions and thus concluded that intermediate products should be transferred between divisions at a market price only when a perfectly competitive market exists for such. Otherwise, the basic conclusion is to price along

²² The transfer pricing phenomenon has been examined using a number of research approaches. For instance, Eccles (1985) divided the literature on transfer pricing theory into early theory, economic, mathematical programming, accounting and management. However, two main approaches identified by Eden (2007) as dominant include the managerial approaches (which include transfer pricing works in relation to organisation behaviour theory and strategic management theory) and the economic approaches (which cover works using economic theory, mathematical programming, and accounting theory).

²³ This was in response to the recommendations of two previous papers - Cook (1955) and Dean (1955) who both discussed the crucial importance of transfer-price policies and also the alternative approaches to the problem.

the marginal cost curve for intra-company transfers.²⁴ This argument holds true even when the assumption of no external market for the intermediate product is relaxed. This market was then studied under situations of both perfect and imperfect competition (Eccles, 1985; Grabski, 1985). Further, in order to reach the same figures for the optimal output of each division but still retaining their autonomies, Hirshleifer (1956) suggested that the manufacturing division supply the distribution division with the quantities to be produced at specified prices. However, as is the case usually, when divisional managers are assessed on the basis of their divisional profits, the temptation frequently would exist to not supply truthful, relevant information. Grabski (1985) therefore suggested that gaming is a possibility inherent in Hirshleifer's model. In addition, Eccles (1985) noted as well that the assumptions of technological independence between divisions are usually unrealistic.

While the Hirshleifer's (1956) proposed model is seminal in nature, the analysis is criticised as not capable of explaining the use of various transfer pricing methods in practice (Göx and Schiller, 2006).

3.3.2.2 Solomons (1965)

Solomons (1965) focused solely on transfer price as a method of resource allocation, although he recognized the effect of transfer pricing on performance evaluation and the problems associated with such. His work represents the first effort to apply Hirshleifer's (1956) theory to accounting. Solomons identified five transfer prices (extent of internal transfers) that are applicable under five different environmental conditions (external markets). The first of his propositions is one with which Kaplan (1982) later agreed. Here, Solomons proposed that market price is applicable when the external market is highly competitive. The other four propositions relate to situations where the market is not highly competitive. Instead, they are for varying forms of cost which depends upon how important the transfer price issue is to the organization. The final proposition is for the situation when there is no competitive external market for the product and Solomons recommended mathematical programming to solve this situation, because the producing division is assumed to be operating under capacity

²⁴ 'The argument made in the present paper is that market price is the correct transfer price only where the commodity being transferred is produced in a competitive market, that is, competitive in the theoretical sense that no single producer considers himself large enough to influence price by his own output decision. If the market is imperfectly competitive, or where no market for the transferred commodity exists, the correct procedure is to transfer at marginal cost (given certain simplifying conditions) or at some price between marginal cost and market price in the most general case' (Hirshleifer, 1956, p. 172).

constraints. Moreover, most of the goods of the producing department are assumed to be transferred to other departments. Under this analysis, Solomons implicitly assumed that the buying division is forced to source internally (Eccles, 1985).

3.3.2.3 Kanodia (1979)

Kanodia's (1979) work is based on Hirshleifer's propositions and he developed a proof to show that Hirshleifer's analysis and proposition are correct for situations where there is perfect competition for the intermediate product. With Hirshleifer's model, Kanodia adapted a certain external market to a mathematical programming approach. Additionally, he employed for a condition of uncertainty Hirshleifer's model which assumes certainty in the environment. In the Kanodia model, central management is assumed to run a linear programme on the basis of honest reports of the manufacturing and distribution divisions. An ideal transfer price is then obtained from this programme and in turn is imposed on these divisions. In this sort of situation, misrepresentations from management with regard to the reports may be expected to occur and this is because such a scenario does not actually provide any incentive for them to report honestly. Consequently, Kanodia (1979) changed the model for uncertainty with the distribution division facing a vector of market prices and probabilities for the final product. Together with the uncertainty, central management added an incentive, i.e., divisional managers receiving a part of division profit. With this situation, only the risk attitudes in the distribution division are reflected. The allocation of rewards would not be Pareto optimal and maximization of the overall objective of the firm is not guaranteed. Kanodia (1979) later introduced risk sharing by the divisions (both local and global) by imposing a vector of values for the transfer price and making it conditional on the final price. In the local risk sharing scheme, the transfer price is attained by forcing a separation between divisional managers' risk aversions. A linear programme is run to find the transfer price which will be imposed on the divisions. The interactions of the divisions will produce the distribution of total firm profits. Pareto optimality is achieved for the manufacturing and distribution divisions. In the global risk sharing scheme, the linear programme provides a solution for total firm optimality. Corporate objectives are considered equally with divisional managers' risk aversions and an imposed transfer price is determined. Both risk sharing schemes, local and global, are assumed to motivate management to want to increase profits.

3.3.2.4 Eccles (1983)

Eccles examined the issue of organisational unity and goal congruence and concluded that ‘the key to transfer pricing problem is strategy’ (Eccles, 1983, p. 151). He interviewed 150 executives in order to look at the various transfer pricing schemes employed by 13 different companies. As a framework for the content analysis of the interviews, Eccles adopted a two-dimensional normative framework referred to as the Manager’s Analytical Plane (MAP) in which transfer pricing policies are one aspect of strategy implementation and depend on vertical integration and diversification. The analysis of the interview results enabled Eccles to develop a categorization of organization type and the transfer pricing methods used. These, with their specified transfer pricing policy included the following categories.

- *Collective Organizations* include the typically small and new firms with very few functions or products. They do not have transfer pricing because there is no interdivisional movement of products.
- *Co-operative Organizations* are highly diversified and have little vertical integration, such as a conglomerate or a holding company. They include the typically mature or capital intensive industries (or evolving collective organizations) with a narrow range of products.
- *Competitive Organizations* are highly diversified and have little vertical integration, such as a conglomerate or a holding company with many different businesses but very little sharing of resources.
- *Collaborative Organizations* are typically project-based industries, such as aerospace and construction, or common technologically-based industries (e.g., electronics) which have numerous related businesses. These are a combination of the competitive and cooperative organizations.

The significance of this work lies in its usefulness in helping to focus on the strategy of the organization guiding the transfer pricing policy, performance evaluation and reward.

3.3.2.5 Cravens (1997)

Cravens examined the results of a survey of executives of US-based multinational firms who describe the international transfer pricing objectives and strategies of their firms. She identified that the strategic objectives of international transfer pricing fall into three areas: (1) taxation-related objectives; (2) internal management-oriented objectives; and (3) international

or operational objectives. These objectives represent areas of business activity which are essential to the continued success of the MNE. In order to investigate transfer pricing effectiveness with regard to these objectives, 542 US-based firms were surveyed with a response rate of 21%. The results confirm that MNEs do seek multiple objectives from their transfer pricing decisions. Basically, her findings revealed that managing the tax burden or complying with tax law is not the singular focus of transfer pricing for all MNEs. It is found that the transfer pricing also influences measures of corporate performance and contributes towards the corporate objectives.

3.3.2.6 Gabrielsen and Schjelderup (1999)

Gabrielsen and Schjelderup (1999) studied the performance of jointly owned production units where upstream firms sell inputs to a downstream final market producer. By modeling three firms, with each located in (potentially) different tax jurisdictions (countries), their analysis revealed that in case where the downstream firms buying from upstream firms are co-owned through joint ventures or otherwise, the transfer pricing is generally over invoiced. They found that apart from performing the role of tax management, transfer pricing plays a strategic role even in co-owned downstream firms of multinational corporations (MNCs).

3.3.2.7 Elliot and Emmanuel (2000)

Elliot and Emmanuel (2000) carried out an exploratory fieldwork study of 12 multinational enterprises based in the UK which attempts to place current practices of international transfer pricing within organizational and fiscal context. While viewing transfer pricing from many perspectives and as being associated with many tensions both within and outside the MNE, they asked each of the 12 MNEs to describe international transfer pricing for an individual, specific cross-border intra-group transaction of their choice. By building on an earlier survey (Elliot 1998), 12 respondents (tax managers and directors) were interviewed on a face to face basis. They argued that each MNE's strategy and its current level of attainment will differ and that the dynamics of global markets imply that ITP adjustments may lead to strategic reappraisal over time. Their findings suggest that product transfers almost inevitably involve intangible transfers and this imposes a dual concern for MNEs to document and justify both their international transfer pricing and royalty agreements. Also, the industry sector affiliation of these MNEs is associated with a preferred transfer pricing method.

3.3.2.8 Cools and Emmanuel (2006)

Cool and Emmanuel (2006) argued that when trades cross national boundaries, there is also an opportunity for multinational enterprises to optimize global after-tax profit. They reviewed the regulatory framework on transfer pricing in order to examine the implications of adopting a tax-compliant strategy on the design of management control systems. The analysis looks at the norms, rules and procedures that MNEs face in relation to the arm's length requirement under the fiscal rules and relates this to the current foreign direct investment theory, especially when seeking comparables for inter-unit transactions. They contended that the detail and volume of documentary evidence required to justify transfer prices from a fiscal perspective is unlikely to offer scope for meaningful participation by sub-unit managers in setting or changing the transfer price. They however agreed to the fact that international related party trade gives rise to the opportunity for MNCs to optimize global profit after tax (PAT). They found that since 1990 the increased fiscal regulations and compliance to the same have become a potential alternative strategy to overcome clash with the management control system prevailing in the MNE.

3.3.2.9 Dikolli and Vaysman, (2006)

In an attempt to show how information technology affects transfer pricing, Dikolli and Vaysman, (2006) found that information technology plays an important role in the transfer pricing process as a management control tool for multinational corporations (MNCs). They contended that although negotiated transfer price possesses some informational advantage, managements prefer the cost based method over the negotiated price method, since the negotiation can defeat the strategic objectives of transfer pricing. However, when negotiated prices approximate the firm's cost of internal trade more precisely than cost-based transfer prices, the former is preferred. They however concluded that firms generally prefer the cost based methods in their use of transfer price as a strategic tool.

3.3.2.10 Martini, Niemann and Simons (2007)

Martini, Niemann and Simons (2007) analyzed the impact of different international tax allocation regimes on a corporate group's investment and production decisions. In doing so, they acknowledged the problem of coordinating economic decisions like investment or production within multinational groups (MNGs). The findings suggest that transfer prices are a widespread device for splitting up complex decision situations and allocating the

responsibility for the resulting sub problems to several decision makers. However apart from doing this transfer prices are also used for tax management.

3.3.2.11 Urquidi (2008)

Urquidi (2008) examined the issue of transfer pricing as an increasingly key issue in international business and trade and therefore considered the topic from both micro (firm level) and macro (economy wide) perspectives. He argued that beyond tax implications, however, transfer pricing is an area with strong roots in the discipline of economics that presents a challenge for proper implementation at the firm level. Further, apart from its impact on the firm, transfer pricing can also have significant impacts on cross border, international trade and on the macro economy. In his case study analysis, Urquidi (2008) found that transfer pricing can play an important role in the strategic decisions made by multinational firms. Basically, 'the corporate seek to solve the transfer pricing problem for three reasons, namely: (i) satisfies the needs of the business with respect to strategy and internal incentives; (ii) results in an efficient use of resources; and (iii) provides the "right" transfer pricing answer from a tax perspective' (p. 27). He submitted that this is a daunting task for the corporate especially in the financial services sector which does not have any specific transfer pricing regulations. He further found that the macro economic factors play a vital role in transfer pricing and the firms will have to rely upon the economic factors to help them navigate the problem of transfer pricing process.

3.3.2.12 Curtis (2008)

Curtis (2008) challenged the common view that transfer pricing is essentially a tax issue and a responsibility of the corporate tax department. He consequently made a case that an integrated, multi-functional approach to MNE treasury planning in the context of transfer pricing can be an important component in improving the efficiency of cross-border financial management. However, in doing this, Curtis (2008) submitted that whenever a payment crosses borders in a treasury context whether to provide a loan, purchase a receivable, provide a guarantee, sweep cash, factor a receivable, provide a hedge or insurance product a transfer pricing issue is present. The study used conceptual and empirical information as well as numerical examples to illustrate relevant tax and transfer pricing concepts for policy planners and others responsible for MNE treasury and tax planning. It also examined the multinational corporations' (MNCs) corporate treasury management responsibilities from the perspectives

of international capital structure and cost of capital, the financing of cross border acquisitions, foreign direct investment, international capital budgeting and cash management, management of foreign exchange and transactional risk, and port-folio and investment management. In all of the above when there is a fund movement between international boundaries there is a transfer pricing issue involved.

3.3.2.13 Cools and Slagmulder (2009)

Cools and Slagmulder, (2009) studied the effect of international transfer prices within management control systems by investigating how transfer pricing tax compliance influences responsibility accounting when one multinational enterprise (MNE) uses a single set of transfer prices for both tax compliance and management control. They aimed to contribute to the stream of research documenting and explaining how management control systems (MCSs) are designed and used under environmental pressures. The study was carried out via an in-depth case study in one MNE that uses one set of transfer pricing books. For the purpose of the study, transfer pricing negotiations are eliminated giving rise to economically harmful decisions. Administrative mechanisms for profit determination can lead to suboptimal decisions and lastly revenue or cost centres are designated as profit centers for tax compliance. Transfer pricing and tax compliance is related to profit centers. In the case study undertaken, it was found that the management found utility in treating the associate as profit centre than revenue or cost center.

3.3.2.14 Ćirić and Gracanin (2010)

Ćirić and Gracanin (2010) noted that the selected model of transfer pricing in many ways defines the success and interest of the responsibility centres for internal transactions. They argued that transfer pricing is an important motivator of costs reduction, which also contributes to more efficient spending of limited resources, as well to the better business results of the responsibility centers and the whole company. Their work showed that transfer pricing affects the divisional revenues, expenditures and results. This creates competition amongst the divisions for increasing their performances. The method used for transfer pricing thus plays an important role and is of most interest to the managers. They also found that the more successful divisions get more share in the allocation of resources. In multinationals where the transfer pricing is not used as a strategy for tax planning, there is a very strong case that a trade-off is made by the managers of the divisions between benefits of tax management

and higher share in resources from the management. Also there will be considerations given to the performance based bargaining capacity of the division manager which can have impact on the transfer pricing method as well as price. They subsequently concluded that the most commonly used model of determining transfer pricing is the cost model, although it has certain disadvantages.

3.3.2.15 Klassen, Lisowsky and Mescall (2013)

Klassen et al. (2013) investigated the extent to which transfer prices are a tax maximization tool for multinational corporations. They surveyed tax executives from 219 multinational corporations to explore their approaches to cross-border transfer pricing and explored more deeply the belief that transfer pricing are set to achieve tax maximization. They attempted to provide new and direct evidence on the role of transfer pricing in tax minimization. The study found that the link between tax minimization and transfer pricing is contextual as it pertains to a firm's tax department, resources, goals, and other characteristics. Through a multivariate analysis, they reported that transfer pricing is a material tax minimization tool and that a significant number of firms are evaluating their transfer pricing success based on tax minimization. Transfer pricing-related tax minimization is associated with greater tax resources overall, more experienced tax personnel, employing more resources on transfer pricing tax planning, and assessing transfer pricing success based on cash taxes paid. However, there is diversity in both transfer pricing practices and strategies as most multinationals aim to comply with tax laws. Collectively, the study suggests that differences in transfer pricing practices and strategies determine the extent to which transfer prices truly aid tax reduction.

3.3.2.16 Conclusion

Generally, the study of the role of transfer pricing in MNEs required that the particular organizational context is taken into account.²⁵ MNEs usually operate in many countries in order to take advantage of structural market imperfections that abounds within international economic exchange process. The review above relates to the role of transfer pricing as an instrument of resource allocation, strategy, management control and, tax optimization.

²⁵ The work of Solomons (1965) is actually considered as the seminal work on a contingency approach to transfer pricing study. Other contributions on this include Anthony et al (1984); Kaplan and Atkinson (1989); Mehafdi (1990) and Borkowski (1990)

However, the different considerations outlined by Leitch and Barrett (1992) are argued as playing a role in most MNEs. These include profit, cash flow, marketing, operations (productions), tax savings, socio-political, and behavioural factors. While some of these factors are inter-related, others are conflicting but they however represent the MNE's long term and short term goals.

More relevantly, the broad literature on transfer pricing in a tax setting mostly suggest that a popular factor which many MNEs consider in their transfer pricing policy is the minimization of taxes - including duties, tariffs, and profit taxes (Hassett and Newark, 2008). However, since different national governments operate different corporate income tax rates, the financial results of different MNE divisions which are located in the different countries, and that of the MNE's total after-tax profit are largely influenced. Given this scenario, many empirical studies have investigated this 'income shifting' behaviour by MNEs.

3.3.3 Income Shifting Literature

3.3.3.1 Grubert and Mutti (1991)

Grubert and Mutti (1991) aimed to address a number of international tax issues of which a key part was the issue of income shifting and tax planning opportunities available to MNEs. They examined a cross-section of 33 countries using 1982 data to investigate whether MNEs took advantage of tax planning opportunities by shifting taxable income to low tax countries. A negative correlation between the after-tax profit rate and the tax rate would indicate some support for the occurrence of income shifting. In running the regression model, measurable indicators were identified for the key variables of tax (measured by average effective tax rate and statutory tax rate), profit (measured by book income/sales net of purchases from parent and book income/equity), and algebraic relationship (linear relationship or non-linear relationship) both with and without an adjustment for GDP growth rate. Their findings revealed that tax rates are a highly significant determinant of reported profits in all cases. They also revealed that while GDP is often a significant determinant of US affiliates' reported profitability, its inclusion in the regression however was not found to greatly affect the estimated role of taxes.

3.3.3.2 Harris et al. (1993)

Using a similar method to that of Grubert and Mutti (1991), Harris et al. (1993) sampled 200 US manufacturing firms. These were randomly selected from the SIC3000 industry file on Compustat from 1984 to 1988. The data from Compustat were supplemented with company annual reports. With a dependent variable of ‘current taxes payable to the federal government net of investment tax credits’ (p. 138), Harris et al. (1993) found evidence to suggest that US manufacturing companies did engage in income shifting during this period. The regression analysis comprised data for dummy variables for location and other additional variables from Compustat. These included variables like R&D expenses, investment tax credit, interest expense and number of employees.

3.3.3.3 Klassen et al. (1993)

Klassen et al. (1993) examined changes in the reporting of taxable income by US MNEs in response to worldwide relative changes in corporate tax rates during the period 1984 to 1990. Their geographic study covered 191 US MNEs and they evaluated shifts in income between specific geographic regions on a year by year basis. Rather than a cross-section analysis of MNEs, they focused attention on the changes in reported profitability over a period, on financial statement data, subsequent to a particular tax change. They reported that US MNEs shifted income into the USA in 1987 in response to the US Tax Reform Act of 1986 (TRA86). US MNEs were reported to have shifted income to the USA from Canada and from the USA to Europe in 1985 and 1986 with such findings being consistent with the increasing Canadian rates and decreasing rates in Europe at the time (p. 142). However, these results reversed in 1988 with MNEs shifting income out of the USA in 1988. They attributed the 1988 change either to lower rates in other countries (such as Canada, France and Japan) or to the large non-tax costs of shifting income into the USA.

3.3.3.4 Harris (1993)

Harris (1993) investigated whether US MNEs shifted income into the USA and deductions out of the USA after the lowering of the corporate tax rate under TRA86. The Tax Reform Act (TRA) of 1986 reduced the corporate tax rate from 45% to 34% and reduced subsidies for capital investment. His analysis covered the period of 1984-1990, with the post TRA86 period inclusive of years 1987 – 1990. For his entire sample, Harris’s analysis found little evidence of income shifting but there was more significant evidence of income shifting to the USA after

TRA86 for firms with 'high flexibility'. He defined 'high flexibility' firms as those with higher levels of interest, R&D, rent, and advertising expenses. Harris's argument is that these expenses are less firmly fixed to a particular place or time and, therefore, can be shifted between locations without incurring significant costs.

3.3.3.5 Jacob (1996)

While aiming to extend the work of Harris (1993), Jacob (1996) attempted to link the level of taxes paid by firms and reported profits in the USA and other foreign jurisdictions to the volume of inter-geographic area transactions within firms. Thus, he supplemented the data on taxes paid and geographic profits with information on volumes of inter-geographic trade. Jacob examined two time periods in this study - 206 US MNEs in 1982 – 1984 and 289 US MNEs in 1988 – 1990. Data were gathered from both Compustat and annual reports. The assumptions made are that if firms use transfer pricing to minimize taxes, then multinationals with the greatest volume of transfers and the greatest differences in tax rates between the USA and foreign jurisdictions have the most opportunities and the greatest incentive to shift income through transfer pricing policies. On the basis of this assumption, he suggested that: (1) if firms use transfer prices to shift income, then firms with large volumes of transfers should pay lower global taxes; (2) if firms use transfer prices to shift income to the USA, then firms with large volumes of transfers should pay greater US taxes; and (3) if firms with large differences in tax rates between jurisdictions use transfer prices to shift income, then firms with large volumes of transfers and greater differences in tax rates should report greater differences in profitability between the USA and foreign jurisdictions in order to minimize taxes. From investigation of these hypotheses for the period before and after TRA86, the reported results are consistent with global tax minimization using transfer prices to shift income between jurisdictions in both time periods. Jacob (1986) also found that the profitability differences between USA and foreign operations are consistent with the management of transfer prices to minimize taxes in both time periods.

3.3.3.6 Oyelere and Emmanuel (1998)

This study attempted to determine whether the profitability (performance) and dividend (post-performance) distribution of FoDCs (foreign-owned domestic companies) operating in the UK reveal evidence of the use of ITP for income shifting. Focus was given to the link between reported profitability and dividend distributions of UK-based FoDCs and UK-controlled

enterprises (UKCEs) to determine whether ITP is used for income shifting purposes. The authors matched samples of FoDCs with that of UKCEs on the basis of capability (total assets) and thereafter, compared the reported profitability (performance) and dividend (post performance) distributions of the two samples. By matching a sample of 36 FoDCs operating in the UK with 36 UKCEs on the basis of total assets value, the analysis revealed a significant divergence in the performance and post-performance distributions of the two samples. They found an unusual relationship between the profitability and distribution of FoDCs, suggesting that ITP was used to shift income from the UK.

3.3.3.7 Conover and Nichols (2000)

In an attempt to extend the work of Jacob (1996), Conover and Nichols (2000) evaluated the effect of firm size on income shifting between tax jurisdictions through the use of transfer prices both before and after the passage of the Tax Reform Act of 1986 (TRA86). Unlike most prior studies in this area, they included smaller and in some cases financially distressed firms in their sample and tested the effect by firm size on income shifting. For this study, the authors drew their sample from the random sample identified by Jacob (1996) consisting of a sample of firms from the COMPUSTAT database that reported pre-tax earnings separately for US and foreign operations for the fiscal year 1988. The study mainly focused on addressing the question of whether firms with subsidiaries facing lower foreign tax rates shift income out of the USA while those facing higher foreign tax rates shift income into the USA. Their analysis suggests that firm size has some influence on the use of transfer pricing to shift income. They found that prior to TRA86, only the largest firms use transfer pricing to shift income in order to reduce global taxes. After TRA86, a broader group of firms (including small and medium sized) with intra-firm transfers appear to use transfer pricing policies to shift income to reduce global taxes. The authors reported a change in Jacob's results when the smaller firms were included, suggesting that smaller and/or distressed firms with missing COMPUSTAT data are less likely to shift income through transfer pricing than larger firms.

3.3.3.8 Jensen and Schjelderup (2009)

Jensen and Schjelderup (2009) carried out an empirical investigation of how differences in national taxes affect prices and quantities that make up net intra firm trade flows among multinationals in Norway using a comprehensive firm level data set from the census of Norwegian based MNEs. The study focused on the importance of tax induced transfer pricing

by Norwegian based multinational enterprises in the period 1999 – 2004. The data set included the value of all transactions, both inwards and outwards, between a parent MNE and each of its affiliated firms abroad. A theoretical model was initially set up which predicts how net trade flows are affected by international taxation. The authors later tested the theoretical predictions that followed from the model using micro level panel data of all Norwegian multinationals and their wholly controlled affiliates in the OECD area in the period 1999 – 2004. Their analysis showed evidence that multinational firms manipulate prices and quantities across time and countries so that profit is shifted to low tax countries. Further, the data indicated that multinationals manipulate prices of intra-firm export and import in response to changes in the host country statutory tax rate.

3.3.3.9 Conclusion

In addition to the reviewed empirical studies on cross-jurisdictional income shifting, there is quite a large number of other empirical studies that seek to investigate the income shifting behaviour of MNEs.²⁶ However, not all of these researchers arrive at conclusive results about the income shifting hypothesis. In some cases, there is evidence of reported profits responding to host country effective tax rates and tariffs. In other situations, there is no proof that the reduced tax burden of certain MNEs could be attributed to income shifting or what is otherwise referred to as transfer pricing manipulation. Despite the different evidence provided by this body of literature, the fact remains that the nature of intra-firm trade between MNE divisions is not such that it can be visually related to simple supply and demand (Cools, 2005). Hence, it is understandable when tax authorities started becoming suspicious towards transfer pricing activities of MNEs and the associated possibilities for manipulating taxable income and tax avoidance in their jurisdiction (Section 2.3.1). Consequently, as shown in Section 2.3.2, the need for an international yardstick in order to ensure a correct and fair transfer pricing system in each jurisdiction compelled the OECD to introduce and promote the arm's length principle as the central theme in its Transfer Pricing Guidelines. When the arm's length principle is adopted by a national government, its tax authority can be given permission to adjust taxable profits of MNEs within its jurisdiction if it is established that the arm's length principle has not been respected. However, in addition to the OECD rules, there are diverse

²⁶ Some of the other empirical studies that deal with transfer pricing manipulation within MNEs include among others, those works from Wheeler (1988; 1990), Kim and Lyn (1990), Scholes and Wolfson (1992), Crain and Stitts (1994), Grubert and Slemrod (1998), Bartelsman and Beetsma (2000), Clausing (2003), Eden (2003) and Bernard et al. (2006).

national tax rules which have been issued in recent years and this has placed on MNEs pressure to respond to different regulatory requirements at the same time. This consequently results in an increasing number of MNEs incurring the risk of becoming the subject of a specific transfer pricing audit (Markham, 2012). Aside from the practical difficulties of complying with the arm's length principle, MNEs face a difficult situation in adhering to this fiscal requirement, given some of the theoretical rationales that underpin their choice for internal transfers (see Section 3.2.1 above). As such, the inherent tension that these firms face naturally put them in a very uncertain situation in relation to their transfer pricing tax operations. This problem of satisfying compliance requirements from a tax perspective however represents only one component of the 'corporate transfer pricing problem' faced by MNEs (Urquidi, 2008).²⁷

Attempts by many tax administrations to reduce these uncertainties for MNEs result in more of them putting in place the administrative process of an APA (Chapter 2). APAs give them the certainty that a particular transfer pricing policy will not be disputed during a certain period of time, as long as the facts and circumstances do not substantially change. This way, in order to achieve certainty of tax treatment and to resolve real or potential transfer pricing disputes before they arise, companies may seek an APA with their host tax authority. However, while the agreement guarantees that the use of the agreed upon transfer pricing method will not trigger an audit, it does *not* guarantee that the MNE will not be audited for other aspects of its transfer pricing activity (Borkowski, 2008).

3.3.4 Implications of the FDI theory for Advance Pricing Agreements (APA)

The two theories of foreign direct investment, as described above, both have implications in relation to MNEs' consideration for the APA programme. These implications however, arise when the theoretical propositions of these theories are considered alongside the fiscal regulations for APAs as provided by different tax authorities globally.

The tax directive as provided by the OECD (which is followed by many fiscal authorities around the globe) presents what can be regarded as the 'comparability argument'. This

²⁷ Urquidi (2008) noted that a major concern for multinationals is the need to solve the 'corporate transfer pricing problem' by establishing transfer pricing policies and practices that: (i) satisfy the needs of the business with respect to strategy and internal incentives; (ii) result in an efficient use of resources; and (iii) provide an appropriate transfer pricing answer from a tax perspective (p. 27).

requires MNEs to cope with the ability to demonstrate compliance with the arm's length principle through thorough functional analysis, especially with respect to the most advantageous position that can be robustly defended (Section 2.3.3). Compliance with the arm's length principle however requires that the MNE provides an acceptable comparison as part of the comparability analysis for the transaction (OECD, 2010, p. 107) otherwise, as stated earlier, a tax authority may adjust the TP taxable amount of the MNE by imposing what it believes reflects better the amount of taxable income that ought to reside in its country.

However, the 'comparability' argument as presented in the guidelines appears inconsistent with the propositions of FDI theories discussed above. Both the OLI and TCE theories recognize that when MNEs aim to transfer to firms in foreign countries, products that embed firm-specific advantages (competitive advantages), 'internalization' serve as the best way through which such transfers should be conducted. This is regarded as the 'competitive advantage' argument. As noted earlier, MNEs consider the OLI framework in order to operate in a way that maximizes their desired set of objectives and the differences in the framework of this paradigm among countries allow them to exploit market imperfections to maximize their own objectives. Also, the internalization/TCE theory gives a framework of the different alternatives within which firms can organize the creation and exploitation of their core competencies (O) in consonance with the locational attractions (L) of different countries or regions. Here, Transactions with high asset specificity, high frequency and high level of uncertainty will be conducted within the fully integrated firm (Williamson, 1979; 1985; 1993), while transactions with the lowest degree of these properties are more economically suited for the 'market'.

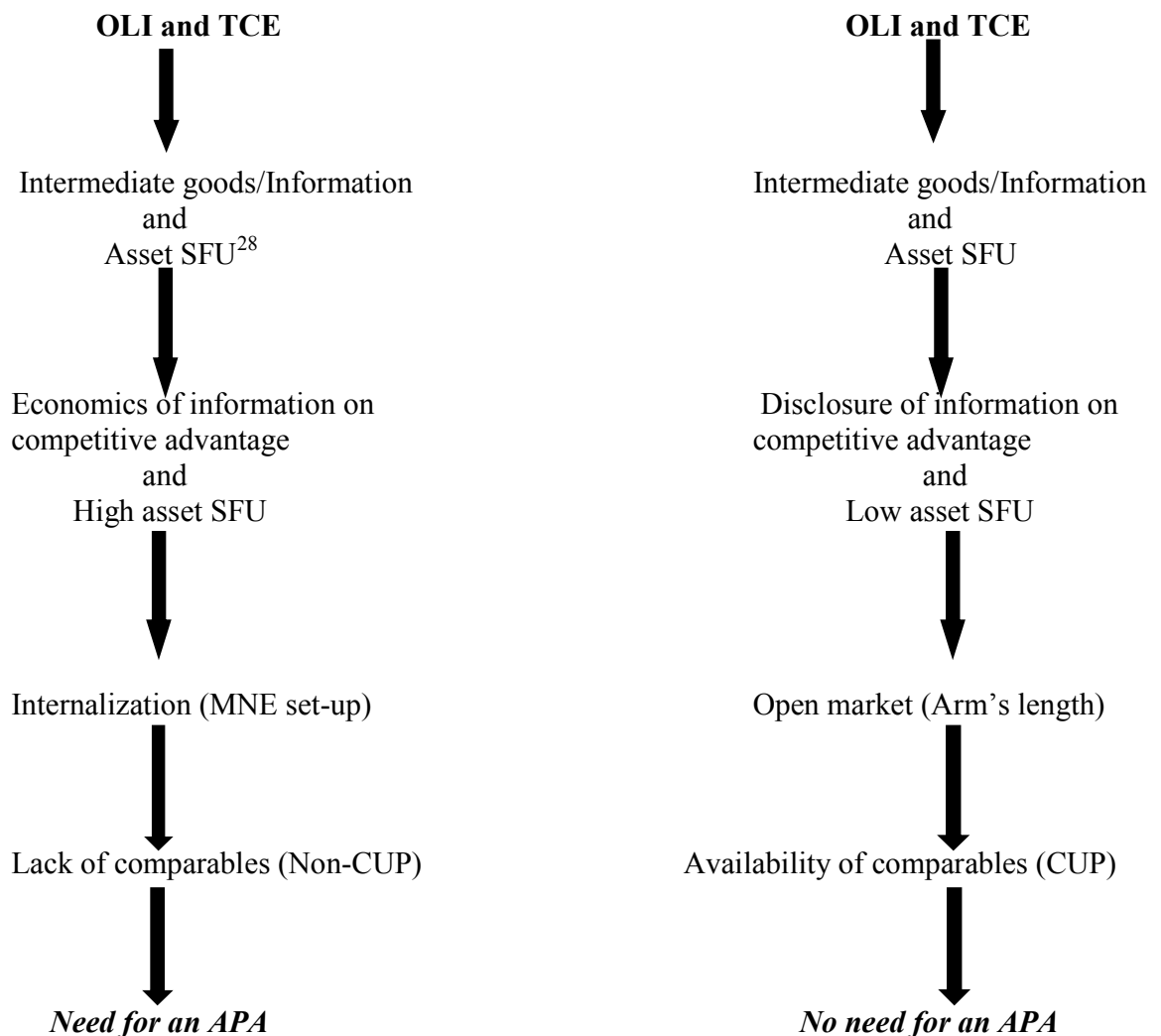
Accordingly, where MNEs' internal transfers are comprised of transactions with high asset specificity, high frequency and high level of uncertainty and appropriately conducted within the fully integrated firm as proposed by TCE, there arises a complex and difficult situation for such firms in their bid to employ transfer pricing methods in accordance with the OECD Transfer Pricing Guidelines which advocate the arm's length principle. The search for acceptable comparables will be difficult, given that such transactions that are characterized with unique firm-specific advantages will be nearly impossible to compare with any other transactions in the open market as required by the arm's length principle. Moreover, other MNEs with near comparables would have, on the basis of TCE/Internalization proposition,

conducted their own transfers within the hierarchy governance structure. Using such a situation for comparability analysis is, however, not acceptable for arm's length purposes. Paragraph 3.25 of the OECD 2010 TP Guidelines states that 'Comparisons of a taxpayer's controlled transactions with other controlled transactions carried out by the same or another MNE group are irrelevant to the application of the arm's length principle and therefore should not be used by a tax administration as the basis for a transfer pricing adjustment or by a taxpayer to support its transfer pricing policy' (p. 115). Also, where MNEs choose to conduct foreign manufacturing by themselves, as expected by the internalization sub-paradigm in order to exploit their unique ownership advantages, obtaining reliable market comparisons for such products may be very difficult for the purpose of transfer pricing. As one might expect, the uniqueness of such transactions would be associated with potential doubts as to how an arm's length price can be satisfied leaving room for doubts in any arm's length standard adopted. Consequently, the cooperative nature of the APA process and the in-built mechanisms for negotiation that are employed, make it a viable option for MNEs as a process that not only could ensure adherence to the arm's length principle, but also could help to accommodate the practical observance of the propositions of the OLI and TCE/Internalization theory as applicable to the MNE concerned. The theoretical argument that is being put forward here is as represented by Figure 3-1 below. The Figure illustrates how the comparability argument as embedded in the OECD Guidelines for transfer pricing constitutes a compliance tension for MNEs when placed alongside the propositions of the OLI and TCE/Internalization theories and how, by giving regard to this, the APA could be utilised to take care of this tension.

The last two decades, however, have seen APAs in general, and to a large extent the bilateral APAs in particular, being used worldwide to give businesses an opportunity to reach an agreement with the tax administrations on either side of a cross-border transaction. This is in a bid to achieve a fair principle to allocate income and expenses between related parties. The programme is being deployed by many OECD states although such states differ in timing, type and scope of the APAs used for resolving transfer pricing issues. This popularity of the APA programme coupled with its increasing relevance in presenting an efficient alternative to the traditional means of resolving transfer pricing dispute, largely informs the development of both academic and professional interest in this area of research. However, much of the literature on the APA process is professional and non-empirical in nature. The multidisciplinary nature of the APA concept presents a situation whereby many of the

publications comprise legal/tax bulletin debates and non-empirical approach towards the consideration of the topic of discussion. Thus, the APA issue is not being given much attention within the sphere of business and accounting research but more within the field of law and international taxation. Nevertheless, an attempt is made to identify some of these prior empirical studies on the APA process and this are reviewed below.

Figure 3-1 Theoretical Framework for APA Applications by MNEs



²⁸ SFU is an abbreviation for specificity, frequency and uncertainty.

3.3.5 APA Literature

3.3.5.1 Borkowski (1993)

Borkowski (1993) reported the result of her study of US based multinational corporations. She examined MNEs' view on why they would not want to take an APA as an alternative method of solving transfer pricing disputes with the US Internal Revenue Service (IRS), i.e., why MNEs are reluctant to have an APA with the IRS. She also compared the arm's length standard (which is preferred by the IRS) to other pricing approaches (which are preferred by the MNEs in practice). In examining these issues, Borkowski sampled 340 MNEs which were already listed in either Fortune 500 or Business Week 1000 for the year 1992. Each of these companies was also US based with at least one subsidiary, and the companies were in industries that are likely to use transfer pricing. With a response rate of 43% (146 MNEs but with 140 usable surveys), Borkowski classified the survey response into those that did not use any form transfer pricing (35) and those that engaged in internal transfers of goods and services (105), thereby helping to define the focal direction of the study. Her survey, however, revealed that the main deterrents to MNEs' consideration of the APA process were the 'volume of information and documentation' required by the APA process and, the 'costs of obtaining' an APA relative to its benefit. The third concern identified was that MNEs believed that 'an APA application could trigger section 482 audits of prior years' (p. 7).

In general, an APA is not considered a viable option for most of the MNEs surveyed and as such Borkowski (1993) also gauged the MNEs' preferred method in resolving a Section 8 dispute with the IRS. While the IRS acknowledged that the Formulary approach is a viable alternative to the arm's length standard, Borkowski found that a less significant number (5.9%) of MNEs gave consideration for this option. Majority of the MNEs preferred other options such as litigation in the tax court (30%), some method of arbitration (26%), and baseball arbitration (6%).²⁹ Borkowski's (1993) findings that about 30% of MNEs surveyed preferred litigation as a method of dealing with Section 482 disputes can be described as interesting given the huge cost associated with such a process. Nevertheless, generalisation of the findings may be limited to the US APA legislation since her sample only includes US based companies with an international subsidiary.

²⁹ According to Borkowski (1993), 'baseball arbitration requires the IRS and MNE to choose the preferred transfer price, with a winner-take-all format: an expert panel chooses one of the two figures, with no adjustment allowed between the two proposed prices and no appeal of the outcome' (p. 4).

3.3.5.2 Borkowski (1996b)

Borkowski (1996b) extended her 1993 APA study by focusing on status of APAs from both host countries and MNEs' perspective. The study entailed a survey of MNEs in five countries - Canada, Germany, Japan, the UK and the USA to provide some insight into the extent of, and perceived problems with usage of APA by MNEs. Her survey sample comprised 1,363 MNEs domiciled in Canada, Germany, Japan and the UK each with US-based subsidiaries and US MNEs with subsidiaries in those countries. Administration of postal questionnaires to these MNEs returned an overall response rate of 46%. In general, Borkowski (1996b) found that APAs had not been embraced by many MNEs. She reported that MNEs that had or planned to have APAs, either with the USA or with home country, only range between 5% and 29%. Borkowski however noted that this does not support the Ernst & Young report on APAs during that period which reported a range of 24% to 68% for similar sample set. For MNEs that are headquartered in the UK, Borkowski reported this category as most likely to embrace the APA programme, whether with the IRS or HMRC while those MNEs in Canada and the USA were least likely to pursue an APA. However, when APA and audit status are compared, prior audits by the IRS positively affect the willingness of the MNEs to seek an APA with the IRS. On the other hand, MNEs in all countries ranked either the 'volume of documentation' or the 'cost of the APA' (p. 31) as the most important deterrent in participating in the APA programme, the least important issue being the 'term of the APA', which she noted was previously criticized by some as too short. The transfer pricing methods used by MNEs and their audit and APA status were significantly related, such that those using market- and negotiated- based transfer pricing methods were less likely to participate in US APA programmes than cost-based and other-based MNEs. Overall, no significant connection was reported between APA status and other factors, such as MNE size, industry, economic stability and host country relationships. However, large MNEs were more likely to be audited by both home and host country tax authorities.

Borkowski (1996b) argued that the discrepancies between the reported results of her study and that of the Ernst & Young survey on APA was most likely a result of the composition of the samples. While her sample was restricted to manufacturing MNEs only, the Ernst & Young survey sample covered both financial and manufacturing sample MNEs and this, in her view, distorted the interpretation of the Ernst & Young results.

3.3.5.3 Elliott and Emmanuel (2000)

Elliott and Emmanuel (2000) attempted an assessment of the APA process as part of the transfer pricing process investigation in management accounting. They conducted face to face interviews with tax managers and directors of 12 multinationals to determine patterns of preferential treatment for current international transfer pricing issues by placing such within an organizational and fiscal context. Their investigation, however, included the perceptions of the MNEs about APAs. They found a divergent expression of views about the programme which is largely influenced by the individual experience of the APA process. Although the results tend to suggest an absence of any form of mutual compatibility or benefit which can be derived from an APA association with tax authorities, such divergent views could not, however, be associated with industry sectors, parent company nationality, size or type of transactions.

3.3.5.4 Ernst & Young (2003)

The Ernst & Young biennial Global Transfer Pricing study represents the most comprehensive empirical survey of transfer pricing. The study has been published every two years since 1995 and information on APAs is usually included. In 2003, they measured the transfer pricing practices, perceptions and trends of multinational corporations in 22 countries. Also contained in the report is information about APAs on over 800 multinational corporations. They showed that 14% of the parent companies surveyed and 18% of the subsidiaries use the APA process to seek a higher level of transfer pricing certainty (p. 23). From those that use the APA process, close to 90% of them indicated that they would use the APA process again. This comprises 87% of the parent companies and 89% of the subsidiaries. In general, they identified a declining trend in the use of the APA process by MNEs. The 33% of parent companies that responded favourably to the questions on APA represent a downward trend when compared with 38% responses that were gathered for similar questions in 2001, and also the 45% responses that were gathered in the 1999 study. The 2003 study found that 47% of non-APA using subsidiaries indicated an increasing openness to future use of APAs when compared with the 34% in 2001 and 41% that indicated similar interest in 1999. For the UK, about 57% of UK subsidiary respondents that had not used APAs would consider using an APA as a controversy management tool in the future. The survey, however, noted that if tax administrations wanted their APA programmes to attract taxpayers, they must still overcome the perception that they are not 'user friendly' (p. 23).

3.3.5.5 Ernst & Young (2005/2006)

For the 2005/2006 survey, Ernst & Young reported only a minority of the MNEs using APAs. The report examined as a package, the use of APAs and competent authority referrals by MNEs to mitigate the effects of transfer pricing adjustments by tax authorities. Respondent MNEs were asked for their experience with APAs and the competent authority process as a dispute resolution tool. Ernst & Young however reported an increase compared with the 2003 report in the use of the APAs by respondent MNEs. Whereas the 2003 survey reported that about 14% of the MNEs who had used the APAs, the 2005/2006 survey showed that 23% of parent companies surveyed had the APAs. These comprise APA agreements with the USA (38% of APAs), Australia (19%), the UK (19%) and Canada (16%). Of those using the APAs, 84% of them stated that they would do so again.

3.3.5.6 Ernst & Young (2007/2008)

In the 2007/2008 Ernst & Young Global Transfer Pricing Survey, the trends, practices and analyses of 850 MNEs across 24 countries were measured and, as has been the trend since 1999, information about the use of APA by MNEs as a controversy management tool is also included. Ernst & Young noted in the 2007 report that countries worldwide have increased their investment in the APA process. In terms of the use of the process by MNEs, they stated that only 21% of parent respondents use Advance Pricing Agreements (APAs) as controversy management tools but for those who had used APAs, only 86% of them would do so again. Seventy-eight percent of parent MNEs reported that they are generally satisfied with the APA process. Nevertheless, many remained unconvinced (or unaware) of the benefits of APAs, with fewer than half (47%) of parent respondents not currently using APAs saying they would consider doing so in the future. The 2007 report interestingly noted a continuous increase in the trend of usage of the APA process by parent MNEs from 1997 (4%) up until 2007 (21%). The USA, UK, and Australia were reported to have remained, since the 2003 survey, the top three most popular jurisdictions for MNEs to conclude APAs. For the UK, only 16% of parent companies use the APAs as a controversy management tool compared with the 24% that is reported for the USA. However, while 100% of parent MNEs which had used the APAs in the USA would use them again, only about 88% in the UK would do so.

3.3.5.7 Borkowski (2008)

Borkowski's (2008) study looked at how the Pacific Association of Tax Administrators (PATA) is able, through several documents released to assist both tax authorities and multinational corporations, to influence the latter's behaviour in the areas of APAs, mutual agreement procedures, and transfer pricing documentation. The study aimed to analyze the responses of MNEs to PATA's activities and those of their respective tax authorities. Its focus on the APA was in terms of analysing the usage and efficiency of the process. For this study, Borkowski surveyed the vice presidents or directors of tax of 325 MNEs (with an overall response rate of 34%) listed on either the BusinessWeek Global 1000 or listed as the largest home-based MNEs and largest foreign affiliates of home-based MNEs in accordance with the UNCTAD report of 2005. Borkowski proposed that if membership of PATA has encouraged improved relationships and information sharing among tax authorities, especially among their competent authorities (CAs), then APAs should look more attractive to MNEs. She further assumed that since the CAs are directly involved in APA negotiations, better cross-border CA relationships should result in more timely and less costly completion of APAs. By hypothesising about both the usage of the APAs, and the efficiency of tax authorities in negotiating APAs, in relation to the release of the PATA Transfer Pricing Documentation (TPDOC), Borkowski assessed for both hypotheses during two-time periods: the five years (2002 – 2006) when PATA's profile became more prominent, with the release of the TPDOC package, and three years (2004 – 2006) when bilateral APA (BAPA) documentation became available. While her analysis revealed an increase in the use of the APAs by MNEs within the PATA during these two periods, the results concerning time taken to complete APAs (i.e., APA efficiency) in general, and bi/multilateral APAs in particular, indicated no significant improvements for the pre-/post-2002 and pre-/post-2004 periods.

In general, Borkowski (2008) reported that the percentage of MNEs currently reporting completed APAs varies from 10% in Canada to 32% in Japan.

3.3.5.8 Borkowski (2010)

In 2010, Borkowski followed up her 2008 study on PATA history and its influence on APA and mutual agreement procedure (MAP) by further examining the transfer pricing practices of MNEs in PATA countries. As part of the analyses, Borkowski (2010) examined the relationship between audit risk and APA status by looking at whether the usage of APA

among others, led to a reduction in audit risk of MNEs. Borkowski assumed that similar to MAP, an MNE's APA status should be factored into its audit risk, since the use of an APA theoretically eliminates some of the uncertainty regarding the acceptability of a specific transfer pricing methodology (TPM) to one or more tax authorities. In examining those factors that may affect an MNE's choice of TPM, Borkowski included 'APA status' (p. 42) as part of the behavioural variables/characteristics and in turn tested the hypothesis that '*There is no correlation between an MNE's audit history and its behavioral characteristics*' (p. 41). She argued that some behavioural variables such as 'APA status' may be correlated with an MNE's choice of a TPM, and that, in turn, is a factor in an MNE's risk of audit. Using the same data source as that used for the 2008 study, Borkowski initially identified, on a country by country basis, some differences in the use of APAs. APA status differs significantly by country, in that the US and Canadian MNEs negotiated the fewest advance pricing agreements, citing cost considerations, the volume of information required and confidentiality issues. There is also a marked discrepancy between the MNEs reporting double taxation situations and the MNEs seeking relief through APAs. While most US MNEs experienced double taxation, only 19% of them used APAs. Also, Borkowski found that her hypothesis of no relationship between audit risk and APA status could not be rejected. Her analyses showed that there were no significance differences in audit status, given an MNE's APA status (thereby contrasting the popular assertions by major tax authorities that the fundamental benefit of advance pricing agreements is as an effective strategic tool to reduce or eliminate an MNE's probability of a transfer pricing audit). Generally, the study revealed that negotiating an APA with a PATA tax authority did not reduce an MNE's audit risk.

3.3.6 Gap in the Literature that Justifies the Research Question

Some tax bulletins which are not really situated within mainstream academic literature have also looked at the APA process in some empirical way. Also, some tax authorities do attempt to assess how well the APA programme is working on a regular basis. For instance, annual statistics on the extent of the use of the programme are usually collated and reported by both the Australian Tax Authorities (ATO) - i.e., ATO's Annual Report on APA Development; and the US Internal Revenue Service (IRS) - i.e., IRS's Announcement and Report concerning Advance Pricing Agreements. While the figures reported for operating APAs as at 2005-2006 fiscal year by the ATO was 146, the 'ATO Advance Pricing Arrangement programme 2010-2011 update' revealed that 53 APAs were completed during the 2011 financial year

(comprising of 23 renewals, 14 new APAs arising from compliance activity, and 16 new, unprompted APAs - the programme's largest number of completions in any one year). The US IRS on the other hand reported a figure of 692 operating APAs for the 2005-2006 period confirming a larger link between the US economy and major MNEs' operations throughout the world. The number of executed APAs reported for the year 2010 was 69. However, this approach only considered the extent of use of the APA as a proxy to success. APA success is, by this approach, only being measured within the framework of the specific transfer pricing requirements imposed on MNEs rather than in the context of the wider cost-benefit relationship between the tax authorities and the MNEs.

Nevertheless, the assessment of the APA process in most of the prior studies as reviewed above looked at the APA status of MNEs and why many MNEs are not fully embracing the APA process. The Ernst & Young Transfer Pricing Survey has over the years, examined the likelihood of MNEs taking up the process but the reported probabilities are inconsistent with similar studies in the area. The first Ernst & Young transfer pricing report in 1995, for example, showed that the likelihood of a US MNE negotiating an APA was 50%. This represented a largely different outlook from the 4 – 18% likelihood that Borkowski (1996b) reported for similar respondents. For the year 2001, Ernst & Young reported that the number of MNEs that was likely to negotiate an APA was 39% of the surveyed sample but only 15% of the surveyed sample actually had negotiated APAs. Borkowski (2008) however contended that the estimated APA usage by MNEs in the Ernst & Young studies of the mid-1990s through to 2003 far exceeded the actual APA activity. Her position was that realistic APA usage was not reported in the Ernst & Young studies until 2003. In 2003, Ernst & Young reported that only 14% of the MNEs in their sample had entered into one or more APAs, a far cry from the numbers they themselves had predicted only eight years earlier (Borkowski, 2008). Whereas Borkowski (1993, 1996b) noted the existence of some key deterrents to the consideration of APAs by MNEs, the Ernst & Young studies nevertheless continued to report and project a positive increase in the number of MNEs that considered using APAs. The 2007/2008 survey reported a continuous increase in the trend of usage of the APA process by parent MNEs from 1997 (4%) up until 2007 (21%). However, previously identified key concerns about the use of APA remained a source of disinterest to the MNEs with regard to APA applications (Borkowski, 2008). The inconsistency between results of previous research on the uptake of the APA necessitates a re-assessment of the process and its operations

especially from the perspective of attitudes and potential attitudes of the users - (principally MNEs) towards the process. Further, the marked discrepancy reported by Borkowski (2010) between the MNEs reporting double taxation situations and the MNEs seeking relief through APAs does not lend support to the claim that the programme is increasingly being embraced by MNEs. Also, despite the positive trend in the statistics presented on APA uptake by tax authorities, the level of usage of the process is still very low if more attention is given to the transfer pricing problem and its implications given the magnitude of transfer pricing disputes occurring between tax authorities and MNE taxpayers.

Of particular interest is the case of the UK where the number of cross-border transfer pricing cases (enquiries, adjustments, and penalties) reported regularly in the UK House of Commons debates over the years is not in any way reflected in the level of interest in the APA process by UK-based MNEs (Hansard, UK House of Commons Debates, 2006, 2008 and 2010 cited in Sikka and Wilmott, 2010). It was reported that around 50 – 60 cases are currently in the UK's APA programme (Clayson and Beeton, 2010). The researcher argues that the low uptake of the APA programme in the UK reveals an important need to reflect better the primary operational realities of multinationals in APA operations and policies. An attempt to identify empirically the significant reasons for applying/not applying for the APA process by investigating the underlying motive of a sample of MNEs in the UK is warranted. It is hoped that by properly identifying and assessing MNE taxpayers' goals/reasons for their attitudes towards the APA process, a clearer understanding of the relative importance of these goals can be obtained. Such investigation should in turn reflect a positive impact on the APA application process.

3.3.7 Conclusion

This chapter introduced some of the key theoretical foundations used to explain the activities of MNEs. Transfer pricing has been discussed using theories relating to market imperfections, foreign direct investment and transaction cost of organizing interdependencies between firms. Based on the implications of these theories for transfer pricing, the chapter subsequently reviewed relevant transfer pricing literature that relate to transfer pricing as an instrument of resource allocation, strategy, management control and tax optimization. This was followed by a literature review of income shifting studies as an introduction towards the more relevant topic of APAs. The last part reviewed empirical evidence from different APA surveys as

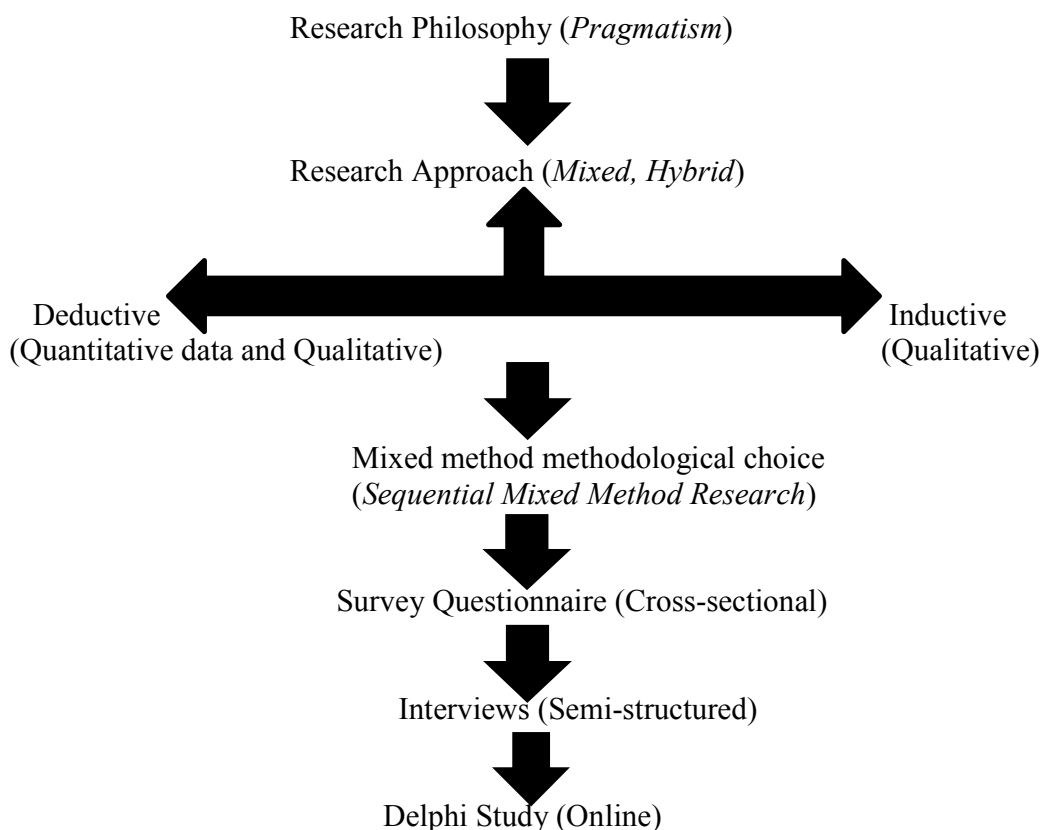
reported in academic literature. Obviously, there exists an established APA literature outside the field of accounting which is largely based on logical discussions, legal provisions and, inductive reasoning (Viehe, 1992; Ring, 2000; Brem, 2005; Sadiq, 2007; etc.), these were however excluded from this review in agreement with Mehafdi's (1990) contention. Mehafdi (1990, p. 71) stated 'hypothetical and simulated cases, and inductive reasoning can all be beneficial but cannot give a true and fair picture of the realities of the modern corporation'. Thus, the researcher believes that gauging the primary realities of MNEs' operations as related to the APA process should be founded on a thorough understanding of the real practical complexities associated with the research subject.

CHAPTER 4: RESEARCH METHODS

4.1 Introduction

Generally, research methodology deals with several aspects of a study: the design, procedures for data collection, the methods for data analysis, selection of subjects, and details of specific treatments, if any (Willis et al., 2007, p. 14). In line with Saunders et al.'s (2012) research onion (p. 128), this chapter initially presents the researcher's fundamental assumptions and beliefs about the world which are consistent with the pragmatist's position. The research approach is subsequently presented in line with the philosophical focus adopted. The remainder of the chapter considers the method through which the APA process was examined in order to appropriately address the central research question. Figure 4-1 below depicts the methodological path that was followed and the choices that were made by the researcher from the different alternatives available within the research onion.

Figure 4-1 Methodological Approach and Choices



4.2 Research Philosophy

In the words of Saunders et al. (2012), the research philosophy you adopt can be thought of as your assumptions about the way in which you view the world. This assumption will underpin your research strategy and the methods you choose as part of that strategy (p. 128). Generally, the two major ways through which research philosophy is considered are ontology and epistemology. While ontology is concerned about reality (i.e., raises questions of the assumptions that researchers have about the way the world operates and the commitment to particular views), epistemology on the other hand concerns what constitutes acceptable knowledge in a field of study (Saunders et al., 2012, p. 132). However, research philosophy is defined with the help of research paradigm. According to Cohen et al. (2011), research paradigm can be defined as the broad framework, which comprises perception, beliefs and understanding of several theories and practices that are used to conduct a research. It can also be characterized as a precise procedure, which involves various steps through which a researcher creates a relationship between the research objectives and questions.

Gliner and Morgan (2009) stated that ‘paradigm is a way of thinking about and conducting a research. It is not strictly a methodology, but more of a philosophy that guides how the research is to be conducted’ (p. 7). Research paradigm and philosophy comprise various factors such as an individual’s mental model, his way of seeing thing, different perceptions, variety of beliefs towards reality, etc. Once these beliefs can be identified, it is possible to identify the appropriate research methodologies applicable to that paradigm which determine how the research can be conducted (Elliot, 1999). Although the following sections refer to a number of frameworks (Burrell and Morgan, 1979; Morgan and Smircich, 1980; Hopper and Powell, 1985; Chua, 1986), much of the literature on research paradigms (including research methodology books and articles) concentrated on distinguishing between two main paradigms : interpretive and functionalist. These two paradigms were referred to by many different (almost interchangeable) names. Table 4-1 gives a summary of these different adoptions in names as illustrated by Leedy (1997) and Hussey and Hussey (1997).

Leedy (1997) provided a general overview of the differences between interpretive and functionalist research in very general terms - purpose, nature of research process, data collection methods, reasoning process and communication of the findings (see Table 4-2).

Table 4-1 Terminology: Interpretive versus Functionalist

Interpretive	Functionalist
Qualitative	Quantitative
Subjectivist	Objectivist
Humanistic	Scientific
Phenomenological	Experimentalist
Naturalistic	Traditionalist
Constructivist	Positivist
Post-positivist	Empiricist

Table 4-2 Characteristics of Quantitative and Qualitative Approaches (adapted from Leedy, 1997, Table 5.1)

Question	Interpretive	Functionalist
What is the purpose of the research?	To describe and explain To explore and interpret To build theory Process-oriented	To explain and predict To confirm and validate To test theory Outcome-oriented
What is the nature of the research process?	Holistic Unknown variables Flexible guidelines Emergent design Context-bound Personal view	Focused Known variables Established guidelines Static design Context-free Detached view
What are the methods of data collection?	Informative, small sample Observations, interviews	Representative, large sample Standardized instruments
What is the form of reasoning used in analysis?	Inductive analysis	Deductive analysis
How are the findings communicated?	Words Narratives, individual quotes Personal voice, literary style	Numbers Statistics, aggregated data Formal voice, scientific voice

Further, Leedy (1997) gave some general indications about which approach a researcher should consider using:

Table 4-3 Appropriate Approach to Research (Leedy, Table 5.2)

Use this approach if:	Interpretive	Functionalist
1. You believe that:	There are multiple constructed realities	There is an objective reality that can be measured
2. Your audience is:	Familiar with/supportive of qualitative studies	Familiar with/supportive of quantitative studies
3. Your research question is:	Exploratory, interpretive	Confirmatory, predictive
4. The available literature is:	Limited or missing	Relatively large
5. Your research focus:	Involves in-depth study	Covers a lot of breadth
6. Your time available is:	Relatively long	Relatively short
7. Your ability/desire to work with people is:	High	Medium or low
8. Your desire for structure is:	Low	High
9. You have skills in the area(s) of:	Attention to detail and inductive reasoning	Statistics and deductive reasoning
10. Your writing skills are strong in the area of:	Literary, narrative writing	Technical scientific writing

It is obvious from the above tables that different philosophies are suited to achieving different things. Saunders et al. (2012) argued that the appropriateness of a research philosophy always ‘depends on the research question(s) you are seeking to answer’ (p. 129). They maintained that a particular research question can rarely be answered only within one philosophical domain, as suggested in the ‘research onion’.³⁰ Blumer (1978, p. 39 cited in Tomkins and Groves, 1983, p. 363) noted why the functionalist approach is not always the most appropriate approach to adopt:

³⁰ In addition to interpretivism and positivism (functionalism), the research onion also identified realism and pragmatism as additional research philosophies.

‘In this respect it differs from the somewhat pretentious posture of the research scholar who under established scientific protocol is required, in advance of his study, to present a fixed and clearly structured problem, to know what kinds of data he is to collect, to have and hold to a pre-arranged set of techniques and to shape his findings by previously established categories’.

4.2.1 Seminal Works on Research Paradigms in the Social Sciences

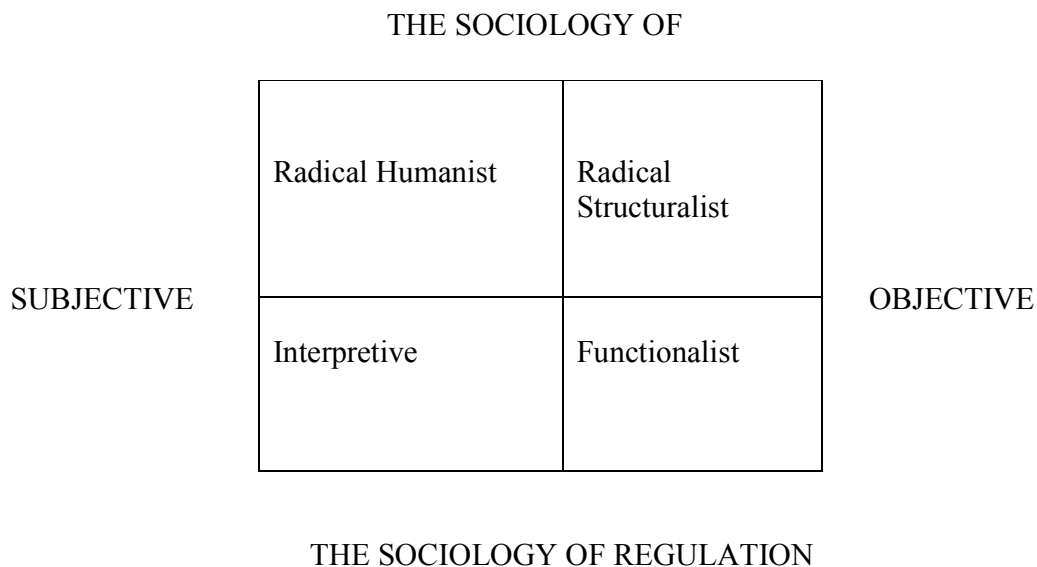
This section discusses early works by Burrell and Morgan (1979) and subsequent improvement of their framework by Morgan and Smircich (1980), Hopper and Powell (1985) and Chua (1986). However, several authors have since considered the specific application of research methods and methodologies to management research (Easterby-Smith et al., 1991; Hassard, 1991) and accounting and finance research (Ryan et al., 1992).

4.2.1.1 Burrell and Morgan (1979)

Burrell and Morgan (1979) identified four sociological research paradigms based on the relationships of two principal dimensions as presented in Figure 4-2 below. These paradigms were analysed in terms of two key dimensions: the subjective-objective dimension and the regulation-radical change dimension (with regard to the nature of society). They further defined as ‘very basic meta-theoretical assumptions, which underwrite the frame of reference, mode of theorizing and modus operandi of the social theorists who operate within them’ (Burrell and Morgan, 1979, p. 23). The fourfold categorization of social science paradigms offered by these authors has attracted the most attention in social and organization theory (Louis, 1983; White, 1983; Morgan, 1990). The four paradigms produced are the functionalist, the interpretive, the radical humanist, and the radical structuralist (Figure 4-2).

Figure 4-2 shows how the four paradigms can be arranged as a matrix corresponding to two conceptual dimensions: subjectivist to objectivist, and radical change to regulation.

Figure 4-2 Burrell and Morgan's Four Paradigms



4.2.1.1.1 Subjective-Objective Dimension

The first principal dimension is the subjective-objective aspect, which was prescribed based on philosophical assumptions related to ontology, epistemology, human nature and methodology. These assumptions relate to views on the nature of the social world. As a continuum, these assumptions can be described as follows:

The subjectivist approach

Nominalism

Anti-positivism

Voluntarism

Ideographic

ONTOLOGY

EPISTEMOLOGY

HUMAN NATURE

METHODOLOGY

The objectivist approach

Realism

Positivism

Determinism

Nomothetic

Ontology

Ontology is concerned with the nature of 'reality', whether the reality is given 'out there' or is a product of one's mind. Subjectivists, who are also known as nominalists (see above), view the social world as the outcome of individual consciousness, whereas the objectivist approach is called realism, which emphasize that reality is external and exists independently of an individual's appreciation.

Epistemology

Epistemology debates the nature of knowledge. The debatable questions regard what forms it takes and how it can be acquired and passed on to other people. Subjective researchers tend to be phenomenologist, as they see knowledge of the world as being soft, subjective and intuitive, able to be obtained, through personal investigation and experience. In contrast, positivist researchers understand the social world through explanation based on predicted regularities and causal relationships among components (Burrell and Morgan, 1979).

Human Nature

The human nature assumption emphasizes the connection between human beings and their environment. In the subjective dimension, human beings are autonomous and free-willed, and act voluntarily in creating the world, whereas, objectivists view man and his activities as being determined by the environment (Burrell and Morgan, 1979).

Methodology

Finally, the methodological issues relate to the approach taken in the process of conducting research. The first three assumptions debated above influenced the researcher as regard to methodological choices. If the personal subjective quality in experiencing the world is stressed, an ideographic methodological or qualitative approach, using observation or in-depth interviews, for example, is emphasized, as it allows insights into individuals' inner world and more focus on qualitative aspects. Alternatively, if the social world is assumed as a hard, external, objective reality, as in the natural sciences, then, the nomothetic methodological or quantitative study is applicable. It utilizes standard research instruments, such as questionnaires and surveys to collect quantitative type data, which are then analysed using statistical techniques to identify, explain and predict relationships and regularities among social elements (Burrell and Morgan, 1979).

4.2.1.1.2 Regulation-Radical Change Dimension

The second principal dimension is the two distinctive views and interpretations of the nature of 'society'. Regulation emphasizes the unity and cohesiveness of society, and the need for regulation in human affairs i.e., maintaining the status quo, social order, consensus, social integration and cohesion, solidarity, need satisfaction and actuality bringing to unity. Radical change views society in terms of structural conflict, modes of domination, contradiction,

emancipation, deprivation, and potentiality leading to radical change (Burrell and Morgan, 1979).

4.2.1.2 Other Sociological Paradigms

Burrell and Morgan's (1979) construction of a general sociological research framework has become a foundation for many researchers, such as Hopper and Powell (1985), Laughlin (1995) and Ryan et al. (2002). However, some of the commentators on these sociological paradigms have modified Burrell and Morgan's classification. Hopper and Powell (1985) reduced the four paradigms to three by combining the two radical paradigms. Putnam (1983) questioned Burrell and Morgan's two-dimensional framework, but accepted the distinction between interpretive and functionalist. Putnam identified naturalistic interpretivists (accepting organization reality without question) and critical interpretivists (uncover distortions and seek to rectify them). Also, Putnam distinguished interpretivists and functionalists in terms of unitary or pluralistic views of the organization - where functionalists adopt a unitary view of the pursuit of common interests and goals, and interpretivists are more likely to adopt a pluralistic view of an organization consisting of diverse groups and purposes. Chua (1986) argued that:

‘mainstream accounting has been grounded in a common set of philosophical assumptions about knowledge, the empirical world, and the relationship between theory and practice and that this particular world-view, with its emphasis on hypothetico-deductivism and technical control, possesses certain strengths but has restricted the range of problems studied and the use of research methods’ (p. 601).

She therefore offered a different set of assumptions as an alternative to the Burrell and Morgan framework. Chua identified three main difficulties with the Burrell and Morgan framework as follows: First, all the assumptions were presented as strict dichotomies; for example, one either assumes that human beings are determined by their societal environment or they are completely autonomous and free-willed. Second, the framework embraced a strongly relativistic notion of scientific truth and reason. Third, the separation of the radical structuralist from the radical humanist paradigm is questioned particularly within sociology itself. Chua's classification of assumptions (p. 605) is as follows:

- A. Beliefs about knowledge
 - Epistemological
 - Methodological;
- B. Beliefs about physical and social reality
 - Ontological
 - Human intention and rationality
 - Societal order/ conflict; and
- C. Relationship between theory and practice.

These dominant assumptions were compared (Figure 4-3 below) for the functionalist view (mainstream accounting) of the world and also for the two alternative world views that were elucidated in her work i.e., the interpretive and the critical.

Figure 4-3 Chua's Comparison of the Three Alternative World Views

Mainstream Accounting	Interpretive Perspective	Critical Perspective
<i>A. Beliefs about knowledge</i>		
Theory is separate from observations that may be used to verify or falsify a theory. Hypothetico-deductive account of scientific explanation accepted.	Scientific explanations of human intention sought. Their adequacy is assessed via the criteria of logical consistency, subjective interpretation, and agreement with actors' common-sense interpretation.	Criteria for judging theories are temporal and context-bound. Historical, ethnographic research and case studies more commonly used.
Quantitative methods of data analysis and collection which allow generalization favoured.	Ethnographic work, case studies, and participant observation encouraged. Actors studied in their everyday world.	

B. Beliefs About Physical and Social Reality

<p>Empirical reality is objective and external to the subject. Human beings are also characterized as passive objects; not seen as makers of social reality.</p> <p>Single goal of utility-maximization assumed for individuals and firms. Means-end rationality assumed.</p> <p>Societies and organizations are essentially stable; 'dysfunctional' conflict may be managed through the design of appropriate accounting control.</p>	<p>Social reality is emergent, subjectively created, and objectified through human interaction.</p> <p>All actions have meaning and intention that are retrospectively endowed and that are grounded in social and historical practices.</p> <p>Social order assumed.</p> <p>Conflict mediated through common schemes of social meanings.</p>	<p>Human beings have inner potentialities which are alienated (prevented from full emergence) through restrictive mechanisms.</p> <p>Objects can only be understood through a study of their historical development and change within the totality of relations.</p> <p>Empirical reality is characterized by objective, real relations which are transformed and reproduced through subjective interpretation.</p> <p>Human intention, rationality, and agency are accepted, but this is critically analysed given a belief in false consciousness and ideology.</p> <p>Fundamental conflict is endemic to society. Conflict arises because of injustice and ideology in the social, economic, and political domains which obscure the creative dimension in people.</p>
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C. Relationship Between Theory and Practice

Accounting specifies means, Theory seeks only to explain Theory has a critical not ends. Acceptance of action and to understand how imperative: the identification extant institutional structures. social order is produced and and removal of domination reproduced. and ideological practices.

Morgan and Smircich (1980) also outlined a set of basic assumptions that underlie the subjective-objective dimension to produce six classifications along this axis. Each of these dimensions was described in terms of the core ontological assumptions, assumptions about human nature, basic epistemological stance and research methods. Towards the subjective end of the spectrum, was reality as symbolic discourse. The ontological assumptions are that the social world consists of symbolic relationships and meanings which are sustained through human action and interaction. The epistemology for this dimension:

‘does not hold that the findings thus obtained would be universally generalizable, but it does regard them as providing nonetheless insightful and significant knowledge about the nature of the world. Such knowledge is inevitably seen as being relative and specific to the immediate context and situation from which it is generated, building what Glaser and Strauss call “substantive theory”’ (p. 497).

As the ontological assumptions shift from objective towards subjective, the appropriate research methods shift from traditional scientific methods towards research methods which allow the researcher to investigate from within.

Within accounting research, Burrell and Morgan’s (1979) framework had been mainly explored more in line with Chua’s (1986) classification i.e., mainstream, interpretive and critical perspectives. These represent the main school of thought on alternative methodological approaches from an accounting research perspective.

The mainstream school of thought, known as functionalism in Burrell and Morgan's (1979) framework comprises research approaches, such as objectivism, social systems theory and pluralism, as described in Hopper and Powell (1985). Laughlin (1995) categorized the positivist, realist, instrumentalist and conventionalist approaches in the same group as functionalism. In general, all of the theories are in the functional frame of preference, which treats individuals and organizations as external reality, constrained by the environment they inhabit. Thus, mainstream researchers adopt a scientific approach and emphasize quantitative methods. Concerning the society, some of them observe inequalities of power and structure, but those disagreements are reconcilable towards a unitary goal and stability of society.

An interpretive methodology attempts to describe, understand and interpret the meanings that human actors apply to the symbols and structures within the settings in which they find themselves. Symbolic interactionism, grounded theory and ethnomethodology approaches are within this school of thought (Laughlin, 1995; Parker and Roffey, 1997). All of them have social subjectivity and disagreement with mainstream approach in common.

Critical or radical research comprises theories, such as Marxism, Structuration, German critical theory and French critical theory (Laughlin, 1995; Ryan et al., 2002). In general, critical theorists regard populations as consisting of conflicting components and being subject to systems of power that lead to disparity and separation in all aspects of life. Their concern is to construct understanding of the social and economic world while criticizing the status quo (Hopper and Powell, 1985). The radical structuralist and radical humanist strands (Figure 4-2) of Burrell and Morgan's (1979) framework are seen as dialectical aspects of the same reality. Hence, they are incorporated into a single philosophical framework straddling the subjective-objective dimension (Hopper and Powell, 1985; Ryan et al., 2002).

However, research in the social sciences has been identified as having predominantly been informed by the functionalist paradigm. Although, the strengths of the mainstream approach are recognized, the natural sciences methods nevertheless have come to be seen as increasingly unsatisfactory as a basis for a social research. Mismatch between theory and practice occurred with the use of scientific approach given the fact that very little research has been published in the interpretive and critical styles Parker and Roffey (1997)

4.2.1.3 Commonalities among the Traditional Paradigms

According to Saunders et al. (2012), the debate on ontology and epistemology is often framed in terms of a choice between positivist and interpretivist research philosophies or between quantitative and qualitative research methods (p. 129). Quantitative (positivist)³¹ purists maintained that social science inquiry should be objective. That is, time - and context-free generalizations (Nagel, 1986) are desirable and possible, and real causes of social scientific outcomes can be determined reliably and validly. On the other hand, qualitative purists (also called constructivists and interpretivists) rejected what they call positivism. They argued for the superiority of constructivism, idealism, relativism, humanism, hermeneutics, and, sometimes, postmodernism (Smith, 1983, 1984; Guba and Lincoln, 1989; Lincoln and Guba, 2000; Schwandt, 2000). These purists contended that multiple-constructed realities abound, that time- and context-free generalizations are neither desirable nor possible, that research is value-bound, that it is impossible to differentiate fully causes and effects, that logic flows from specific to general (e.g., explanations are generated inductively from the data), and that knower and known cannot be separated because the subjective knower is the only source of reality (Guba, 1990).

However, while there are many important paradigmatic differences between the positivist and interpretivist philosophy, some authors have noted similarities between the various approaches that are sometimes overlooked. Sechrest and Sidani (1995, p. 78) pointed out that both methodologies ‘describe their data, construct explanatory arguments from their data, and speculate about why the outcomes they observed happened as they did’. Sandelowski, (1986) also noted that both sets of researchers incorporate safeguards into their inquiries in order to minimize confirmation bias and other sources of invalidity (or lack of trustworthiness) that have the potential to exist in every research study. Also, Biesta and Burbules (2003) have argued that regardless of paradigmatic orientation, all research in the social sciences represents an attempt to provide warranted assertions about human beings (or specific groups of human beings) and the environments in which they live and evolve. Therefore, even though certain methodologies tend to be associated with one particular research tradition, Dzurec and Abraham (1993, p. 75) suggested that ‘the objectives, scope, and nature of inquiry are consistent across methods and across paradigms’.

³¹ This is described as the functionalist approach in the Burrell and Morgan’s (1979) sociological framework.

4.2.1.4 The Philosophy of Pragmatism

Johnson and Onwuegbuzie (2004) have argued that:

‘today’s research world is becoming increasingly interdisciplinary, complex, and dynamic; therefore, many researchers need to complement one method with another, and all researchers need a solid understanding of multiple methods used by other scholars to facilitate communication, to promote collaboration, and to provide superior research. Taking a non-purist or compatibilist or mixed position allows researchers to mix and match design components that offer the best chance of answering their specific research questions’ (p. 15).

This assertion is consistent with the classical pragmatists’³² philosophical approach as a way for researchers to think about the traditional dualisms that have been debated by the purists.

Pragmatism asserts that concepts are only relevant where they support action (Kelemen and Rumens, 2008) and that it is perfectly possible to work with different philosophical positions (Saunders et al., 2012). Some authors have also described the philosophy of pragmatism as that of common sense (e.g., Shields, 1998) which views inquiry as a continuing process that acknowledges the qualitative nature of human experience as problematic situation emerge and are recognized. Advocates of pragmatism believed that ‘there are many different ways of interpreting the world and undertaking research’ (Saunders et al., 2012, p. 130). They therefore always use the method or methods that enable credible, well-founded, reliable and relevant data to be collected that advance the research (Kelemen and Rumens, 2008). Powell’s (2001) views and arguments on the logical foundation of the philosophy of pragmatism clearly distinguished pragmatism from the two main streams as follows:

‘The pragmatist epistemology stands in contrast to prevailing positivist and anti-positivist views of scientific discovery. Whereas positivism emphasizes the objective, law-like properties of a brute reality independent of observation (Donaldson, 1992; Wicks and Freeman, 1998), anti-positivism emphasizes the creative role of active, subjective participants, none of whom owns a privileged claim on truth (Burrell and

³² According to Shields (1998), the notable founders of pragmatism always cited in literature include Charles Sanders Peirce, Williams James, John Dewey and Jane Addams (p. 197).

Morgan, 1979; Astley, 1985; Martin, 1990). Pragmatism, on the other hand, rejects positivism, on grounds that no theory can satisfy its demands (objectivity, falsifiability, the crucial experiment, etc.); and rejects anti-positivism, because virtually any theory would satisfy them. As such, the pragmatist proposes to reorient the assessment of theories around a third criterion: the theory's capacity to solve human problems (Rorty, 1989; Stich, 1990). To a pragmatist, the mandate of science is not to find truth or reality, the existence of which are perpetually in dispute, but to facilitate human problem-solving. According to pragmatist philosopher John Dewey, science should overthrow "the notion, which has ruled philosophy since the time of the Greeks, that the office of knowledge is to uncover the antecedently real, rather than, as is the case with our practical judgements, to gain the kind of understanding which is necessary to deal with problems as they arise" (Powell, 2001, p. 884).

4.2.2 The Assumptions and Beliefs Relevant to the Current Research

The topic of APAs as it is being considered in this study falls within the wide research area of international transfer pricing (ITP). The majority of the previous ITP research, however, was positioned within the functionalist paradigm of the Burrell and Morgan (1979) framework (i.e., positivist paradigm) whereby most have employed the use of questionnaires to test specific ex ante hypotheses. Many authors, however, have identified some of the limitations of surveys (Leitch and Barrett, 1992; Cravens and Shearon, 1996) and others have argued that several years of intensive research using surveys has not improved our understanding of transfer pricing sufficiently - it has merely highlighted the gap between theory and practice (Mehafdi and Emmanuel, 1997). Indeed, the sensitive and confidential nature of the research topic area typically aligns with practical use of questionnaires just like other related studies in the transfer pricing area. Nevertheless, the purpose of the current research is to explore the rationale behind the attitudes that MNEs maintain towards the APA process. It is the belief of the researcher that reliable information that will enhance greater understanding of the process can only be gathered by relying on a philosophy that attempts to fit together the insights provided by different workable methodological approaches. This will help to move beyond the traditional limitations associated with the mono-method approach that is usually adopted to study transfer pricing issues.

Along these lines, the assumptions and beliefs that underlie this research work are more consistent with the philosophical paradigm of pragmatism. The research relies on the useful middle position between the philosophical and methodological extremes of positivism and interpretivism. This philosophical position adopted is pluralist in nature. From an initial positivist outlook, the assumptions and beliefs of the researcher shifted more towards the interpretive end of the spectrum as the research progressed. The focus of the current research is to generate an improved understanding on the mismatch between the ‘intended’ and ‘actual’ workings of the UK APA process by providing clearer explanation and interpretation of its current workings as perceived and described by the parties involved. The researcher maintained the view that further contributions and useful findings can be obtained in this area by adopting an approach (approaches) that offers a practical and outcome-oriented method of inquiry that is based on action and leads, iteratively, to further action and the elimination of doubt.

This chapter describes how two different methodological approaches of deduction and induction were adopted to analyse and interpret perceptions and views of different parties to the UK APA process working back and forth iteratively based on the explanatory understanding that were emerging as the research progressed. In line with the next layer in the research onion (Saunders et al., 2012), the mixed-method methodological choices adopted are further discussed under the headings of questionnaire (associated with the functionalist paradigm), interviews and Delphi approaches (typical of the interpretive paradigm) and their analyses using both deductive and inductive techniques.

4.3 The Research Approach

According to Saunders et al. (2012), research approaches are often based upon the reasoning adopted by the researcher. The common forms of reasoning a researcher adopts are the deductive or inductive. Deductive reasoning occurs when the conclusion is derived logically from a set of premises, the conclusion being true when all the premises are true. In contrast, in inductive reasoning, there is a gap in the logic argument between the conclusion and the premises observed, the conclusion being ‘judged’ to be supported by the observations made (Ketokivi and Mantere, 2010 cited in Saunders et al., 2012, p. 143). The third form of reasoning that is just as common in research is abductive reasoning (Saunders et al., 2012).

This begins with a ‘surprising fact’ being observed and the surprising fact is the conclusion rather than the premise (p. 144).

Following from the pragmatist viewpoint adopted in this research as discussed in section 4.2.2, this study adopts a combination of the deduction and induction approaches towards the study of APAs. This is considered as a research approach which, philosophically, moves past the paradigm wars by offering a logical and practical alternative (Johnson and Onwuegbuzie, 2004). Additionally, it is argued that attempting to study the APA process using multiple approaches represents an eclectic and creative form of research approach towards a transfer pricing issue. This will help to transcend the traditional limitations that are always associated with the use of mono-method approach (survey questionnaire) in many transfer pricing studies.³³ The researcher’s initial positivistic view seeks to examine and explain the association between the APA process and other important variables that influence interest in the process (Saunders et al., 2012). On the basis of the theoretical understanding and data gathered from the APA literature, the researcher collected relevant data and logically examined the different theoretical propositions relating to the associations between the APA process and other factors. This reasoning represents the initial effort to establish the underlying rationales behind MNE attitudes towards the APA process in the UK. For the purpose of generalization, appropriate data were collected from UK based MNEs who were involved in transfer pricing related activities through the use of survey questionnaires. Obviously, this approach was necessitated given the unavailability of publicly accessible data on APAs. Like previous ITP research in general, empirical studies on APAs are relatively skewed towards the use of questionnaires as a means of data collection. Borkowski (1993, 1996b, 1997b, 2008), Elliot and Emmanuel (2000), Ernst & Young (1995, 1997, 1999, 2001, 2003, 2005, 2007, 2010, 2012) are some of the earlier empirical investigations of the APA process both in the UK and other countries that collected their data via the use of a survey questionnaire. Moreover, this seems inevitable given that the APA process as administered by tax authorities both within the UK and elsewhere is treated as highly confidential. For example, on 17th December 1999, the US Congress enacted *Section 521 of the ticket to Work and Work Incentives Improvement Act of 1999*, which amended Section 6103 to describe

³³ In management accounting research, Modell (2010) gave a general argument for the adoption of mixed methods research in terms of its tendency to ‘enable researchers to combine breadth and depth in empirical inquiries; to enhance the validity of research findings through triangulation; and to facilitate the mobilization of multiple theories in examining management accounting practices’ (p. 124).

APAs and their background documents as ‘return information’³⁴ (thereby deemed confidential and not able to be released to the public) and amended Section 6110 to exclude them from the definition of written determination. At the time of this study, this researcher was not aware of any list of companies or MNEs which have APA agreements being publicly accessible or made available by tax authorities and this automatically restricted access to this sort of data. This restriction therefore dictated, in practical terms, the researcher’s initial choice for a survey design approach to answering the research question under consideration. In order to be able to explore the associations between important variables/factors that influence APA applications, an analytic, relational survey instrument was set up to investigate the attitudes of multinationals towards the current UK APA process. Oppenheim (1996, p. 11) explained that analytic survey designs ‘try to explain things, they seek to answer “why” questions, or “what determines X” questions...’. This is consistent with the nature of the research question³⁵ under investigation.

As the study progressed, the researcher’s view on the paradigmatic continuum shifted towards the interpretive philosophy in an effort to further explore the depth of the topic of APA. This pragmatic view necessitated the need to go beyond what is established in the literature and identify whether there are other practical reasons for MNE attitudes towards the APA process in the UK. Consequently, further understanding of the cause-effect link already identified between the APA process and other variables was sought from the principal users of the process i.e., MNEs and APA experts. As pointed out by Easterby-Smith et al. (2008, cited in Saunders et al., 2012, p. 147), establishing different views of phenomena using the inductive approach more likely involve the use of qualitative data and adoption of a variety of methods to collect data. Consistent with this assertion, the researcher sought alternative explanations of initial findings from a small sample of APA users through the use of interview and a Delphi study.

4.4 Methodological Choices

The pragmatist view adopted in this study allowed for a choice of whichever position or mixture of positions that will help to undertake the research in focus (Saunders et al, 2012, p.

³⁴ *Section 6103* of the US tax code makes all taxpayer return information confidential and therefore not able to be released to the public.

³⁵ As stated in Chapter 2, the central research question of this study is ‘Why do MNEs apply/do not apply for APAs in the UK?’.

164). This helped to explain the researcher's combination of deductive and inductive approaches in order to adequately examine the research question. Consistent with this approach, the study adopted a mixed-method research methodological choice combining the use of both quantitative and qualitative techniques and analysis procedure in a simple and sequential pattern (Saunders et al., 2012). This entailed a multiphase research design³⁶ in which the initial effort towards answering the research questions involved the use of survey questionnaire to describe those factors that UK MNEs consider as important in their decision on whether or not to apply for the APA process. The survey questionnaire provided quantitative data describing the different factors which inform the attitudes of MNEs towards the APA process. As noted earlier, using survey questionnaire in collecting data is a method that is commonly considered within the broader ITP research literature.³⁷ ³⁸ In order to elaborate and aid interpretations of the findings from the survey questionnaire, qualitative data were gathered through the use of semi-structured interviews and this helped to explore further the evident issues from the questionnaire. The data collected at this stage also helped to generate further interpretive inquiries which fed into the third data collection stage i.e., the Delphi study. The Delphi study provided a confirmatory evidence of all relevant themes which emerged from the two earlier stages of data collection i.e., survey questionnaire and interviews.

The adoption of a mixed method research design in the manner described above was meant to serve two main purposes among other reasons. First, the different phases of data collection and analysis were meant to complement one another i.e., complementarity. The sequential pattern of the design helped the researcher to use subsequent phases of the research design to elaborate, clarify and confirm the different meanings and findings that emerged from the previous stages (Saunders et al. 2012). Second, the mixed approach and multiple sources of data adopted in this research work are consistent with Podsakoff et al.'s (2003) call for ex ante remedies for the effects of common method variance that is often associated with

³⁶ Saunders et al. (2012, p. 166) described a multiphase research design as a type of mixed method research that involve the use of more than two phases of data collection and analysis.

³⁷ Emmanuel and Mehafdi (1994) observed that 'in most empirical studies the data were obtained via mail questionnaires - a data collection method not always flawless - it remains the case that the published surveys are virtually the only available insights on company practice' (p. 35).

³⁸ Borkowski (1996) strongly supported questionnaire surveys for this type of research :'Survey research is an excellent method of assessing the transfer pricing practices of MNEs when undertaken according to stringent guidelines, and given a sufficient response rate to insure minimal response bias' (p. 51).

behavioural/qualitative research as involved in this study. Triangulation of methods helped to check possible bias that may be inherent in the initial data collected.³⁹

4.5 Questionnaire Survey: Introduction

The build-up of the questionnaire (Appendix 4) involved an initial review of the literature on APA; the design of an APA questionnaire protocol; and an evaluation of the questionnaire using a pilot study.

4.5.1 Theoretical Sensitivity

In order to become sensitised to what is going on within the APA application process, a review of the APA literature was undertaken so as to identify the theoretically espoused rationales for APA applications.⁴⁰ Further theoretical understanding of the APA objectives, concepts, their meanings and descriptions was sought through a review of the previous HMRC Statement of Practice on APA (SP 3/99).⁴¹ The objective of this review was to learn about the factors that might be considered important in theory in the decisions to apply for an APA by interested parties.

4.5.2 Overview of the Questionnaire Design

A major weakness to the survey approach to research is that of a low response rate. In fact, Borkowski (2008) noted that the average response rate for prior transfer pricing studies published between 1997 and 2002 is 32.4% (72 responses). This section looks at the limitations of questionnaires, and how to ensure a good response rate using the Total Design Method (TDM) as developed by Dillman (1978).⁴² McLaughlin and Marascuilo (1990) noted that 28 studies that used Dillman's method produced an average response rate of 77%. The scale of the questionnaire is also examined in this section.

³⁹ Cravens (1992) acknowledged limitations in the use of survey data for transfer pricing, including a lack of available data, the use of numerous surrogates and proxies, difficulties in confirming the validity of responses and a general observation that any primary data source is subject to bias.

⁴⁰ See Table 2-1 in Chapter 2 for some of these. Appendix 2 shows the incorporation of this in the survey questionnaire.

⁴¹ Following the release in September 2010 of a draft Statement of Practice on Advance Pricing Agreements (APAs), the UK tax authority (HMRC) has since issued in December 2010 the final version of the new Statement of Practice (SP2/10). This Statement of Practice replaces a 1999 Statement of Practice. This redrafting process took place after the administration exercise of the survey questionnaire.

⁴² Collier and Wallace (1992) described how the TDM can be used to influence response rate, response speed, and response completeness in the administration of questionnaire survey.

4.5.2.1 Limitations of Questionnaires

While obtaining the reasonably high response rate is a major challenge in the use of questionnaires, three commonly associated disadvantages of questionnaires and their potential solutions are given below in Table 4-4.

Table 4-4 Limitations of Survey and Potential Solutions

Lack of control over who completes the questionnaire (Bourque and Fielder, 1995).	The risk of the wrong person completing the questionnaire can be reduced by identifying the name and address of the most appropriate TP/Tax director/head.
Bias in favour of people who are most interested in the research topic or with a vested interest (Donald, 1960).	It is possible to test for the occurrence of non-response bias by comparing the responses of those who respond immediately with those who respond to the follow up survey (Oppenheim, 1966; Fowler, 1988).
Item non-response when respondents fail to answer individual questions.	Item non-response can be reduced by thorough testing of the survey instrument in the pilot stages.

4.5.2.2 Total Design Method

In their demonstration of how to adopt the Total Design Method to improve survey questionnaire response, Collier and Wallace (1992) identified four factors as part of the TDM process. These four factors are considered and incorporated into the questionnaire design (see Table 4-5 below). The overall administration of the questionnaire was carried out in line with the steps outlined by Fink (1995a).⁴³

⁴³ Fink (1995a) discussed the steps that are needed to be followed when conducting a survey: identify the survey's objectives; design the survey; prepare the survey instrument; pilot-test the instrument; administer the survey; organize the data; analyse the data; and report the results.

Table 4-5 Total Design Method (TDM) Factors

TDM Factors (Collier and Wallace, 1992)	Design Steps Taken
Reward	Respondents were promised and received a copy of the survey result. A four page executive summary of the report (see Appendix 2) was sent to all respondents while an option for a request of the full report (30 pages) was given for interested participants.
Trust	Confidentiality and anonymity was promised and the survey pack included a signed confidentiality letter on a University letter headed paper.
Reduction of costs	Stamped return addressed envelopes were included in the pack.
Survey administration	While the relevant contact name was already supplied in the sample database, the appropriateness of these names was identified via initial telephone calls. Covering letters were included and subsequent follow-up mail was sent to non-respondents.

4.5.2.3 Response Format and Scale of Questions

The total number of questions in the survey instrument is 20. These consist largely of forced choice questions with YES/NO, checklist and rating scale questions. While YES/NO questions are simple to use and score, Fink (2006) noted that a slight misinterpretation means that the answer will be exactly opposite from what the respondent really means. Against this background, her clear instructions for writing survey items with forced choices were followed in the design of the close-ended questions.⁴⁴ The variables that emerged from initial literature review allowed for some checklist questions which in some cases, are of multiple answers/responses in design. The difficulty in formatting and interpreting responses to checklists where multiple answers can be given is, however, recognised. Accordingly, ordinal ranking requests were included in the wording of the questions whereby respondents were asked to rank only the topmost three variables for the purpose of relevance and significance. In order to allow for the identification of real differences in perceptions, the other scaled

⁴⁴ Fink (2006, pp. 18 – 20) outlined seven different rules for writing survey items with forced choices.

questions in the questionnaire used a seven point Likert scale to rate the respondents' views/perceptions. This, however, is not a common feature of many transfer pricing studies as majority adopted the four or five rating scales. Fink (1995b, p. 53) noted that 'self-administered questionnaires and telephone interviews should probably use 4 or 5-point rating scales...conclusive evidence supporting odd or even scales is unavailable'. However, De Vaus (2002, p. 107) also contended that the use of wider scales can have some advantages in that they allow for greater discrimination, especially where people tend to only use the top end of the scale. Cravens (1997) adopted the seven point Likert scale in order to be able to determine significant differences between measured perceptions. With this, easy partition could be made between highly rated perceptions and the lowly rated perceptions. Other fields have adopted a six point scale to ensure that respondents cannot adopt a neutral stance by selecting 'three' as a matter of course (Ashton, 1974; Curet et al., 1996). Such a design may, however, make for artificial opinions/perceptions being created (Presser and Schuman, 1980; Converse and Presser, 1986; Sudman et al., 1996).

For either of these scaling formats, the use of parametric tests for statistical significance is considered inappropriate because the assumption of normal distribution cannot hold for three, five or seven point scales. The use of the median rather than the mean is instead considered a better way to summarize positional information from Likert scales. Because the Likert-scaled questions in the designed questionnaire are also not quantitatively measured on an interval or ratio scale (only numeric values were assigned to qualitative responses), the normality requirements for parametric statistics cannot be assumed. Moreover, the final sample size to be analysed did not meet the requirements of parametric tests. Newbold (1991) stated that when the population distribution differs from the normal, non-parametric tests can have more power than the corresponding normal-theory tests (p. 428).

4.5.3 The Design of the Survey Questionnaire

In line with the objectives of the survey, the questionnaire was designed to capture the status of APA applications with the sampled UK-based MNEs and the other factors that affect attitudes towards the process. Its aim was to capture the common perceptions and attitudes of these MNEs towards the APA programme as well as the reasons that explain these attitudes. The questionnaire protocol was built on the basis of the reviewed APA literature as well as in line with previous empirical studies in this area (Borkowski, 2008; Ernst and Young, 2009).

The design of the questions was largely closed in nature, given the confidentiality nature of the topic. Most of the questions were of forced choices (structured), as MNEs are always reluctant to speak about their APA operations. As such, the less the information they are asked to give, the more the chance that they will be happy to respond to the questions. Relevant questions in this study include asking respondents about the most important reasons underlying their application/non-application for an APA; their experience in terms of prior TP audit examination; their beliefs and perceptions about HMRC's approach to cross-border transaction enquiries/audits; their TP methodologies; and further independent assessment on other related issues. The questions were designed in line with the two broadly operationalized objectives of the survey. The first of this was *to ascertain on an empirical basis, the underlying rationales for applying/not applying for the APA programmes by multinational enterprises (MNEs)*. For the sample of MNEs to be covered, the survey intended to investigate how much of the generally established reasons/rationales (in extant academic and professional literature) for making APA applications actually hold true, among other practical ones. For this objective, the questionnaire instrument was designed to capture the following information:

- primary rationales for APA application (Q13);
- most important rationales for no interest in APA (Q8);
- potential motivation for APA application in next twelve months (Q9);
- inter-company transactions covered by APA in effect (Q12);
- class of APA in effect (Q11); and
- transfer pricing method adopted for different transactions by APA applicants (Q16).

The second objective was *to establish a user-oriented evaluation of the APA process from the MNE perspective*. An implicit assumption under this objective is that if the general intent of the APA process to provide tax treatment certainty is upheld as the main reason for applying for the programme, then APA agreements should be dominated by inter-company transactions perceived by MNE managers as highly vulnerable to TP dispute. This assumption is in line with periodic reports in the Ernst & Young TP biennial global survey where MNE managers were reported to have developed perceptions of inter-company transactions which are vulnerable to TP tax dispute. Thus, the following data are considered as relevant for the achievement of the set objective:

- APA status of all respondents and transactions (Q7);
- duration of completion of APA agreements agreed (Q15);
- TP tax audit examination experience of MNEs in the last three years (Q4);
- country of tax authority carrying out the audit (Q5);
- kind of transactions in MNEs' intra-company transfers (Q2);
- size of MNEs' intra-company transfers in relation to size of Total Group Transactions(Q3);
- perceptions of MNEs about the most vulnerable type of intra-company transactions to transfer pricing tax audit examination/dispute with HMRC (Q6);
- APA consideration for intra-company transactions perceived as most vulnerable to transfer pricing tax audit examination/dispute with HMRC (Q12);
- MNEs' assessment of how well current APA agreements have achieved set objectives (Q14);
- perceptions of MNEs about the most beneficial transactions for an APA agreement (Q17);
- TP methods adopted for different transactions by non-APA applicants (Q10); and
- official capacity of respondents within specific MNE entity (Q1).

4.5.3.1 The Pilot Exercise

On completion of the design of the survey questionnaire, a pilot study was carried out in order to assess the reasonableness of the questions and obtain comments on the content validity (Litwin, 1995; De Vaus, 2002; Fink, 2006). Aside from the original purpose of evaluating the content and general structure of the questionnaire, the choice of who should pilot test the questionnaire arose out of three main concerns, i.e., confidentiality, accessibility, and feasibility of the study in general. As noted earlier, useful information about APA processes is treated and regarded as highly confidential not only by tax authorities involved but also the MNEs themselves. Thus, it is important to ensure that the nature of questions being asked is such that the MNE will be willing to supply on the basis of confidentiality assurance that will be provided. The challenge of getting access to the appropriate target respondents was factored into consideration as well. MNE tax directors/heads of tax whose duties include responsibilities for the transfer pricing decisions of their companies are in a better position to answer questions on the APA operations of their MNEs. There is the need to pre-test the reality of accessibility to individuals of similarly highly placed positions with similar functions

and duties. Finally, the generally low level of APA uptake in the UK (Appendix 1) coupled with the two earlier concerns mentioned put the feasibility of the project in doubt in terms of obtaining the necessary information required in order to proceed with the project. Consequently, bearing in mind the level of administration relevant for validity purposes and the nature of responses desired, a pilot study was administered on a cross-section of ten APA specialists. These comprised of seven TP advisers (partners and directors in globally reputable transfer pricing consultancy outfits) and three TP academics (professors) whose professional and research functions covered APA operations.⁴⁵ Of the pilot sample, seven responses were obtained with three non-responses recorded. Key suggestions were made in terms of the questionnaire contents, problems of confidentiality/letter of consent request, target sample and sequence of the questions.

4.5.4 Sample Description and Data Collection Process

On the basis of the comments from the pilot study, necessary modifications were made. After this process, a list of 400 UK companies was obtained from XL commercial database and this comprised the initial sample for this study.⁴⁶ The list as obtained from XL commercial database included the main tax contacts (tax heads, directors, etc.) of these companies. Among these 400 companies were included the contacts for companies within the FTSE 350 as at June 2009. The list comprised the business name of the company, the business sector, the business address/contact address, the market capitalization of the company, FTSE status as at June 2009, number of employees, main tax contact (full name and position) and contact telephone numbers. A two process data refinement was undertaken to ensure a valid final sample pool. First, the list of all domestic companies was removed from the original sample.⁴⁷ In line with the focus of the CRQ (i.e., why do MNEs apply/not apply for APAs in the UK?), the interest of the research was focussed on the attitudes of MNEs towards the UK APA process. Moreover, the business of cross-border operations for which transfer pricing manipulations may be associated necessitated that companies have related entities/permanent

⁴⁵ Initial emails were sent to twelve pilot participants requesting for their consent to participate in the pilot exercise. The ten respondents included in the exercise were those that gave a positive response to the initial invitation.

⁴⁶ The XL commercial database is a product of Excel data - a software and consultancy company that provides the latest list of key contacts in top companies - www.xldata.co.uk.

⁴⁷ Individual checks were carried out on the business activities, scope of operations, and business affiliations of companies in the original list to ascertain the MNE status of available contacts as provided in the XL database.

establishments⁴⁸ in other jurisdictions and as such assume an MNE status. Thus, for a company to be included in the sample, the company must have at least one non-UK subsidiary. A total of 59 companies was dropped from the original sample during this process. Second, all non-useful contacts whose official designations were unrelated to tax/finance functions were omitted from the sample. Official designations such as management accountants, company secretaries, payroll managers, etc., were also omitted from the original list of 400. Seventy two contacts were deleted from the sample at this stage and the final usable sample covered in the survey is 269 MNEs. These 269 MNEs were involved in the methodological procedures observed during the administration of the questionnaire. The administration of the survey questionnaire took place between September 2009 and March 2010. Initial telephone calls were made to 50% of the valid sample of 269 MNEs in a bid to ensure validity of response obtained and also to maximize response rate. The other half of the sample could not be reached via telephone within the limited time period of this project. These initial telephone calls helped to ensure, to a large extent, that respondent companies were involved in cross-border transfer pricing activities irrespective of whether they have an APA or not. Where respondents initially thought the questionnaire might not be useful for them, they were further asked whether they would find the APA programme either not *useful* or not *relevant* to the company's business. This, in the researcher's view, further helped to determine which MNEs were likely to be involved in transfer pricing activities and which were not. As such, this procedure helped to reduce largely, if not totally avoid, the potential subjectivity that is associated with the use of theoretical classification by previous related studies.⁴⁹ Consequently, the initial (questionnaires only) and follow-up (questionnaires and reminders) mails were sent to 187 MNEs within the UK. Table 4-6 shows the final sample composition surveyed after the initial telephone exercise. An overall response rate of 15.2% (41 responses) was obtained. However, the effective and useful response rate based on total valid sample is 13.8%. Of the 41 surveys originally returned, four gave company policy as reasons for not

⁴⁸ A company is generally assumed to have a permanent establishment in the UK where it has a geographic place of business (premises or a site, or machinery or equipment used in the operation of a business), which is fixed, or has a degree of permanence. This is referred to as a fixed place of business permanent establishment. Broadly, the UK's rules for determining the existence of a permanent establishment follow those of the OECD, which are extensive and have been frequently revised over the years.

⁴⁹ Price Waterhouse (1984), Borkowski (1992b; 1993) adopted an industrial classification method to determine companies in industries that are likely to use transfer pricing and those that are not. Industries that included metals, mining and steel MNEs were classified as Metal Group; industries such as chemical, oil, and food processing were in the Process Group; industries similar to computers, machinery, automotive, electronics, instruments, office equipment and tire/rubber were in the Manufacturing Group; and other industries not fitting into any of the previous three categories were in the Other Group.

participating; leaving a net total of 37 valid responses to be analysed. These 37 responses form the sample size that was analysed in the first stage of data collection for this study.

Table 4-6 Sample Composition in Questionnaire Survey

MNEs in Sample Database	Eligible Participant companies contacted (a)	Questionnaire Sent Out (b)	Valid Feedback Received (c)	Overall Response Rate (c)/(a) * 100
Initial Access via Tel. Contact:				
- Agreed to Participate	51	51	21	41.2%
- No interest in participation	82	0	0	0%
No Telephone Contact	136	136	16	11.8%
<u>Total</u>	<u>269</u>	<u>187</u>	<u>37</u>	<u>13.8%</u>

4.5.4.1 General Characteristics of the Respondents

As shown in Table 4-6 above, 37 completed surveys were returned out of 187 surveys sent out. The primary official position of the direct respondents to questionnaires returned by these 37 MNEs was as shown in Table 4-7 below. Business activities of these 37 MNEs involved different types of transactions, with 35% dealing in all four kinds of transactions (i.e., tangibles, intangibles, services and, financial services); 16% engaging in tangibles, services and financial transactions only (three transaction types); another 19% trading in intangibles, services and financial transactions alone (three transaction types). While 27% of respondents were involved with services and financial transactions only (two transaction types), only 3% engaged in intangibles and services only (two transaction types). The proportion of internal trade between divisions for these transactions as a percentage of group transactions within the MNE is given in Table 4-8. The majority of the MNEs had internal trade between 0% and 50% although one MNE had internal trade above 75% and another MNE did not reply to this question. Other studies in this area have measured internal trade as a percentage of sales but also reported low percentage of internal trades between companies. Emmanuel and Mehafdi

(1994) described seven studies which analyse companies in terms of internal trade as a percentage of total company sales. They concluded that ‘...very few companies have amounts of transfers of more than 30% or 40%’ (pp. 45 – 46). This was also evident in the work of Elliot (1999) where most of the companies surveyed have internal trade between 1% and 25% of their total sales.

Table 4-7 Official Position of Direct Respondents

<u>Official Designation:</u>	<u>Frequency</u>	<u>Percentage (%)</u>
- Group Head of Tax/Head of Tax	11	29.7
- Group Tax Director/Tax Director	10	27.0
- Group Finance Director/Financial Controller	4	10.8
- Group Tax Managers/Tax Managers	11	29.7
- Global Head of Transfer Pricing	1	2.8
- <u>Total</u>	<u>37</u>	<u>100.0</u>

Table 4-8 Level of Internal Trade

Level of Internal Trade	Number of Companies
0-25%	26
26-50%	8
51-75%	1
Above 75%	1
No Response	1

The 37 MNEs that returned completed questionnaires are all within the HMRC Large Taxpayer classification criteria as summarized in the OECD Guidance Notes (see Appendix 3). These businesses represent nine industrial classes using the UK SIC 2007 three digit classifications.

From these 37 respondents, only five MNEs had either reached or were in negotiation for an APA at the time either with HMRC in the UK or other countries’ tax authorities. While three MNEs planned to apply for an APA within the next twelve months, the remaining 29 MNEs

had no plans whatsoever to apply for an APA. The very low number of respondents who had either reached or were in negotiation for an APA necessitated greater emphasis in the research analyses being placed on the second part of the central research question (i.e., why do MNEs not apply for the APA programme?). Nevertheless, it is pertinent to state that the small number of APA respondents obtained (five MNEs) together with the number of APAs maintained (nine APAs) was not far from what actually obtained in the UK as shown in Appendix 1. Tables 4-9 and 4-10 below summarize the broad features of the 37 respondent MNEs and their internal transactions. The industrial spread was based on the UK SIC 2007 3-digit classification.

Table 4-9 Status of Respondent MNEs based on Industrial Spread

<u>Class of Industry</u>	<u>APA Applicants</u>			<u>TP Audit Experience Status</u>		
	NO	YES	TOTAL	NO	YES	TOTAL
Construction	1	-	1	-	1	1
Electricity, Gas, Steam and AC Supply	1	-	1	-	1	1
Financial and Insurance Activities	4	1	5	1	4	5
Information and Communication	7	-	7	3	4	7
Manufacturing	8	3	11	4	7	11
Mining and Quarrying (Oil & Gas)	1	-	1	-	1	1
Support Services (Administrative)	2	-	2	1	1	2
Support Services (Professional)	4	-	4	1	3	4
Wholesale and Retail Trade	4	1	5	1	4	5
Grand Total	32	5	37	11	26	37

Although the small number of the final sample size analysed (37 MNEs) was not considered adequate in analyzing all the previously stated objectives which the research originally set out to achieve, the analyses of the number of transactions involved (in this case 113 transactions - see Table 4-10) are considered where appropriate to complement observed patterns and relationships. This way, test of relationships among variables is still allowed for despite the small sample and important and interesting themes useful for further consideration were allowed to emerge.

Table 4-10 Status of Respondents' Internal Transactions based on Industrial Spread

<u>Class of Industry</u>	<u>APA Status</u>			<u>TP Audit Experience Status</u>		
	NO	YES	TOTAL	NO	YES	TOTAL
Construction	3	-	3	-	3	3
Electricity, Gas, Steam and AC Supply	4	-	4	-	4	4
Financial and Insurance Activities	11	4	15	2	13	15
Information and Communication	19	4	23	10	13	23
Manufacturing	25	4	29	9	20	29
Mining and Quarrying (Oil & Gas)	2	-	2	-	2	2
Support Services (Administrative)	4	2	6	2	4	6
Support Services (Professional)	11	4	15	4	11	15
Wholesale and Retail Trade	16	-	16	2	14	16
Grand Total	95	18	113	29	84	113

In an attempt to detect relationships and search for explanations among key variables generated, use is made of descriptive statistics which help to make sense of the data as required in the realm of social science. More concise indices of the extent to which variables are related are further generated with the use of class descriptive statistics (i.e., correlation coefficients) where possible. These help to provide a succinct description of the extent and character of the relationship between variables. Because of the largely nominal and categorical nature of the data obtained, the chi-square tests of independence are appropriate in examining inherent relationships here. However, the small sample size necessitates further refinement of the summary statistics used for the purpose of obtaining more precise interpretation. Thus, thorough and imaginative analysis of the sample data was carried out with the use of the Fisher-Irwin exact test (also known as Fisher's Exact Probability Test or Fisher's exact test). Fisher's exact test is a statistical significance test for categorical data, measuring the association between two variables in a 2x2 contingency table. It is a useful alternative to chi-square in situations of 2x2 contingency table of relatively small sample. One respect in which the Fisher test is plainly superior to a chi-square test, even in those cases where a 2x2 chi-square might be legitimately employed, is that chi-square is intrinsically non-directional, whereas the Fisher's procedure is capable of being applied as either a directional test or a non-

directional test. However, only 2-tailed tests are necessary in this work as the underlying propositions are non-directional in nature.

4.6 The Interviews: Introduction

Despite the steps taken during the questionnaire administration (Table 4-5) in order to ensure a high response rate, only 37 MNEs returned validly usable responses. Hence, the first methodological strategy in this research, i.e., the survey exercise, was eventually a small scale cross-sectional survey. With the survey aimed at determining the attitudes of MNEs within the UK towards the UK APA process, the responses only provided limited evidence in addressing the intended objectives. Consequently, analyses were done on the basis of theoretical themes that emerged from feedback obtained. These themes helped to provide a structure within which the APA process is examined in a coordinated manner.

In line with the research design, semi-structured interviews were carried out to ask for more in-depth explanations on the themes which were revealed from the questionnaire responses (Drever, 2003). This was aimed to reflect better a more thorough and balanced evaluation of the APA as a process as argued earlier. The interview exercise examined insights from the questionnaire findings by seeking how the interview participants interpret some of the responses and relationships that were reported from the questionnaire. It also sought to consider participants' perspectives on how some of the emergent themes relate to the stances of HMRC on similar issues (Wood, 2006). This provided an opportunity to consider any inconsistencies, ambiguities, or contradictions between patterns discovered from the analysis of the questionnaire and APA regulatory provisions. Apart from helping to explore the study objectives, the additional examination of the APA in this way should provide a potential opportunity for possible hypotheses on the APA process which could be examined from a more rigorous positive approach in future.

4.6.1 Interview: Data Collection Process

At the end of the analyses of responses from the survey questionnaire, a thirty page research report was written on the findings from the exercise. The report gave a summary of the findings under each of the themes identified and discussions on each of these themes with issues of interest were presented in the discussion section of the report. However, the thirty page report was further summarized into a four page executive summary that can easily be

read by respondents while giving recognition to their tight schedules. After going through five redrafts, a concise, professional and informative summary of the initial thirty page report was produced (see Appendix 2). This summarized report contained brief discussions of emergent issues under each of the themes, and an explanation of the researcher's intention to explore the issues discussed through an interview exercise that would focus on each of these themes. Also, participants who were interested could request a copy of the full thirty page report. The executive summary was sent out to all the 37 respondents to the initial questionnaire survey as well as to the 150 non-respondents who did not return the initial questionnaire. For the non-respondents, adjustments were made to the covering letter and these detailed what was done as well as what was being sought from them. After three weeks of sending out the executive summary, a follow-up telephone call was made to each of the participants asking if they had received the report sent to them earlier. Participants were also, at this point, asked for an interview time/slot. During this exercise, four interview appointments were initially scheduled in January-February, 2011.

4.6.1.1 The Interview Protocol

In developing the interview protocol, the questions were designed to elicit interviewees' views and opinions on each of the six themes that emerged from the prior questionnaire survey analyses. Thus, the design of the interview questions was semi-structured in nature (see Appendix 5). The six themes guided the line of discussion and they covered themes in the category of: Cost and Benefits of an APA to Multinationals (MNEs); Transfer Pricing (TP) Audit Experience relationship with APA Applications by MNEs; Alternative Dispute Resolution (ADR) Methods available to MNEs; Complexity of MNEs' TP Cases; Risk Assessment; and Volume and Size of MNEs' Cross-border Transactions. These served as the data collection instruments which, according to Curry et al. (2009) are often referred to as *discussion guides* and may be semi-structured (using open-ended questions within a predetermined set of topics). All the main interview questions were designed to reflect the analysis tables for each of these themes. The inferences from these prior analyses were cited mostly in the prelude to the key questions. During this process, the rationale for each main question was considered as careful thought was given to what each question indicated, the implication and objective of asking the question and how this was meant to contribute to the research question being addressed. Although the questions were focused on each of the themes

set for discussion, care was exercised to check ‘framing’⁵⁰ in the questions asked by making the questions as open as possible so as not to be leading. In ensuring this, alternative views from HMRC’s perspectives as articulated in the APA legislation were developed and where applicable, these counter views were useful as prompt follow-up questions to main questions being asked.⁵¹ Consequently, semi-structured interviews were conducted in the first quarter of 2011 with three tax directors of UK based MNEs. Each of the interviews lasted an average of an hour and attempts were made to feed back interview responses to participants where necessary. Further details about interview participants are given in the next chapter under Section 5.6.

4.6.1.2 Interview: Data Preparation

The interview transcripts produced from this stage of data collection helped to provide information about the subjective perception of a number of tax directors about the UK APA process. Thus, with regard to the use of Schutz’s (1967) social phenomenology processes in describing and interpreting social actions (i.e., descriptive and interpretive theory), the attitudes and perceptions of these tax directors of MNEs towards the UK APA process were further explored from their subjective points of view. Crabtree and Miller (1992) noted that the decision about an analytic approach depends on goals of the analysis and the stage of the research. The interview exercise conducted in this project work is the second stage of the data collection process on the UK APA process.

While the number of tax directors eventually interviewed is small (i.e., three), the researcher still found as sufficient the responses obtained together with the analyses and these allowed for further examination of the process in a way that could feed into a subsequent Delphi methodological process. After the evidence from the initial questionnaire survey was gathered, the semi-structured interviews were used at this stage to explore further in-depth analysis of issues under the themes that emerged earlier from the questionnaire responses. This objective which the interviews sought to achieve necessitated the use of a deductive thematic analysis approach as a suitable option for the analysis of the interview texts. However, the recognition

⁵⁰ King (2004) acknowledged that in doing qualitative interviews, researchers should be wary of framing research questions in a way which reflects his or her own pre-suppositions or biases.

⁵¹ Crabtree and Miller (1999; pp. 89 – 107) noted that in addition to the established questions during in-depth interviews/guided conversations, the interviewer uses prompts and probes to clarify concepts, elicit detail, and extend the narrative.

of the need to allow further insights to emerge from the interview transcripts makes for a further inductive process in the analyses of the data (Boyatzis, 1998). Thus, the method of analysis adopted at this stage involved a hybrid process of deductive and inductive thematic analysis using a template approach to text analysis as outlined by Crabtree and Miller (1992, 1999). This entailed the use of a template in the form of codes from a codebook to be applied as a means of organizing text for subsequent interpretation. Although several approaches may be taken to creating codebooks that serve as the template, Crabtree and Miller (1992) noted that it is common for templates to derive from theory, research tradition, pre-existing knowledge and/or a summary reading of the text. They can also be of theoretical, behavioural, or linguistic structure (p. 95). For the purpose of analysing the interviews, the template was developed a priori, based on the thematic findings from the initial questionnaires. However, in order to explore better the APA issue, the researcher began the analysis at this stage with six basic set of codes and thereafter expanded on them through readings of the texts in line with Boyatzis (1998). This is similar to taking a middle ground in creating the codebook that eventually serve as the template as described in Crabtree and Miller (1992).

Alternatively, one can code the interview texts and then count the frequency of different codes' occurrence as a means of identifying key areas for further investigation. However, this researcher's approach is in using the codebook as a data management tool in which segments of similar text were printed for subsequent reading and analysis. This is necessary as it is a common agreement that most interview transcripts need an open interpretive process. In addition, attempts were made to demonstrate integrity and competence within this study, i.e., rigour (Aroni et al., 1999) by transparently demonstrating how the themes of study were formulated from the participants' data, i.e., theoretical rigour (Higgs, 2001; Rice and Ezzy, 1999); and also by clearly demonstrating how interpretations of the data were achieved using illustrative quotations where necessary, i.e., interpretive rigour (Rice and Ezzy, 1999). This was intended to show not only how the operational themes were supported by the excerpts from raw data but also that the data interpretation remained directly linked to the words of the participants (Eisenhardt, 1989; Fereday and Muir-Cochrane, 2006; Eisenhardt and Graebner, 2007).

Five stages of data coding were adopted in the analyses of the interview transcripts along the line of the above procedure. These stages included the following:

Stage 1: Developing the Code Manual

Fereday and Muir-Cochrane (2006) noted that the use of a template provides a clear trail of credibility for the study. As a data management tool, the codebook will help to organise segment of similar or related text for ease of interpretation and to search for confirming/disproving evidence of these interpretations (Crabtree and Miller, 1992, p. 99). As already mentioned above, the findings from the initial questionnaire analyses were used to develop the template a priori. There were six different themes that formed the code manual. The thematic categories here included that of '*Cost and Benefits of an APA to Multinationals (MNEs)*'; '*Transfer Pricing (TP) Audit Experience Relationship with APA Applications by MNEs*'; '*Alternative Dispute Resolution (ADR) Methods available to MNEs*'; '*Complexity of MNEs' TP Cases*'; '*Risk Assessment*'; and '*Volume and Size of MNEs' Cross-Border Transactions*'. These themes were the results of a simultaneous analysis of all findings from the questionnaires based on a user-perspective evaluation of the UK APA process. Effort was made to define each of these themes in the codebook before the commencement of the data analysis by clearly identifying: (1) the code name and label; (2) the definition of what the theme concerns; and (3) a description of how one knows when the theme occurs.

Stage 2: Deciding the Level of Detail and Identifying Initial Themes

The aim of the data analysis was to identify key points and insights given by interviewees in their response to questions asked. As such, rather than a basic content analysis, the encoding of recognisably important sentences and paragraphs reflected the initial processing of information by the researcher. By reading, re-reading and summarizing the raw data, the analysis of the transcripts in line with Boyatzis (1998) helped to enter information 'into the unconscious, as well as consciously processing the information' (p. 45). This provided the opportunity to observe and take note of potential themes in the raw data. The intention was to use the interviews to provide further insights and develop an interpretative level of inquiry that will feed into a subsequent Delphi methodological process. This then necessitated that sentences and paragraphs be concentrated on for common threads that raised issues of interest and/or which were in line with the preliminary themes in the codebook. Consequently, while a single sentence could provide a relevant basis for a separate coding, identifying the full idea and key issue being raised usually provided the complete segment for coding. This helped to reflect again the basic purpose of the codebook as used to organise segments of similar or related text for ease of interpretation.

Stage 3: Applying Templates of Codes and Additional Coding

While the use of computer coding could help to match the text data with the codebook by telling the software programme where each segment begins and ends, initially hand-coding a hard copy of the interview texts is advised by different authors (Miles and Huberman, 1984; Seidel et al., 1988; Tesch, 1990; Bee and Crabtree, 1992). However, given the manageable size of the number of interviews (i.e., three tax directors) and the resultant transcribed texts that were to be analysed, this researcher undertook the coding of the texts manually without the use of computer applications as exemplified in the work of Addison (1992, cited in Crabtree and Miller, 1992). This process required multiple copies of the interview transcripts since codes were not mutually exclusive and the same segments of text needed to be sorted into different places. Following the template analytical technique described in Crabtree and Miller (1992, 1999), the researcher applied the codes from the codebook to the text while aiming to identify meaningful units of text. This involved coding all the data with the preliminary codebook. The researcher coded the texts by matching the codes with segments of the texts highlighted as representative of the code (Eisenhardt, 1989). As this coding process was going on, the researcher made notes/memos in the text margin to note down any interpretative insights that came about by being closely involved with the data (Crabtree and Miller, 1999). Doing this sometimes allowed for initial ideas and interesting insights that warranted confirming/disproving verifications which were then identified as relevant for the subsequent Delphi exercise. Consideration was also given to any potential codebook modifications that might emerge as the memos took on a more focused meaning. While the analysis of the interview texts was being guided by the preliminary codes, it was not particularly confined to these as the objective of exploring better the issues of interest surrounding the APA process led to making a note of any new theme regarded as important by the interviewees. As such, inductive codes were assigned to segments of data for new themes observed in the text, in line with Boyatzis (1998). Here, credence was given to any additional codes that were either different from the initially determined ones or could serve to modify or expand any of the pre-determined ones.

Stage 4: Connecting the Codes and Identifying the Themes

The process of connecting the codes and identifying the themes across the three texts of interview transcripts involved the creation of a code file that contained the code name from the codebook with the starting and ending line for each segment. Crabtree and Miller (1999)

described this process as that of discovering patterns in the data. This initially necessitated six code files relating to the predetermined themes used in the codebook. However, other comments with similar thread patterns in the response of interviewees resulted in additional code files for four different data-driven themes, thereby making the number of code files in use ten. Segments with similar codes were sorted into a code file, at which stage similarities and differences between the responses from the three different interviewees in relation to identified themes could be highlighted.

Stage 5: Confirmation and Interpretation of Themes

One of the problems a researcher has to handle in the process of confirming themes and interpretation of the data is what Crabtree and Miller (1999) refer to as the fabricating of evidence. This constitutes the unconscious 'seeing' of the data that the researcher expects to find even though it is not intentional. Several iterative processes were involved between the text, codes and themes during the analysis and subsequently, the interpretative phase. First, a scrutiny of each of the segments was undertaken to validate that the assigned themes were representative of the initial data analysis and assigned codes. Afterwards, the researcher chose, in line with Crabtree (1992), the option of reading through all the segments about a particular topical issue in order to see which themes were recurrent and thereby salient. Some themes which seemed important to the interviewees emerged from the segments on a specific topic. These included those of 'Distrust and Secrecy' and 'Retrospective Tax Effect'. Sentences and paragraphs describing the meaning and implications that underpin a theme were selected and the connections created by this cluster were used to guide the interpretations until a coherent description was possible. Consequently, open-ended questions were created in line with the interpretations and descriptions for each of these salient themes. This process was in preparation for a subsequent Delphi exercise that sought to explore further confirming or disproving cases for these themes. The triangulation that was achieved by the Delphi exercise helped to verify the credibility, dependability and confirmability of the interpretations and thematic descriptions that evolved from this thematic analysis (Kuzel and Like, 1991; Lincoln and Guba, 1985).

4.7 The Delphi

4.7.1 Introduction

The Delphi method is an iterative process to collect and distil the anonymous judgements of experts using a series of data collection and analysis techniques interspersed with feedback. It originated in a series of studies that the Rand Corporation conducted in the 1950s with the objective of developing a technique to obtain the most reliable consensus of a group of experts (Okoli and Powloski, 2004). Consistent with the pragmatic philosophy adopted in this study, the Delphi technique possesses a hybrid epistemological status as it straddles the qualitative and quantitative divides (Cricher and Gladstone, 1998). Researchers have applied the Delphi method to a wide variety of situations as a tool for expert problem solving. They have also developed variations of the method tailored to specific problem types and outcome goals. For example, Linstone and Turoff (1975) examined a variety of studies which have used the Delphi method. Skulmoski et al. (2007) also explained that the Delphi method has been used in information system (IS) research and looked at other IS projects that used the Delphi method in greater depth. They noted that the method has been used to develop, identify, forecast and to validate in a wide variety of research areas. Whereas a three round Delphi process is typical, single and double round Delphi studies have also been completed.

The researcher found a large body of studies using the Delphi method within the academic literature on nursing. However, very few accounting related studies were found to have utilized this research strategy in the past (e.g., Dinius and Rogow, 1988; Greenstein and Hamilton, 1997). This assertion was supported by Worrel et al., (2012) who noted that while there have been many studies utilizing the Delphi method within the management, marketing, information systems and psychological disciplines, accounting researchers have been slow to adopt this method (p. 195).⁵² Consequently, the use of the Delphi method in this study represents a significant contribution towards the adoption of a pragmatic approach to research design in accounting research.

⁵² Worrel et al., (2012, p. 196, Table 1) provided an overview of selected Delphi studies from the accounting information systems (AIS) and management information systems (MIS) literature, and also gave detailed expert panel composition, implementation approach and summary findings.

4.7.2 Preparing for the Delphi Exercise

Consistent with the work of Hartman and Baldwin (1995), the Delphi was employed at this stage to confirm or disprove the insights that were obtained from the previous evidence, thereby advancing the knowledge and understanding of MNE problems with cross-border transfer pricing cases in general. This methodological strategy was aimed at producing a broader understanding with detailed data on the APA process in the UK. It is, however, generally acknowledged that researchers use this method as a quantitative technique (Rowe and Wright, 1999), but the Delphi method can also be employed with qualitative techniques. It is indeed a method that is well suited to rigorous capture of qualitative data (Skulmoski et al. 2007).

4.7.2.1 Suitability for this Research

Although further interviews could have been carried out with APA advisers as another traditional survey to further gather input from a major stakeholder group in the APA process, the Delphi method however, is adjudged to be a stronger methodological strategy for rigorous questioning of experts about their specialist views on reasons already advanced by the principal users of the APA process, i.e., the MNEs. On this basis, the researcher selected the Delphi method for the reasons below.

1) The study sought to investigate the different underlying reasons that are responsible for the perceptions and attitudes that MNEs maintain towards the UK APA process. Greater understanding was pursued as to why MNEs apply or do not apply for the process. Having gathered evidence from the principal APA users themselves via the two previous data collection exercises that were undertaken, a confirmation of this evidence requires knowledge from people who understand the different economic, financial, legal and political issues that are associated with the process. Thus, a Delphi study performs this function more appropriately.

2) Given that the APA process is a complex one with multidisciplinary perspectives, a Delphi study most appropriately supports/validates the answering of the research question, rather than any individual expert's response. Again, APAs always involve cross-border operations of MNEs in different countries and the specialist knowledge of international experts is highly relevant in the overall assessment of the process. Delphi, as opposed to focus group study, is

desirable in that it does not require the experts to meet physically which could be impractical for international experts in addition to constituting an expensive endeavour for the researcher.

3) The relatively limited number of tax advisers with APA expertise/specialist knowledge is consistent with the modest size requirements of a Delphi exercise. For example, Paliwoda (1983) noted that it would be practical to solicit up to four rounds from a Delphi study sample of 10 – 18 members.

4) The Delphi study is flexible in its design and amenable to follow-up interviews, although this was not intended at this stage of the project. However, this possibility permits the collection of richer data leading to a deeper understanding so as to answer more thoroughly the research questions.

4.7.2.2 Developing the Questions

The questions that were considered at this stage were more open-ended in nature. However, they were also more focused and structured to guide the Delphi participants along the lines of the four new themes that emerged from the prior interview exercises and which were now the area under focus. In this way, the collective intelligence of the participants was obtained without any constraint on the degree of their responses.

4.7.2.3 Research Sample

A Delphi study does not depend on a statistical sample that attempts to be representative of any population. Okoli and Pawloski (2004) noted that the process is a group decision mechanism requiring qualified experts who have deep understanding of the issues. These authors regarded the choice of appropriate experts as perhaps the most important, but yet most neglected aspect of the Delphi method. Skulmoski et al. (2007) also noted that the selection of research participants in a Delphi process is a critical component of the research since it is their expert opinions upon which the output of the Delphi process is based. For the purpose of this research, a purposive sampling method was adopted and tax experts were selected not to represent the general population, but rather for their ability to answer the research/Delphi questions since, according to Fink and Kosecoff (1985), it is their expert opinion that is being sought. In selecting the sample for the Delphi, the four requirements for ‘expertise’ criteria as

advanced by Adler and Ziglio (1996) were used in selecting the sample for this exercise. The criteria adopted in meeting these requirements were as shown in Table 4-11 below:

Table 4-11 Criteria for Delphi Sample Selection

(i) Knowledge and experience of the issues under investigation	Delphi participants consisted of academics and tax advisers whose work involved APA research and operations (i.e., the UK APA process in particular and the APA arrangements in general) as an area of speciality. While the academics were selected from a literature review of academic and practitioner journals on transfer pricing tax/APAs, the list of tax advisers with APA specialization was obtained from Expert Guides 2010 (a bi-annual report on ‘The World Leading Transfer Pricing Advisers’; published by the Legal Media Group, a unit of Euromoney institutional investor).
(ii) Capacity and willingness to Participate	Initial emails were sent to target participants informing them of the objectives of the exercise as well as seeking confirmation of their willingness and consent to participate.
(iii) Sufficient time to participate in the Delphi	Target participants were informed before obtaining their consent that the Delphi study was a one-round exercise and that no further iteration was intended.
(iv) Effective communication skills	All correspondence was made in the English language and participants were informed beforehand that the Delphi process will be conducted via email.

In Skulmoski et al.’s (2007) review, sample sizes for a typical Delphi process varied from 4 to 171 experts. Also, there is no typical Delphi: rather the method is modified to suit the circumstances and research question.

4.7.2.4 Number of Participants

Again, Skulmoski et al. (2007) showed a wide range in the sample size in different Delphi studies. Where the group is homogenous, a smaller sample of between 10 and 15 people was deemed sufficient to yield valid results. However, several hundreds of people might be required to participate if disparate groups were involved. The sample of experts considered in this project were homogenous with all participants involved in similar area of expertise. Initial emails were sent to 20 APA specialists seeking their willingness and consent to participate in the Delphi exercise. The small number in the target sample contacted reflects the limited number, and difficulty involved in identification, of tax advisers who are well versed in APA operations. Also, this is considered sufficient for this purpose. The Delphi method was employed as part of methodological triangulation exercise. It was intended to allow for verification checks of the findings obtained from the initial questionnaire and interview exercises. Of the 20 APA specialists contacted, 10 of them consisted of those who were contacted earlier during the pilot study for the questionnaires that were administered earlier on the MNEs. This was comprised of transfer pricing specialists/advisers with either prior or present APA responsibilities, as well as academic researchers whose work over time largely involved looking at the workings of the APA and other transfer pricing legislative aspects.

4.7.2.5 Number of Rounds

According to Delbecq et al. (1975), a two or three iteration Delphi process is sufficient for most research, but the number of rounds is again dependent upon the purpose of the research (Skulmoski et al., 2007). The primary aim of the Delphi study at this stage was to verify and confirm the findings and interpretations that emerged from interview analyses (Kuzel and Like, 1991; Lincoln and Guba, 1985) in an attempt to link these interpretations and any future hypothesis into an explanatory model. The researcher attempted to utilize the linkages between the different data collection stages to explicate the decision making processes that MNE taxpayers use to manage their tax uncertainty problems. The use of this Delphi method as part of the methodological triangulation effort that was pursued in this project, coupled with the homogeneity of the sample participants that was considered, consequently allowed a one round Delphi process to be sufficient to achieve this objective.

4.7.2.6 Mode of Interaction

Hartman and Baldwin (1995) have previously used a group networking technology to complete a one round Delphi process before, and a similar approach was adopted via the use of electronic mail as the mode of interaction in this project. This afforded the advantage of being able to reach the target number of participants who all had access to electronic mail and at the same time helped to make the process a faster one than most other means of interaction. Moreover, as responses were all returned in already typed format i.e., email and completed documents attached therewith, the task of transcription which the research would have needed to carry out was eliminated.

4.7.2.7 Delphi Analysis and Results

The method of data analysis and results reporting in a Delphi study are directly related to the type of questions used in the Delphi instrument. Rowe and Wright (1999) illustrated the use of the Delphi process as a typical quantitative technique, although a researcher can also use qualitative techniques with the Delphi method (Skulmoski et al., 2007). Qualitative research is interpretivist in the sense that the researcher is interested in how the social world is interpreted, understood and experienced; the researcher is flexible and sensitive to the social context within which the data were collected; and qualitative research is about producing holistic understandings of rich, contextual and detailed data (Mason, 1996). Creswell (1998) argued that the qualitative researcher attempts to make sense of or interpret the phenomena in terms of the meaning the participants place on them.

The Delphi method, as mentioned earlier, is well suited to rigorous capture of both quantitative and qualitative data within the pragmatist view of knowledge. It may be seen as a structured process within which one uses qualitative, quantitative or mixed research methods. Such flexibility not only allows the method to answer many research questions, but also can be well matched to the abilities and aptitudes of the graduate student (Skulmoski et al., 2007), such as this researcher. The nature of this research involved the use of qualitative data (following the initial quantitative strategy already adopted) as a means of obtaining more understanding of how MNEs perceive the UK APA process and the reason for their attitudes towards the process. Given that this stage of data collection is aimed at verifying the credibility of and confirming the thematic descriptions that evolved from the prior interview exercise, qualitative content analysis was deemed appropriate in line with this objective. The

procedure followed here was in line with Taylor-Powell and Renner's (2003) work on '*Analyzing Qualitative Data*'. The analysis of the Delphi results is sequentially presented in the next chapter in Section 5.7.1

4.7.3 Further Verification

The use of a Delphi study is usually associated with the need to conduct further verification of reported results. The reason for this may be attributed to a variety of issues. For example, Hartman and Jugdev (1998) and Schmidt et al. (2001) stated as a limitation the difficulty in generalizing the results to a wider population owing to sample size. Nambisan et al. (1999) and Niederman et al. (1991) gave their own reasons as being related to their limited views or specific agenda. Consequently, most researchers have recommended further study to refine and verify their results as proposed in Nambisan et al. (1999), Wynekoop and Walz (2000), and Keil et al. (2002). Others have mentioned the need to investigate related sets of research questions (Brancheau et al., 1996; Niederman et al., 1991), and the need to extend the results to a similar sample, but from other geographical locations (Brungs and Jamieson, 2005) or to an entirely different sample (Schmidt et al., 2001). The common argument is that verification studies can provide rich research opportunities for new researchers (Skulmoski et al., 2007).

In relation to this project, one limitation with the Delphi exercise is the small sample size, as this may make it difficult to generalize the findings from the exercise. Additionally, a limitation of the online/email Delphi option which was adopted here is the inability to explore differences in opinions of participants on the same questions. This is because of the inability to get them all together around the same table, as pointed out earlier. After the analyses of the Delphi study, the researcher attempted to contact HMRC to talk generally about the Delphi findings and other related TP issues for additional insight. This was also expected to help explain how the Revenue goes about some of its APA processes. Interview protocol was developed for this purpose and this encompassed the findings so far from all data gathered up to date. Subsequently, contact emails were sent to HMRC Business International Office as well as their Large Business Service Oil and Gas. However, nobody was willing to speak to the researcher at the time.

4.7.4 Data Source Triangulation

It would not be surprising if the collection of limited data is recognised as a constraint upon the research. However, it is the researcher's belief that the multiple sources of the data gathered as well as the development of the sequence of data collection helped to demonstrate rigour and gave a more comprehensive examination of why/why not MNEs apply for APAs. Besides, this should also help to take care of common method variance (CMV) as identified by Podsakoff et al. (2003).

Podsakoff et al. (2003) noted that when self-report questionnaires, as adopted in this study, are used to collect data at the same time from the same participants (a common occurrence in behavioural research), then common method variance (CMV) may be a concern. According to Podsakoff and Organ (1986), this is a matter of concern that is strongest when both the dependent and focal explanatory variables in a research project are perceptual measures derived from the same respondents. Common Method Variance (CMV) otherwise known as Method Biases 'refers to variance that is attributable to the measurement method rather than to the construct of interest' (Podsakoff et al., 2003, p. 879). It creates a false internal consistency, that is, an apparent correlation among variables generated by their common source. CMV could occur, for example:

'if a researcher asks respondents to evaluate an MNE's organizational capabilities and the firm's international performance in the same survey. In such cases, self-report data can create false correlations if the respondents have a propensity to provide consistent answers to survey questions that are otherwise not related. Thus, common methods can cause systematic measurement errors that either inflate or deflate the observed relationships between constructs, generating both Type I and Type II errors' (Chang et al. 2010, p. 178).

While there is a number of approaches that are recommended by the authors (i.e., Podsakoff et al. 2003) and in other literature as methods that researchers should use to avoid CMV, the

most obvious strategy, according to Chang et al. (2010), is to avoid any potential CMV in the research design stage by using other sources of information for some of the key measures.⁵³

The sequential nature of the methodological triangulation that was adopted in this research work represents a good check on the response bias and other CMV issues that are associated with survey studies. The content of the original survey was developed from the academic and professional literature on APA. This was used initially to design the questionnaire protocol. In giving responses to the questionnaires, MNE respondents had the tendency to display, among others, the *consistency motif* type of bias (Johns, 1994; Podsakoff and Organ, 1986; Schmitt, 1994) or what is also referred to as the *consistency effect* (Salancik and Pfeffer, 1977). Podsakoff et al. (2003) refers to this sort of bias as ‘the tendency of respondents to try to maintain consistency in their responses to similar questions or to organize information in consistent ways’ (p. 881). They noted that this is likely to be particularly problematic in those situations in which respondents are asked to provide retrospective accounts of their attitudes, perceptions, and/or behaviours. In the questionnaire that was administered in this study, non-APA MNE respondents for example, who rated a particular type of transaction (say licensing of intangible property, i.e., intangibles) as highly vulnerable to transfer pricing disputes⁵⁴ are likely to regard the APA process as ‘not beneficial’ to the same type of transaction⁵⁵ in order to justify their decision of not being an APA applicant/user in the first place. Such a form of consistency bias in the responses gathered as related to this example as well as other questions in the survey, however, constituted important parts in the process of deriving the six themes of relevance from the questionnaire survey results as a whole. The result from the survey questionnaire analyses was used to develop the protocol for the interviews. The interviews helped to provide on the one hand, a counter source of evidence on the results from the questionnaire; and on the other hand an alternative source of gathering more insights into such evidence that was eventually validated from the interview responses. Data from the interview transcripts were coded using a hybrid approach of deductive and inductive approaches. While the deductive approach examined inherent insights from the interviews that relate to the six themes previously generated, the inductive coding approach to the interview transcripts led to

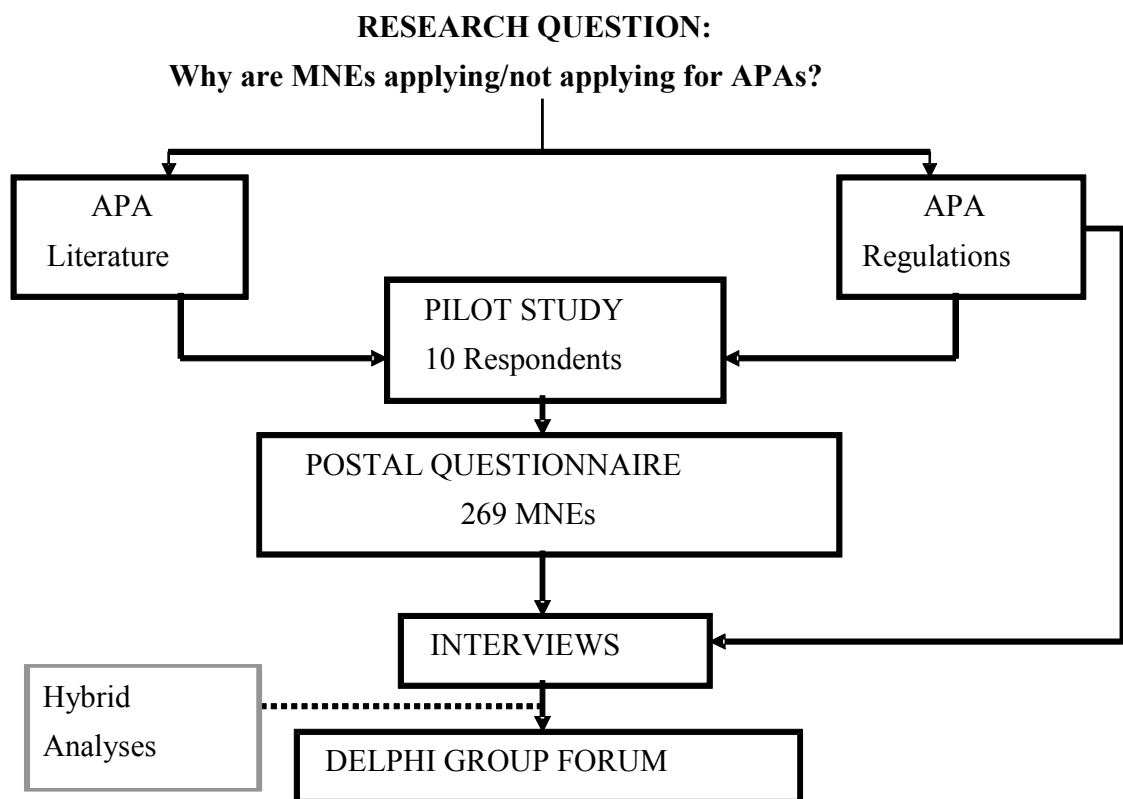
⁵³ For detailed discussion and comprehensive summary of the potential sources of method biases as well as how to control for them, please see Podsakoff, MacKenzie, Lee, & Podsakoff (2003), “Common Method Biases in Behavioral Research: A Critical Review of the Literature and Recommended Remedies”, *Journal of Applied Psychology*, vol. 88, no. 5, 879–903.

⁵⁴ Survey instrument question 6

⁵⁵ Survey instrument question 17

four themes that will be shown in the next chapter. These four themes were later examined through a Delphi study with a cross-section of academics and tax practitioners who worked in the transfer pricing area. Also, even though the following intended aim at this stage could not be achieved, the responses from the Delphi study were analysed and prepared with the intention of informing planned discussions with HMRC. This was done in order to have their own key point of view on this transfer pricing determination process. Despite the small amount of data collected in each methodological stage, the eventual sequence of data collection sources achieved (Figure 4-4) provided for a solid demonstration of how a good check is kept on inherent common method variance/bias. Moreover, the provision by the researcher of an official guarantee of the protection of respondents' anonymity throughout the data collection processes additionally helped to remedy potential CMV related bias from the respondents. This was useful in reducing respondents' evaluation apprehension of the subject topic (Podsakoff et al. 2003).

Figure 4-4 Methodological Triangulation of Data Sources



4.8 Conclusion

This chapter has presented both the research methodology and methods that were adopted in answering the research question. Following the methodological stages illustrated in the research onion (Saunders et al. 2012, p. 128), the researcher's philosophy was clearly explained following a detailed overview of the different dominant philosophical paradigms within the social science realm. Given the confidential nature of the APA process, the researcher justified why a pragmatic approach towards the study of APAs will help to improve understanding of the process. This was followed by a discussion of the researcher's approach in this study. Subsequent sections detailed the methodological choices and the chosen research strategies adopted by the researcher in examining the research question. The last part of this chapter explains how validity checks were considered during the data collection process in regard to the issue of Common Method Variance/Bias (CMV). While there are many remedies that can be adopted in correcting for such a variance, the researcher believed that the triangulation of research methods (sequential mixed-method methodological choice) adopted in this project provided the best check for this problem as recommended by established authors on the topic.

CHAPTER 5: DATA ANALYSIS

5.1 Introduction

This chapter describes the analysis carried out within the methodological choice that was adopted as depicted in the previous chapter (Figure 4-1). Following a simple and sequential mixed method design, the chapter describes the types of data collected for each of the methodological strategy adopted and what was done with the data collected, presented as a step by step process. The three stages of data collection and how each of these stages sequentially fed into the subsequent one are analysed. At the first stage of data collection, i.e., questionnaire survey, six themes of interest were identified. The second stage of data collection consisted of a semi-structured interview exercise during which additional four themes of interest were further identified. A one round Delphi study was undertaken as a confirmatory exercise to validate the findings from the two earlier stages.

5.2 The First Methodological Strategy (Survey Questionnaire)

The goal of this study was to obtain a user-perspective evaluation of the UK APA programme. As already mentioned in Section 4.5.3, relevant questions in this study include asking respondents about the most important reasons underlying their application/non-application for an APA; their experience in terms of prior TP audit examination; their beliefs and perceptions about HMRC's approach to enquiries/audits of cross-border transactions; their TP methodologies; and further independent assessment on other related issues. The original population for the first data collection stage comprised 269 UK based MNEs, with valid responses received from 37 MNEs which returned usable surveys. This gave an effective overall response rate of 13.8%. The 37 MNEs which returned feedback were all within HMRC Large Taxpayer classification criteria as summarized in the OECD Guidance Notes (see Appendix 3). These were of businesses representing nine industrial classes using the UK SIC 2007 three digit classifications.

According to Fink (2006), the appropriate analysis method for survey data depends on the sample size, the survey's research design, and the characteristics and quality of the data. In her view, determining the best method for analyzing survey data is dependent on seven issues/questions. These include: number of people being surveyed (sample size); search for relationships or associations; need for comparison of groups; frequency of survey (cross-

sectional or longitudinal); form of data recorded (numbers and percentages or scores and averages); number of independent and dependent variables of interest; and data quality.

For the analyses of responses from the survey questionnaires, the non-parametric test of association was used to analyze the responses as key variables did not meet the normality requirements of parametric statistics. Moreover, the final sample size of the responses that were to be analyzed was small relative to what parametric statistical analyses usually require. The survey conducted was cross-sectional with most of the questions being of forced choice nature. This categorical nature of the data from the questionnaires provided useful numbers and percentages that were amenable to the comparisons and test of associations between key variables. On this basis, the Fisher-Irwin exact test was also employed as an alternative to the chi square test of association in the examination of relationships among variables of interest. Also, most responses were not quantitatively measured on an advanced scale (interval or ratio scale). Some were derived from seven point Likert scales where numeric values are assigned to qualitative responses, i.e., 1 = not effective or 7= very effective. For the purpose of clarity, the descriptive statistics and analytical summary of the responses are presented below along two lines. First the univariate results are presented in line with the structure of the questionnaire instrument. The bivariate relationships/results are thereafter presented in both tabular and narrative analytical form in an attempt to explore additionally the pre-specified objectives as outlined in Section 4.5.3.

5.3 Questionnaire Survey - Univariate Results

5.3.1 Audit Status and Perceptions of Audit Vulnerable Transactions: Introduction

At the time of this survey, HMRC in the UK has operated an APA programme in the UK for complex transfer pricing issues since 1999. Also, several of the UK's major trading partners (e.g., the USA, Canada, Germany, France, Australia and Japan) have APA programmes. The APA rules, previously in Part III, Sections 85 to 87 of the *UK Finance Act 1999*, have only recently been rewritten as Part 5 *Taxation (International and Other Provisions) Act (TIOPA) 2010* as part of the UK's Tax Law Rewrite Project, and HMRC were then in the process of

revising their guidance.⁵⁶ These and other UK transfer pricing rules apply to a wide range of transactions, including those between two UK companies or between any person (including individuals and charities) and a company or partnership.

Historically, taxpayers were more likely to be subject to audit where they have low profits or losses, or where the international related parties have different effective tax rates (particularly in transactions with related parties in ‘tax haven’ jurisdictions). However, the UK tax authorities have, around this period, focused on larger transfer pricing cases, which have resulted in more litigation.⁵⁷ There was in place a penalty imposition of 10% of the value of transfer pricing adjustments, even where the adjustment merely reduced tax losses and did not result in a taxpayer having a primary tax liability. As such, transfer pricing issues remained at the forefront of tax planning issues for multinational enterprises (MNEs), such that some issues were so fundamentally uncertain that it made sense to agree the transfer pricing with the tax authorities in advance. This implied that MNEs were increasingly seeking to enter into advance pricing arrangements (APAs) with the relevant tax authorities to determine prospectively their tax liabilities. As it seemed logical that MNEs would pursue APAs as a means of reducing their risk of an audit triggered by transfer pricing policies, ascertaining the audit status and audit vulnerability perceptions of MNEs was relevant in assessing the attitudes and eagerness being shown towards the process.

5.3.1.1 Audit Status and Perceptions of Audit Vulnerable Transactions: Results

5.3.1.1 (i) Audit Status

Table 5-1 shows the audit status of sample MNE respondents within the last three years, using the UK SIC 2007 three digit industrial classification. This describes the response to question 4 in the questionnaire instrument asking ‘Has your specific MNE entity experienced transfer pricing audit within the last three years?’ All MNE respondents provided an answer to this question. Similarly, Table 5-1a presents the number of transactions that had undergone audit in each of the industry. Out of the 37 respondent MNEs in the study, 26 MNEs had

⁵⁶ In September, 2010, HMRC issued statements of practice (SoP) covering the APA and other procedures, in order to clarify their approach and to incorporate best practice into their guidance.

⁵⁷ The Euromoney Transfer Pricing Review (2009/ 2010) revealed that for the 2008/2009 period, HMRC worked on approximately 700 active transfer pricing cases and 50% of the audits were settled, while over 100 new transfer pricing audits were commenced.

experienced TP audit either from HMRC in the UK or other tax authorities in the last three years. The 37 respondent MNEs covered 113 transactions in total and for these 113 transactions, 74% (i.e., 84 transactions) were subjected to TP audit in the last three years. Obviously, the two tables can be said to reflect the intense TP audit activities being undertaken in recent years both by the UK tax authority and tax authorities of other jurisdictions. Table 5-2 further describes responses to question 5, and partitions the auditing tax authority into that of HMRC on the one hand and that of ‘Others’ on the other hand. Whereas some MNEs had just a single audit experience within either of this classification, 10 MNE respondents had been separately audited by both HMRC as well as other tax authorities within the last three years, thereby having what is herein termed ‘multiple audit experience’. The table shows that about 53% (i.e., 14 MNEs) of all audited MNEs had their TP businesses already audited by HMRC, thereby suggesting that HMRC are also active in their demand for more transparency in transfer pricing activities through their audit enquiries and investigations.⁵⁸

Table 5-1 Audit Status of Respondent MNEs based on Industrial Spread

	TP Audit Experience Status		
<u>Class of Industry</u>	NO	YES	TOTAL
Construction	-	1	1
Electricity, Gas, Steam and AC Supply	-	1	1
Financial and Insurance Activities	1	4	5
Information and Communication	3	4	7
Manufacturing	4	7	11
Mining and Quarrying (Oil & Gas)	-	1	1
Support Services (Administrative)	1	1	2
Support Services (Professional)	1	3	4
Wholesale and Retail Trade	1	4	5
Grand Total	11	26	37

⁵⁸ This is consistent with happenings around the period of administering the survey instrument. David Jetuah (2009) in the November issue of ‘Accountancy Age Tax News’ noted that there were about 1000 open transfer pricing enquiries with HMRC around the time of publication.

Table 5-1a Audit Status of Respondents' Internal Transactions based on Industrial Spread

<u>Class of Industry</u>	<u>TP Audit Experience Status</u>		<u>TOTAL</u>
	<u>NO</u>	<u>YES</u>	
Construction	-	3	3
Electricity, Gas, Steam and AC Supply	-	4	4
Financial and Insurance Activities	2	13	15
Information and Communication	10	13	23
Manufacturing	9	20	29
Mining and Quarrying (Oil & Gas)	-	2	2
Support Services (Administrative)	2	4	6
Support Services (Professional)	4	11	15
Wholesale and Retail Trade	2	14	16
Grand Total	29	84	113

Table 5-2 Audit Experience of Respondent MNEs based on Auditing Tax Authority's Classification⁵⁹

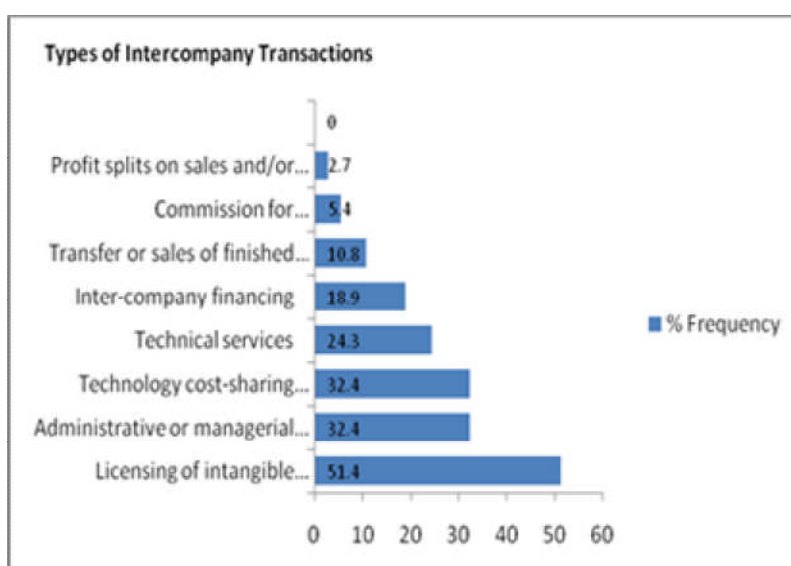
<u>Question</u>	<u>Survey Question Number.</u>	<u>Scale</u>	<u>Auditing Tax Authorities Classification</u>	<u>Number of MNEs</u>
Which country's tax authority carried out this audit?	5	Australia's ATO; Canada's CRA; UK's HMRC; US's IRS; Other(s).	AUDIT EXPERIENCE: <i>HMRC</i> <i>OTHERS</i>	14 <u>22</u> 36 - (10) = 26
			NO AUDIT EXPERIENCE	11
			Total	<u>37</u>

⁵⁹ Number of MNE Respondents with multiple audit experience = 10.

5.3.1.1 (ii) *Perceptions of Audit Vulnerable Transactions*

The TP tax audit experience of MNE respondents as revealed above served as a reliable basis on which respondents were further asked about their perceptions of what type of inter-company transactions they considered as most vulnerable to TP tax audit examination/dispute with HMRC. ‘In your experience/opinion, how *vulnerable* do you consider the following types of inter-company transactions to transfer pricing disputes with (and/or tax audit examinations from) HMRC?’ (1 = not vulnerable; 7 = highly vulnerable).⁶⁰ It is also on record by the Ernst & Young Biennial Global TP Survey that over the years, MNEs have developed reliable perceptions regarding the audit vulnerability of the various types of intercompany transactions.⁶¹ However, unlike the E&Y survey where parent companies generally viewed administrative or management services as becoming increasingly and particularly susceptible to transfer pricing disputes with tax authorities in Head Office countries, MNEs in this survey generally perceived ‘licensing of intangible property’ as particularly vulnerable to TP tax audit/dispute with HMRC. Perhaps an inclusion of this finding by E&Y in their country by country analysis could have been more useful in identifying any real difference or similarities in these two results. Figure 5-1 below is used to show the pattern of perception as reported.

Figure 5-1 MNEs’ Perceptions of Most Vulnerable Inter-Company Transactions to TP Tax Audit/Dispute with HMRC



⁶⁰ Survey Instrument Question 6.

⁶¹ See the E&Y 2007/2008 Global Transfer Pricing Survey, p. 13.

5.3.2 Rationales and Practices of Non-APA applicants: Introduction

In line with the central research question ‘Why do MNEs apply/do not apply for APAs?’, question 7 from the survey questionnaire sought first to ascertain the APA status of respondent MNEs. Documentary reports and evidence around this period showed a very low rate of uptake for the UK APA process^{62 63 64} and allowing for more taxpayers’ participation in the APA programme was at the discretion of HMRC.⁶⁵ From responses gathered, 32 respondents (representing 86% of valid responses) did not have an APA in place. Further, in recognition of the continuing effort of tax authorities to improve on the APA process in order to make it more attractive, the non-APA respondents were required to indicate whether they had any plans of applying in the next twelve months. Only three MNEs had the intention of contacting the tax authorities within the next 12 months for an APA (two MNEs to contact HMRC and one to contact the Netherlands’ tax authority). The remaining 29 MNEs, however, did not have any plans whatsoever of applying for an APA.

5.3.2.1 Rationales and Practices of Non-APA Applicants: Results

5.3.2.1 (i): *Rationales against APA*

Following the above, the non-APA respondents were asked to identify the topmost three reasons why their MNEs were not interested in negotiating an APA process at this time.⁶⁶ Consistent with prior studies in this area (see Borkowski 1993, 1996b, 2008), most of the MNEs still believed that the *cost of negotiating and sustaining an APA agreement outweighed its perceived benefit*. Table 5-3 summarizes the responses on this. Having again the issue of cost as a major deterrent to APA application tends to necessitate getting to know how much understanding tax authorities have about these costs that MNEs supposedly assume are inherent in an APA application, especially as the issue of cost/benefit has always taken prominent position in most APA debates. Also, a sizeable number of respondents did not find an APA necessary if *the volume of cross-border transactions was not large*. Still, in about

⁶² Appendix 1 shows the trend in the UK APA take-up to 2008.

⁶³ Clayson and Beeton (2010) reported that around 50-60 cases are currently in the UK’s APA programme, and that around 20 will be added annually.

⁶⁴ Only 21% of all companies surveyed in the E&Y 2007/2008 Global Transfer Pricing Survey used APAs as controversy management tools. For the UK based parent MNEs, the percentage was just 16%.

⁶⁵ At the Joint ‘International Fiscal Association/Her Majesty Revenue and Customs (i.e., IFA/HMRC) meeting of June 25, 2010’, HMRC Deputy Director of Business International and Head of Transfer Pricing Board - Melissa Tatton, explained that the Revenue was then presently looking to improving the UK APA programme.

⁶⁶ Survey Instrument Question 8.

53% of all responses, respondents cited the *volume of information/documentation required by the process* as a major deterrent to their application for an APA (Table 5-3). The significance of these responses was grounded in the extent of feedback provided by respondents. In this case, respondents returned valid response to this question in over 88% of all responses (see footnotes to Table 5-3). The results depicted in Table 5-3 cover the following.

Column 1 records the number of respondent MNEs who did not have an APA at the time of the survey. The figure in this column also represents the maximum possible frequency of occurrence for any of the rationale.

Column 2 shows the number of MNEs that nominated each rationale (i.e., how many times each rationale was nominated) as the *most important rationale* against interest in an APA.

Column 3 records the number of MNEs that nominated each rationale (i.e., how many times each rationale was nominated) as *one of the topmost three rationales* against interest in an APA.

Column 4 lists the ordinal ranking position in importance of each rationale.

Table 5-3 Most Important Rationales against Interest in an APA⁶⁷

<u>Primary Rationales against Interest in an APA</u>	Question 7(i) (Numbers)	Question 8 (Times)	Question 8 (Times)	<u>Overall Rank</u>
APA upfront and annual cost implication (in terms of time, funds and management resources) is greater than its perceived benefits.	32	14	21	1
Not enough volume of cross-border transactions.	32	8	12	2
Volume of information/documentation required by the process.	32	3	17	3
Uncertain outcome associated with APA application and negotiations.	32	3	14	4
Potential misuse of information by tax authority to trigger prior year tax audits.	32	2	10	5
Non-flexibility in adjusting transfer pricing policy once APA is agreed.	32	-	6	6
Confidentiality problems with materials submitted to the tax authority.	32	-	3	7
Not available in own key jurisdictions on a bilateral/multilateral basis.	32	1	1	8
No need for aggressive tax reduction strategy.	32	1	1	8
Total Number of Responses		<u>32</u>	<u>85</u>	

5.3.2.1 (ii): Possible consideration for APA in Future

When also asked to indicate which factors were likely to affect their decision to apply for an APA in the next 12 months, the results (see Table 5-4) indicated some positive but not

⁶⁷ Total expected number of response for this question is 96 (i.e. 32 * 3). However, 85 responses were generated thereby providing an 88% response rate.

dominant possibility of MNEs changing their mind on an APA in the near future. A substantial portion (respectively 36% and 33%) was likely to consider applying for an APA if either ‘a change in existing tax treatment was effected by the relevant tax authority’ or more especially ‘they found a need to avoid double tax and penalties’. The possibility of giving an APA application a second thought based on other reasons ranged from 7% (Need to avoid negative publicity by the MNE) to 29% (Need to resolve a tax authority’s open transfer pricing dispute). These findings offered evidence that respondents still attached high importance to those factors which they considered as deterrents to their application for an APA. In fact one particular respondent stated clearly that the MNE ‘would only consider an APA only if there was a specific local legal requirement for such in a country of its operation’. Yet another respondent did not believe any factor could affect the MNE decision to consider an APA application.

Table 5-4 Factors That May Affect Decision to Apply for an APA in the Next Twelve Months

	Very Unlikely	Unlikely	Likely	Very Likely	Total ⁶⁸
(a) Changes in existing tax treatment by tax authority.	28%	36%	32%	4%	28
(b) Need to develop a representative arm’s length outcome on a fact pattern basis to be repeated in other countries.	28%	61%	11%	0%	28
(c) Need to avoid exposure to double tax and penalties.	28%	39%	25%	8%	28
(d) Need to resolve an open tax authority’s transfer pricing disputes.	35%	36%	25%	4%	28
(e) Need to regain good working relationship with tax authority in the event of your MNE experiencing tax audit examination.	43%	43%	14%	0%	28
(f) Need to maximize post-tax profitability as a Group.	57%	32%	11%	0%	28
(g) Need to avoid negative publicity.	61%	32%	7%	0%	28
(h) <i>Others</i> : Specific local requirement for an APA in country of operation.	0%	0%	0%	100%	1

⁶⁸ This consisted of the 29 MNEs who did not have any plans whatsoever of applying for an APA. One MNE did not respond to any of the factors as capable of affecting its decision to apply for an APA in the next 12 months.

5.3.2.1 (iii): *Transfer Pricing Methodology Practices*

Given the large disparity in the category of APA and non-APA respondent MNEs, there was a large difference in the number of transactions apparently dealt in by each of this class of respondents. Non-APA MNEs covered 95 of the 113 transactions reported by all respondents. This, however, entailed the four broad types of transactions suggested as shown in Table 5-5 below.

Table 5-5 Different Types of Transactions Covered by Non-APA MNEs

Types of Transactions	Numbers
Tangibles	15
Intangibles	17
Services	32
Financial Transactions	31
Total	<u>95</u>

In line with this, the survey instrument sought to identify the primary TP methodology typically adopted by non-APA users for these different types of transactions, and the number of transactions covered under each of the suggested methodology is presented in Table 5-6. Two TP methods apparently stood out as the most often used for internal transfers by this class of MNEs. The Comparable Uncontrolled Price (CUP) method and the Cost-Plus Method were the two most popular from the results gathered as shown below in Table 5-6. The total number of instances reported for each class of transactions, however, suggests that MNEs did use a combination of methods for similar class of transactions (see footnote to Table 5-6).

Table 5-6 Number of Internal Transactions Covered by Each TP Method

Comparable Uncontrolled Price (CUP) Method	50
Resale Price/Resale Minus Method	2
Cost Plus Method	31
Profit Split Method	11
Transactional Net Margin Method	8
Other Methods: Please specify	
Market Rates/Arm's Length Rates	5
Cost contribution Arrangement	1
Total Number Of Transactions For Each Category	<u>108⁶⁹</u>

⁶⁹ Multiple methodology transactions = 14; No response = 1.

5.3.3 Rationales and Practices of APA Applicants

Along with the questions for non-APA applicants, respondents that had or were already into an APA negotiation were asked to also identify their APA status.⁷⁰ Responses to questions under this section were limited. The reported frequencies in Tables 5-7 to 5-9 cannot be said to be enough for any meaningful conclusion, but it is considered informative to present a summarised table of responses collated for these few respondents. This is because such information on an APA cannot be considered totally irrelevant, given the very small number of total APA agreements in force in the UK itself at the time of the survey (see Appendix 1). Of all the 37 responses obtained, only five MNEs had either currently reached an agreement or were in negotiation for an APA. Table 5-7 gives the spread of the frequencies for the APA respondents.

Table 5-7 APA Status of Respondent MNEs

APA Status	Number
MNEs in APA	5
MNEs with Unilateral APAs	3
MNEs with Bilateral APAs	3
MNEs with both Unilateral and Bilateral/Multilateral APAs	1
Number of APA agreements covered	9 ⁷¹
Number of Unilateral APAs	4
Number of Bilateral/Multilateral APAs	5

Question 12 from the survey instrument sought to identify the kinds of inter-company transactions that were covered under these APA agreements and the results are given in Table 5-8.

⁷⁰ Survey Instrument Question 7(ii).

⁷¹ Survey Instrument Question 11.

Table 5-8 Inter-company Transactions Covered in APA Agreements

Transactions under Unilateral APA	Number
Licensing of intangible property	2
Administrative or managerial services	4
Technology cost-sharing agreements	1
Transfer or sales of finished goods for resale	3
Sales of raw materials or components between group companies	1
Technical services	2
Investment management services	1
Total	<u>14</u>

Obviously, with the most frequent reason for negotiating an APA agreement hinging on the fact that APA guarantees that the use of the agreed upon transfer pricing method will not trigger an audit, thereby ensuring tax treatment certainty to the taxpayer, respondents were asked to identify the most important rationales underlying their application for a specific APA.⁷² As expected, the common reasons for seeking an APA by MNE taxpayers concerned the generally espoused advantage of ‘certainty’ as opposed to other beneficial features associated with an APA. Within this context was meant ‘*certainty on existing tax treatment (avoiding adjustments)*’ and ‘*certainty of avoiding TP tax audit examination*’ (see Table 5-9). These reasons did not, however, differ on the basis of the type of APA involved as all respondents identified the same reason for seeking both a unilateral and a bilateral/multilateral APA where they had both agreements in place.

Table 5-9 Most Important Rationales for Making APA Applications by MNEs

Most Important Rationales for Applying for an APA	Number of MNEs
(a) To avoid tax audit examination and its attendant time and cost implications	2
(b) To obtain greater certainty on existing tax treatment by tax authority	2
(c) To get group consent to pay group charges	1

⁷² Survey Instrument Question 13.

5.3.4 Evaluation of the Current APA Process

In an effort to obtain a user-perspective evaluation of the UK APA programme, the survey instrument included questions on the extent to which the current APA agreements in place were able to achieve preset objectives within the last two years.⁷³ Respondents were asked to indicate an applicable rating for each of the topmost rationale already stated under question 13 (1 = not effective; 7 = very effective). However, only three of the five APA applicants already had an APA in place with just one of them having to deal with HMRC. The other two had their APAs with other countries' tax authorities. In addition, the remaining two APA applicants in the sample were still in the negotiation process. The mean rating of all three MNEs who already had completed APA agreements in place was seven (very effective) for the three topmost rationales behind their application for the APA under consideration. The average length of time taken to negotiate unilateral APAs was given as 'less than 12 months' while that of a bilateral was reported as 'more than 24 months'.

5.3.4.1 Usefulness of an APA for Different Types of Cross-Border Transactions

On a general note, the usefulness of an APA for different types of transactions was assessed from the views of the two categories of respondents, i.e., APA applicants and non-applicants. For each type of transactions, MNEs were required to rate how beneficial they thought an APA agreement was (with 1 = not beneficial and 7 = highly beneficial).⁷⁴ A substantial portion of all respondents (54%) thought that an APA was beneficial for intangibles more than any other type of transactions (see Table 5-10 below). More particularly, for the non-APA user respondents, 59% of them thought that an APA gave more benefit when intangibles were covered as opposed to other types of transactions. The collective perception of MNE respondents regarding the usefulness of an APA for intangibles appeared to be significantly related to HMRC's belief as illustrated in their '*Guidelines for the conduct of Transfer pricing enquiries - p. 10, paragraph 35*' where cases involving transactions relating to the use of intellectual property or other intangibles are considered as indicators of complex TP issue⁷⁵ thereby attracting more in-depth TP enquiries/audits.

⁷³ Survey Instrument Question 14.

⁷⁴ Survey Instrument Question 17.

⁷⁵ HMRC SP 2/10 also stated in paragraph 14 that they will be looking for complex rather than straightforward cases in consideration of APA applications.

Table 5-10 APA Benefits for Various Types of Transactions

Transaction Type	Not Beneficial 1	2	3	4	5	6	Highly Beneficial 7	No Response	Total MNEs
APA Applicants									
Tangibles	-	-	-	20%	-	20%	20%	40%	5
Intangibles	-	-	-	40%	-	-	20%	40%	5
Services	-	20%	-	20%	-	-	20%	40%	5
Financial Transactions	-	20%	-	20%	-	-	-	60%	5
Non-APA Applicants									
Tangibles	6%	22%	6%	34%	13%	6%	-	13%	32
Intangibles	-	6%	13%	9%	31%	25%	3%	13%	32
Services	-	16%	18%	21%	16%	16%	-	13%	32
Financial Transactions	-	22%	19%	28%	9%	9%	-	13%	32
All Respondents									
Tangibles	5%	19%	5%	33%	11%	8%	3%	16%	37
Intangibles	-	5%	11%	14%	27%	22%	5%	16%	37
Services	-	16%	16%	21%	14%	14%	3%	16%	37
Financial Transactions	-	22%	16%	27%	8%	8%	-	19%	37

5.4 Questionnaire Survey - Bivariate Results

As stated in Section 5.3.1, it seemed logical that MNEs would pursue APAs as a means of reducing their risk of an audit triggered by transfer pricing policies, given the stiff penalties in place for any TP adjustment that HMRC in the UK may deem applicable. This is implying that the incidences of TP tax audit adjustments either already or being presently experienced by respondent MNEs and their underlying inter-company transactions should bear a relationship with MNEs' consideration for an APA process. Such experiences were expected to influence positively MNEs' application for APAs so as to minimize their TP audit risks either at present or in the near future (i.e., 12 months' time). Given that the general intent of the APA process is to provide tax treatment certainty for taxpayers dealing in inter-company transfers (SP2/10, paragraph 2), analyzing the relationship between respondent MNEs' prior audit experience

and their consideration for APAs was considered essential in the assessment of the APA process.

5.4.1 TP Audit Experience relationship with APA Applications by MNEs

Tables 5-11 to 5-13 together with the accompanying narratives help to summarize the relationship between these variables of interest.

Table 5-11 MNEs' Prior Audit Experience and Their APA Status

APA by Audit Status:	MNEs	Fisher's Index	Transactions	Fisher's Index
Total Audited	26 (70%)	-	84 (74%)	-
Total Non-Audited	11 (30%)	-	29 (26%)	-
Total Audited : APA Applic.	26:3	0.623	84:18	0.396
HMRC Audited : APA Applic.	14:0	0.267	-	-
Other T. A. Audited : APA Appl.	23: 3	0.267	-	-

Table 5-12 MNEs' Prior Audit Experience and Plan for APAs

Alternative Dispute Resolution (ADR):	MNEs	Fisher's Index	Transactions	Fisher's Index
Total Audited: Planned APA Application.	26:2 (8%)	-	84:7 (8%)	-
Non-APA Audited : Planned APA Appl.	23:2 (9%)	1.000	72:7 (10%)	1.000
HMRC Audited : Plans for APA	14:1 (8%)	1.000	-	-

Table 5-13 APA and Audit Status for Types of Internal Transactions

APA Status	Types of Cross-border/Domestic Internal Transactions				
	<u>Tangible</u>	<u>Intangibles</u>	<u>Services</u>	<u>Financial Transactions</u>	Total
APA Applicants (Agreed) - <i>All Audited</i>	3	3	3	3	12
APA Applicants (Negotiating) - <i>All Non-Audited</i>	1	1	2	2	6
APA Non-Applicants but plan to apply within 12 months:					
<i>Audited</i>	1	2	2	2	7
<i>Non-Audited</i>	-	-	1	1	2
APA Non-Applicants - <i>No Audit</i>	4	2	8	7	21
APA Non-Applicants - <i>Audited</i>	10	13	21	21	65
Total	19	21	37	36	113

Company Level Analysis:

- Out of the 37 respondent MNEs in the study, a total of 26 MNEs had experienced TP audit either from HMRC or other tax authorities in the last three years (Table 5-11, i.e., Total Audited).
- Of these 26 MNEs (i.e., 70% of total respondents), only 2 companies (7%) planned to contact the tax authority for an APA application in twelve months' time (Table 5-12, i.e., Total Audited : Planned APA Application)
- While 53% (i.e., 14 MNEs) of these audited MNEs have their TP businesses audited by HMRC, none of them had an APA or any APA negotiation pending with them (Table 5-11, i.e., HMRC Audited : APA Application). However, 1 MNE planned to contact HMRC in 12 months for an APA (i.e., HMRC : Plans for APA) while the rest had no plan at all for an APA (Table 5-12).
- On the other hand, 88% (i.e., 23 MNEs) of the audited MNEs had their TP audits carried out by tax authorities other than HMRC. Among these, only 3 MNEs (13%) applied for an APA (Table 5-11, i.e., Other T.A. Audited : Plans for APA). Perhaps the remaining 20 MNEs were adopting more attractive procedural applications in dealing with TP audit incidences.

Transaction Level Analysis:

- The 37 respondent MNEs covered 113 transactions in total (Table 5-13). For these 113 transactions, 74% (i.e., 84 transactions) were subjected to TP audit in the last three years (Table 5-11, i.e., Total Audited).
- Only 12 out of the 84 previously audited transactions were involved in APA agreements (Table 5-13, row 1). These 12 transactions were all subjected to TP tax audit by other tax authorities. Another 6 transactions presently involved in subsisting APA negotiations were never subjected to any form of TP audit in the last three years (Table 5-13, row 2).

- The 29 MNEs who had no plan whatsoever for APA had 86 transactions being covered by their activities (Table 5-13, row 4 and 5 total). However, 76% of these (i.e., 65 transactions – Table 5-13, row 5) were subjected to TP audit by either HMRC or other tax authorities. Still they did not find any use for an APA in whatever form.

The statistical test of association depicted in Tables 5-11 and 5-12 above revealed a ‘no significant association’ between the prior TP tax audit experience of respondents and their application for the APA programme. The direct interpretation of the above summary will be to suggest that previous TP tax audit experience does not seem to trigger APA application by MNEs.

5.4.2 APA and Audit Vulnerable Transactions

Table 5-9 above showed that among the APA user-MNEs, gaining certainty on their transfer prices ranked as the most important rationale behind their consideration of an APA programme. On the one hand, it was expected that an APA will help to ensure certainty on existing tax treatment by addressing the inconsistent interpretations and enforcement of TP rules both in the UK and other countries. On the other hand, such certainty was also expected to help avoid tax audit examination and its attendant time and cost implications. This suggests that most MNEs would be willing to employ the APA process to guard against uncertainties related to perceived audit vulnerable transactions as reported in Figure 5-1 above. However, Table 5-14 below did not show evidence of this. Rather, the pattern of the reported figures seemed to corroborate further the no-association pattern already reported between audit experiences of MNEs on inter-company transfers and their (i.e., MNEs’) consideration for APA application.

Table 5-14 APA Consideration for Audit Vulnerable Transactions

Most Vulnerable Inter-company Transactions	Number of APA Applicants in Agreement	Number of times in APA Agreements
Licensing of Intangible property	4	2
Administrative or managerial services	1	4
Technology cost-sharing agreements	2	1

The reported figures in Table 5-14 were not supportive of the logical expectation that MNEs will apply for APAs to cover transactions which their tax managers perceive as of high vulnerability to tax audit investigation, hence another attempt was made to examine the significance of the ‘rationales against APA application’. Here, an effort was made to determine which of the rationales already reported in Table 5-3 were also identified as being responsible for MNEs’ non-consideration of APAs, even for the most commonly perceived audit-vulnerable transactions. This analysis of association was as shown in Table 5-15.

Consistent with the results in Table 5-3, the most noted rationale against APA consideration was still confirmed even for the transactions most perceived as vulnerable to audit. The cost of APAs, as perceived by the MNEs, as well as the insufficient volume of cross-border transactions both remained as the most common rationale against consideration of APAs for audit vulnerable transactions.

Table 5-15 Rationale against APA Consideration for Audit Vulnerable Transactions

Rationales	Licensing of intangible property	Administrative or managerial services	Technology cost-sharing agreements	Total Frequency for Rationales
Volume of information and/or documentation required by the process.	-	1	-	1
APA upfront and annual cost implication (in terms of time, funds and management resources) is greater than its perceived benefits.	6	4	4	14
Potential misuse of information by tax authority to trigger prior year tax audits.	1	1	1	3
Uncertain outcome associated with APA application and negotiations.	1	2		3
Other (<i>Please state</i>): (1) <i>Not enough volume of cross-border transactions.</i>	8	3	5	16
	<u>16</u>	<u>11</u>	<u>10</u>	<u>37</u>

5.4.3 TP Audit Approach

From the above, the expectation that respondent MNEs' audit risk should be associated with, and by extension, would be a catalyst for, MNEs to develop an interest in the APA process was not borne out from the reported results. However, the no-association reported between these two variables in the survey gave room to inquire about the pattern of the tax authorities' audit approach as an influencing factor. Hence, focus was given to the primary TP methodology typically adopted by non-APA users for different types of transactions and the audit status of such transactions within the last three years. From Table 5-16 below, non-APA user MNEs on average adopted a single transfer pricing method for each type of transaction in over 80% of all instances. However, such consistent judgement calls on the choice of TP methods were largely associated with tax audit examinations (i.e., over 70% of all types of transactions were in this category). Moreover, the calculated proportion of audited single-methodology-treated transactions to that of non-audited for same class of transactions was 76% : 24% (Table 5-16 inference).

A second focus adopted in assessing the TP audit approach of tax authorities was by looking at the relationship between the size of MNEs' intra-firm transfers and the number of audit experiences they have witnessed in the last three years. The presumption here is that if firms use transfer pricing to minimize ultimate tax liability as commonly claimed, then MNEs with the greatest volume of intra-group transfers have the most opportunities and the greatest incentives to shift income (see Jacob, 1996). Thus, tax authorities' efforts should be more prominent in these types of companies in form of TP tax audit enquiries and investigations. Table 5-17 summarizes the findings in this area. Seventy percent (70%) of respondent MNEs had between 0 and 25% of total general transactions of their organization as internal transfers among different units of the company. Twenty seven percent (27%) of the sample had above 25% as internal transfers and 3% did not answer the question. The reported pattern here was, however, contrary to this researcher's logical proposition.

Table 5-16 TP Methods Adopted By Non-APA User MNEs for Transaction Categories

Transaction types with Audit Status	Tangible Transfers		Intangible Transfers		Services		Financial Transactions	
	<i><u>Audited</u></i>	<i><u>Non Aud.</u></i>	<i><u>Audited</u></i>	<i><u>Non Aud.</u></i>	<i><u>Audited</u></i>	<i><u>Non Aud.</u></i>	<i><u>Audited</u></i>	<i><u>Non Aud.</u></i>
Traditional Transaction Methods	55%	20%	47%	12%	58%	22%	63%	20%
Transactional Profit Methods	15%	10%	41%	0%	17%	3%	14%	3%
Total Transaction	14 + 6 = <u>20</u>		15 + 2 = <u>17</u>		27 + 9 = <u>36</u>		27 + 8 = <u>35</u>	
Multiple Methods for Tangibles: <i>Audited = 3</i> <i>Non-Audited = 2</i>					Multiple Methods for Intangibles: <i>Audited = 1</i> <i>Non-Audited = 0</i>			
Multiple for Services: <i>Audited = 4</i> <i>Non-Audited = 0</i>					Multiple for Financial Transactions: <i>Audited = 4</i> <i>Non-Audited = 0</i>			
No Response- Intangible=1								

N.B. - Actual total number of transactions = 108 – 13 (i.e., multiple TP transactions) = 95. This is the same as total transactions less APA covered transactions, i.e., 113 – 18=95.

For the MNEs which had experienced more audit investigations, there was a higher percentage (46%) of those with lower intra-group transfers involved as opposed to only 30% of MNEs with higher proportion on intra-group transfers. This basically makes no difference if an analysis is considered in absolute terms (see Table 5-17 below).

Table 5-17 Number of Audit Experience of MNEs for Different Size of Intra-Group Transfers

	Relative Proportion Of Internal Transactions (Internal Transfers) To Total Transactions Within MNEs			
	<i><u>0-25%</u></i>	<i><u>Above 25%</u></i>	<i><u>No Response</u></i>	<i><u>Total</u></i>
<u>TP Audit Experience</u>				
Single Audit Experience: <i>UK HMRC</i>	12%	-		3
<i>Other(s)</i>	15%	40%		+ 8 = 11
Multiple Audit Experience: <i>HMRC and Others</i>	34%	20%		11
<i>Others Only</i>	12%	10%		+ 4 = 15
No Audit Experience	27%	30%	100%	11
<i>Total</i>	<u>26</u>	<u>10</u>	<u>1</u>	<u>37</u>

5.5 Questionnaire Survey - Discussion

The very low number of APA applicants as reported in the results from the survey, as well as the small size of the overall sample, only provided limited evidence for the analyses of the intended relationships. Nevertheless, the analysis carried out on the small sample obtained produced enough evidence for further investigation. Within the basic principles of statistical sampling, it is allowed to a degree to draw possible conclusions about a large population based on these sorts of small samples (Lowry, 2008). However, in this case, the necessary assumptions and the expected degree of statistical confidence needed were not evident in the survey data analyzed up to this point. Rather, an effort was made to consider all findings together on a simultaneous basis. On the basis of the central research question being investigated, the pattern of reported results revealed some important themes that can be further considered in order to allow for a more coordinated and rounded assessment of the APA process.

5.5.1 Cost and Benefit

This represents the first and central theme of the survey analyses. For more than a decade now, different surveys have consistently reported the views of taxpayers that the cost of APA (both initially and annually) is greater than its perceived benefit (Borkowski, 1993; 1996b; 2008). This concern was again evidenced in the results from the survey (see Tables 5-3 and 5-16). Some of the obvious direct costs were reported to include professional fees and expert opinions as well as the cost of staff to produce the necessary documentation. Leading tax authorities in TP and APA regulations such as the US Internal Revenue Service (IRS), Australia Tax Office (ATO) and Canada Revenue Agency (CRA) all make different efforts in minimizing these costs, especially in terms of time duration for completing APA negotiations and agreements. Specifically, HMRC stated in its International Manual (INTM422090) that it aims to complete APAs within 18 – 21 months from the date of formal submission. Despite this, the MNEs covered in this survey still referenced ‘high APA cost’ as the main deterrent to making APA applications. This continuing concern therefore encouraged the researcher to consider whether the APA costs cited by MNEs are so great and whether there may be some discrepancy in the definition of cost and benefits of an APA between the tax authorities and MNE taxpayers. Also of interest is an understanding of what are the internal and external costs that MNEs assume. Perhaps the more the tax authorities are able to understand about these costs in their cost-minimization efforts, the better. Moreover, our understanding of whether

MNEs recognize the relevant costs and benefits where necessary could be aided when this theme is further considered together with the other themes under consideration in this study.

5.5.2 Transfer Pricing Audit Experience Relationship with APA Applications

As many business operations carried out within regulated business environments always require certain degree of certainty in managing their tax, the MNEs in the survey sample would have a similar need given that they carry out their businesses within the UK (which is a regulated economy). Moreover, the high demand of transparency in environments such as the UK necessitates the prevalence of potential audit risks and exposure and this obviously is one of the main problems APAs are meant to address. Tables 5-16 and 5-17 seemingly indicated that MNEs faced several transfer pricing examinations possibly going on at the same time at different stages of development which were being carried out according to different national rules. Besides, the results from Table 5-11 revealed a situation where none of the MNEs previously audited by HMRC had applied for an APA or even had a pending APA negotiation. This and other results (see Tables 5-12, 5-13 and 5-15) clearly suggest that previous TP audit experience does not seem to trigger an APA application. MNEs seemed to be content with their TP audit hassles as compared with applying for an APA to cover such uncertainties, even with the chances of subsequent adverse audits and related possibilities of adjustment. If we therefore consider the cost justification for no interest in APAs as shown under section 5.5.1, it is pertinent to consider whether the costs of TP audits to an MNE are significantly outweighed by that of an APA. Besides, recent developments around the time of the survey were highlighting the convergence of global fiscal forces to create more challenging tax environments for MNEs.⁷⁶ Hence, it was considered relevant to investigate how the new position of different tax authorities on multi-country coordinated audits and simultaneous examination will impact on the reported association (relationship) between APA and TP audits. Further, as such cooperative efforts would possibly increase information sharing among tax authorities, it would be helpful to know whether, on the one hand, this would change the views of MNEs on this cost relationship, or on the other hand, this would just rather change views on the individual cost implication of both the APA process and TP audit

⁷⁶ The PwC 'International Transfer Pricing Report, 2011' reported the Australian Tax Office (ATO) to have had such cooperation with foreign revenue authorities - 'The ATO and overseas revenue authorities share information that might be relevant to particular industries or transaction types. Specifically in its 2007-2008 compliance programme, the ATO stated that it completed 874 "exchange of information" requests with treaty partners during the 2005-2007. This has led to a number of simultaneous audits of taxpayers in multiple jurisdictions' (p. 228).

cost as against the association between both. With these issues in mind, an open consideration for this researcher at this point was to identify what role MNEs actually think APAs could play in dealing with this challenge even when the major deterrents to applying for one are acknowledged. Also, what form of reactions would TP audits trigger in MNEs aside from considerations for an APA?

5.5.3 Alternative Dispute Resolution (ADR) Methods Available to MNEs

The lack of evidence in popularity of the APA programme with MNEs in the survey sample gave room for the explanation that other ADR options were utilized by companies to settle their TP tax dispute and associated uncertainties. From Table 5-12, only one of 14 MNEs (i.e., 8%) with prior HMRC audit experience in the last three years had a plan to apply for an APA in the next 12 months. The larger picture showed over 70% of the sample was audited in the last three years for TP cases (Table 5-11). This suggests the possible existence of outstanding TP audit issues for most MNEs to settle with tax authorities. This possibility that MNEs may be using other ADRs in lieu of APAs in handling their TP audit risks is reinforced if consideration was given to the spread of transactions considered for APA. Such ADR may include other TP dispute settling procedures such as administrative appeals, competent authority matters (mutual agreement procedure (MAP) or litigation assistance.

From the responses gathered, only an average of 10% of previously audited transactions which were dealt in by respondent MNEs was proposed to be covered under an APA agreement in the next twelve months (Table 5-12). With this scenario, it was worth considering whether MNEs perceived ADR methods as less costly than APAs in settling outstanding TP audits where necessary. Also, by having over 90% of the audited non-APA MNEs in the survey sample as neither having nor planning to negotiate an APA, the researcher thought it would be richly informative if more light could be shed on any form of relationship that MNEs may maintain with relevant tax organs such as HMRC International Division, and which might tend to negate any dire need for an APA. In addition, how well these arrangements, if any, work in practice was considered as information that would be very helpful to others.

5.5.4 Complexity of MNEs' TP Cases

HMRC information section on APAs stated that 'APAs are intended to offer assistance in resolving complex transfer pricing issues. In the absence of significant doubt as to the manner

in which the arm's length principle should be applied, APA negotiations are not a sensible use of resources. HMRC may, therefore, decline to accept applications that do not satisfy a complexity threshold'.⁷⁷ Thus, complexity of TP cases constitute the primary consideration for acceptance of an APA application with HMRC as at the time of this survey. However, only prescriptive but no definitive or exhaustive meaning of what constitutes a complex transfer pricing issue was given within the available guidelines. The satisfaction of the complexity threshold was only related to where there is significant doubt as to the manner in which the arm's length principle should be applied (HMRC's 2007 consultative document on approach to Transfer pricing for large businesses).⁷⁸ Again, HMRC's (2008) Guidelines for the conduct of transfer pricing enquiries only discussed the idea of 'complexity' within the context of drawing the 'Enquiry time tables and Action plans'. Here, the level of complexity of a case will need to be gauged by reference to both *procedural elements of the enquiry* that will affect the ability of HMRC to meet its expected normal timescale and the *nature of the transactions under consideration*. This section gave 'intangibles' among others as illustrations of possible indicators of complexity.

This situation thus suggests the need to identify any convergence in perceptions of complexity between MNE taxpayers and the tax authority. The researcher's belief here is that such an effort would help to clarify how both the MNEs and HMRC interpret complex TP cases.

If complexity is related to TP methodology only as stated above, then Table 5-16 above gives some relevant insights. For the MNEs which adopted more of the transactional profit TP methods for each type of transactions, there was a relatively larger proportion of them being associated with previous TP audits than for those which have adopted the traditional transaction TP methods. In the case of intangibles, all MNEs which adopted the transactional profit TP methods were audited. It therefore begs the question of whether the larger incidence of TP audits of the transactional profit methods imply that HMRC regard them as more complex than the traditional transactional TP methods; or is it a case of HMRC just having

⁷⁷ The final version of the new 'Statement of Practice' on APA (SP2/10) released by HMRC in December 2010 has, however, lowered the threshold for applying for an APA with the UK tax authority such that not only complex cases are covered but also cases where there is a high likelihood of double taxation arising without an APA, or where the taxpayer is seeking to apply an innovative transfer pricing method, for example.

⁷⁸ An attempt to define what complexity is to the tax authority even in the new SP (SP2/10) seems to bear a generic description. To HMRC, 'complex means there is doubt as to how the arm's length standard should be applied'.

preference for the traditional transaction TP methods in the past before the OECD new guidance on the selection of the most appropriate transfer pricing method to the circumstances of the case?⁷⁹ In any of these cases, the researcher considered it useful to determine if HMRC regard some methods as more complex than the others.

On the other hand, over 51% of MNEs in the survey regarded intangibles (i.e., licensing of intangible property and technology cost-sharing agreements) as highly vulnerable to TP tax audits/disputes (see Figure 5-1 in Section 5.3.1.1). What is not known is whether they regard these kinds of transactions as particularly complex or even more complex than services and/or financial transactions. With this level of perception, would vulnerability then translate to the global adoption of a similar kind of TP method for ‘licensing of intangible properties’ (or other types of intangibles) in all the company’s businesses? With HMRC, is the adoption of a similar TP method for same type of transaction a better defence on the part of the MNE instead of adopting multiple methods for such? The data in Table 5-16 do not seem to support such a proposition. For example, only one of the MNEs in the survey adopted more than one TP method for intangible transfers (Table 5-16 above). This seems to suggest that less trouble is encountered by these taxpayers in determining definite transfer prices of intangibles. However, there is still the need to determine how clear MNEs regard the guidelines that they follow in determining how to assess the most appropriate TP method for their organizations. This is because in other cases where they have adopted only a single TP methodology for each type of transactions, they still experienced considerable incidence of TP tax audit in the past (Table 5-16). This is in contrast to prior surveys where MNEs adopting particular kind of TP methods were reported to be less likely to have TP related problems with tax authorities (Borkowski, 1996b). On the other hand, getting to know why MNEs adopt different TP methods for same types of transactions in the same company should help to explain the sort of challenges MNEs face when attempting to determine transfer prices for these kinds of inter-company transactions. This should help to shed more light on the views about complexity.

⁷⁹ On July 22nd 2010, the OECD Council approved the 2010 version of the ‘Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations’. Chapter I-III of these TP Guidelines, which were substantially revised, included new guidance on the selection of the transfer pricing method most appropriate to the circumstances of the case, the practical application of transactional profit methods (the transactional net margin method and the profit split method) and the performance of comparability analyses. The 1995 TP Guidelines, which was effective before this time, had expressed an explicit preference for traditional transaction methods over the transactional profits methods. This hierarchy for TP methods previously adopted in the 1995 TP Guidelines was replaced in the 2010 version by the adoption of ‘most appropriate method to the circumstances of the case’ principle for the selection of transfer pricing method.

5.5.5 Risk Assessment

The theme of risk assessment played out in this survey when regard was given to the link between what the experiences and beliefs of MNEs were, and what their actions had been. In Figure 5-1, over 51% of MNEs perceived ‘licensing of intangible property’ as most vulnerable inter-company transactions to TP audit/dispute. Table 5-12 further revealed that 59% of non-APA MNEs also agreed that an APA is beneficial when employed to cover this class of transactions, i.e., intangibles. This researcher found it interesting that even when their experiences and beliefs tallied as to the usefulness of an APA to guard against TP risk, MNEs were still not interested in the process.

Of interest therefore is whether the APA advice available to MNEs on intangibles is sufficiently clear so as to encourage APA application. With the amount of information requested for an APA application, it will be useful to know how MNEs seek to manage the inherent cost and risk of disclosing sensitive information once an APA is being examined and/or renewed. Further, for any amount and sensitivity of information that may have already been provided to the Revenue, how easy is it for MNEs to stop an APA process? Also, where an APA is being stopped, the ways by which MNEs manage the implications of HMRC’s alternative interpretations of such discontinuation is worth examining.

5.5.6 Volume and Size of MNEs’ Cross-border Transactions

This theme was examined as an indication of ‘materiality’ of TP transactions of MNEs. Despite being an open response option, MNEs in the survey cited ‘Not enough volume of cross-border transactions’ either as sole rationale or in conjunction with other rationales as the reason for no interest in APA in more than 37% of all responses (Table 5-3). However, over 33% of MNEs in this class had nevertheless experienced prior TP tax audit in the last three years but only 8% of them (though non-audited) planned to negotiate an APA within the next 12 months.

Within Section 166 of the *Taxation (International and Other Provisions) Act (TIOPA) 2010*, there are provisions in place which exempt from transfer pricing rules a vast majority of transactions carried out by a business that is a small or medium-sized enterprise. This appears as a conscious effort by HMRC to ensure maximization of resources expendable on TP issues. The survey results, however, seemed to reveal a different group of companies of which a

significant portion was exposed to TP audit risk. These were large ‘non-dormant companies with small related party transactions’. The definition of small or medium-sized enterprise in the Act appears to remove from consideration from TP rules those companies with small and simple related-party transactions. While HMRC made it clear that applications for APAs will not be declined solely by reference to the size of the transactions giving rise to the transfer pricing issue (Paragraph 15 - HMRC Statement of Practice on APA SP2/10), it was deemed as more effort-worthy to identify any consistencies and/or inconsistencies between the claims of HMRC and the real experience of the MNE taxpayers with the UK tax authority. In terms of how ‘volume’ is understood, it is pertinent to examine any possible differences between how MNEs interpret ‘volume’ as opposed to how they perceived HMRC to interpret ‘volume’. If the physical volume is not influential in a TP audit, is it the value, potential future value or volume, % of all transactions, industry specificity or even the type of transaction involved that is perceived to be influential here? More importantly though is whether the required information should be restricted when complex low-volume transactions are the focus of an APA so as to encourage participation by more MNEs. The researcher considered that by seeking to bring to the fore the inherent usefulness of an APA for those categories of businesses which hinged their lack of interest in APAs mainly on the volume of their intra-group transactions, a better evaluation of the process could be achieved.

A second consideration for this theme largely evolved from a more theoretical focus rather than just a consideration for fiscal provisions. In addressing the ‘prior TP audit experience of MNEs in the survey sample’ as an important variable in the evaluation of the APA process, the association between two variables was considered. It was considered relevant to identify any relationship between the volume (size) of intra-firm transfers within MNEs and the number of audit investigations which such MNEs had experienced. The APA programme is typically a policy instrument against potential TP disputes that may arise between tax authorities and taxpayers during TP tax investigations; and such investigations are usually carried out by tax authorities in order to curtail opportunities for shifting income using transfer prices. Against this background, tax authorities should tend to audit more MNEs with large intra-group cross-border transactions, given that the opportunity to shift income using transfer prices appears to be greatest for firms with sizeable transfers (greatest volume of transfers) between regions (Jacob, 1996). In other words, if firms use transfer pricing to minimize taxes, then MNEs with the greatest volume of intra-group transfers have the most opportunities and

the greatest incentives to shift income. It was therefore expected that tax authorities' efforts should be more prominent in these types of companies in the form of TP tax audit enquiries and investigations. The patterns reported from the survey, however, did not justify this proposition. Table 5-17 revealed that a higher percentage (46%) of the MNEs with a lower proportion of intra-group transfers had experienced a higher number of TP audit investigations in the last three years compared with only 30% of MNEs with a higher proportion of intra-group transfers. This seemed to suggest that the pattern of TP scrutiny by tax authorities may be more transaction-specific rather than that of volume (size) consideration. With this suggested HMRC's approach to TP audit, as implied by this revelation, not apparently different from the general pattern shown in this survey, it seemed that HMRC's approach to its transfer pricing review processes is more of a random scrutiny rather than that of a theoretically informed structure. How this approach could have helped to trigger more APA participation is not clear as it can be argued that HMRC may be employing its TP tax audit exercises as a substitute for APA agreements.

The above discussed themes were used to provide a basis for the second data collection stage so as to provide a clearer path for conclusion in the evaluation of the APA process. These six themes allowed for further qualitative enquiries to be carried out in form of interviews. The interviews were used to explore further the issues that emerged under each of the themes above.

5.6 The Second Methodological Strategy (Interviews)

The second stage of data collection in this project was recorded interviews. These interviews were intended to look more at the APA as a process as well as further explore the previously identified themes that emerged from the survey data. The researcher also saw these exercises as a potential way capable of generating possible hypotheses about the APA process for which a more rigorous positive research approach could be taken in the future.

Following the complete analyses of the questionnaire survey data, three tax directors were interviewed: two face to face interviews and one telephone interview were recorded. The first interviewee was the tax director of a manufacturing MNE (Interviewee 1), the second one was

the tax director of an oil, equipment, services and distribution MNE⁸⁰ (Interviewee 2), while the last interviewee was the director of group tax for an MNE that dealt in general industrials (Interviewee 3). Only one of the interviewees had an APA agreement in place for his MNE, while the others had experiences dealing with unsuccessful APA applications, other transfer pricing cases, as well as preparing support for a transfer pricing policy for their respective MNE. As already noted, the interviews were semi-structured in nature and the six themes initially derived from the questionnaire survey served as the main ‘discussion’ guides for these exercises.

5.6.1 Coding the Interviews

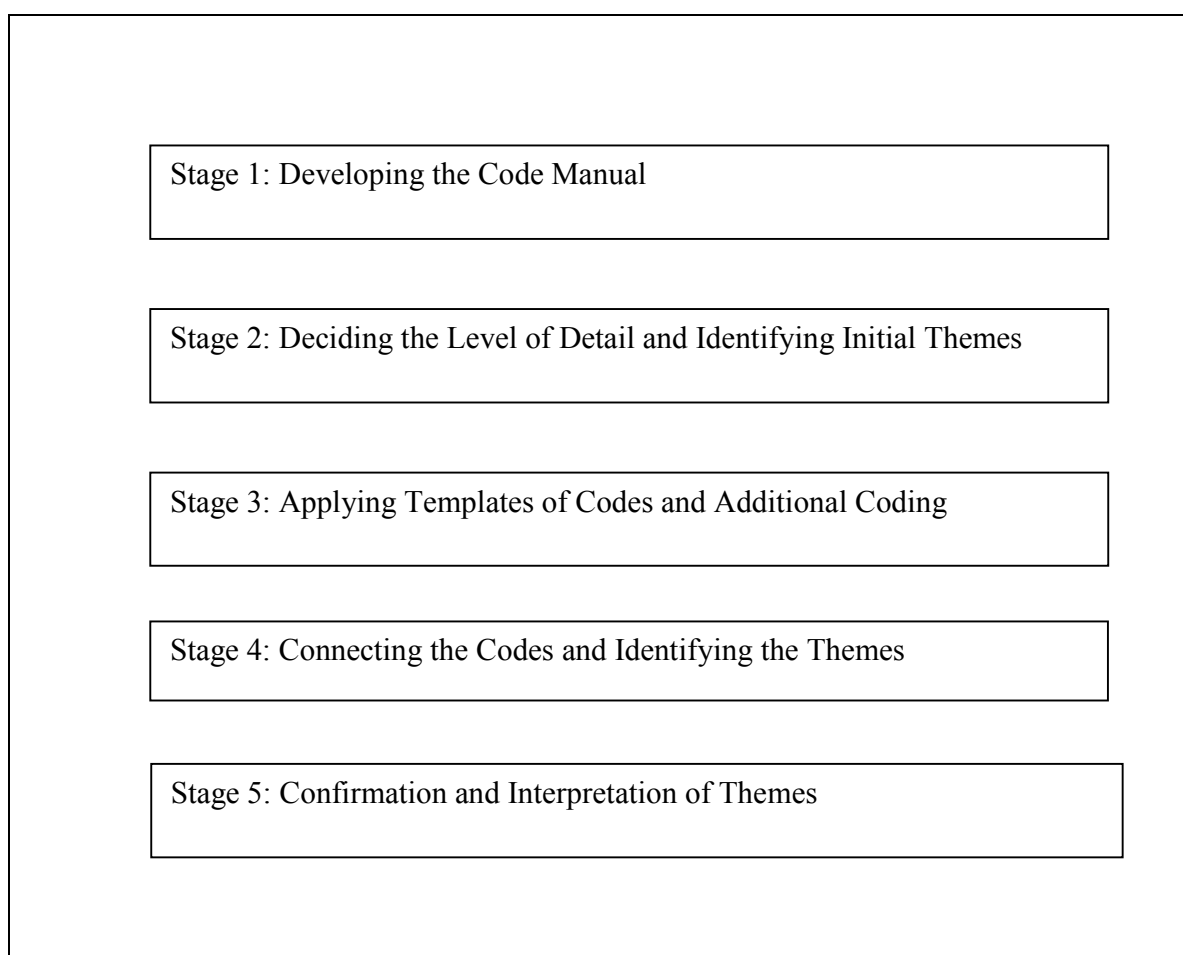
The method of analyzing and interpreting the data collected at this stage of the research was that of a hybrid process of deductive and inductive thematic analysis. This process attempts to integrate theory-driven codes (i.e., from survey questionnaires) (Crabtree and Miller, 1992; 1999) with data-driven codes (i.e., raw interview data) (Boyatzis, 1998) as a staged process of data coding and identification of themes. A theme is ‘a pattern in the information that at minimum describes and organizes the possible observations and at maximum interprets aspects of the phenomenon’ (Boyatzis, 1998, p. 161). The analysis of the raw data from the interviews helped to progress towards the identification of the over-arching themes that capture the important factors relating to the UK APA processes.

Koch (1994) noted that interpretative research requires a trail of evidence throughout the research process to demonstrate credibility or trustworthiness. This credibility is provided by the use of template approach as outlined by Crabtree and Miller (1992; 1999). The template was in form of codebooks and these were applied as a means of organizing the interview texts for subsequent interpretation. In addition to this deductive thematic analysis, further themes were allowed to emerge direct from the data using inductive coding and efforts were made to ensure that such themes were well grounded in the data. The primary objective of data collection at this stage was to explore the UK APA more as a process and explore the subjective views of participants on the themes that emerged from the survey questionnaires. Following the three interviews conducted, the process of data coding and identification of

⁸⁰ Under the three digit UK SIC classification, this was categorized as part of support services (professional).

themes are as described in the section below.⁸¹ Figure 5-2 diagrammatically depicts the stages undertaken to code the data.

Figure 5-2 Diagrammatic Representation of Stages Undertaken to Code the Data (adapted from Boyatzis, 1998; and Crabtree, 1992, 1999)



5.6.1.1 Stage 1: Developing the Code Manual

Deriving from the survey findings, there are six different themes that were used to develop the code manual. These include the themes of ‘*Cost and Benefits of an APA to Multinationals (MNEs)*’; ‘*Transfer Pricing (TP) Audit Experience Relationship with APA Applications by MNEs*’; ‘*Alternative Dispute Resolution (ADR) Methods Available to MNEs*’; ‘*Complexity of*

⁸¹ While these processes are presented as a linear step by step procedure, the analysis of the interview transcripts was actually undertaken with several iterations and reflections carried out throughout the process. Such interactivities are normally applied throughout the process of qualitative inquiry and are described by Tobin and Begley (2004) as the overarching principle of ‘goodness’.

MNEs' TP Cases'; *Risk Assessment*'; and *'Volume and Size of MNEs' Cross-Border Transactions*'. These themes formed the code manual and each of them served as the basis from which a code label⁸² was formed for the codebook. With reference to Boyatzis (1998), an a priori template was thus developed on the basis of previous survey findings and codes were written and identified as tabulated below.

Code 1

Theme Name	Cost and Benefits of an APA to Multinationals (MNEs)
Code Label	COST-BENEFIT
Definition ⁸³	Those factors considered as either advantages/gains or disadvantages/losses which the MNE stands to experience whenever it considers an APA.
Description	Any given rationale (which the MNE considers as having economic implications) that defines the action/attitude displayed towards an APA consideration at a point in time.

Code 2

Theme Name	Transfer Pricing (TP) Audit Experience Relationship with APA Applications by MNEs
Code Label	AUDIT
Definition	Identifiable closeness between any TP audit experience (time of such experience) by an MNE and attitudes shown towards APA consideration in relation to same/similar transactions (within similar time period by the MNE).
Description	A link between TP audit experience of an MNE on a particular

⁸² Boyatzis (1998, p. 31) noted that 'to be of most utility, the label should be (a) conceptually meaningful to the phenomenon being studied; (b) clear and concise, communicating the essence of the theme in the fewest words possible; and (c) close to the data. It is this researcher's belief that the adopted labels for this analytical effort reflect these conditions as much as possible.

⁸³ Drever (2003) also recommended that in analysing interview transcripts aimed at finding answers to a research question, the researcher needs to write down a working definition of each category, one that is valid (that is, it makes sense) in terms of the research. The categories can then be applied to parts of the interview analysis (p. 65). The deductive category definitions and descriptions adopted here have been formulated with respect to discussions raised under the initial survey reports together with other theoretical discussions on APAs in related research. Attempts were made to reflect less rigidity in the adopted definitions so as to achieve an easy use as well as improve the validity in the usage of these definitions.

transactions(s) and mention of APA consideration for the same/similar transaction(s).

Code 3

Theme Name	Alternative Dispute Resolution (ADR) Methods Available to MNEs
Code Label	ADR
Definition	Identifiable closeness between any TP audit disagreement (time of such disagreement) by an MNE and any action, other than APA, taken in resolving such disagreement.
Description	Action only - the MNE makes actual attempt towards resolving a disagreement by means other than an APA.

Code 4

Theme Name	Complexity of MNEs' TP Cases
Code Label	COMPLEXITY
Definition	Admittance or perception of difficulty in the exercise of choices for the valuation/valuation method of the MNE's inter-company transaction(s).
Description	MNE not being able to accurately describe or fix the TP for an inter-company transaction due to specific difficulty in its comparability.

Code 5

Theme Name	Risk Assessment
Code Label	RISK
Definition	MNE's consideration of chances and possibilities of specific outcomes in its dealings with tax authorities regarding TP procedures on its inter-company transaction(s).
Description	Analyses of actions/events/occurrences which an MNE maintains sensitivity towards in its consideration or non-consideration for an APA.

Code 6

Theme Name	Volume and Size of MNEs' Cross-Border Transactions
Code Label	VOLUME
Definition	Key numerical indicator/description adopted by the MNE in measuring the relevance or non-relevance of an APA for its inter-company transaction(s).

Description MNE consideration for the numerical description/features of transaction(s) and for which reason APA is considered either as relevant or non-relevant.

5.6.1.2 Stage 2: Deciding the Level of Detail and Identifying Initial Themes

Initial information processing from the transcripts was done by encoding recognisably important sentences and paragraphs. The level of detail adopted for this purpose were sentences and paragraphs with common threads in line with preliminary themes in the codebook. Efforts were made to identify full ideas and key issues that were being raised by an interviewee and this provided a complete segment for coding.⁸⁴ By reading, re-reading and summarising the raw data using this approach, analyses of the transcripts were done in line with Boyatzis (1998) and this helped to provide sufficient opportunity for ‘codable moments’ within the transcribed notes from the interviews (p. 65). With this choice of coding unit, raw, unsummarised interview transcripts were manually coded by associating sentences and paragraphs with one or more of the already pre-determined themes.

5.6.1.3 Stage 3: Applying Templates of Codes and Additional Coding

At this stage, the researcher applied codes from the codebook as shown under Stage 1 to the transcripts’ texts with the intent of identifying meaningful units of text (Crabtree and Miller, 1999). The texts were coded by matching the codes with segments of the data that were selected as being representative of the code. Each of the six codes developed was initially applied to each of the three individual interview transcripts. The segments of text were thereafter sorted and the data were retrieved across all three interview transcripts. Tables 5-18 to 5-24 highlight the data retrieval process under each of the code label.

The first of the code is that of COST-BENEFIT as shown in Stage 1 which was derived from the theme of ‘Cost and Benefit of an APA to MNEs’. Under this theme, interviewees were asked questions about those relevant costs that their MNEs considered significant in making APA applications. Further discussions were held with regard to their views on these costs, HMRC’s understanding of the cost concern and also the benefits which HMRC associate with making APA applications.

⁸⁴ Boyatzis (1998, p. 63) defined a unit of coding as the most basic segment, or element, of the raw data or information that can be assessed in a meaningful way regarding the phenomenon. This determines the comprehensiveness of the researcher’s insight into the unit of analysis (i.e., the MNEs).

Table 5-18 Applying ‘COST-BENEFIT’ Code to Interview Data

Name of Theme-driven Code	COST-BENEFIT
<i>Explanation of Code</i>	<ul style="list-style-type: none"> - <i>Reasons for not considering APA</i> - <i>Economic advantages/disadvantages derived from prior/current APA experience.</i> - <i>Justifications for action/attitude displayed towards APA consideration by the MNE.</i>
Interviewee 1	<ul style="list-style-type: none"> • The cost of paying advisers can run into thousands of pounds sterling in fees and other costs. • The company does not enter into any APA without estimating the cost it will involve right from the beginning as this ensures it gets the benefits for the money being invested. • Being a large organisation, these costs of using advisers and keeping personnel are not really significant given the size of the company.
Interviewee 2	<ul style="list-style-type: none"> • APAs are only beneficial when a large volume or amounts (a financial amount of transactions) which are reasonably similar and comparable with one another are the subject of an APA.⁸⁵ • APAs are not designed for MNEs with large numbers of relatively smaller transactions. • If the internal transfers are not easily defined, the time and effort needed for negotiating an APA cannot be really justified. The amount and conditions for determining the pricing formula of such transactions vary regularly. • APA cost-efficiency is more obvious for producers of a wide range of goods.⁸⁶ • An APA is of limited benefit if it is unilateral.

⁸⁵ ‘...the issue is if they are actually that much of benefit; and if people don’t perceive much of a benefit, then you don’t go to spend lots of money in pursuit of it. Now I guess it’s only a benefit probably if you have a large volume or large amount, i.e., a financial amount of transactions which are reasonably similar and comparable with one another and are therefore capable of being subject of an APA.... but the bulk of what we are doing is providing inter-company services, finance management services, intellectual property, etc., and it’s difficult to see that there is much benefit in an APA which might very need to be of cost given its terms to be able to apply to that sort of transactions’ ... (Interviewee 2, p. 1).

⁸⁶ ‘...Okay they (i.e., tax authority) think it’s a good idea [that maintaining an APA is cost-efficient] but I can’t really see why unless you are the Toyotas of this world. If you are a dealer in manufactured goods, that is, for a range of manufactured goods it could be quite easy to see why maintaining an APA is a good idea. The certainty for that actually in price overlaps a period of time. If you are not a provider of wide range of goods and services, I thought very much less so...’ (Interviewee 2, p. 2).

Interviewee 3	<ul style="list-style-type: none"> • APA applications involve big upfront fees and high cost of professional advisers but benefits may be slightly intangible. • Pre-application meetings do not necessarily reduce the cost of APA applications.⁸⁷ • Bilateral APA gives more significant benefits through upfront coordination. • APA benefits are more significant and obvious for MNEs with large flows of internal transfers.⁸⁸ • APAs will be normally undertaken for quite complicated transactions and that involves engaging quite expensive advisers.⁸⁹
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The second code ‘AUDIT’ was derived from the theme of ‘Transfer Pricing (TP) Audit Experience Relationship with APA Applications by MNEs’. This code captured any identifiable link(s) between prior/current transfer pricing audit experience of MNE interviewees and their consideration for an APA application with HMRC and other tax authorities.

⁸⁷ ‘... With HMRC... when it is real risk and real money that they take for corporate, then corporate actually have a different view of the world sometimes. This is not just in transfer pricing; this is in other areas... I think for APA; I think, yes having a meeting is not very expensive. They would say the process after the meeting is not necessarily very expensive. The corporate who want to make sure that when they put a submission into HMRC that it’s the best possible submission that they can put which supports their case in the sphere of transfer pricing. People like me can’t do any economic analyses as we’re not economists. It’s not what we do for a living but we need outside advisers. These outside advisers cost £800.00 an hour. I honestly think when HMRC say things like that, people should not take any notice of it because it might be right and it might be wrong (Interviewee 3, p. 2).

⁸⁸ ‘... I think in our experience, if I’m averaging it out, not getting an APA has been cheaper because I said earlier; in some territories we have big audit enquiries and in others we had very little enquiries on virtually the same transaction and business model. On average, it’s not been too expensive, however, I can imagine if we were in a slightly different industry say the pharmaceuticals, the flows will be so big and the range of possible disagreement on values will be so big that it might be that you just cannot run the risk of someone disagreeing; you know the pharmaceutical groups have big transfer pricing problem, they would say actually it would have been a lot cheaper for us if we agree all this upfront but sometimes you get it right and sometimes you get it wrong. As it actually turned out for us over the last few years with our complex business model; on the average it has been cheaper not to have got APA territory by territory where we apply this model...’ (Interviewee 3, pp. 5 – 7).

⁸⁹ ‘... The professional advisers that one would use for that sort of thing would be one that would be quite expensive because normally you only do it for something quite complicated anyway... ... when you ring out an adviser in one of the big four; you know that he talks to other corporate; he’s not sitting there waiting for you to call and then worn out; and you know that he knows things about other companies that you don’t know; and in a sense you’re paying for him to use all the different experience that he has in advising you, and that’s what you’re paying lots of money for... (Interviewee 3, p. 15).

Table 5-19 Applying ‘AUDIT’ Code to Interview Data

Name of Theme-driven Code	AUDIT
<i>Explanation of Code</i>	<ul style="list-style-type: none"> - <i>APA application for already audited intra-group Transactions.</i> - <i>Consideration of APA for perceived TP audit-vulnerable transactions.</i>
Interviewee 1	<ul style="list-style-type: none"> • Our MNE’s prior audit experience necessitates a consideration for an APA. • Previous experience, however, shows that APAs are less expensive as an option even though some jurisdictions charge for APA applications. • Our MNEs operate on the basis that tax authorities know what we do and therefore have information about the company operations. • With respect to HMRC, APA applications can be pretty straightforward and less costly.
Interviewee 2	<ul style="list-style-type: none"> • The internal time taken during an audit investigation is not more (probably less) than that required to prepare required documentation needed for an APA.⁹⁰ • Dealing with APAs for all intra-group transactions is more costly than undergoing a TP audit for only a sample of them.⁹¹ • Auditing an MNE simultaneously is not different from a separate audit.
Interviewee 3	<ul style="list-style-type: none"> • The evidence, documentation and, argument that most MNEs need to put together for the revenue are very similar for the APA process and also for the audit. • It is not convincing how ‘joined up’ tax authorities really are on everyday audit. • Our MNE is not worried about tax authorities sharing information during an actual audit process because we are very compliant.

⁹⁰ ‘...One issue I think is the amount of time, internal time; I suspect that that internal time is certainly no greater and probably on the less than would have been involved in putting together a large package of materials always with the help of external advisers to go in advance to the Revenue just because I thought it will be easier and should make sure you’re doing things probably correctly to provide support after the events...’ (Interviewee 2; p. 2).

⁹¹ ‘... If I get 20 transactions, three of which end up with issues with the tax authorities, I got three disputes to deal with as opposed to 20 agreements in advance and dealing with three is probably less costly than dealing with 20...’ (Interviewee 2, p. 10).

Interviewees were prompted further to discuss their consideration for the cost difference between having an APA and experiencing TP audit investigations and the potential impact of the information sharing process associated with TP audits (Table 5-19).

Table 5-20 Applying ‘ADR’ Code to Interview Data

Name of Theme-driven Code	ADR
<i>Explanation of Code</i>	<ul style="list-style-type: none"> - <i>Non-APA Methods utilized to settle TP Disagreements.</i> - <i>Non-APA Methods Considered for perceived TP audit-vulnerable transactions.</i>
Interviewee 1	<ul style="list-style-type: none"> • The company is equally open to use of Mutual Agreement Procedure (MAP) and the EU Arbitration Convention procedure. • Currently, the company is still in the process of one_MAP. The reason for opting for this is because the country involved does not have an APA procedure in place. • The MAP is, however, taking too long a time to conclude.
Interviewee 2	<ul style="list-style-type: none"> • The MNE’s disputes on all matters get settled through negotiation/discussion with tax authorities. • Tribunal used to be the last resort because it is expensive and the outcome result is not necessarily predictable. • HMRC in the UK tries to find ways of resolving disputes outside the court system and the MNE has the ability to have a more involved discussion with the large business office inspectors.
Interviewee 3	<ul style="list-style-type: none"> • How the company settles TP audit dispute depends on the size and complexity of the transactions involved. • Tribunal is always the MNE’s last resort where agreement cannot be reached.⁹²

The third code i.e., ADR, was related to the theme of ‘Alternative Dispute Resolution Methods Available to MNEs’. The questions covered in this area sought to identify the different options

⁹² ... but it depends on exactly how that territory tax system works. In one example I can think of is one in which our numbers were not really big in this case, but we’ve exhausted all the concessions and correspondence that we can have with a normal tax inspector transfer pricing team; so we’re taking what remains on the table to a tax tribunal in that country... (Interviewee 3, pp. 5 – 6).

that MNEs utilize to settle any TP disagreements/disputes where an APA is not considered. Questions were asked about the ways in which any such other arrangements work and also, whether such alternative options were considered less expensive than applying for an APA to sort out same issue (see Table 5.20 above).

The theme of ‘Complexity of MNEs’ TP cases’ served as the basis on which the fourth code i.e., COMPLEXITY, was derived. Under this theme, discussions involved questions about the kinds of transactions considered as particularly complex by MNEs, the determination of transfer prices for such transactions which are acceptable to HMRC (relevant tax authority), as well as the clarity of guidelines available on how to determine the most appropriate TP prices for such complex transactions such as intangibles (see Table 5-21 below).

‘RISK’ was the next code in line and this emerged from the theme of ‘Risk Assessment’. The code sought to capture how MNEs react to the information requirements associated with the APA process. Questions in this category explored MNEs’ sensitivity towards information that is supplied during an APA application process as well as the information that they considered to be too private to divulge to the tax authorities but which the APA process may require. Also, related discussions about MNEs’ consideration of the possibilities associated with the APA application decisions were captured under this theme (see Table 5-22 below).

The last theme of ‘Volume and Size of MNEs’ Cross-border Transactions’ was developed as an indication of materiality. The code ‘VOLUME’ was used to capture discussions about this phenomenon within the interview transcripts. Questions involved asking about the appropriateness of requested information in an APA application when the volume of transactions involved is taken into consideration. Also, enquiries were made about how different MNEs interpret the volume of transactions involved in their inter-group operations (see Table 5-23 below).

Table 5-21: Applying ‘COMPLEXITY’ Code to Interview Data

Name of Theme-driven Code	COMPLEXITY
Explanation of Code	<p>- Expression of doubts or uncertainty about the appropriateness of chosen TP method(s).</p> <p>- Expression of difficulty in identifying needed comparables for the determination of TP methods.</p>
Interviewee 1	<ul style="list-style-type: none"> • The cost of sharing technology processes which the MNEs uses with all its subsidiaries took a very long time in terms of determining the agreed TP methods. • The MNE, like every other company in same business, just follows what is believed to be the right procedure and price in its TP valuation of intangibles as the Guidelines are not clear enough.
Interviewee 2	<ul style="list-style-type: none"> • It is much more difficult for the MNE to establish third party comparison when pricing intangibles. • Intangibles are weak by their very nature. • For comparison purposes, there are usually only three or four manufacturing cases in the world where new oil well equipment is developed as for the MNE. • An efficient APA system should require sufficient information for proper understanding of complex transactions.
Interviewee 3	<ul style="list-style-type: none"> • The MNE intangible is for general leadership strategy covering the use of the group name and the benefit it brings. • The MNE charges a flat royalty on external sales for its intangible but determining the percentage charge is very judgmental. • It is very much more difficult for the MNE to set the royalty charge as compared with applying it.

Table 5-22 Applying ‘RISK’ Code to Interview Data

Name of Theme-driven Code	RISK
<i>Explanation of Code</i>	<p>- <i>Expression of possibilities of alternative outcomes associated with APA application consideration.</i></p> <p>- <i>Sensitivities expressed towards requirements/features associated with consideration of APA applications by MNEs.</i></p>
Interviewee 1	<ul style="list-style-type: none"> • APA application has the risk of whether or not the tax authority considers the methodology and assumptions to still be applicable and appropriate. • Withdrawing an APA application will trigger tax authorities’ curiosity thereby making it more risky.
Interviewee 2	<ul style="list-style-type: none"> • For MNEs with lots of products, the risk of having TP audit disputes for a fraction of total intra-group transactions is less than having APA for all the discrete types of transactions that the company undertakes. • Not having an APA renewed after expiry will be a big risk for an MNE because of having disclosed lots of information already about the whole set up.
Interviewee 3	<ul style="list-style-type: none"> • Having an APA renewed is not a material risk to consider because the tax authorities already know everything. • An APA is not necessary where the financial risk of the group is negligible compared to the benefits of going for an APA.⁹³ • Rather than applying for an APA, the MNE sometimes works with advisers to come up with appropriate TPs that are defensible should the tax authorities come up with any issues even though they might not.

⁹³ ‘... but if something is complex and small, then the group is likely maybe to take a view on whether it’s worth going through the process of an APA. It’s all like cost-benefit issue, isn’t it? In value terms, if we had £5 million flow, although we are one of the biggest groups but we’re not the biggest; as massive as some groups are; if we had £5 million of cross-border flows on a particular transaction, I won’t even waste half an hour thinking about going for an APA. It should take also some judgement. You say how wrong is my pricing? To view any need for an APA to support your pricing; or you’ll say how wrong is my pricing likely to be if we hadn’t a reasonable estimate of fixing a price? What’s is the likelihood of someone saying that it’s wrong and proving that it’s wrong? And what’s the tax at stake if they do so successfully? And if it was a £5 million inter-company transaction, I might say well, how wrong is it likely to be, maybe it is a million pounds wrong! Why would I then waste my time, advisers, resource, cost on something where the financial risk in my group is negligible compared with the benefit of going for an APA?...’ (Interviewee 3, pp. 11 – 11).

Table 5-23 Applying ‘VOLUME’ Code to Interview Data

Name of Theme-driven Code	VOLUME
Explanation of Code	<ul style="list-style-type: none"> - Primary indicators identifying volume of transactions under discussion. - Expression of MNEs’ intra-group transactions in relation to other key variables as indication of significance or magnitude
Interviewee 1	<ul style="list-style-type: none"> • The MNE does not really look at the volume of transactions in its APA applications but rather looks at the value. • The MNE looks at the amount of tax risks it is trying to mitigate.
Interviewee 2	<ul style="list-style-type: none"> • The UK APA is not designed for MNEs with large numbers of relatively smaller transactions. • An APA will not be a good idea for an MNE which is not a provider of a wide range of goods and services. • There is the perception that any small medium sized company would not consider applying for an APA.⁹⁴ • The risks in absolute terms of transactions which are complex but not large are not too great. • Lots of people will not consider APAs unless they have big numbers to deal with and on which the APA will be sustained if an application is made.
Interviewee 3	<ul style="list-style-type: none"> • Our MNEs considered applying for an APA to cover a major change (business restructuring) as the flows across borders were very big numbers and it was something which we only want to do if we have some level of clarity and it was compliant and not extremely high risk. • For smaller transactions within the MNE, we normally trust ourselves in getting the pricing right and not put any cards on the table with the tax authority. • Anybody going for a formal APA will definitely have reasonably material sums of money. • Complex but small inter-group transactions may not be worth going through the process of an APA if the numbers are not big enough.

⁹⁴ ‘... We’ve never had anything big or significant enough and also if you have a relatively small company, given that APA have appeal to generally being used by very rich companies, there is again also the perception that any smallish medium size multinational couldn’t have thought of seeking an APA;_there is something very funny about that and what exactly are they up to. I think if we went to HMRC and say we want an APA, their first reaction would be why? And they are suspicious why?...’ (Interviewee 2, p. 3).

The deductive process adopted above to analyze the interview transcripts was complemented by an inductive process in order to achieve a hybrid coding analysis. By this, analyses of the three interview transcripts were not confined, although they were guided, by the preliminary codes from the initial survey exercise. This researcher believed that in order to explore better the issues surrounding the APA process, it would be very useful to consider, in addition, any new theme(s) which the interviewees may have considered as either important or relevant during discussions. Thus, in line with Boyatzis (1998), inductive codes were assigned to segments of the data that describe new themes observed in the interview texts. The initial objective here was to sense and identify potential themes that were present in each of the interviewee transcripts. Boyatzis (1998) noted that at this stage in the analysis, less concern is given for a detailed, precise description of the theme and more attention is paid to recording any glimmer of themes or patterns among different sub-set of interview texts, i.e., the three interview transcripts in this research. During a review of the interview texts for the three tax directors, the following themes were identified as possibly relevant and additional issues to consider in an APA application process.

- Interviewee 1
- Role of new transactions versus existing transactions
 - APA suitability for new rather than existing transactions
 - APA application sometimes conditioned on how new the transactions are
 - Desirability of light APA process
- Interviewee 2
- UK withholding taxes and transfer pricing tax savings
 - National regulatory requirements on transfer pricing that affects APA
 - Withholding tax relevance in tax arbitrage process
 - Flexibility in transfer pricing career options in different countries
 - Dependence of APA relevance on tax regime
 - Intangible transactions and third party comparison
 - Difficult to identify APA benefits for inter-company intangibles as compared with inter-company financing
 - APA process perceived as inefficient by most MNEs
 - HMRC will always question application for APAs by small MNEs
 - Unilateral APAs are not of much benefit
 - Joint statement on APA requirements may encourage applications
 - HMRC APA process and distrust
 - Little belief in possibility of tax authorities conducting simultaneous TP Audits
 - The immediate value of ex-TP inspectors working for MNEs may decrease as time goes on due to change in Revenue approach and people.
 - Inconsistent supply of TP information to different tax authorities
 - MNEs not disclosing full information in public about the size and volume of their cross-border transactions.

- Lack of total belief in HMRC's claims about APA being an easy process
- Risk in APA application withdrawal
- Small MNEs and entrapment in APA process

- Interviewee 3
- National differences in transfer pricing audit risk and documentation requirements
 - UK consideration for only complex transactions in its APA programme
 - Access to APA programmes dependent on country policies
 - Strict transfer pricing requirements in the USA
 - APA similar to TP Audit
 - APA application and timing of transactions' production
 - Intangibles and exercise of judgment
 - APAs' unsuitability for instant transactions
 - Desire for easy APA process
 - Relationship between HMRC officials' career moves and APA application is a legitimate issue
 - Lack of total belief in tax authorities' ability to share information at all times
 - MNEs' sensitivity towards kinds of information supplied to tax authorities
 - Sensitivity of information supplied by taxpayers to tax authorities and request for additional information
 - Sensitivity of information supplied by taxpayers to tax authorities and MNEs' competitors
 - Trust relationship between MNEs and HMRC

The summary of additional issues above which were raised within the three interview transcripts in a way helped to reflect the initial processing of information by this researcher. This initial processing assisted in providing the opportunities to observe and take note of further potential themes in the raw data as recorded.

5.6.1.4 Stage 4: Connecting the Codes and Identifying Themes

During the application of the template of codes on the basis of the prior themes obtained from the initial survey exercise, code files containing code names from the code book were created. Each code file contained relevant segments of the texts with starting and ending lines for the line of discussion/level of detail describing the theme of interest. This way, on the basis of the pre-identified themes from the survey, six different code files were created. However, at this further stage of the analysis, additional code files were created in order to identify the inductive themes from the additional coding being covered.

After exhausting the potential themes in each interview transcript from additional coding under Stage 3, the outline of the potential themes displayed above were examined in an effort to look for themes from each interviewee’s text that may be related. Boyatzis (1998) noted that at this point, while some of the already identified potential themes may appear as polar opposites of a characteristic, others may merely seem to involve similar phenomena (p. 87). From the comparisons of the outlines given under Stage 3, the processes of connecting these additional codes and identification of themes across the three interview texts are illustrated in Table 5-24. These are clustered under a heading that directly relate to the central research question.

Connecting the codes and identifying additional themes using the central research question as heading: Why do MNEs apply/not apply for the APA process in the UK?

Table 5-24 Code Connection and Identification of Inductive Themes.

INTERVIEWEE 1	INTERVIEWEE 2	INTERVIEWEE 3
	<ul style="list-style-type: none"> - Amount of tax savings from withholding taxes and from the trade-off between withholding and corporate taxes in different countries affects consideration for an APA. - Regulatory requirements on the filing of transfer pricing analysis and reports may not make consideration for an APA necessary - Less developed countries tend to be heavy withholders and may not encourage the need for an APA. - There are certainly tax arbitrage opportunities between different countries on sale of goods, low cost supply chain management and other sorts of things. 	<ul style="list-style-type: none"> - MNEs may/may not experience complex TP audits on their complex transactions depending on the country. - Being able to support material transactions under the UK self-assessment tax regime makes APA consideration absolutely unnecessary. - Restricting of APA applications by HMRC to only the complex transactions will not encourage APA application. - Different countries have different contradictory APA policies that may not encourage bilateral APA applications.

A common idea that was linked under this segment is the implicit propositions that differences among countries with regard to tax regulations and policies do play a role in MNE considerations for APAs. The extent to which these variations in national tax regulations and requirements impact on APA decisions by MNEs was noted as relevant for further investigation in this research.

EMERGENT THEME: NATIONAL TAX DIFFERENCES

INTERVIEWEE 1	INTERVIEWEE 2	INTERVIEWEE 3
<ul style="list-style-type: none"> - It is more costly to negotiate an APA for existing transaction as compared with new ones. - The possibility that tax authorities may revise already adopted TP methodology for existing transactions does not encourage APA applications. 	<ul style="list-style-type: none"> - Lack of third party comparables available for intangibles makes it very difficult to negotiate APAs for such transactions. 	<ul style="list-style-type: none"> - APAs are unsuitable for instant inter-company transactions. - Concluding an APA process is essentially synonymous with a TP audit/enquiry.

The initial common impression obtained from the submissions of two of the interviewees was that of retrospective impact of the APA process which in turn impressed an initial theme of 'Retrospective Tax Effect'. However, a more consensual area of concern identifiable for the three interviewees was their worries about the suitability of the APA process for varying types of transactions. They seemed to be expressing their worries about the guides to follow to decide acceptable transfer prices for these transactions with minimum 'hassles' from the tax authorities. Following this, a more consistent theme of 'Clarification of APA Guidelines' was taken as emergent from this section of the data and considered for further investigation.

EMERGENT THEME: CLARIFICATION OF APA GUIDELINES

INTERVIEWEE 1	INTERVIEWEE 2	INTERVIEWEE 3
<ul style="list-style-type: none"> - Having a light APA process in place is desirable. 	<ul style="list-style-type: none"> - Having a Joint Statement of Requirements on the APA process by two or more tax 	<ul style="list-style-type: none"> - A light touch APA process will make it more practical and beneficial to apply for

	<p>authorities may encourage APA applications by MNEs.</p> <ul style="list-style-type: none"> - Many MNEs presently perceive the current UK APA process as too inefficient to encourage applications for the process. - The proposition about tax authority carrying out joint and simultaneous TP audits on MNEs' inter-company transactions will not necessarily encourage applications for APAs. 	<p>the programme.</p> <ul style="list-style-type: none"> - Complex TP documentation and report requirements create a barrier towards mostly the bilateral APA process and make it more costly. - Getting to supply TP information and analyses that are equivalent to that of audit requirements makes APA more risky and costly to consider for MNEs.
<p><i>An obvious observation from the respondents was the concern that the present APA process prove too burdensome and inefficient for them. The three interviewees commonly express their desire for an easier process in the APA application procedure. There seemed to be some real possibility for a generic APA consideration by the respondents. There was a common desire for less stringent but more general procedure in the APA application process among tax authorities.</i></p>		
<p>EMERGENT THEME: <u>GENERIC APA PROCESS</u></p>		
INTERVIEWEE 1	INTERVIEWEE 2	INTERVIEWEE 3
	<ul style="list-style-type: none"> - MNEs do not believe that tax authorities can conduct simultaneous TP audits and this will therefore not influence APA submissions. - MNEs do not usually supply consistent TP information to 	<ul style="list-style-type: none"> - MNEs do not necessarily believe in HMRC's claim about the ease and efficiency of the APA process given its chance-based outcomes. - Familiarity of HMRC TP inspectors with MNE

	<p>different tax authorities as will be necessary to agree a bilateral APA.</p> <ul style="list-style-type: none"> - Small MNEs believe that UK APA process as presently operated portends higher tax risk especially where they want to withdraw from the process. - Familiarity with HMRC TP inspectors does not change perceptions about the APA process. 	<p>taxpayer’s competitors may affect their (MNEs’) perceptions about the confidentiality of information required in an APA process.</p> <ul style="list-style-type: none"> - MNEs that are tax compliant will not be influenced to consider APAs because of the purported simultaneous TP audits. - Many MNEs do not normally disclose all their tax problems to tax authorities as is necessarily required in an APA process.
<p><i>The line of thoughts of two of the interviewees under this section related to the personal relationships between MNE taxpayers and the tax authorities. The two opinions were reflective on the one hand, of the level of trust relationship that MNEs maintain towards HMRC/tax authorities and their associated APA programmes; and on the other hand, of the extent of information disclosure that MNE taxpayers are willing to make in relation to the requirements of the APA process. There was some consistency as per the degree of such perceptions and practices by MNEs across the two transcripts which were consistent with an underlying idea of trust/distrust relationships as well as secrecy of information.</i></p>		
<p>EMERGENT THEME: <u>DISTRUST AND SECRECY</u></p>		

5.6.1.5 Stage 5: Confirmation and Interpretation of Themes

The process of confirming the findings has been described by Crabtree and Miller (1999) as ‘corroborating’ (p. 170). A general picture that appeared from the foregoing analysis could simply be related to the difference between the complicated view with which MNE taxpayers considered the usefulness and benefits of an APA and the simplistic focus seemingly held by the tax authority (HMRC) about the workings of the programme. However, as noted by Crabtree and Miller, ‘fabricating of evidence’ in the process of interpretation of data is one issue about which a researcher will need to take care. This is an attempt to guard against the researcher’s bias in the interpretation process such that the researcher does not just only observe that evidence that she/he expects. The iterative process that was carried out at this stage involved a repetitive scrutiny of the previous stages already highlighted. In order to validate that the assigned themes were representative of the initial data analysis, a scrutiny of the thematic segments was undertaken via ‘pattern matching’⁹⁵ with these clustered themes. During this pattern-matching process, interpretative insights were developed from the textual discussions that were related to the clustered themes. In addition, in line with Crabtree and Miller (1992), a re-read of all segments together about each of the inductive themes was undertaken to identify the most salient themes. During this process, some specific topical issues in line with some of the themes came to light and these helped to form areas of potential enquiry and question areas under the proposed Delphi exercise from the already clustered themes. Table 5-25 below provides an outline of some of the sub-topical enquiries that were revealed and were in line with each of the already clustered inductive themes above.

These topical enquiries formed the basis on which the corroboration of the four new inductive themes was sought. An open-ended Delphi questionnaire on these themes was subsequently developed in order both to confirm and explore these thematic descriptions. Expert opinions were sought to assess the extent to which any of these themes were likely to be considered in weighing up applications for APAs.

⁹⁵ Eisenhart and Graebner (2007) noted that by effectively pattern-matching between theory and data during the process of building theory from case, a researcher is able to achieve consistent propositions with most (or even all) of the cases. This is done by recognizing patterns of relationships among constructs within and across cases and their underlying logical arguments. This methodological procedure was replicated at this stage of the research in the search for consistency between the clustered themes and the data segments.

Table 5-25 Topical Issues under the Inductive Themes

Inductive Themes	Sub-Topical Enquiries
National Tax Differences	<ul style="list-style-type: none"> - What is the relationship between the UK tax regime system and consideration for the APA? - How important is tax arbitraging for APA consideration?
Clarification of APA Guidelines	<ul style="list-style-type: none"> - Is the mode of operating the APA process in the UK consistent with the APA programme objectives? - What form of transactions are APAs more suitable for: new or existing? - How much commercial expediency and flexibility is allowed by the APA system for taxpayers to revise pricing procedures and methodology? - How reliable are the TP and APA guides available for pricing intangibles? - What choices of methods are mostly available for the different class of comparables?
Generic APA	<ul style="list-style-type: none"> - How feasible is the adoption of a light APA process? - Will joint statements on APA regulation influence submission rates? - How would the new HMRC risk-based approach to APA affect submissions? - How would APA experts react to the adoption of a light touch APA process?
Distrust and Secrecy	<ul style="list-style-type: none"> - Do MNEs see the UK APA process as entrapment-associated? - Does this entrapment phenomenon have different impacts for different MNEs? - Is there any legitimate relationship between confidentiality of information and the TP inspector in charge? - What consideration is given to the relationship between MNE taxpayers and tax authorities in the assessment of secrecy by MNEs?

5.7 The Delphi Survey Technique

Ideally, the Delphi survey is a group facilitation technique, which is an iterative multi-stage process, designed to transform opinion into group consensus. It is a flexible approach commonly adopted within the health and social science discipline (Hasson et al., 2000). There are many deferring forms of the Delphi technique, including the ‘modified Delphi’ technique (McKenna, 1994), the ‘policy Delphi’ technique (Crisp et al., 1997), and the ‘real-time Delphi’ technique (Beretta, 1996) which reflects its flexibility. However, as already noted in the previous chapter, the use made of the Delphi method in this project is consistent with the way it was used by Hartman and Baldwin (1995), i.e., to validate the research outcomes.

Following the completion of the interviews with three tax directors, the four new themes together with the insights that emerged from the analyses of the interviews were prepared for expert confirmation and/or disapproval via a one-round Delphi study. This researcher intended to gather more insightful qualitative data that would help to validate and seek agreements on the relevance of these themes in APA considerations by MNEs.

In most cases, an initial questionnaire in a Delphi process may collect qualitative comments which are fed back to the participants in a quantitative form through a second questionnaire. Alternatively, qualitative data can be collected through focus groups or interviews and used to inform a quantitative first round of the Delphi. This is usually the practice in the use of the Delphi survey technique. However, Skulmoski et al. (2007) already argued that this method is also well suited to rigorous capture of qualitative data. The use made of the Delphi technique in this research together with the specialist knowledge associated with the APA process, justifies the collection of the necessary expert data in qualitative form. The Delphi questionnaire examined questions under the four new themes that emerged from the interviews. The questions were specifically structured to cover the themes of *Tax Regime Differences*; *Clarification of APA Guidelines*; *Generic APA Options*; and *Distrust and Secrecy*. The questions were open-ended and covered issues related to topical enquiries highlighted under Table 5-25. The full Delphi questionnaire is as shown in Appendix 6.

As expected of all good surveys, the need for pilot-testing of the Delphi questions was recognized and the questionnaire was sent out to three APA consultants for this purpose. During this period, no response was received from any of the pilot respondents and the timing

of events did not allow for adequate space to follow up rigorously with the contacted sample. The original sample for the Delphi exercise was purposefully selected. This comprised 20⁹⁶ participants involving a cross-section of academics and tax practitioners whose work covered the area of transfer pricing in general and APAs in particular. Participants were contacted via email first to obtain their consent to participate in the Delphi exercise. Confirmation emails were received from 12 of the intended respondents after follow up emails were sent to the non-respondents two weeks after the first email.

The researcher needed to grapple with some issues during the sample selection and that involved the case of obtaining a home perspective of the APA process as concerned HMRC in the UK. This was relevant because the selected participants were both located in the UK and USA. Also in some cases, some of the UK based participants were currently working in non-UK APA areas even though they had sufficiently dealt with UK APAs in the past. However, the similarity in the nomenclature and purpose of the APA process in most countries made the blend of responses to be obtained a valid one. Moreover, some of the Delphi questions were more general in nature and therefore not particular to the UK APA process. As such, having a global perspective/experience of them would be quite useful in answering such questions. Nevertheless, all participants were supplied with relevant sections of the UK Guidelines on the APA process as part of the full Delphi package.

The full Delphi package was later administered to the 12 respondents who returned the earlier confirmation email. In order to avoid bias of opinion, however, reports on previous data collection were withheld at this point. It was expected that this would help to maintain a balanced approach towards all anticipated respondents. Participants were however notified about the six themes that had emerged earlier from the questionnaire survey. In addition, the researcher sent follow-up emails to all expected respondents three weeks after the original package was sent. This was in an attempt to avoid non-response bias. At the end of the data collection period, responses were received from six of the Delphi participants. These six responses constituted the Delphi analyses as shown in the next section.

⁹⁶ Gustafson et al. (1973); Nambisan et al. (1999); and Lam et al. (2000) have all previously used a Delphi sample size of less than 10 in their research (i.e. 4, 6 and 3 respectively). While the homogenous nature of the sample components in this research makes the number of participants sufficient for the purpose of the Delphi process, the researcher, nevertheless, gives consideration to the implication of this on the intended next stage of the research after the Delphi process. It was intended that the three data sources would be used to hold dialogue with HMRC for their comments about the results of this research work.

5.7.1 Delphi Analyses

The Delphi responses were analyzed using basic content analysis approach for analyzing and interpreting narrative data. Taylor-Powell and Renner (2003) outlined the systematic approach to be followed in evaluating and analyzing qualitative data. The analysis of the responses obtained was done with regard to identifying similarities and/or dissimilarities among the Delphi responses in relation to each of the themes examined.

In sequence, the researcher first attempted to identify the purpose of the exercise before it was conducted. This was meant to verify the credibility and confirmability of the interpretations and thematic descriptions about the UK APA process as evolved from the earlier data collections specifically the interviews (Lincoln and Guba, 1985; Kuzel and Like, 1991). The Delphi exercise was intended to identify any additional confirming or disproving cases for the themes identified earlier as reflected from the responses gathered. By so doing, the researcher wanted to collect expert opinions on the emergent themes as a form of insight in the previous evidence obtained from earlier data collections. This exercise eventually completed the triangulation of data sources in this project and also helped to reflect the validity checks that are related to possible CMV issues as advocated by Podsakoff et al., 2003 (Chapter 4; Section 4.7.4)

The second issue that was considered as outlined by Taylor-Powell and Renner (2003) is that of determining the type of questions or rather the basic questions that the Delphi process was meant to answer. The researcher considered this in order to help focus the analysis of the Delphi exercise. Taylor-Powell and Renner (2003) stated that identifying the purpose of the evaluation helps to decide how to begin the analysis and also influences how the results will be used. The analysis carried out under this section was intended to address two main questions as follows.

(a) *What level of credibility⁹⁷ for these themes is reflected in the Delphi responses and responses given by the respondent APA experts?*

⁹⁷ The credibility criteria involve establishing that the results of qualitative research are credible from the perspective of the participant in the research. Since from this perspective, the purpose of a qualitative research is to describe or understand the phenomena of interest from the participant's eyes, the participants are the only ones who can legitimately judge the credibility of the results.

(b) *What are the possible/suggested cases that helped to confirm or disprove the thematic descriptions that specifically evolved from the interviews in particular, and from the earlier data collections in general, i.e., confirmability criteria.*⁹⁸

After identifying these questions of interest, the Delphi responses were organized by question in order to look across all respondents and their answers for consistencies and differences. All data from each question were put together to show how all respondents responded to each of the question. Table 5-26 below summarizes this process.

⁹⁸ Confirmability refers to the degree to which the results could be confirmed or corroborated by others.

Table 5-26 Organization of Delphi Data by Question

Delphi Questions	Focus of Analysis		Consistencies	Inconsistencies
<u>THEME 1: TAX REGIME DIFFERENCES</u>	Level of Credibility	Suggested Cases		
Question (1) <i>How does the UK tax regime affect consideration of the benefits of negotiating an APA by MNEs?</i>	<u>Respondent 1</u> Withholding tax consideration is only one of other factors to consider in APA applications. Others include scrutiny and audit history.	<u>Respondent 1</u> Intangibles generally increase desire for an APA/certainty irrespective of tax regime.	- UK Tax regime has impact on its unilateral programme (Respondent 2). Its SoP now signals more willingness to accept unilateral APA applications (Respondent 3).	- While HMRC's effort at encouraging APA applications over time has been impacting on Unilateral APA considerations by MNEs, the Revenue has just been opening up in its willingness to now accept unilateral APAs.
	<u>Respondent 2</u> UK tax regime will impact in unilateral APA considerations but has less relevance in bilateral APA.	<u>Respondent 2</u> HMRC's 'real time working initiative' and 'risk assessment process' have had more impact on unilateral APA considerations by MNEs.	- Complexity and quantum of the transactions in question likely to increase the importance of APA benefit to MNEs (Respondent 5). Intangibles, being generally recognised as complex transactions are taken to increase desire for an APA/certainty irrespective of tax regime (Respondent 1).	- Many MNEs, before now, perceive the UK tax regime as not fully supportive of its APA programme (Respondent 3). However, HMRC, it is asserted, generally agree to negotiate an APA (Respondent 4).
	<u>Respondent 3</u> Many MNEs, before now, perceive the UK tax regime as not fully supportive of its APA programme.	<u>Respondent 3</u> The newly updated APA SoP signals HMRC's increased willingness to now accept unilateral APAs, and to accept APA		

		from small MNEs.		
	<u>Respondent 4</u> HMRC will generally agree to negotiate an APA.	<u>Respondent 4</u> N/A		
	<u>Respondent 5</u> APA main benefit is to obtain certainty of tax treatment either in the UK only or UK and other countries.	<u>Respondent 5</u> Complexity and quantum of the transactions in question likely to increase the importance of APA benefit to MNEs.		
	<u>Respondent 6</u> Withholding tax does not play a role in policing the arm's length rule in the UK.	<u>Respondent 6</u> - UK domestic policy imposes withholding tax on very limited range of items. - UK treaty policy is to seek to eliminate withholding tax.		
Question (2) <i>Is tax arbitrage an</i>	<u>Respondent 1</u> - Tax arbitrage not of much concern	<u>Respondent 1</u> N/A	- MNEs operating in low to high tax jurisdictions (Respondent 3)	APAs are almost never the mechanism sought to gain

<p><i>important consideration in an MNE's application for an APA? Please explain.</i></p>	<p>for APA. - APA almost never the mechanism sought to gain certainty related to intra-group trade abuse.</p>		<p>will be acknowledging larger tax arbitrage (Respondent 2). The size of this arbitrage connotes the size of double taxation risk inherent (Respondent 2) and the search for certainty over this risk makes an APA application relevant and more likely an option to consider.</p>	<p>certainty related to intra-group trade abuse (Respondent 1). Yet, the structure and/or transactions covered by the APA may be driven by tax arbitrage (Respondent 5).</p>
	<p><u>Respondent 2</u> The larger the tax arbitrage, the more relevant certainty becomes in respect of a particular transaction (thereby requiring an APA).</p>	<p><u>Respondent 2</u> MNEs in countries within the EU Arbitration Convention (EUAC) may be less likely to consider an APA as they will be confident that double tax can be avoided by way of the EUAC.</p>	<p>- The current environment for exchange of information makes tax arbitrage unlikely to be a factor in unilateral APAs (Respondent 6). As such, arm's length price negotiation should not allow for tax arbitrage considerations (Respondent 4).</p>	
	<p><u>Respondent 3</u> If the MNE operates mostly in average to high tax rate jurisdictions, then tax arbitrage is not important. For MNEs operating in low to high tax jurisdictions, tax arbitrage must be one of the important considerations when negotiating the APA.</p>	<p><u>Respondent 3</u> N/A</p>		

	<u>Respondent 4</u> Hard to see how arbitrage can arise when the parties are seeking to agree on an arm's length price.	<u>Respondent 4</u> N/A		
	<u>Respondent 5</u> Tax arbitrage is not an important consideration per se in APA application.	<u>Respondent 5</u> The structure and/or transactions covered by the APA may be driven by tax arbitrage.		
	<u>Respondent 6</u> Tax arbitrage not a factor in bilateral or multilateral APAs.	<u>Respondent 6</u> Current environment for exchange of information makes tax arbitrage unlikely to be a factor in unilateral APAs.		
<u>THEME 2:</u> <u>CLARIFICATION OF</u> <u>APA GUIDELINES</u>				
Question (3) <i>In line with the objective of an APA to help to determine a clear transfer pricing methodology in</i>	<u>Respondent 1</u> N/A	<u>Respondent 1</u> N/A	The UK APA process has improved in recent years in terms of the time taken to agree an APA (Respondent 5). Getting to put the burden of determining a TP	

<i>advance, what is your view on the UK HMRC process?</i>			methodology in advance on the MNE (Respondent 3) appears to	
	<p><u>Respondent 2</u></p> <p>For formal bilateral APA applications, HMRC are generally very pragmatic and helpful. Where real time discussions tend towards arranging an informal unilateral APA, HMRC can be very aggressive and discussions may result in a formal TP enquiry.</p>	<p><u>Respondent 2</u></p> <p>N/A</p>	<p>have contributed to the decreasing amount of time and documentary information involved in the negotiation processes.</p>	
	<p><u>Respondent 3</u></p> <ul style="list-style-type: none"> - The APA process in the updated SoP is generic. - HMRC's current SoP rightly puts the burden of determining a TP methodology in advance on the MNE. HMRC being responsible for this would require so much confidential information from the MNEs that it would make them totally opt out of the APA process. 	<p><u>Respondent 3</u></p> <p>Small MNEs trying to negotiate APA for the first time have little guidance on the process as included in the updated SoP.</p>		

	<p><u>Respondent 4</u></p> <p>HMRC APA process will be equivalent to an audit where it is not possible to agree the arm's length price before the relevant tax period ends. This frequently occurs.</p>	<p><u>Respondent 4</u></p> <p>N/A</p>		
	<p><u>Respondent 5</u></p> <ul style="list-style-type: none"> - HMRC's need to understand fully the covered transactions and to draft carefully the critical assumptions may require the taxpayer to provide a significant amount of information and analysis - possibly the same/more than an audit. - The UK APA process has improved in recent years in terms of the time taken to agree an APA. 	<p><u>Respondent 5</u></p> <p>N/A</p>		
	<p><u>Respondent 6</u></p> <p>Current approaches to transparency in the compliance process such as enhanced cooperation mean that there is little difference between an enquiry</p>	<p><u>Respondent 6</u></p> <p>N/A</p>		

	and seeking agreement in advance.			
Question (4) <i>From your APA experience, is there any added danger in negotiating an APA for existing transactions as opposed to new transactions?</i>	<u>Respondent 1</u> - Although negotiating APA for existing transactions can cause disruptions to established prices in earlier years, it can lead to the ‘right answer’ for these earlier years, which can yield tax benefits, and resolve disputes, in these earlier years. - Added Danger and benefit is obtaining certainty for back years.	<u>Respondent 1</u> N/A	There is always a possibility that tax authority may revise already adopted approach for existing transactions when negotiating an APA.	Whereas the new SoP does not indicate any threat of additional audit from HMRC during an APA negotiation process (Respondent 3), there is, however, usually the chance of retrospective audit on existing transactions carried out by the Revenue during APA negotiation process (Respondent 2 and 5).
	<u>Respondent 2</u> Yes! There is danger of tax authorities wanting to apply the APA method to earlier years where possibly a different approach was used.	<u>Respondent 2</u> N/A		
	<u>Respondent 3</u> Where rollbacks are undertaken, no threat of penalties and additional audits in the new SoP as opposed to	<u>Respondent 3</u> N/A		

	the previous one.			
	<u>Respondent 4</u> APAs technically only apply to the future.	<u>Respondent 4</u> N/A		
	<u>Respondent 5</u> - There is always a possibility that HMRC may disagree with approach adopted for existing transactions. - Taxpayers may well view the APA process as the best way for agreeing historical periods as a way of formalizing the outcome.	<u>Respondent 5</u> N/A		
	<u>Respondent 6</u> APAs are frequently used for existing transactions.	<u>Respondent 6</u> N/A		
Question (5) <i>Given that HMRC will typically look at complex TP cases like intangibles in their APA programme, how can the adopted method be justified if</i>	<u>Respondent 1</u> - There are methods that are employed in some countries, and by some economists, that do not use comparables. - Sometimes less than perfect comparables are better than one of	<u>Respondent 1</u> Profit Split Methods, Foregone Profits/Income Methods, Discounted Cash Flow Analyses.	Indirect TP methods are acceptable to tax authorities in line with the guidance of the OECD Guidelines.	

<i>there are no comparables?</i>	these other methods. - The best method, or most appropriate method, analysis must always be employed.			
	<u>Respondent 2</u> It will be necessary to rely upon other indirect methods.	<u>Respondent 2</u> Profit splits.		
	<u>Respondent 3</u> Adequate documentation as to how an MNE derived the value of its intangibles can take care of this.	<u>Respondent 3</u> - MNEs can use discounted cash flow approach to come up with an arm's length value for its intangibles. - MNEs can also calculate the weighted average return on assets and compare it with its weighted average cost of capital to back into the returns of some intangibles.		
	<u>Respondent 4</u> N/A	<u>Respondent 4</u> One can use profit split		

		method.		
	<u>Respondent 5</u> The taxpayer should apply the OECD Transfer Pricing Guidelines as well as possible.	<u>Respondent 5</u> N/A		
	<u>Respondent 6</u> The issue is addressed in OECD Guidelines which form part of UK law.	<u>Respondent 6</u> Difficulties related to intangibles are universally recognised.		
Question (6) <i>Would it be worthwhile for the guidelines to clarify the relative influence of available comparables and choice of methods?</i>	<u>Respondent 1</u> OECD Guidelines contain enough clarification on this.	<u>Respondent 1</u>	- Information relating to choice of methods is contained in the OECD Guidelines. - Often, there are no true comparables particularly in the case of intangibles (Respondent 4). As there are so many classes of intangibles, trying to clarify anything about available comparables would be futile and	- The information in the Guidelines seems clear enough for some and whereas others believe it will be difficult to attain such level of clarification. - For some transactions e.g. intangibles and services, there are clear statements about which methods are
	<u>Respondent 2</u> - Difficult as everything will be very factual and circumstance dependent. - The revised Guidelines give guidance on principles that can then be adapted to specific situations.	<u>Respondent 2</u> N/A		

	<p><u>Respondent 3</u></p> <p>- There are so many classes of intangibles that trying to clarify anything about available comparables would be futile and more confusing to MNEs.</p> <p>- The Guidelines should remain silent on this issue and let the MNEs come up with the best method for their particular unique situation.</p>	<p><u>Respondent 3</u></p> <p>N/A</p>	<p>more confusing to MNEs (Respondent 3).</p>	<p>likely to be more applicable (Respondent 5). However, trying to clarify anything about available comparables for intangibles would be futile and more confusing to MNEs (Respondent 3).</p>
	<p><u>Respondent 4</u></p> <p>Often, there are no true comparables.</p>	<p><u>Respondent 4</u></p> <p>This will be the case with intangibles.</p>		
	<p><u>Respondent 5</u></p> <p>The 2010 OECD Transfer Pricing Guidelines have, if anything, moved away from a hierarchical application of the various TP methods.</p>	<p><u>Respondent 5</u></p> <p>For some transactions, e.g., intangibles and services, there are clear statements about which methods are likely to be more applicable.</p>		
	<p><u>Respondent 6</u></p> <p>I believe the OECD Guidelines do this.</p>	<p><u>Respondent 6</u></p>		

<u>THEME 3: GENERIC APA OPTIONS</u>				
Question (7) <i>How would you react to the adoption of a light touch APA as a basic condition for Double Taxation Agreements?</i>	<u>Respondent 1</u> This will not work in all circumstances.	<u>Respondent 1</u> The USA has a light touch process for small business taxpayers, where the process is supposed to be faster and less intensive. There has been limited success.	- Light-touch APA process is desirable (Respondents 2, 3, 5). - The complexity of bilateral/multilateral APA situations makes it difficult to achieve (Respondent 3, 4, 5).	
	<u>Respondent 2</u> Swifter time frames for dealing with information provided to HMRC would be helpful.	<u>Respondent 2</u> N/A		
	<u>Respondent 3</u> - Complex bilateral and multilateral APAs make this difficult. - Light touch approach to APA cannot be a basic condition but a desirable condition for double tax agreement.	<u>Respondent 3</u> MNEs considered lower risk should experience a lighter touch treatment than those MNEs classified as high risk by HMRC and/or other tax		

		authority (ies).		
	<u>Respondent 4</u> Different tax authorities' approaches to pricing will not allow for this.	<u>Respondent 4</u> N/A		
	<u>Respondent 5</u> Desirable in theory but difficult in practice to establish what transactions warrant a 'light touch' approach (even more so for bilateral or multilateral APAs).	<u>Respondent 5</u> N/A		
	<u>Respondent 6</u> I do not see any connection between the two.	<u>Respondent 6</u> N/A		
Question (8) <i>How much benefit can be associated with having a generic bilateral APA in place with transparent and concisely defined details?</i>	<u>Respondent 1</u> Generic APA for simple transactions between taxpayers has some benefit, but generally as influential precedent for other transactions, and not for the specific transactions under APA.	<u>Respondent 1</u> Memos of Understanding between the two countries would be helpful, but this should not be a UK document as much as an OECD/MEMAP (Manual	- Generic APA has benefits when transactions involved are simple rather than specific transactions (Respondent 1) as it is highly unlikely that a generic bilateral APA would capture the intricacies and unique attributes of complex	- While it is submitted that a lot of APAs can be set out as generic boilerplate thereby lessening actual time and work involved in APA negotiation (Respondent 3), However, a

		on Effective Mutual Agreement Procedures) document.	transactions (Respondent 5). - The benefits associated with a Generic APA are limited (Respondent 1, 2, 6).	specific APA is noted to give greater certainty than generic APA (Respondent 6).
	<u>Respondent 2</u> There would be some benefit but not major benefit as most MNEs will be reasonably aware of what is being agreed by various taxpayers.	<u>Respondent 2</u> N/A		
	<u>Respondent 3</u> - A lot of APAs can be set out as generic boilerplate. - Could lessen actual time and work involved in APA negotiation.	<u>Respondent 3</u> N/A		
	<u>Respondent 4</u> Generic APA will give greater certainty.	<u>Respondent 4</u> N/A		
	<u>Respondent 5</u> It is highly unlikely that a generic bilateral APA would capture the intricacies and unique attributes of complex transactions.	<u>Respondent 5</u> N/A		

	<p><u>Respondent 6</u></p> <ul style="list-style-type: none"> - Specific APAs give greater certainty than generic APAs. - If there is benefit in such an APA, it must be measured in the context of the particular circumstances. 	<p><u>Respondent 6</u></p> <p>N/A</p>		
<p>Question (9)</p> <p><i>Do you regard the recent communications by HMRC of a risk based approach to all its TP audit procedures as likely to increase the take-up of submissions for an APA? Please explain.</i></p>	<p><u>Respondent 1</u></p> <p>Probably.</p>	<p><u>Respondent 1</u></p> <p>The US and Australia's efforts regarding uncertain tax positions have shown this is likely.</p>	<p>There exists a general agreement that a risk based approach by HMRC will bring forth greater conversational medium between the Revenue and taxpayers (Respondent 2, 5). This is expected to impact positively on the consideration of APA by MNE taxpayers (Respondents 1, 2, 3, 5).</p>	<p>In contrast to the views of other participants, Respondent 6 believes that a risk based approach by the Revenue will have <i>no impact</i> as all TP enquiries practice already are risk-based (Respondent 6).</p>
	<p><u>Respondent 2</u></p> <ul style="list-style-type: none"> - Possibly. - The recent communications make it clear that real time conversations cannot give the certainty of a formal unilateral APA so this may encourage MNEs to pursue the formal APA route. 	<p><u>Respondent 2</u></p> <p>N/A</p>		

	<u>Respondent 3</u> HMRC need to hold to their statement that low risk MNEs will not be the subject of transfer pricing audits.	<u>Respondent 3</u> Low risk MNEs will now see APAs as a way to continue in that low-risk category.		
	<u>Respondent 4</u> N/A	<u>Respondent 4</u> N/A		
	<u>Respondent 5</u> - A risk based approach is likely to increase the level of dialogue between HMRC and non-low risk taxpayers. - Increased dialogue may lead to consideration of how best to deal with complex/difficult/uncertain transactions – with an APA being one possible solution.	<u>Respondent 5</u> N/A		
	<u>Respondent 6</u> No impact as all TP enquiries practice already risk-based.	<u>Respondent 6</u>		

<u>THEME 4: DISTRUST AND SECRECY</u>				
<p>Question (10) <i>How much distrust among MNE taxpayers is caused by this 'entrapment' attributed to the UK APA process? Does this have any additional implications for small MNEs in particular?</i></p>	<p><u>Respondent 1</u> Withdrawal from the APA process, regardless of country, will always cause audit concern based on information made available.</p>	<p><u>Respondent 1</u> N/A</p>	<p>- In general, the issue of 'entrapment' is not taken to be a unique problem with HMRC processes. The idea of availability of options that MNEs can take to overcome this perception appears to be common in all respondents. - No real problem of 'entrapment' with small MNEs is perceived or experienced. Respondent 6 maintained that APAs are rare among small MNEs outside the thin-cap areas. Moreover such small MNEs harbour more fears due to their lack of extensive experience with the Revenue even in non-APA areas (Respondent 3).</p>	
	<p><u>Respondent 2</u> Anonymous expressions of interest are useful if MNEs are in doubt as to whether they will want to pursue an APA.</p>	<p><u>Respondent 2</u> Real time working discussions generally lead to more dissatisfaction with HMRC processes than APA applications.</p>		
	<p><u>Respondent 3</u> - HMRC's new risk approach is meant to decrease the distrust already associated with the process but it will</p>	<p><u>Respondent 3</u> N/A</p>		

	<p>take several years before most MNEs fully trust the APA process and HMRC.</p> <ul style="list-style-type: none"> - HMRC must begin to prove their low-risk approaches. - Small MNEs harbour more fears due to their lack of extensive experience with HMRC in non-APA areas. 			
	<p><u>Respondent 4</u></p> <ul style="list-style-type: none"> - HMRC intends to build trust on open dialogue. - Open dialogue should not lead to ‘entrapment’ if based on well researched information. 	<p><u>Respondent 4</u></p> <p>N/A</p>		
	<p><u>Respondent 5</u></p> <ul style="list-style-type: none"> - No encounter with so called ‘entrapment’ attributed to the UK APA process. 	<p><u>Respondent 5</u></p> <p>N/A</p>		
	<p><u>Respondent 6</u></p> <ul style="list-style-type: none"> - ‘Entrapment’ is not an issue in the context of the UK tax system. - APAs are rare among small MNEs 	<p><u>Respondent 6</u></p>		

	outside the thin-cap area.			
Question (11) <i>Given this 'entrapment' issue, how credible is HMRC's purported willingness to encourage APA application? Please state your views on the UK APA process as related to this 'entrapment' issue for all MNEs.</i>	<u>Respondent 1</u> Withdrawal should be the exception to the normal process.	<u>Respondent 1</u> - If the withdrawal is due to slowness of the tax authority, that is a concern that needs to be tracked for trending, and resolved. - If it is due to disagreement, the taxpayer should weigh up whether it will receive a more principled answer/resolution at APA or during examination (audit).		
	<u>Respondent 2</u> - Entrapment has not been an issue in my experience.	<u>Respondent 2</u> HMRC are very willing to engage in bilateral APAs but less comfortable with unilateral.		

	<p><u>Respondent 3</u></p> <ul style="list-style-type: none"> - HMRC need real shift in attitudes to match the improved nature of its APA programme. - HMRC needs to be less adversarial in approach. - Entrapment issue is true but exaggerated by MNEs. 	<p><u>Respondent 3</u></p> <p>N/A</p>		
	<p><u>Respondent 4</u></p> <p>No belief in this entrapment issue.</p>	<p><u>Respondent 4</u></p> <p>N/A</p>		
	<p><u>Respondent 5</u></p> <p>N/A</p>	<p><u>Respondent 5</u></p> <p>N/A</p>		
	<p><u>Respondent 6</u></p> <p>HMRC's willingness is not a trap and should be taken at face value.</p>	<p><u>Respondent 6</u></p> <p>N/A</p>		
<p>Question (12)</p> <p><i>In your opinion, is this perception about confidentiality as related to HMRC inspectors' career movement a valid concern?</i></p>	<p><u>Respondent 1</u></p> <ul style="list-style-type: none"> - This concern is not any more valid for APA vis-à-vis examination (audit). - No way to prevent sharing confidential information with the tax authorities. 	<p><u>Respondent 1</u></p> <p>N/A</p>	<p>All respondents did not view this as a valid concern.</p>	

	<p><u>Respondent 2</u></p> <p>No, People move about from practice to industry and from one business to another all the time without huge issues arising.</p>	<p><u>Respondent 2</u></p> <p>N/A</p>		
	<p><u>Respondent 3</u></p> <ul style="list-style-type: none"> - Not an HMRC-only issue. - Should not be an issue. 	<p><u>Respondent 3</u></p> <p>Certainly, most MNEs do not consider this an issue when negotiating an APA with the US IRS, and I think they will have the same attitude toward HMRC.</p>		
	<p><u>Respondent 4</u></p> <p>No, Inspectors and former inspectors should respect taxpayer confidentiality.</p>	<p><u>Respondent 4</u></p> <p>N/A</p>		
	<p><u>Respondent 5</u></p> <ul style="list-style-type: none"> - Not a view that I have come across. 	<p><u>Respondent 5</u></p> <p>N/A</p>		
	<p><u>Respondent 6</u></p> <p>I do not see any evidence of this.</p>	<p><u>Respondent 6</u></p> <p>N/A</p>		

After assembling all the data pertaining to each of the four themes as shown in Table 5-26, the researcher then tried to identify the key ideas that were expressed within each thematic category. This process firstly outlined the key points under each of the themes in an attempt to assess their relative relevance. A summary of these ideas was then produced for each theme in order to reflect the relevance of each theme to the APA process as well as highlight any connections between these themes. The within-category description was as highlighted below.

Key ideas under Theme 1 - Tax Regime Differences

- The desire for an APA increases with quantity and complexity of transaction involved (such as intangibles) irrespective of the tax regime. Thus, ‘nature of transaction’ is more influential than ‘tax regime’ in the MNE’s decision on whether to consider an APA or not.
- The influence of tax regime in the consideration of APA applications by MNEs is more related to those specific APA operating processes and initiatives that are put in place by the tax authority. The relevance of other non-APA/TP tax rates and policies within the UK is not borne out as materially considerable in APA decisions by MNEs.
- Although withholding tax may be one of the factors to consider in an APA application, its influence in the UK is minimal as the UK domestic policy on withholding tax only affects a very limited range of items.
- HMRC seemed to have recently taken the right step that is consistent with the impact of their working initiatives by opening up the channels for more unilateral APA applications in its updated Statement of Practice (SoP). However, HMRC’s desire for an increased consideration of bilateral/multilateral APAs by MNEs may necessitate more collaborative initiatives and working processes (as opposed to individualistic working processes) with tax authorities of many other countries.
- Where possible, MNEs do actually look and seek to take advantage of tax arbitrage opportunities in their APA applications, although, pursuing this objective with sophisticated tax authorities such as HMRC may prove difficult.

Summary

The UK tax regime does not give tax arbitrage opportunities for MNEs to capitalize on in the consideration of an APA. Benefiting from any possible tax manipulations would require considerable profit to accrue to the MNE on majority of its internal transactions but this, as reflected with the specific example of withholding tax, is not the case with the UK. On the other hand, more influence on whether MNEs consider an APA or not appeared to rest on the specific procedures that HMRC put in place and the attitude of their employees in administering these processes. Specifically, an MNE’s views about these initiatives and processes feed directly more into the consideration of unilateral APAs more than bilateral/multilateral APAs.

Key ideas under Theme 2 - Clarification of APA Guidelines

- The long duration of negotiation that is usually associated with the UK APA process is a frequent occurrence. This is common with a unilateral APA.
- The problem of lack of clarity in guidelines also re-emerged in the newly updated HMRC Statement of Practice (SoP). The generic nature of the guidelines would not be of sufficient help to small MNEs in particular.
- The possibility of having already existing price methodology revised in an APA negotiation can always be viewed as an advantage rather than danger. The inevitability of this occurrence stems from the fact that many APAs are meant to cover existing transactions as opposed to new transactions.
- The OECD TP Guidelines recognized that exact comparables may not be possible in some situations (such as when intangibles are involved) but recommended alternative methods to be adopted. Acceptance of these methods rest with the tax authority in question. However, less than perfect comparables are sometimes better than one of these other methods.
- While the OECD Guidelines attempt to address the choice of methods applicable for transactions like intangibles, users have different notions about the clarity and usefulness of this guidance.
- Presenting exact comparables and choice of methods for intangible transactions will not be necessarily helpful.
- Most TP situations are specific in nature.

Summary

The factual nature of most TP situations will not allow for MNEs to be able to obtain assurance about the methods applicable and/or exact comparables to their circumstances beforehand. The OECD Guidelines (adopted by HMRC) made efforts to recommend alternative methods in situations where exact comparables cannot be obtained for some transactions. While some tax authorities will be comfortable with the adoption of any of these alternative methods (i.e., profit-based methods) in situations that warrant such, other tax authorities may prefer less than perfect comparables in lieu of any of these alternative methods recommended by the Guidelines. MNEs always maintain different notions of how helpful these Guidelines are in these areas and this perception was reflected on the level of certainty that MNEs feel HMRC (which follow the same Guidelines) can give with their APA process. Also, even though HMRC maintained that they are willing now to accept APA applications from small MNEs in their newly updated Statement of Practice (SoP), the guides given for this class of MNEs are still very generic in nature and not considered as really helpful.

Key Ideas under Theme 3 - Generic APA Options

- Determining the duration of time spent in bilateral/multilateral APA negotiations requires a high degree of cooperation among tax authorities.
- It is not the sole decision of one tax authority (in a bilateral/multilateral APA negotiation) to decide which transactions/MNEs would require less documentary evidence and/or details of requested information.
- The adoption of a light touch APA is seemingly dependent on a generic APA package being in place.
- A light touch approach to an APA cannot be a basic condition but a desirable condition for a double tax agreement.
- More often than not, the real determination of the methods to adopt in an APA agreement must be fact specific.
- The pursuance of a risk based approach to TP audit procedures by HMRC is to have a positive rather than negative impact on APA consideration by MNE taxpayers.
- The focus of HMRC TP audits on high risk business areas of the MNE taxpayer would increase the chances of possible disagreements/disputes.
- MNEs may consider APAs if the risk of TP audit disputes and adjustments increases.

Summary

The optimism of improving the take-up rate of APA applications by having a generic APA in place was being cautiously upheld. On the one hand, there seemed to be a preference for specific APA guidance as opposed to generic. The belief is that the level of certainty achievable with specific APAs outweighs what a generic APA option can offer because of the usually fact-specific nature of internal transfers carried out by many MNEs. On the other hand, there was also an opinion pool that having a generic APA guide may be useful in achieving some convergence between tax authorities in terms of adopting similar approach to pricing. This was expected to advance the achievement of a light touch APA where feasible. The UK's risk basis approach to transfer pricing audit at present is in turn a very useful basis on which a unilateral light touch APA can possibly be built. However, it is difficult to recognize any serious impact of such an approach in relation to bilateral/multilateral APAs. This is because of the complexities of bilateral/multilateral relations among tax authorities (UK inclusive).

Key ideas under Theme 4 - Distrust and Secrecy

- The idea of entrapment seems to be derived from personnel attitudes at HMRC rather than their formal operational processes. Any feeling of ‘entrapment’ should be avoidable through proper use of preliminary APA discussions.
- Given that consideration for an APA application is optional for MNE taxpayers, expressing their concern in terms of distrust towards the process seems an easy way for them to justify their lack of interest in the process. As a result of this, HMRC may find it needful to put less emphasis on their adversarial approach as far as the APA programme is concerned.
- Even though APAs are rare among small MNEs, their limited experience with the tax authorities in general may have contributed to any perception of ‘entrapment’ that they may have.
- The confidentiality associated with the career move of an HMRC inspector is not only associated with the APA process but also with other non-APA tax areas. Nevertheless, this issue is not a major influence on decisions to apply or not to apply for an APA with HMRC.

Summary

Having distrust about HMRC’s APA process is not, in substance, a result of HMRC’s specific process. This was reflected as more of perceptions of MNE taxpayers and their inability to utilize sufficiently means at their disposal that can be employed to validate/disprove such perceptions. Perhaps, some of the MNEs’ negative attitudes towards the APA process seemed to be based on perceptions rather than on real experience of the process. Where this distrust has actually been experienced and led to a feeling of entrapment, such a problem seems to be exaggerated by MNEs.

5.8 Conclusion

The chapter has clearly demonstrated the procedures followed within the mixed-method methodological choice adopted. The sequence of each data collection and analysis procedure has been discussed. Multiple sources of data were obtained and analysed in order to explore the research question that is being addressed. While the use of survey questionnaire was used to examine the structure of the APA, semi-structured interviews and online Delphi method were both utilised to provide an extensive view of the issues that were emerging as the study progressed. In all, the methodological path that has been followed provided a unique way of researching the APA topic.

CHAPTER 6: FINDINGS AND DISCUSSIONS

6.1 Introduction

This chapter looks at the eventual themes that ultimately emerged as relevant to the decision of MNEs on whether or not to consider APAs and an attempt is further made to identify the connections among these themes. Additional effort is then made to examine the findings of this study in the light of other findings from similar studies on APAs. Finally, the theoretical and policy implication of the reported findings are discussed.

6.2 Themes of Relevance

A look at the results of each of the methodological steps that were carried out sequentially up to this stage revealed the differences between the perceptions of the APA process by the MNEs and the views being maintained by HMRC in particular and other tax authorities in general. The emergence of different thematic issues throughout the data analysis process suggest an overriding theme that can be related to the differences between the complicated view with which taxpayers consider the usefulness and benefits of an APA and, the simplistic and streamlined view seemingly held by the tax authorities. In many cases, tax authorities do give regard to some of the issues raised by MNEs in this study, especially that of cost of APAs,⁹⁹ but in practice, however, they typically address these issues based on some broad generic classifications¹⁰⁰ of their focus on the APA process and as such direct their policies towards such areas. Nevertheless, there seem to be other unidentified issues that crop up during the MNEs' APA decision making process. These issues are reflected in the form of the themes that have emerged in this research. The initial sets of themes are deductive from the questionnaire survey results. These are six in number as already shown in Chapter 5 above and they include the following: (i) Cost and Benefit of APAs; (ii) Transfer Pricing Audit

⁹⁹ HMRC already stated in their International Manual (INTM422090) that they aim to complete a bilateral APA within 18 – 21 months of formal application and emphasis has always been placed in many of the Revenue's publications on the authority's drive to reduce time taken to complete APA negotiations. On the other hand, the US IRS announced on July, 27 2011 a realignment of its APA programme from the IRS Office of Chief Counsel to the IRS Large Business and International Division under the Director for Transfer Pricing Operations (Internal Revenue Service Bulletin, July 2011, Issue Number: IR-2011-81). This was done with the expectation of streamlining its APA process and eventually reducing the time it takes to complete an APA.

¹⁰⁰ While HMRC in the UK typically classify transfer pricing issues applicable for an APA as that of 'complex' and 'non-complex' TP cases (HMRC Statement of Practice - SP 2/10); the US IRS divides all its APA cases between those that are determined to either be 'strategic' or 'non-strategic' (IRS Announcement on APA and Mutual Agreement Program Realignment, March, 2013).

Experience and APA Application; (iii) Alternative Dispute Resolution Methods and APA Application; (iv) Complexity of MNEs' Transfer Pricing Cases; (v) Risk Assessment of MNEs' Transfer Pricing; and (vi) Volume and Size of MNEs' Cross-border Transactions.

In the consideration of these themes, the theme of 'Cost and Benefit of APAs' served as basis against which most of the other themes were examined. In an attempt to identify the full range of perceived cost and benefit of APAs by the MNE respondents, effort was made to analyse most of the other themes in the light of their cost and benefit implications as may be considered relevant by the respondents in their decision on whether or not to apply for an APA. Thus, in the light of other themes, issues were considered on whether or not it is worth the cost to apply for an APA when gauged against the benefit the process can give (see Section 5.5). This allowed for broader consideration to be given to those potential expenses, resource commitments and opportunity costs which, while discernible from the data collected, were considered by the researcher as important to the MNE in its consideration for an APA application. Table 6-1 below depicts the sequential emergence of these deductive themes with reported findings.

The table highlights the results of the researcher's concern about the rationale behind MNE attitudes towards the UK APA process. The observed relationships among key variables which were integrated into the six key themes as reported above revealed this concern. However, more evidence was sought through qualitative data in order to validate further these findings and also enhance generalizability. Each of these themes was examined via interviews in order to take on board the participants' perspectives on the pre-identified themes. The resulting evidence as gathered for the themes are outlined in Table 6-2.

Table 6-1 Outline of Initial Findings on Questionnaire Themes

Data Sources	Emergent Themes	Reported Findings
<i>Questionnaire Survey</i>		
Theme 1	- Cost and Benefit of APAs	High APA cost ranks as the most significant deterrent against MNEs' applications for APAs.
Theme 2	- TP Audit Experience and APA Applications	Previous TP audit experience by MNEs does not trigger MNEs' interest in APA application.
Theme 3	- ADR Methods and APA Applications	Non-existing evidence of plans by MNEs for APA in future is highly indicative of greater ADR usage in handling TP risks.
Theme 4	- Complexity of MNEs' TP Cases	<p>- MNEs' inter-company transactions determined under the transactional profit TP methods have undergone more TP audits previously when compared with those that are adopting the traditional transaction TP methods.</p> <p>- Licensing of intangible property is perceived as the inter-company transactions most vulnerable to TP tax audits/disputes with HMRC.</p>
Theme 5	- Risk Assessment	Majority of MNEs believed the APA is most beneficial when intangibles are involved as compared with other types of inter-company transactions.
Theme 6	- Volume and Size of MNEs' Cross-border Transactions	<p>- Large MNEs with small related party transactions face a high incidence of TP tax audit and do not seem to be automatically exempted from TP rules.</p> <p>- A higher percentage of 'MNEs with lower proportion of intra-group transfers' have experienced a higher incidence of TP tax audit investigations in the last three years.</p>

Table 6-2 Outline of Corroborating Evidences on Questionnaire Themes

Data Source	Deductive Themes	Corroborating Evidence
<i>Interview Exercise</i>		
Theme 1	- Cost and Benefit of APAs	The high cost of APA applications makes them generally associated with very large MNEs which can bear the huge cost of APA application and maintenance.
Theme 2	- TP Audit Experience and APA Applications	<ul style="list-style-type: none"> - There is no clear cut difference between the cost associated with an APA and that of a TP audit. - TP audit experience does not, on a cost basis, trigger a direct need for APA consideration. - MNE consideration for an APA is not influenced by simultaneous audit experience.
Theme 3	- ADR Methods and APA Applications	<ul style="list-style-type: none"> - Cost implications play a role in MNEs' consideration for ADR. - Depending on the country of operation, MNEs typically adopt non-legal means to settle TP disputes.
Theme 4	- Complexity	<ul style="list-style-type: none"> - MNEs experience difficulty in determining the TP of intangibles owing to lack of adequate comparables. - TP valuation of intangibles is typically a judgemental process.
Theme 5	- Risk Assessment	- APA risk is typically associated with information supply and demand.
Theme 6	- Volume and Size	- APA is only considered for transactions with large sums involved.

The corroborating evidence that emerged from the triangulation of these six deductive themes was, however, reflected in the inductive themes that later emerged from the interviews. The ideas expressed in the interviews about the initial six themes provided the relative linkage among the deductive themes on one hand, and between the deductive and inductive themes on the other hand. Table 6-3 shows the inductive themes and evidence reported from the interviews. The classification includes a reflection of some of the initial deductive themes in the general ideas surrounding the inductive themes that subsequently emerged. However, the theme of 'Cost and Benefit of an APA' remained dominant as a stand-alone for which interview evidence from some of the other deductive themes could be related. The corroborating evidence from theme 2 - 'TP Audit Experience and APA Applications', Theme

3 - ‘ADR Methods and APA Applications’ and Theme 6 - ‘Volume and Size of MNEs’ Cross-border Transactions’ was largely reflected and consequently submerged under the theme of ‘Cost and Benefit of an APA’, i.e., Theme 1, based on the interpretation of the evidence from Table 5-20 and Table 5-23 in the last chapter.

Table 6-3 Inductive Themes and Reported Findings

Data Source	Inductive Themes	Reported Findings	Deductive Themes Reflected
<i>Interviews</i>			
Theme 7	National Tax Differences	<ul style="list-style-type: none"> - Tax arbitrage is an important consideration in an MNE’s consideration for an APA. - The consideration for an APA is determined in relation to the assessment of the nature of APA regulations and policies in the country of operation. 	<p><u>Theme 3 - ADR Methods and APA Application</u></p> <ul style="list-style-type: none"> - Depending on the country of operation, MNEs typically adopt non-legal means to settle TP.
Theme 8	Clarification of APA Guidelines	<ul style="list-style-type: none"> - APA application is sometimes conditioned on how new the transactions under focus are. - The longer the period within which the MNE has been dealing in a transaction, the slimmer the chance that an APA will be considered. 	<p><u>Theme 4 - Complexity</u></p> <ul style="list-style-type: none"> - MNEs experience difficulty in determining the TP of intangibles owing to lack of adequate comparables. - TP valuation is typically a judgemental process
Theme 9	Generic APA Process	<ul style="list-style-type: none"> - Joint but less stringent APA requirements/regulations from collaboration between the UK and other tax authorities will make the APA process less costly and more efficient. 	<p><u>Theme 2 - TP Audit and APA Application</u></p> <p>MNEs’ consideration for an APA is not influenced by simultaneous audit experience.</p>
Theme 10	Distrust and Secrecy	<ul style="list-style-type: none"> - MNEs’ desire for information secrecy does not make the APA process attractive. - Lack of a trust relationship between MNEs and HMRC influences consideration for the APA process. 	<p><u>Theme 5 - Risk Assessment</u></p> <p>APA risk is typically associated with information supply and demand.</p>

The idea around this theme is the operationalisation of ‘cost and benefit of an APA’. This was mainly interpreted as the ‘time of putting documentation together for an APA application as compared with the preparation of documentation for defence in a TP audit’. This assessment was, however, done in relation to the value (i.e., financial amount) of transactions under consideration.

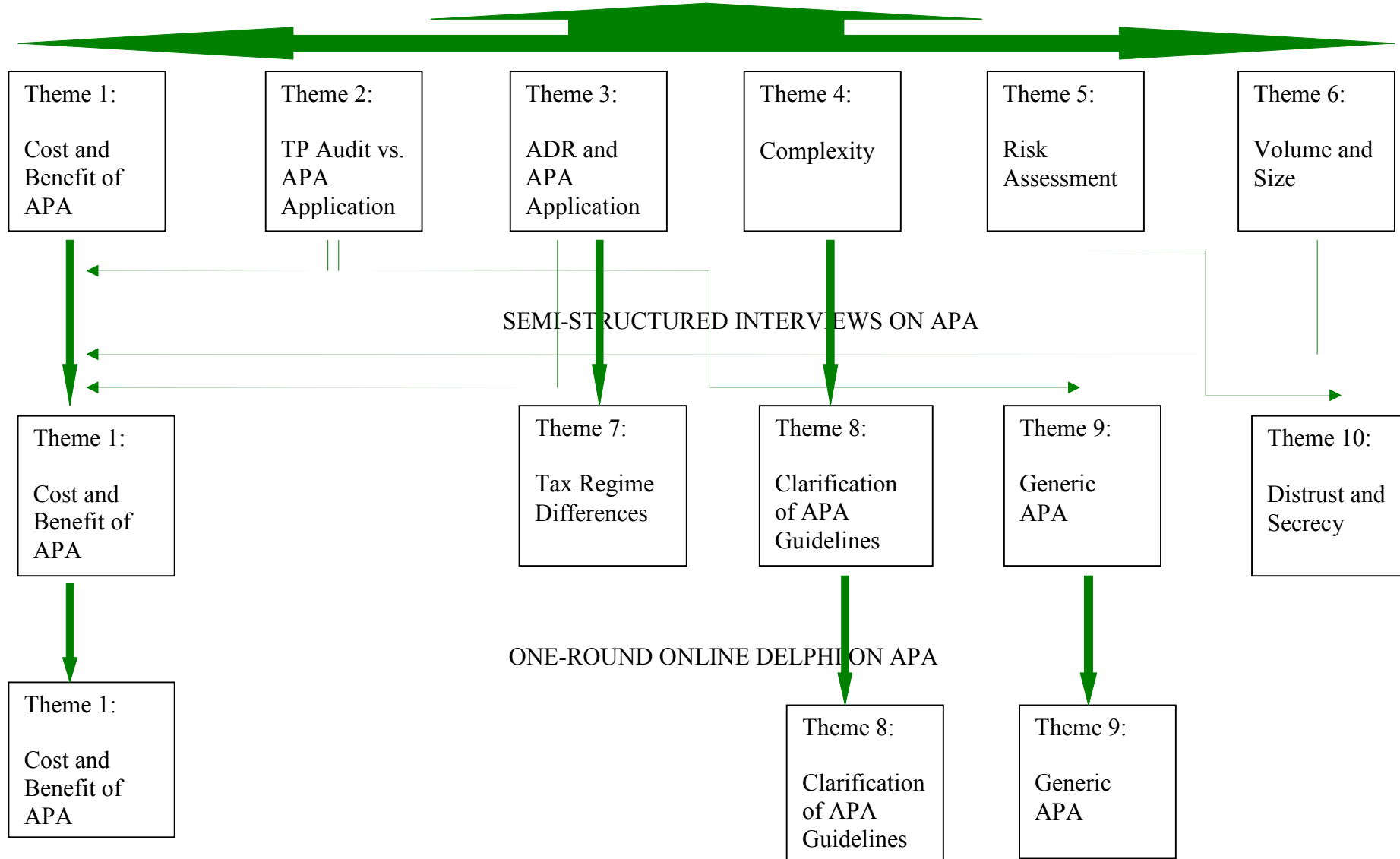
The submerged deductive themes were thereafter included as part of the issues investigated under the inductive themes during the subsequent Delphi exercise. The Delphi study was intended as a means of confirming/disproving the credibility and relevance of the four inductive themes that ultimately emerged from the interviews, i.e., to validate other relevant themes in addition to the theme of ‘cost and benefit’. The crux of experts’ opinions obtained for these inductive themes are shown in Table 6-4 below.

Table 6-4 Experts’ Opinions on Inductive Themes from Delphi Study

Inductive Themes	Delphi Expert Confirmation/Disconfirmation
Theme 7: National Tax Differences	Rather than differences in tax rates and regulations among countries, the decision of whether or not MNEs consider an APA is influenced by the specific interactive processes and working initiatives that HMRC put in place and the attitude of their personnel in administering these processes.
Theme 8: Clarification of APA Guidelines	MNEs’ perception about the uncertainty and inexactitude of the APA guidelines influence their attitudes towards the UK APA process.
Theme 9: Generic APA	MNEs’ desire and interest for a light touch APA process is more feasible by having a generic bilateral/multilateral APA process in place.
Theme 10: Distrust and Secrecy	The feeling of distrust is a false perception largely associated with small MNEs, although this category of MNEs cannot be associated with any expected increase in UK APA submissions.

The methodological process of filtering out the themes of relevance from the data gathered as well as the connection among the emergent themes throughout the abstraction process is shown in the web as depicted by Figure 6-1 below. In the cases where the evidence from the interviews was contradicted by the responses from the Delphi process, such themes were suppressed during the abstraction process. This was necessary in order to validate the key

Figure 6-1 Analytical Connection between Themes of Relevance from All Data Sources
QUESTIONNAIRE SURVEY ON APA



themes that eventually emerged as being of general consideration across the multiple data sources. This was the case with Theme 7 - 'National Tax Differences' and Theme 10 - 'Distrust and Secrecy'. Both themes were not strongly confirmed by the results of the Delphi study.

Consequently, three key thematic issues permeated through the data analyses as ultimately relevant to the decisions of MNEs on whether or not to consider an APA. These included the issue of the 'Cost and Benefit of an APA to the MNE'; 'The Clarification of the APA Guidelines to the MNE' and; finally the desire and usefulness of having a 'Generic APA' in place as a channel for improving APA submissions.

6.2.1 Cost and Benefit of an APA

The issue of cost and benefit originally assumed significance in this study during the questionnaire survey analysis. Respondents rated the 'Cost of APA' as the most important primary rationale working against their interest in the APA process.

This did not come as a surprise as prior research in this area has always reported similar claims by MNEs in the past (Borkowski, 1993; 1996b; 2008). Together with the empirical studies that have reported this claim, the issue of cost of negotiating and sustaining an APA being greater than that of the benefit is always present in many transfer pricing discussions. This study, however, made an effort to investigate this issue by trying to relate what is involved in MNEs' interpretations of 'cost and benefit' of an APA in relation to the meanings that HMRC accorded to this issue. For MNEs, the cost of an APA was recognized as relatively significant when the transactions are large. This also included the cost of hiring advisers and sustaining applications over the long duration of negotiations, especially in bilateral applications. On the other hand, APA benefits were construed in terms of comparable transactions and the range of transactions under focus (Table 5-18). For other MNEs not regarded as large enough to want to consider an APA, the theme of 'cost and benefit' was interpreted in terms of the time involved in putting documentation together for APA application as compared with that of preparing documentation for defence in a TP audit. This was further reflected in relation to the volume of transactions involved (materiality). Here,

APA would only be given consideration if the volume of transactions involved is significant in order to cover the cost associated with the APA application. Otherwise, there was the notion that being a chance outcome, undergoing an audit for internal transactions is always generally less costly when compared with an APA. Not even the threat of experiencing joint and simultaneous audit appeared strongly enough to persuade MNEs to consider APAs.

Given that this cost was revealed as relative to the duration of negotiations that is always experienced in bilateral applications (this being where there was an agreement that the APA is most useful), it is recommended that a greater pursuit of collective commitment on the part of HMRC should be exercised across jurisdictions as a means of speeding up the process.

Further, HMRC may need to pursue a harmonization of their working procedures with that of tax authorities of other UK treaty partners. This recommendation could take the form of more collaborative initiatives and working processes (rather than a largely individualistic working process) with tax authorities of many of their trading partners.¹⁰¹ This should be both in the interest of the MNEs and HMRC which before now have always advocated more consideration for the bilateral and multilateral APA by the MNEs involved in complex transfer pricing issues. However, it is recognised that the extent of the impact that such collaboration will have in helping to speed up the process will, to a large extent, be influenced by the capabilities and resources of the participating tax authorities. A bilateral APA negotiation between HMRC and any of the highly sophisticated tax authorities in ITP/APA matters (e.g., the US IRS and Australian Tax Office (ATO)), will most certainly be more influenced by the demands and requirements of the latter. This could be viewed differently as the possible impact of the existence of the highest common denominator. For example, the depth of the functional analysis required by the US IRS and its more detailed documentation requirements when compared with that of HMRC may make it more difficult, in a way, for HMRC to be able to influence significantly the cost and time duration that will be taken in

¹⁰¹ This recommendation is in similar line with the workings of the International Accounting Standard Board (IASB) in relation to the pursuit of uniformity in financial reporting practices. The body focused its effort initially on harmonization (i.e., the reduction of differences among the accounting principles used in major capital markets around the world and later, a concentration on the achievement of convergence which is the development of a single set of high-quality, international accounting standards that would be used in at least all major capital markets.

bilateral/multilateral APA negotiations. Nevertheless, if HMRC could pursue more harmonious collaborations for greater uniformity in most of these areas where they tend to have greater discrepancies in terms of APA regulatory requirements, it should not be out of place to expect a more positive and smoother APA experience for MNEs in terms of cost reduction and less time duration.

6.2.2 Clarification of APA Guidelines

This is an inductive theme that came forth from the interviews following the questionnaire survey. The idea of how clear the APA guidelines are (mainly HMRC's Statement of Practice and the OECD Guidelines on transfer pricing which HMRC follow) was largely expressed in terms of acceptable methods of pricing intangibles as well as new inter-company transactions. Evidence from the interviews revealed that MNEs' perception of the level of certainty that can be obtained from the UK APA process is influenced by their inability to clearly determine from the guidelines available, which TP methodology is acceptable to HMRC on their class of transactions and subsequently, whether or not the eventual TP methodology to be imposed by HMRC will be suitable for the company. This sentiment was further evidenced in the Delphi process where the new HMRC Statement of Practice was additionally regarded as generic and not helpful enough. A look at the OECD Transfer Pricing Guidelines (2010) for intangible property as set out in the most recent OECD update made mention, during the discussion of the arm's length consideration, of the application of the comparable uncontrolled price method, the resale price method and, in cases involving highly valuable intangible property where it may be difficult to find comparable uncontrolled transactions, the use of transactional profit methods. However, the Guidelines reject the application of the cost plus method with respect to intangible property on the basis that there is not necessarily a link between costs and value. HMRC follow the OECD Transfer Pricing Guidelines as related to the determination of the most appropriate method. According to the KPMG's (2011) Global Transfer Pricing Review report, transfer pricing methods acceptable to the Revenue include the transaction methods: comparable uncontrolled price; resale price; and cost plus. Also acceptable are the profit-based methods which include profit split and transaction net margin method (TNMM). Other methodological issues discussed in the Guidelines include that of 'taking account of the transferee's willingness to pay' in the arm's length pricing process of intangible property; and

also the ‘determination of the arm’s length prices based on anticipated benefits’ where valuation is highly uncertain at the time of the transaction. Nevertheless, despite the recommendation of the Guidelines for the adoption of one of the indirect methods where comparables are difficult to find, this study shows that MNEs tend to find it difficult to negotiate APAs for intangibles owing to lack of third party comparables. Hence, the need to exercise judgement in the application of what the Guidelines provide appear to bear an influence on the degree of certainty that MNEs attach to the APA process as operated in the UK. One explanation that is tenable for this attitude at this point may be that because most intangibles are regarded as highly uncertain in nature, then a strong degree of uncertainty leads to high transaction costs for the MNEs, especially in the area of technology, having the effect that market transactions become inefficient (Williamson, 1985), so that true comparables are missing. Consequently, there may be a need for HMRC/OECD to examine and clarify the applicable benchmarking process for intangibles after a transfer price is selected, i.e., a need for guidance on benchmarking for intangibles. The judgemental and uncertain nature of the current procedure presently seems not to be providing the motivation for MNEs to consider an APA. Moreover, as the adoption of either of the present two categories of applicable TP methods could produce vastly different results for MNE operations, a clear identification of which category is applicable to what class of intangibles should provide the certainty and exactness that MNEs seek in an APA and hopefully in turn improve submissions.

Most importantly, there is the need for HMRC to adopt, on a consistent basis, a less adversarial approach towards the administration of their APA process and endeavour to collaborate more with MNEs in their APA initiatives. It is recommended that HMRC should adopt at the moment a more lenient view towards the APA process. This approach should be carried out in the hope that they can learn and thereafter come up with a more definite guidance. Such an approach could ultimately help them to maximize their subsequent tax revenue from transfer pricing without ‘hassles’ and excessive resource expenditure. For now, the burden of determining the appropriate TP methodology needs to rest on the MNEs while the procedure to determine definite and appropriate pricing methodologies for intangibles is finalized. More details and examples of the different kinds of modern intangibles with clearer definitions that go beyond the mere descriptions of traditional intangibles should be pursued

for better clarity. The present OECD Guidelines, in describing what constitutes an intangible property, does not give a clear-cut definition of the term which will be helpful enough in assisting MNEs to identify relevant factors for the valuation of their intangible property.¹⁰² While giving different examples of intangible property, the Guidelines split the definition of ‘intangible property’ into categories of ‘commercial (or trade) intangibles’ (used in manufacturing products or performing services) and ‘marketing intangibles’ (used for supporting the distribution of products and performance of services). Such categorisation seems largely traditional, given the modern ways of conducting businesses by modern firms. Adopting such a classical industrial basis for describing intangibles offers minimal assistance to modern day multinationals that are increasingly faced with changing economic situations. Moreover, these MNEs, in modern times, are now generating different forms of complex intangible assets within the value chain of their modern businesses. Clearer guidelines that will capture their practical business realities will be more helpful than what is presently obtainable from the fiscal authorities as far as APAs are concerned.

6.2.3 Generic APAs

The theme of generic APAs also emerged during the interviews. This theme was supported and identified as needed more when an APA is typically bilateral or multilateral in nature in order to be effective and embraced by MNEs. From Table 5-24, respondents noted their desire to have a more simplified APA regulatory requirement in place, and the positive impact that a uniform TP documentation requirements (rather than a uniform TP audit exercise) could have on APA application submissions with HMRC. Subsequently from the Delphi exercise, a generic APA appeared to be a sufficient condition on which a light APA process and less troublesome provisions for a bilateral APA process can be built. This is expected to make the programme more efficient and attractive. Although Delphi respondents sometimes attributed greater certainty to a specific APA as opposed to a generic one, they however noted that the idea of having a unified documentation requirement that could suffice for different tax authorities involved in an APA application would be a welcome development for MNEs

¹⁰² It needs to be stated that the OECD is presently making efforts to review the Guidelines on transfer pricing aspects of intangibles. The latest publication in this area, i.e., ‘Public Consultation: Revised Discussion Draft on Transfer Pricing of Intangibles, 30 July 2013’, contained among others, explanatory changes to the definition of intangibles.

(Table 5-24, Theme 3). This desire by MNEs, as established by the Delphi experts in this study, could be related to the present workings of the Pacific Association of Tax Administrators (PATA) which is an inter-country affiliation between Australia, USA, Canada, and Japan. These countries provide principles under which taxpayers that are resident within their jurisdictions can create uniform transfer pricing documentation (i.e., the PATA Documentation Package) in order that only one set of documentation meets their individual transfer pricing documentation provisions. Under the workings of the PATA agreement (2004), MNEs are not subject to legal requirements which are greater than those imposed under the local laws of the PATA member; rather the use of the PATA Documentation Package is voluntary for the MNEs. Nevertheless, each PATA member has its own different legal systems, statutes, regulations and administrative approaches with regard to transfer pricing. The PATA agreement is such that an MNE will satisfy each PATA member's documentation provisions by complying with all of the principles contained in this PATA Documentation Package, and will therefore avoid the imposition of the PATA members' transfer pricing penalties as far as it concerns documented transactions among associated enterprises resident in PATA member jurisdictions. In this way, the PATA Documentation Package is aimed at responding to the potential difficulties that MNEs face in complying with the laws and administrative requirements of multiple tax jurisdictions, as evident in the analyses of the survey questionnaire used in this study. The PATA members believe that such documentation package is consistent with the general principles outlined in Chapter V of the OECD TP Guidelines. The consistency of this sort of arrangements with the principles advocated by the OECD Guidelines is reflected in the operative principles which are required to be satisfied in order to use the PATA documentation package.¹⁰³

Borkowski (2008) undertook an empirical test for this theme, by surveying the vice presidents or directors of tax of 325 MNEs. She gathered data in relation to the release of this TP Documentation Package and reported results for two specific time periods; starting with 2002,

¹⁰³ First, MNEs need to make reasonable efforts, as determined by each PATA member tax administration, to establish transfer prices in compliance with the arm's length principle. Second, MNEs need to maintain contemporaneous documentation of their efforts to comply with the arm's length principle. Third, MNEs need to produce, in a timely manner, that documentation upon request by a PATA member tax administrator (PATA, 2004, p. 2).

when PATA's profile became more prominent, and starting with 2004, after PATA's Bilateral APA (BAPA) guidance was released. Her evidence showed that the number of APAs did not increase for these periods, and the APA process did not become more efficient. Borkowski, however, believed that the level of awareness that MNEs have about PATA and its activities is not sufficient and that the body will need to present a much higher global profile if it hopes to have any significant effect on MNEs' transfer pricing related practices.

In addition to Borkowski's recommendation above, it can also be argued that an alternative explanation of the lack of evidence for an increase in APA usage after the introduction of the PATA TP Documentation could be related to how cost effective MNEs find their adherence to the documentation package. Although PATA's objectives for introducing the package was to develop a uniform, multilateral guidance for taxpayers and tax administrators alike, it is difficult to see how the package addresses the fundamental cause of the compliance burden which is experienced by MNEs in the first place. The package still bears the inconsistency that exists among member countries' transfer pricing rules. Thus, it still lacks the harmony and consistency which is desired in the TP administrative practices of member countries. This therefore cannot be said to be in line with OECD progressive intent of having principles that balance the tax administrators' need for documents against the cost and administrative burdens to the taxpayers of creating or obtaining the documents (OECD, 2010, Chapter V).

The real possibility for a generic APA process that came out from the data in this study was that of a light touch APA process. Delphi experts' reactions to this theme, though, reiterated the need for specific APAs with regard to complex transactions. Nevertheless, their responses validated the usefulness of this form of APA arrangement as relevant in helping to simplify the process. HMRC, in this light, need to make effort at developing a uniform and closely harmonised substantive set of APA rules and administrative practices vis-à-vis other tax authorities. Such a generic arrangement would be one that would materially assist MNEs in easing their documentation burdens (i.e., light touch). In this case, it is recommended that HMRC need not just pursue a uniform APA regulatory arrangement but a standardised generic APA collaboration. This should carefully balance not only the need of the tax authorities involved in such arrangements, but also that of taxpayers particularly with respect to the

burden of documentation requirements that are involved. Such an effort should help to address one of the reasons identifying why the PATA Documentation package has not significantly improved the usage of the APA process with the member countries. By having in mind that MNEs will not be willing to support a more burdensome generic APA arrangement than the ones already imposed in the UK or the countries with which they are required to individually comply, HMRC can make their APA process more attractive to MNEs through a consistent and standardised harmonization of their APA rules, procedures, documentation requirements and penalties vis-à-vis their major treaty partners. Consequently, the existence and increasing involvement of HMRC in generic APA arrangements with other tax authorities should, through increased APA submissions, hopefully guard against any perception of loss in tax revenues deriving from increased tax manipulations by MNEs via transfer pricing.

6.3 Other Related Findings

In relation to other studies in this area, the present study represents a wider focus on the key considerations that explain the attitudes of MNEs towards the APA process giving greater focus to the UK APA process. While the data gathering processes involved enquiries about why MNEs are and are not interested in the APA process, other previous research in this area typically examined the reasons for MNEs' lack of interest in the process. Almost all these studies employed the use of a survey questionnaire (see Chapter 4). The present study, however, took a step further by adopting a mixed-method methodological approach that sought to look at the APA both as a structure (survey questionnaire) as well as a process (interviews and Delphi technique). From the three methodological strategies adopted in the data collection process in this study, three key issues were raised as highly relevant to MNEs' decision making process whenever APAs are being considered. These key issues reported in this study are related to findings in previous research as depicted in Table 6-5 below.

Of the three key thematic findings reported in this study, only the theme of 'Cost and Benefit' has consistently recurred (although mainly in cost terms) in much of the prior work on APAs. The other two issues discussed above have not really been identified in relation to aiding the APA process. This may be because previous efforts have concentrated on just the negative features of the process based on the way it is structured presently. Little or no attention has

Table 6-5 Comparison of the Key Findings on APAs in Previous Research

Studies	Research focus	Method	Key Findings	Consistency With Present Study
Borkowski (1993)	Why US MNEs are reluctant to apply for APAs.	Postal questionnaire	Volume of information and documentation of APA.	Yes
			Cost of obtaining an APA.	Yes
			Audit trigger effect.	No
Borkowski (1996b)	Perceived problems of APA usage by MNEs.	Postal questionnaire	Volume of documentation.	Yes
			Cost of the APA.	Yes
Borkowski (2008)	Usage and efficiency of APAs among PATA countries.	Postal questionnaire	Increase in usage of APAs.	No
			No significant improvement in time taken to negotiate APAs.	Yes
Borkowski (2010)	Reasons for low usage of APA on a country by country basis.	Postal questionnaire	Cost consideration.	Yes
			Volume of documentation.	Yes
	Relationship between APA status and audit risk.	Postal questionnaire	No relationship.	Yes

been given to the bigger picture of what MNEs, which are the principal users themselves, would rather prefer to have in place in the process so as to attract greater interest from them. This study covered this second aspect of APA evaluation. As a significant contribution, this study looked at the APA programme not only as a structure in place but also as a process. It is this researcher's hope that additional consideration of the two other issues (i.e., Clarification

of APA Guidelines and Generic APA) that were raised in this work will help to improve the understanding of APA policy makers, particularly HMRC, in taking realistic steps on how to improve the APA process in future.

6.4 Theoretical Implications of the Research Findings

The most obvious theoretical implication of the findings in this study is with respect to the reported theme of ‘Clarification of APA Guidelines’ and what contribution this might have for the theory of OLI/FDI as discussed in Chapter 3. The need for better clarification and definite guidance from MNEs surveyed in this study, in the APA Guidelines as presently constituted is valid as regard a critical aspect of the theoretical proposition of the OLI framework of Dunning (1979, 1980, 1981, 2001), i.e., the internalization sub-paradigm. Ethier (1986) explained in relation to Dunning’s work that the sub-paradigm of ‘internalization’ has to do with the economics of information (Figure 3-1 depicted this analogy). Basically, the internalization approach to the modern theory of the multinational enterprise rests on two general axioms, according to Buckley (1988). The first is that ‘Firms choose the least cost location for each activity they perform and secondly, firms grow by internalizing markets up to the point where the benefits of further internalization are outweighed by the costs’ (p. 182). The two propositions are not independent as the internalization of markets will interact with least cost location, e.g., internalization allows international transfer price manipulation that will bias location towards consideration of low tax locations. The problem of transacting information whereby firms guard sensitive information relating to their products and operations informs, according to the FDI theory, the assumption of MNE status. Ethier (1986) noted that the critical consideration determining whether a particular international transaction should be internalized usually reduces to an analysis of the exchange of information between two agents. As such, coordination of contracts can be done either at arm’s length or internally (Figure 3-1, Chapter 3). Generally, imperfect markets will be internalized until the benefits are equalled by the costs. In this light, MNEs try to guard their monopoly advantages by being sensitive to information that is disclosed to any contracting party. This sensitivity could explain why MNEs are reluctant to consider APA applications under the present guidelines as they are not exactly certain as to the extent of information to be released. Complex transfer pricing cases or ‘Complexity’ as demanded under the present HMRC APA regulations was

construed by MNEs in this study in terms of more information to be demanded by HMRC. However, MNEs seemed sensitive to information supplied to HMRC as HMRC may request more information than that which the company is willing to release in an APA application procedure. Additionally, they were also sensitive to information supplied to HMRC and the risk of it getting into the hands of competitors. From the interviews, the two major ways by which MNEs make contact with UK tax authorities with regard to transfer pricing were identified as either through TP tax audits or the MAP. Through these processes, MNEs are able to gauge the skill and competence of HMRC officials with whom they deal and this affords them the opportunity of identifying whom to follow up. Through this process in some cases, MNEs tend to attract these officials for employments as in-house tax directors within the company. Such possibilities help to substantiate the sensitivity that they maintain towards the amount of information they would be willing to release in an APA procedure.

On the other hand, the uncertainty that MNEs associate with the choice of acceptable TP methodology for intangibles owing to the lack of clarity of the present APA guidelines could be contributing to the transactional costs of conducting such internal transfers which in turn justifies the general propositions of transaction cost economics (TCE) as discussed in Chapter 3. Much of the argument under TCE rests on the incidence of transaction costs in internal and external markets and this informs the choice of the appropriate governance structure between 'markets and hierarchies'. Williamson (1985) argued that a strong degree of uncertainty will lead to high transaction costs especially in the area of technology, having the effect that market transactions become inefficient. The uncertainty of the APA guidelines is more applicable where transactions are conducted via hierarchies and the lack of definite and clear information on the choice of acceptable methodology as reported in this study will only indicate a possible perception of an increase in the overall transaction cost of conducting such transfers. Thus, having clearer information beforehand as to what is involved in their decision making process on whether or not to consider an APA will put MNEs in a better situation of assessing the most cost-effective governance structure for their internal transfers.

6.5 Policy Implications of the Research Findings.

Although the policy contributions of this study are restricted by the inability of the researcher to access HMRC and obtain their perspective on the findings, some tentative implications can, however, be drawn from the available evidences.

A key theme from this study in relation to MNEs' consideration of an APA is the issue of 'Clarification of APA Guidelines' and one policy implication of this study in relation to this theme is that of the role of new transactions as against existing transactions. We can consider the issue of whether HMRC should, during their TP tax audit investigations and enquiries, target more new transactions. Findings from the interviews in this study revealed that the longer the period within which the MNE has been dealing in a transaction, the slimmer the chance that an APA will be considered. HMRC however, in 2011, noted that in carrying out their transfer pricing audit, or adjusting controlled transactions for transfer pricing purposes, a general assessment of the transfer pricing risks of an MNE is undertaken and this will include a consideration of the level of controlled transactions and hence tax at risk (OECD, 2011). If a concentration of effort is made by HMRC on relatively new intra-group transactions where they exist, rather than already existing transactions, it may encourage MNEs to perceive a greater need for an APA as a means of obtaining greater certainty on those transactions which it is not always easy to defend in terms of the TP adopted. As a means of improving compliance and enforcement processes, the OECD is making effort to promote the adoption of cost-effective use of taxpayers' and tax administrations' resources by encouraging governments to direct compliance and enforcement efforts to the riskiest, biggest and most complex transactions. Already, HMRC have adopted a risk-based approach towards their transfer pricing audit exercise which makes for an allocation of resources to audit activities in terms of tax at risk. However, it is thought that giving consideration for new rather than existing transactions within MNEs could assist in simplifying the HMRC's transfer pricing process the more and ultimately reduce the cost of compliance.

The policy implications of the other two key themes in this study (i.e., 'Cost and Benefit of APA' and 'Generic APA') could be considered in relation to the possibilities of HMRC engaging in 'generic APA arrangements' as a basis of 'reducing the cost' of an APA for

MNEs. Already, the existence of different transfer pricing rules among tax authorities for associated companies constitutes a major tax obstacle for MNEs (Markham, 2012). Moreover, the determination of the arm's length price to be agreed in an APA negotiation is not always an easy process for either the MNE taxpayers or the tax authorities. In most cases, different tax authorities have defined specific rules to determine their own acceptable transfer price but the inconsistencies associated with these practices would have contributed to the length and duration of time involved in reaching APA agreements of a bilateral and multilateral nature. Consequently, the increased cost of negotiating APAs with other administrative burdens would be imposed on MNEs.

Within the European Union (EU), the EU Commissioner for Taxation and Customs Union is actively engaged in trying to address similar issues in cross-border transfer pricing among member states. The commission, in collaboration with expert personnel from the Joint Transfer Pricing Forum as well as the private sector, had previously implemented some codes of conduct within the EU. The body, however, also champion the use of APAs (under the dispute avoidance measures) among the region as a means of avoiding transfer pricing disputes among tax administrations and taxpayers. However, the fact that these codes of conduct are not binding on member states still leaves in existence the problem of inconsistencies and individual preferences among member states. Hence, a joint bilateral or multilateral APA process in generic form could be of great relief for MNEs and as such encourage them to perceive lower risk (cost and information-wise) in any consideration for APAs which in turn should encourage them to make more applications than is currently the case. The benefit of this should not only be for the UK alone but indeed, for other European countries as well.¹⁰⁴ An encouraging effort by the Commission, however, is that of a Common

¹⁰⁴ For example, on April 21, 2010 the Italian tax administration published its first Bulletin on APA procedures - known as International Rulings in Italy - carried out from 2004 to 2009, containing statistical information about the applications submitted and agreements made between taxpayers and the Italian Revenue Agency. The report provides general statistics concerning the applications submitted in the period 2004-2009 and the details are as follows:

- Fifty-two (52) applications were submitted, among which 19 'international standard rulings' (unilateral APAs) were granted.
- Seventeen (17) procedures are in progress.
- Seven (7) applications were rejected.
- Nine (9) applications were withdrawn.
- The median completion time was 17 months, and the average was 20 months.

Consolidated Corporate Tax Base (CCCTB) which considers an arrangement related to the Formulary Apportionment Basis for Corporate Income Tax Administration. The CCCTB enables those companies that are operating within the internal market and who choose to adopt its provisions to follow the same rules for the calculation of their tax base across the EU. This will be in lieu of doing such calculation in accordance with, at maximum, 27 systems that are in existence within the body. Consequently, tax authorities would then distribute the taxable base according to some pre-determined legal criteria (sales, labour factor, and asset). This has an expectation of improving efficiency and reducing compliance costs and other general administrative burdens.

While adopting such a Formulary approach is considered as an alternative to the arm's length principle given its difficulties (see Chapter 2, Section 2.3.4), this researcher thus argues for caution in the adoption of such an approach. Basically, both the arm's length approach and the Formulary approach that is implemented by the CCCTB aim at ensuring that the taxable income of group companies is not distorted by control over the group exercised by the parent company. With the arm's length principle, a discrepancy between the market price and the transfer price of a controlled transaction does not necessarily mean that there is income shifting contrary to the arm's length principle, i.e., the principle requires benefits of integration (economies of scale) to be considered. However, the principle will normally give recognition to the prices of uncontrolled transactions relating to the purchase and sale of goods and services. As such, its key expectation is that the transfer prices of controlled transactions must conform to prices of market transactions. The Formulary approach, on the other hand, takes into account the fact that a multinational enterprise normally functions as an economic unit and as such, income allocation is usually based on the consolidated profit of the group. Such consolidated profits are allocated between group companies based on predetermined allocation mechanisms. This implies that both uncontrolled and controlled transactions are affected by such norms, thereby having economies of integration being allocated among all group companies. Although MNEs find it almost impossible to make an allocation of economies of integration based on empirical market data as required under the arm's length

In general, 74% of the submitted applications were completed within two years (Bloomberg BNA Transfer Pricing Watch, July 2010).

principle, it has been argued that adopting Formulary apportionment approach in an international context, as an alternative to the arm's length principle, is likely to cause the administrative burdens for both taxpayers and tax authorities to increase (Wittendorff, 2011). Wittendorff explained that under the arm's length principle, taxpayers are required to produce transfer pricing documentation whereas the Formulary apportionment approach requires taxpayers to produce documentation regarding both the components of the allocation formula and the controlled transactions that must be eliminated for purpose of the consolidation. The 2010 OECD Guidelines, in justifying its support for the arm's length approach, also stated that taxpayers will still be required to prepare separate accounts for financial accounting purposes and if Formulary apportionment approach does not cover all group entities, taxpayers may be faced with compliance burdens under both norms (par. 1.31 of the OECD 2010 Guidelines).¹⁰⁵

On this basis, the sort of uniformity (i.e., generic APA arrangements) that is recommended in this study is such that should encourage applications for APAs by helping to reduce the cost of APAs in particular as well as TP compliance cost to MNE taxpayers in general. While the present effort of the CCCTB is commendable in that it aims to adopt a common approach towards the calculation of transfer pricing, such cooperation could be enhanced by focusing on a common approach among member states regarding the application of the arm's length principle. This is because it cannot be clearly established yet whether the present Formulary approach will reduce the cost to MNEs of complying with such a formula. On the other hand, adopting a common arm's length basis through generic APA arrangements should help to simplify further the APA procedures as this will assist in avoiding situations whereby individual criteria for determining acceptable arm's length price are being applied. HMRC will basically need to pursue this kind of an arrangement, given that they largely consider complex TP cases. Such cases are ones that MNE taxpayers perceive as of high risk (e.g., non-routine intangibles) and for which the required TP documentation requirements are considered burdensome at present, thereby increasing the perceived cost of APA to MNE users. Hence, a greater effort by HMRC on such generic APA arrangements that focus on standardised arm's

¹⁰⁵ Par. 1.31 of the OECD 2010 Guidelines stated that the MNE group would also be required, in any event, to maintain separate accounting for corporations that are not members of the MNE group for global formulary apportionment tax purposes but that are still associated enterprises of one or more members of the MNE group (p. 41).

length approach rather than a Formulary apportionment method (as being considered by the EU CCCTB details) should help to ease the perceived burden of the APA process as viewed by MNE taxpayers. Perhaps, if anything, Formulary arrangements may be considered for low risk transactions where documentation requirements are not too severe in the view of MNE taxpayers. In such a situation, the limited documentation requirements that may be applicable in this case could still be bearable by taxpayers despite the possible need to maintain separate accounts. In all likelihood, a further step by the tax authorities towards generating common regulatory provisions and requirements for APA processes, such that similar documentation requirements and information can satisfy all member states' tax authorities, should (with reference to the findings in this study) help to encourage a greater need for APAs by MNEs.

6.5.1 Practical Considerations under Policy Relevance of the Research Findings

The idea of engaging in 'generic APA' arrangements by HMRC as a basis of reducing 'Cost' of the process for MNEs may not be as straightforward as many of the MNEs would desire. As such arrangements are meant to facilitate more bilateral/multilateral negotiations between different tax authorities, careful thought may need to be given to the implications of such negotiations, of the existence of the 'Highest Common Denominator'.

While it remains safe to maintain that an APA assumes that parties in negotiations have relatively equal information, the disparity in the resource capabilities and sophistication of different tax authorities (which in turn defines their access to details/detailed information on MNE taxpayers) may influence how easy or difficult it is for such a 'generic' arrangement to be drawn up. Under such a scenario, proposals by HMRC for a mutual arrangements in the form of 'generic APAs' with requirements that are not in line with the broader economic objectives of the approached party/parties may be an obstacle to the accomplishment of 'generic APA' arrangements with many tax authorities.

With the US IRS, for example, its reputation of having the most detailed and stringent requirements in relation to transfer pricing regulations apparently puts it in a dominant position (highest common denominator) in any potential generic arrangements with its tax administration. However, where there may be some similarities between the two tax

authorities in terms of request made for the purposes of supporting the tax return and the need for documentation to be contemporaneous with the submission of the return, there are most likely to be other information required by the USA which are not considered necessary in the UK. Any generic arrangement therefore, would most likely have to fall in line with the extensive requirements of the US regulations which MNEs themselves view as very strict. On the other hand, similar documentation requirements as demanded in the UK may not be required by other less sophisticated tax authorities such as may be obtainable in the developing countries. Thus, the differences in the transfer pricing rules of different countries may impress on HMRC to isolate some countries in their pursuit of any generic arrangement for their APA process, even though MNEs taxpayers have an important aspect of their operations in these jurisdictions. As such, opportunities for HMRC in the UK to pursue a 'generic APA' could be stifled.

Similar considerations apply to situations where fiscal requirements for transfer pricing are identical between the UK and another tax administration but the depth of such requirements is different. For example, although there are no specific requirements set down in the legislation to this effect, the conduct of 'functional analysis'¹⁰⁶ is only generally expected by HMRC to be included in an MNE taxpayer transfer pricing study along with other components like risk analysis, industry analysis, financial performance, intra-group agreements etc. (KPMG 2012). The US IRS, on the other hand, requires that the determination of the degree of comparability must be based on a functional analysis made to identify the economically significant functions performed, assets used, and risks assumed by the controlled and uncontrolled parties involved in the transactions under review.¹⁰⁷ As such, the depth of compliance expected for such a requirement by the two tax authorities will differ. These differences in depth of legislative requirements between the two bodies may constitute an obstacle even in a bid to negotiate timely bilateral/multilateral APAs involving the USA in addition to the possible hindrances that such frictions will present to the achievement of a 'generic APA' agreement by HMRC.

¹⁰⁶ Functional analysis is a method of finding and organizing facts about a business in terms of its functions, risks and intangibles in order to identify how these allocated between the companies involved in the transactions under review (PWC, 2011).

¹⁰⁷ Section 482-1 (d) (3) (i) of the transfer pricing regulations i.e., *Internal Revenue Code (IRC) Section 482* contains the official definition and requirements for functional analysis as it applies under United States transfer pricing rules.

Also, differences in financial reporting and disclosure requirements between two countries may impact on the transfer pricing needs and practices of MNEs operating within these jurisdictions. In the USA, as yet another example, the need to standardize the reporting of uncertain tax positions and related unrecognized tax benefits, necessitated the Financial Accounting Standards Board to introduce in 2006 the *Financial Accounting Standards Board Interpretation No 48: Accounting for Uncertainty in Income Taxes* (FIN 48), which has become mandatory since 2008 for MNEs following US GAAP irrespective of the parent MNE's home country. Borkowski and Gaffney (2012) argued that this now mandatory disclosure in the financial report and tax return of MNEs will assist tax authorities in identifying those issues to be assessed further in a transfer pricing audit, and in uncovering evidence of any significant income-shifting activities. They consequently reported that FIN 48 increased both the quality and quantity of tax-related reporting in the annual reports of its adopters, making their transactions more transparent and understandable to the external users of their annual reports. More particularly, they also showed that FIN 48 seems to have led to an increase in MNE interest in negotiating advance pricing agreements with their own and with related tax authorities. These helped the MNEs to mitigate the effects of one of the largest and most uncertain tax positions, cross-border transfer pricing transactions.

With the above evidence among, the requirement to comply with FIN 48 will be required to be an integral part of any potential 'generic APA' arrangement that the US IRS may be willing to enter into. The implication of such possibilities for UK based MNEs may be worthy of consideration, given that the International Accounting Standard Board (IASB), which produces the IFRS provisions that most UK MNEs follow, does not yet provide specific guidance to MNEs about Uncertain Tax Positions and does not require disclosure of Uncertain Tax Positions by IFRS-compliant MNEs (Borkowski and Gaffney, 2012). Hence, greater considerations will need to be given to the implications for APAs in general for the existence of the highest common denominator, such as the US IRS, in order to understand better how to improve the APA process in general.

6.6 Conclusion

The chapter has discussed in detail the key findings that eventually emerged from this study. After presenting the themes that were considered relevant by MNEs in their decision making process on whether or not to apply for an APA, each of these key themes was discussed. The theoretical implications of the themes were presented in relation to the FDI theories as presented in Chapter 3. Also, the policy and practical relevance of these themes were also analysed. Additionally, the chapter showed how the findings of this study are related to previous research in this area. However, only the theme of 'Cost and Benefit of an APA' has been reported before in previous APA studies. The findings from this study have therefore shown that MNEs consider more than just the 'cost of an APA' in their decision on whether or not to apply for one. Other issues such as the 'clarification of the APA guidelines' to follow as well as whether or not such an APA arrangement will be easily acceptable to other tax authorities (as a result of a 'generic APA arrangement' between HMRC and such tax authorities) are all relevant to MNEs in their APA decision.

CHAPTER 7: CONCLUSIONS AND DIRECTIONS FOR FUTURE RESEARCH

7.1 Introduction

The objective of this research has been to contribute towards an improved understanding of the rationales behind the attitudes of MNEs towards the UK APA process. This goal has been pursued by trying to examine the perceptions of the principal users of the process as related to the way the process currently operates, in the hope of identifying the reasons for the mismatch between the intended objective and the actual workings of the process. In this chapter, the researcher's conclusions on the findings are discussed and an assessment of the strength and limitations of the research is provided. The original contributions of the study are also presented while the remaining part of the chapter identifies the possible changes and recommendations for future research on the APA process.

7.2 Relevant Conclusions of the Research Study

The central focus of this study has been to investigate the rationale behind MNEs' decision to consider or not to consider an application for the APA process as presently operated in the UK. In particular, the study has responded to the desire of HMRC to improve the UK APA programme. HMRC in 2010 stressed the high priority attached to the improvements to the UK's APA programme and the likely increased utility of unilateral, bilateral and multilateral APAs (Melissa Tatton, 2010). Towards this end, HMRC initiated a new approach to their transfer pricing enquiries involving greater specialization and team work, a focus on issues of higher risk, action plans for enquiries agreed where possible with companies and active monitoring of progress. However, for the first time, HMRC released in December, 2011, statistics relating to APAs as well as other transfer pricing areas. While HMRC claimed to have made progress in settling some very old APA cases during 2010/2011, an increase in the average time to reach settlement was recorded during this period. The average time to reach agreement was reported to have risen from 20.3 months to 22.7 months. Thus, the new approaches towards transfer pricing issues identified above and the APA guidance¹⁰⁸ as

¹⁰⁸ Some changes made in the Final APA Statement of Practice (SP 2/10) include:

1. Much greater emphasis on the significance of the pre-filing meeting (the so-called 'Expression of Interest' phase), which can be done on a 'no-names' basis and in a relatively informal manner.

constituted in the new HMRC Statement of Practice SP2/10, both still support the common taxpayer complaints that the process is too long, thereby becoming onerous to undertake. This study however, endeavoured to identify some of the key issues that HMRC would have to look into as a means of achieving the much desired improvement in the process. Behind the consideration of APAs with HMRC by MNEs are: issues of cost of the process as related to its benefits; how clear the APA guidelines are so as to indicate convincingly the certainty desired (i.e., what sort of issues will meet HMRC's complexity threshold and how acceptable will the methodology proposed be for intangible transactions); and finally the possibility of having a less burdensome process to fulfil by having a generic APA requirements/process in place. These are all fundamental to the achievement of any positive change/improvement in attitudes of MNEs towards the process. The findings that were reported in the previous chapter in relation to each of these key issues inform the researcher's conclusion as to the following issues.

(i) The lack of financial certainty and finality in the APA process contributes towards high APA cost to MNEs

Contrary to expectation, the present working of UK APA process does not seem to support the objectives of MNEs as proposed by the FDI theory. The 'comparability vs. competitive advantage argument', as presented in Chapter 3, led to the expectation that the APA process, given its cooperative nature, would assist in accommodating the practical observance of the propositions of the OLI and TCE/Internalization theories as applicable to the MNE concerned. FDI theory explains that the process of 'internalizing' transactions within MNEs has to do with the economics of information (Ethier, 1986). Both the OLI and TCE theories stated that MNEs will choose to internalize when there is need to protect sensitive information which may be associated with their core advantage. However, this MNE objective is not supported by the present APA process in the UK because of its lack of certainty and finality.

2. The threshold for applying for an APA has been lowered so that not only complex cases are covered but also cases where there is a high likelihood of double taxation arising without an APA, or where the taxpayer is seeking to apply an innovative transfer pricing method, for example.

3. A greater scope for multinationals to conclude unilateral APAs.

4. A much more user-friendly approach and attitude of HMRC towards APAs in general.

HMRC will typically claim to be looking for a more transparent tax system. However, MNE taxpayers, as gathered from this study, seemed to perceive the APA process as presently constituted as not providing enough of a platform for the reduction of TP tax risk and achievement of certainty for their tax liability. In one of the new sections to their International Manual (i.e., HMRC International Manual - INTM471010), HMRC claimed that the only way that MNEs can obtain assurance for legal certainty that HMRC will accept the arm's length price of a transaction is through an APA. However, the legal position that is effectively obtainable from the process is, arguably, still not certain. This uncertainty relates to the level of assurance or protection which an MNE may enjoy from HMRC after obtaining initial general opinion about a proposed APA application. On the contrary, MNE taxpayers seem to be increasingly concerned about the best way to get not only legal certainty but also some financial certainty and finality, together with the key concerns about the amount of transfer pricing information that HMRC request. Their sensitivity to the nature and kind of disclosure that they make is underlined by their primary motive of operating as a multinational in the first place as advanced under the FDI theory. However, despite the possibility of supplying this information, HMRC may conclude that they still do not have the information that they need to consider fully the issue proposed by the MNE. Hence, the process does not carry the element of finality that MNEs desire to see in the process. This bears on the cost of an APA that MNEs perceive with the process and their comparison of what would be involved if they were to have undergone a TP audit instead. This therefore has implications for the key finding of 'Cost and Benefit of an APA' as very relevant in MNE decision to consider APAs.

The desire for an element of 'finality' in the APA process by MNEs could also be related to the theme of 'Clarification of Guidelines' and that of 'Generic APA'. With the former, MNEs tend to look to the tax authorities for clear guidance in relation to the acceptable TP methodology to be imposed by the tax authorities as well as the level of adjustment to be undertaken in an APA process. However, evidence from the interviews and the Delphi process showed that such specific directions have not emerged from the different APA regulations in place. Particularly, the new HMRC Statement of Practice SP2/10 is regarded as generic and not helpful enough for MNEs in their APA decision making process. MNEs are faced with a situation where they exercise their discretion/judgement without the desired level

of certainty or finality as to the deciphering and application of what the guidelines provide. Consequently, the non-existence of such an element of finality impacts negatively on the degree of certainty with which MNEs view the APA process.

On the other hand, the desire for a 'Generic APA' arrangement by MNEs in the study further reinforces their desire for an element of 'finality' in the APA process. Basically, in terms of the sovereignty of tax law, the OECD arm's length principle can be interpreted in different ways by different tax authorities. MNEs are faced with the potential problem of complying with the laws and administrative requirements of multiple tax jurisdictions. This difficulty generates a high level of compliance cost for taxpayers who seek to negotiate bilateral/multilateral APA arrangements. Therefore, the need for a 'Generic APA' in the form of a uniform and standardised multilateral guidance with harmonised and consistent administrative requirements from member tax authorities is undoubtedly an indication of the element of 'finality' being sought by MNEs in the effort to make the process more appealing.

(ii) Greater certainty in HMRC's advice on APA will increase MNEs' perception of clarity in the Guidelines

The non-availability of the certainty which MNEs seem to be looking for so as to reduce cost involved in their APA application, as earlier pointed out, does play out in the HMRC's International Manual but more particularly in relation to the nature of advice that HMRC are prepared to provide about appropriate TP methodology as part of real time working. According to the Guidance, HMRC are happy to discuss transfer pricing methods but will however, not discuss the price. For illustration, the authority will not provide opinion as to whether a 5% administrative charge is arm's length: rather, they will give their thoughts on whether such administrative charge that is set with reference to external CUPs (comparable uncontrolled prices) is appropriate. The provision of 'general opinion' about methodology is now part of HMRC's real time working. However, the extent of the opinion that they are prepared to provide can be related to the search for more clarity and exactness from MNEs (as found in this study) in relation to their decision as to whether to consider an APA or not.

(iii) A review of HMRC's facilitating role should increase MNEs' interest in APAs

The above issues about the findings in this study provide a path for a broader conclusion in this research. Up to this point, the general view that is indicated could arguably be taken as that of MNE taxpayers looking for more tax avoidance platforms while tax authorities on the other hand are seeking to reduce or prevent tax evasion through transfer pricing. Such a facilitating role is considered along the line of some key issues which were originally intended to be discussed with HMRC but for which an invitation for an interview was declined (see HMRC interview protocol in Appendix 7).

First, HMRC's concerns about the take-up rate of their APA programme need to be established clearly in respect of the way the process is administered. Recent APA statistics showed an increase of 50% for the year 2010/2011. Forty nine applications were made in 2010/2011, compared with 32 the previous year while 35 APAs were agreed in 2010/11, with 69 applications on hand at year end. HMRC seem to regard these figures as indicating significant progress in the programme and tend to be measuring the success of the programme only on these quantitative parameters. This may not necessarily be the case as these statistics are not sufficient to indicate the reasons for the APA applications. Also, these statistics on the number of APAs may not necessarily demonstrate the balance of interest between the MNE taxpayers and HMRC. Further issues that should be examined are the need to relate these statistics to the tax authority's objectives for the programme by placing them in a broader context of the overall number of taxpayers with transfer pricing issues. In addition, there is the issue of whether or not HMRC can handle a large take-up rate for their APA programme. HMRC, in regard to this point, will need to be clear whether or not like the Australian Taxation Office (ATO), they desire to have all MNEs involved in their APA programme as an attempt to measure relative success in this area.

Second, while data from the APA questionnaire respondents showed no evidence of any positive connection between the tax audit experience of MNEs and their consideration of APA applications with HMRC, some of the Delphi respondents, however, suggested that there is only a little or no difference in the cost involved in these two processes. It is therefore pertinent to consider how HMRC would react to the APA process being taken as equivalent of

an audit. The general notion about the APA process is that if a taxpayer wishes to avoid the risk of an audit, along with ensuing penalties, in relation to related-party transactions, entering into an APA is the only option. However, the perception of taxpayers about an APA being equivalent to an audit is suggestive of the possibility that MNE taxpayers do not view the present process as helpful enough in achieving reduction in their compliance costs and/or increase in efficiency.¹⁰⁹ HMRC need to examine and push to clarify through their APA working process the difference that makes entering into an APA more worthwhile than undergoing a TP audit and also clarify that the audit could not serve as a substitute for an APA application.

Further, the impact of the new HMRC Statement of Practice SP2/10 (SoP) on the facilitating role of HMRC in the APA process needs to be examined. HMRC rightly need to identify whether the new SoP has brought about improvement in submissions of APA applications since its introduction. Perhaps any sort of feedback which the authority can obtain from MNEs on the new SoP may help to provide useful information on the administration of the process. Moreover, HMRC need to examine how far their SoP could reflect 'light APA requirements' for unilateral APAs. On the other hand, as the new SOP seems presently to have put the burden of determining a TP methodology in advance on the MNE, there is the need for HMRC to give consideration to whether or not there is a generic process of recognizing comparables that they will deem as acceptable. It should be helpful to consider how MNE taxpayers get to know whether the comparables acceptable to HMRC are only based on independent UK companies and if not, whether HMRC accept others.

Addressing these issues will provide an opportunity to HMRC whereby they are able to measure the potential impacts and effectiveness of their APA policies in an attempt genuinely to improve the process.

¹⁰⁹ Interview data (Table 5-22) revealed MNEs' perceptions that with a TP audit, fiscal authorities will only choose questionable TP items for investigation out of a possible large amount of transactions that can be worth large sums of money, whereas with an APA, they know that more information will have to be disclosed.

7.3 Strengths and Limitations of the Research Study

A limitation associated with this study is related to the sample size, particularly in relation to the use of survey questionnaire as a means of data collection. The use that was made of this research strategy suffered from the weaknesses associated with any survey questionnaire, especially the fact that the researcher did not have control over who completes the questionnaire (Bourque and Fielder, 1995). As previously stated, the use of a survey questionnaire in the collection of data on APA seems inevitable given that the APA process as administered by tax authorities both within the UK and elsewhere is treated as highly confidential and as such there are no publicly available data on companies who have APAs.

Another limitation that can be identified in this research is in the use of the online/email form for the Delphi study in the third stage of data collection. This mode of administering the Delphi did not allow the researcher to explore differences in opinions of participants, where necessary, on same questions. The inability to get them all together around the same table made it difficult to achieve this check on data gathered via this source.

Further, it is difficult to generalize the results to a wider population as a result of the overall sample size examined. The difficulty in having access to target respondents and the degree of confidentiality always attached to the research topic did not allow for adequate data collection as desired by this researcher. However, despite this weakness, it is pertinent to restate that the small sample size is still very informative.

However, despite these weaknesses, this study has the strength of demonstrating some rigour by adopting a mixed method methodological choice to investigating the APA process. The research gathered data from multiple sources and also demonstrated a sequential data collection procedure from these sources. The original survey questionnaire was developed by reference to literature, and the result from this survey was used to develop the protocol for the interviews. The coding of the interview transcripts led to four themes which were later examined with a cross-section of academics and tax practitioners who worked in the area of APA. While the survey questionnaires examined the structure of the APA, the interviews helped to look more at the APA as a process and explore more the insights which emerged

from the questionnaire. This researcher has no knowledge of any other UK study on APAs that have applied a similar mixed method methodological choice and approach in addressing APA related research issues. The whole triangulation of the research methods (Section 4.7.4) helped to provide a solid attempt at checking construct validity and also helped to demonstrate how the common method bias (CMV) was taken care of. Figure 4-4 in Chapter 4 showed how this sequence played out.

7.4 Contributions of the Research Study

In general, this study has made original contributions under two key areas. The first area is related to the general aim of the research. The study helped to generate improved understanding of the reasons for the ‘mismatch’ between the ‘intended’ and the ‘actual’ as far as the UK APA process is concerned. With the APA process, the intention of HMRC is to provide MNE taxpayers with an alternative avenue through which they (MNEs) can obtain certainty on their transfer pricing tax positions. Through this, MNEs are expected to be able to overcome any doubts that they would have faced in their bid to satisfy the mandatory application of the arm’s length principle as required by the transfer pricing regulations. The actual reality, however, is the persistent lack of interest in the APA process by MNEs which is reflected in the low level of applications made over the years. This study therefore makes an effort to examine not just what users consider as problematic with the present process (as typically focused on by previous studies), but also what they desire to have in place in order to improve the process. A broader examination of the UK APA process was carried out using a more extensive approach (mixed method methodology) of validating the research outcomes. The relevant themes that were generated would allow for future research to concentrate on them and enable some propositions to be tested in relation to subsequent debates on the process.

The second aspect of original contributions of this study is in the area of methodology. As already noted in Chapter 4, the majority of the previous research studies on ITP, and indeed APA (Table 6-5, Chapter 6) have employed the use of survey questionnaires. However, many authors have identified some of the limitations of surveys (Leitch and Barrett, 1992; Cravens and Shearon, 1996). This researcher recognises the limitations that researchers of this subject

face in getting access to the required data. Nevertheless, this study has attempted to explore the topic of APA beyond the traditional consideration of the structure of the programme. The efforts made involved the use of a mixed method methodological choice that covered the use of questionnaire survey, interviews and Delphi study. By adopting this multiple approach, the study not only helped to explore the APA as a process, it also contributed toward moving beyond the traditional limitations associated with the mono-method approach that is usually adopted to study transfer pricing issues.

Another contribution in the area of methodology is the use of Delphi study as one of the methodological strategy in this study. The Delphi study is a structured communication technique, originally developed as a systematic, interactive forecasting method which relies on a panel of experts. This is a research strategy that has been largely used in the nursing and allied health literature with a variety of methodological interpretations and modifications. Despite the popularity of this technique in these areas, the Delphi technique is one that accounting researchers have not been quick to adopt (Worrel et al., 2012). Only few accounting related studies have actually utilized this technique in the past. This scenario helps to highlight the significant contribution that is made by this study through the adoption of the Delphi technique. The use of this technique represents a significant methodological contribution in accounting related research. Particularly in relation to the study of APAs, the Delphi study, as adopted, helped to combine the knowledge of a group of APA experts. Through this process, the most relevant conclusions to all APA stakeholders were reached.

7.5 Directions for Future Research on APAs

The concept of an APA represents a specific administrative process within the multidisciplinary area of the transfer pricing spectrum. There are some considerations which may be of further interest and influence the directions for future research on APAs.

1. There is need to explore the role and influence of information exchange processes on the extent of considerations being given to APAs by MNEs. It is on record that in order to tackle the issue of income shifting more intensively, governments of many countries have initiated information exchange programmes with their counterparts in foreign jurisdictions. These

information exchange programmes are typically implemented as part of the exchange of information article of bilateral tax treaties.¹¹⁰ In fact, the OECD ‘Global Forum Working Group on Effective Exchange of Information’ originally developed the ‘Agreement on Exchange of Information on Tax Matters’, i.e., Tax Information Exchange Agreements (TIEAs), in 2002 as a model agreement on exchange of information on tax matters. This was meant to promote international cooperation in tax matters through exchange of information and as a means of addressing harmful tax practices. In addition to helping tax authorities to identify individual evaders, the agreements allow tax authorities to request information from offshore financial centres and other matters relevant to transfer pricing enquiries, which determine how multinationals split taxable profits between countries. Interestingly though, recent studies are beginning to show evidence of the use of networks among MNEs in sharing information among themselves as a source of benchmarking and defence for their adopted arm’s length prices. Whether these networks are responses to fiscal authorities’ strengthening of information exchange agreements¹¹¹ or the reverse is a question which requires empirical evidence to answer, but in order to understand better what influences the need for an APA by MNEs, it may be more insightful to consider the relationship among MNEs and their use of information networks on one hand, and the relationship and use of information exchange process among tax authorities on the other hand.

2. Also, there may be need to investigate how the informal intra-network information benchmarking among MNEs compares with the comparability requirements of different tax authorities and the consequent effect of this ‘match-making’ on the need for APAs by MNEs. Already, many authors have noted that MNEs find it difficult to comply with the fiscal requirements for the demonstration of arm’s length principle in their transfer pricing policies

¹¹⁰ In addition to this bilateral approach is the multilateral attempt to implement a tax information exchange programme, known as the Joint International Tax Shelter Information Centre (JITSIC), established in 2004 to identify and share information on a real-time basis. The information exchange facilities of the JITSIC have enabled the country members to uncover and challenge transactions that would be likely to have been neither found nor understood. Among the country members are Australia, Canada, China, Japan, the USA, and the UK, as well as Korea as an observer.

¹¹¹ Vanessa Houlder reported in the *Financial Times*, March 20, 2010 that following the G-20 summit meeting in London in April 2009, which led to a surge of new tax information exchange agreements being signed in the second half of that year, tax authorities are better placed to challenge the transfer pricing strategies of multinational companies.

(e.g., Bartelsman and Beetsma, 2000; Adams and Coombes, 2003). This difficulty is always pegged down to the non-existence of external comparable markets for many intra-firm transactions, especially in the case of intangibles. As such, MNEs face doubt as to how the arm's length standard should be applied and thereby encounter what HMRC regard as complex TP issues which are key in the consideration of APA applications by the UK tax authority. Future research could examine whether the new practice whereby MNEs share TP information among themselves has helped to make it easier for MNEs now to adhere to the arm's length principle as required by fiscal regulations. This could help explain whether or not by having such arrangements among themselves, MNEs now have less need to enter into APA agreements with HMRC.

3. This study reports three key issues that influence the decision making process of MNEs in their consideration about an APA. Although MNEs in this study has expressed concern about the present design of the APA process based on these three issues, future research could also explore the impact that the present UK APA processes have on the need for an MNE to consider applying for an APA using the procedural justice literature. This may look at how the combination of the different interactions within the APA process with HMRC takes account of procedural justice for the parties involved. Basically, procedural justice focuses on the fairness of decision making procedures and the treatment individuals receive from decision making authorities. This could play an important role in the decision to comply with tax legislation. Related studies in this area could attempt to examine further the impact of the UK APA process on MNEs' willingness to apply for the programme and whether the principles of procedural justice are embraced better by HMRC. Such efforts should help to provide a better lens for viewing the relationships between the considerations for APAs and voluntary tax compliance and also APA consideration in relation to procedural justice.

7.6 Summary

This research offers some insights into the reasons for MNEs' attitudes towards the current UK APA process. The value of the study is seen from the mixed method methodology (unlike the common single survey questionnaire approach) that is adopted by this researcher in looking at the APA process. Initially, a survey (postal questionnaire) was carried out to obtain

a user perspective of the process and examine the rationales behind MNE attitudes towards it. The evaluation of the survey data helped to highlight the most important rationales why MNEs apply and do not apply for the APA process. It also revealed their assessment and perceptions about the usefulness of the APA. In general, six key themes emerged from the analysis and these helped to provide the basis for the examination of the APA process.

Consequently, a semi-structured interview was conducted with three tax directors who provided more insights into the six themes that emerged from the questionnaire. Their responses were analysed with a hybrid approach (mixed approach) and this brought forth some new inductive themes that emerged as key issues in MNE decision making process over whether or not to apply for the process. The third stage of the method triangulation finally attempts to confirm the validity of the new inductive themes with APA experts via an online Delphi exercise (see Appendix 6). The findings from the Delphi process helped to inform the conclusion of the research as three key issues were confirmed as fundamental to MNEs' consideration of the APA process. MNEs paid key attention to the cost of applying and sustaining the APA as compared with the benefits it gives in return in handling associated TP audit risk and uncertainty. The desire for more clarity in the guidelines to be followed in agreeing and managing an APA also appeared as valid and very important. Finally, MNEs believed that a common approach towards the APA process by both HMRC and other tax authorities will make the process more attractive and easy to undertake.

The research helps to generate a clearer understanding of not just why MNEs do not embrace the APA process but also what they desire and believe that would help to trigger greater interest in the process. Figure 6-1 showed the links between the themes highlighted and the connections among these themes. The eventual findings will allow for future research to concentrate on the key issues reported and as such, allow some propositions to be tested where necessary. Also, these should trigger interest in the use of alternative approaches towards the study of the APA and the conduct of more empirical investigation into the process in future.

APPENDICES

APPENDIX 1: Advance Pricing Agreements in the UK

Year	Number of APAs signed	Number of APAs In force at year-end
1996	3	8
1997	2	10
1998	3	13
1999	2	15
2000	10	25
2001	11	36
2000-01	6	5
2001-02	9	14
2002-03	6	16
2003-04	10	22
2004-05	10	22
2005-06	7	18
2006	14	33
2007	16	37
2008	15	46

Sources: Hansard, UK House of Commons Debates, 17 June 2002, col. 137; 6 Jul 2006, col. 1258; 5 January 2010, col. 178. (Extracted from 'The Dark Side of Transfer Pricing: Its Role in Tax Avoidance and Wealth Retentiveness- Sikka and Wilmott, 2010, p. 31)

APPENDIX 2: Executive Summary on APA Survey Report



An Empirical Evaluation of the APA Process in the UK
(EXECUTIVE SUMMARY)

Oluwaseun AVOSEH (Main Researcher)

(PhD Student in Accounting and Finance, Business School, University of Glasgow, UK)

BUSINESS SCHOOL (ACCOUNTING AND FINANCE)
UNIVERSITY OF GLASGOW (*OCTOBER 2010*)

Executive Summary

This survey sets out to evaluate empirically the APA process with a major focus on the UK programme. It investigates the underlying reasons why MNEs based in the UK apply and do not apply for the APA programme both with HMRC and other tax authorities. Only about 50-60 cases are reported to be currently involved in the UK APA programme - a far cry from the number of cross-border transfer pricing cases (enquiries, adjustments, penalties) reported regularly in the UK House of Commons debates over the years. Moreover, the inconsistency between results of previous research (Borkowski, 1993, 1996b; Ernst & Young, 1997 – 2007) on the uptake of the APA both within and outside the UK necessitates a re-assessment of the process and its operations especially from the perspective of attitudes and potential attitudes of the users - principally the Multinationals (MNEs) towards the process.

Two hundred and sixty nine (269) tax directors/heads of UK based MNEs were surveyed for which 37 MNEs returned validly usable feedback. All respondents are classified as large taxpayers under the UK criteria. Of these, five are APA applicants (with nine different agreements/negotiations in place) and 32 are non-APA applicants. Despite the disparity, six themes emerged from the responses given. These helped to bring forth more insights on the APA process in line with the following categories.

1.1 Theme 1: *Cost and Benefits*

Consistent with prior research (Borkowski, 1993; 1996b; 2008), MNEs in this survey referenced 'high APA cost' as the main deterrent to making APA applications (see Table 1). Still, like other leading tax authorities in TP and APA regulations, HMRC is also making distinct efforts in minimizing some of these costs in terms of time duration of completing APA negotiations and agreements (see HMRC tax bulletin 43E (part 3) for example). Could there be some inconsistency in the definition of cost and benefits of an APA between the tax authorities and MNE taxpayers? What about the internal and external costs that MNEs assume in APA applications: do the tax authorities have enough understanding of these cost implications in their cost-minimization efforts? Moreover, do fiscal legislation users recognize the same cost and benefits when an APA is in focus?

Table 1: Most Important Rationales for No Interest in APA

<u>Primary Rationales Against APA Application</u>	% of Occurrence	Proportion of Ordinal positioning (1st Rank)	<u>Overall Rank</u>
<i>APA upfront and annual cost implication (in terms of time, funds and mgt. resources) is greater than its perceived benefits.</i>	65%	<u>67%</u>	1
<i>Not enough volume of cross-border transactions</i>	38%	<u>66%</u>	2
<i>Volume of information/documentation required by the process</i>	53%	<u>18%</u>	3

With a clear understanding of the nature of APA cost and its relativity especially in terms of other associated themes outlined below, a more practical evaluation of the process could be engendered in addition to generating the desired consensus view on APA cost.

2. Theme 2: TP Audit Experience relationship with APA Applications by MNEs

MNEs in our sample all operated in regulated business environments where there is high demand for transparency. This necessitates the prevalence of potential audit risks and exposure which obviously is one of the main problems APAs are meant to address. Nevertheless, MNEs' previous TP audit experience does not seem to trigger APA application. A no-association pattern is reported for both variables as shown in Table 2 below:

TABLE 2: MNEs' Prior Audit Experience and Their APA Status

<u>APA BY AUDIT STATUS:</u>	<u>MNEs</u>	<u>FISHER'S INDEX</u>	<u>TRANSACTIONS</u>	<u>FISHER'S INDEX</u>
Total Audited	26 (70%)	-		-
Total Non-Audited	11 (30%)	-	84 (74%)	-
Total Audited : APA Application	26:3	0.623	29 (26%)	0.396
HMRC Audited : APA Application	14:0	0.267	84:18	-
Other T. Auth Audited: APA Appl.	23: 3	0.267	-	-

Given the cost justification for no interest in APAs by the MNEs in this survey, do the costs of an APA outweigh that of TP audits for UK MNEs? If not, why would MNEs be contented

with TP audit hassles without resorting to APAs, given the chances of subsequent adverse audits and related possibilities of adjustment? On the other hand, how would the new position of different tax authorities on simultaneous multiple TP audit impact on this association (i.e., APA vs. TP Audits). Would the possible increase in information sharing that would characterise this process change the views of MNEs on the cost relationship between the APA process and the TP Audit experience? Besides, would this rather change views on the individual cost implication of both the APA process and TP audit cost as against the association between both?

1.3 Theme 3: *Alternative Dispute Resolution (ADR) Methods Available to MNEs*

Only 8% of MNEs with prior HMRC audit experience in the last three years have plans for applying for an APA in the next 12 months (Table 3). With this lack of evidence in popularity of the APA programme with MNEs, are other ADR options utilised by companies to settle their potential TP tax dispute and associated uncertainties?

TABLE 3: MNEs' Prior Audit Experience and Their Plan for APAs

<u>ALTERNATIVE DISPUTE RESOLUTION (ADR):</u>	<u>MNEs</u>	<u>FISHER'S INDEX</u>	<u>TRANSACTION NS</u>	<u>FISHER'S INDEX</u>
Total Audited: Planned APA Applicatn.	26:2 (8%)	-	84:7 (8%)	-
Non-APA Audited: Planned APA Appl.	23:2 (9%)	1.000 1.000	72:7 (10%) -	1.000 -
HMRC Audited : Plans for APA	14:1 (8%)			

Besides, only an average of 10% of previously audited transactions which are dealt in by respondent MNEs are being proposed to be covered under an APA agreement in the next 12 months (see Table 3 above). This further reinforces the probability that MNEs may be using other ADRs in lieu of APAs in handling their TP audit risks. If this is the case, does that imply that MNEs perceive ADR methods as less costly than APAs in settling outstanding TP audits where necessary? What form of relationship do MNEs maintain with HMRC International Division that tends to negate such a dire need for an APA and how well do these arrangements work in practice?

1.4 Theme 4: Complexity of MNEs' TP Cases

HMRC's information section on APAs emphasises the exclusive focus of the process on complex TP cases. With only prescriptive but no definitive or exhaustive meaning of complexity given in both the '*HMRC 2007 consultative document on approach to Transfer pricing for large businesses*' and the HMRC's '*Guidelines for the conduct of Transfer pricing enquiries*' (where complexity is only discussed within the context of drawing the 'Enquiry time-tables and Action plans'), there exists the need to identify any convergence in perceptions of complexity between MNE taxpayers and the tax authority. This should help to clarify how both the MNEs and HMRC interpret complex TP cases.

For the MNEs which adopt more of the transactional profit TP methods for each type of transactions, Table 4 below shows a relatively larger proportion of them being associated with previous TP audits than for those who have adopted the traditional transaction TP methods. In the case of intangibles, all MNEs adopting the transactional profit TP methods were audited.

Does the larger incidence of TP audits on the transactional profit methods imply that HMRC regard them as more complex than the traditional transactional TP methods or is it a case of HMRC just having preference for the traditional transaction TP methods in the past before the OECD new guidance on the selection of the most appropriate transfer pricing method to the circumstances of the case? If this is the case, does HMRC regard some methods as more complex than the others?

On the other hand, 51% of MNEs in our survey perceived intangibles (*i.e., licensing of intangible property and technology cost-sharing agreements*) as highly vulnerable to TP tax audits/disputes with HMRC. As complexity is often related to doubts about arm's length TP method adopted, would vulnerability then translate to the global adoption of a similar kind of TP method for 'licensing of intangible properties' (or other types of intangibles) in all the company's businesses? With HMRC, is the adoption of similar TP method for same type of transaction a better defence on the part of the MNE instead of adopting multiple methods for such?

If however complexity is not related to type of methodology adopted, are intangibles viewed by MNEs as of greater complexity than services and/or financial transactions?

TABLE 4: Audit Status of TP Methods Adopted for Transactions by Non-APA User MNEs

<u>Transaction types with Audit Status Methods Described in The OECD 1995 Guidelines</u>	<u>For Tangible Transfers</u>		<u>For Intangible Transfers</u>		<u>For Services</u>		<u>For Financial Transactions</u>	
	<u>Audited</u>	<u>Non Aud.</u>	<u>Audited</u>	<u>Non Aud.</u>	<u>Audited</u>	<u>Non Aud.</u>	<u>Audited</u>	<u>Non Aud.</u>
Traditional Transaction Methods	55%	20%	47%	12%	58%	22%	63%	20%
Transactional Profit Methods	15%	10%	41%	0%	17%	3%	14%	3%
TOTAL TRANSACTIONS	14 + 6 = 20		15 + 2 = 17		27 + 9 = 36		27 + 8 = 35	

1.5 Theme 5: Risk Assessment

Here, the link between what MNEs' experiences and beliefs are and what their actions have been is examined. Not only did 51% of MNEs perceive 'licensing of intangible property' as most vulnerable inter-company transaction to TP audit/dispute with HMRC, 59% of the non-APA MNEs also agreed that an APA is beneficial when employed to cover this class of transactions i.e., intangibles (Table 5).

Table 5: APA Benefits for Various Types of Transactions

Transaction Type	<u>Not Beneficial</u> 1	2	3	4	5	6	<u>Highly Beneficial</u> 7	<u>No Response</u>	<u>Total MNEs</u>
Non-APA Applicants									
Tangibles	6%	22%	6%	34%	13%	6%	-	13%	32
Intangibles	-	6%	13%	9%	31%	25%	3%	13%	32
Services	-	16%	18%	21%	16%	16%	-	13%	32
Financial Transactions	-	22%	19%	28%	9%	9%	-	13%	32

This seems to call for questioning whether the APA advice available to MNEs on intangibles is sufficiently clear so as to encourage APA application. With the indeterminate amount of information requested in an APA application, how do MNEs seek to manage the inherent cost and risk of disclosing sensitive information once an APA is being examined/renewed? Moreover, given the amount and sensitivity of information that has already been provided to the tax authority, how easy is it to stop an APA process? On the other hand, where an APA is being stopped, how do MNEs then manage the implications of HMRC's alternative interpretations of such discontinuation?

1.6 Theme 6: *Volume and Size of MNEs' Cross-border Transactions*

Our survey revealed some large 'non-dormant companies with small related party transactions' as highlighted in Table 1 above. The definition of small or medium-sized enterprise in new *Taxation (International and Other Provisions) Act (TIOPA) 2010* appears to foreclose from consideration automatic exemption from TP rules those companies with small volume related-party transactions. Despite their 'Not enough volume of cross-border transactions', 33% of MNEs in this class have experienced prior TP tax audit in the last three years with only 8% of them (though non-audited) planning to negotiate an APA within the next 12 months. Could there be differences between how MNEs themselves interpret 'volume' and how they perceive HMRC to interpret 'volume'? If the physical volume is not influential in an audit, is it the value, potential future value or volume, % of all transactions, industry specificity or even the type of transaction involved that is perceived to be influential here? More important though, is whether required information should be restricted when complex low volume transactions are the focus of an APA so as to encourage participation by more MNEs.

Addressing the issues raised in this report should help to achieve better clarity as to why few MNEs are really interested in HMRC's APA process. Consequently, by being able to gauge effectively their actual or assumed resentment for the UK APA process, a progressive agenda for improving the UK APA process could be highlighted.

APPENDIX 3: Large Taxpayer Classification Criteria - United Kingdom

HMRC have adopted the EU definition as the departmental definition with some adaptations. HMRC looks at the tax affairs of large businesses in two parts of the organization, the Large Business Service (LBS) and Local Compliance (LC) in the 'Large and Complex' customer group. The criteria to qualify as a 'Large' business are:

- UK enterprises with more than 250 employees;
- UK enterprises with fewer than 250 employees, and more than €50 million turnover and more than €43 million assets;
- UK companies owned by foreign multi-nationals and more than 100 UK employees;
- UK companies and enterprises with high risk scores for Corporation Tax or Value Added Tax, and VAT avoidance and partial exemption cases;
- Large and complex partnerships;
- Businesses liable to Income Tax with a turnover of more than £5 million; or
- Employers who fall within any of the preceding categories.

Source: 'Forum on Tax Administration: Compliance Management of Large Business Task Group - Guidance note on Experiences and Practices of Eight OECD Countries, July 2009, p. 8'.

APPENDIX 4: Survey Questionnaire

Department of Accounting and Finance

Date: xx/xx/xxxx**Mr/Ms Xxx**

Official Designation

Address

Dear Sir/Madam,

Introduction - A study on rationales for (not)/applying for Advance Pricing Agreements (APAs)

Initially, we would like to thank you for your support and participation in this study. The following questionnaire has been developed (as part of a PhD research work at the University of Glasgow) for Tax directors/Heads/Managers and/or Directors of Finance of UK based multinationals (MNEs) in order to obtain a user-perspective evaluation of the APA programme. *(Please pass this on to the person in appropriate position if this is not your area of expertise).*

It is notable that the APA process has been designed to produce a formal agreement between taxpayers and revenue authorities in order to avoid uncertain consequences of changes in transfer pricing methods applied and fiscal regulation changes. The questionnaire attempts to identify empirically significant reasons for applying/not applying for the APA process. The resultant findings should inform Her Majesty's Revenue & Customs' (HMRC) policy in this important area as well as reveal the underlying motive of a sample of MNEs. Moreover, results from this survey should assist MNEs and tax practitioners in effective preparation for the APA process and of APA policies.

Consequently, your participation in the following questionnaire will be highly appreciated. Prior test shows that the questions will take about 15-20 minutes to complete. Taking into consideration the high sensitivity of the information required, it is important to stress that all information you provide will be strictly confidential and used only for the purpose of the project. Data will only be used in aggregate form and no respondent or individual company will be identified by name. To this effect, a signed *guarantee of confidentiality* is included herewith.

We thank you for taking the time to read this letter and hope to receive your positive response.

Sincerely,

Oluwaseun Avoseh

(Main Researcher)

Doctoral Research Student

*Dept. of Accounting and
Finance, University of Glasgow.*

Phone: 0141 330 2672

Email: *o.avoseh.1@research.gla.ac.uk*

Clive Emmanuel

Professor of Accounting

Dept. of Accounting and

*Finance,
University of Glasgow.*

Research Supervisor

Dr George Kominis

Lecturer

Department of Accounting

*and Finance,
University of Glasgow.*

Research Thesis Advisor.

N.B. *Please do direct all correspondence, clarifications or enquiries to the main researcher as addressed above.*

November 1st, 2009.

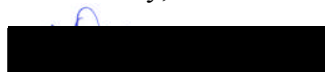
Dear Participant

Re: Assurance of Confidentiality

This letter serves as affirmation of confidentiality in the storage and use of data obtained from your organization. Documents, individuals, and the company comprise confidential information, and therefore will not be identifiable in this respect. Particulars relevant to data analyses and results will be done by reference to participants only by function and/or abstract assignment of a letter. Also, the company's identification will not be disclosed other than in general terms (i.e. size, general product offerings).

All data will be securely stored and access limited to the research team only. On completion of the PhD, the data will be destroyed.

Yours sincerely,



Avoseh O. Oluwaseun
Researcher



Professor Clive Emmanuel
Research Supervisor



Dr George Kominis
Research Thesis Advisor

INFORMED CONSENT LETTER

Although your participation in this study is voluntary, it will be highly appreciated if you could indicate your consent, if given, by signing below for onward documentation and submission to the university as part of its ethical approval process.

Also, while it will be highly appreciated if you could fill in all questions asked, you however retain the liberty to withdraw from the study at any time. All correspondence regarding this study can be addressed to the main researcher via the contact details in the previous page.

The University of Glasgow Ethics Committee Review Board has approved this study.

Signature.....

Date.....

N.B. Please return this page with completed questionnaire.

QUESTIONNAIRE

(1) As a direct respondent to this questionnaire, please state your official position/capacity within your specific Multinational Enterprise (MNE) entity. _____

(2) Within your specific MNE business entity, what kinds of transactions are typically involved in its cross-border and/or domestic internal transfers? Please check off 'X' in all that apply.

Tangibles (e.g., products, inventory, equipment, trade fixtures etc.) _____

Intangibles (e.g., software, R&D, brands, licenses etc.) _____

Services (e.g., consultancy, special expertise transfer etc.) _____

Financial Transactions (e.g., loans, guarantees etc.) _____

(3) Generally, what relative proportion of total general transactions are 'internal transactions (internal transfers) within your specific MNE entity? Please check off 'X' in applicable box.

(a) 0 - 25% ____ (b) 26% - 50% ____ (c) 51% - 75% ____ (e) Above 75% ____

(4) Has your specific MNE entity experienced transfer pricing audit within the last three years?

YES _____ NO _____ (If No, Go to question 6)

(5) Which country's tax authority carried out this audit? Please check off 'X' in all that apply.

Australia's ATO ____ Canada's CRA ____ UK's HMRC ____ US's IRS ____ Other(s) ____

(6) In your experience/opinion, how **vulnerable** do you consider the following types of inter-company transactions to transfer pricing disputes with (and/or tax audit examinations from) HMRC?

Please use the following rating scale.

<u>Types of Inter-company Transactions</u>	<i>Not Vulnerable</i>					<i>Highly Vulnerable</i>	
	1	2	3	4	5	6	7
Transfer or sales of finished goods for resale.	1	2	3	4	5	6	7
Commission for sales/transfer of goods.	1	2	3	4	5	6	7
Sales of raw materials or components between group companies.	1	2	3	4	5	6	7
Licensing of intangible property.	1	2	3	4	5	6	7
Administrative or managerial services.	1	2	3	4	5	6	7
Technical services.	1	2	3	4	5	6	7
Inter-company financing.	1	2	3	4	5	6	7
Technology cost-sharing agreements.	1	2	3	4	5	6	7
Other category (Please state):	1	2	3	4	5	6	7

- (7) Advance pricing agreements (APAs) are offered by many tax authorities as binding agreements with an entity or entities within a group covering the transfer pricing method that will apply for specified goods or services that are transacted within the group. What is the status of your specific MNE entity regarding APAs? Please check off 'X' for all that applies.

- (a) Do not have and have no plans to seek an APA now or in the next twelve months.
- (b) Do not have any but will be contacting UK HMRC within the next twelve months about an APA
- (c) Do not have any but will be contacting the US IRS within the next twelve months regarding an APA
- (d) Do not have any but will be contacting another country's tax authority within the next twelve months regarding an APA- Country/Jurisdiction: _____

N.B. *If you checked off any of these responses please skip directly to question 8*

- (e) Have an APA with UK HMRC
- (f) Have an APA with the US IRS
- (g) Have an APA or equivalent with other country's tax authority - Country: _____
- (h) Are currently in negotiation with UK HMRC regarding an APA
- (i) Are currently in negotiation with the US IRS regarding APA

N.B. *If you checked off any of these responses please skip directly to question 11 from here*

- (8) Please rank the top three reasons why your specific MNE entity does not have or is not interested in the APA process at this time. Give ordinal preference in 1, 2, 3 with 1 being topmost, 2 as next; and so forth.

_____ Volume of information/documentation required by the process

_____ Confidentiality problems with materials submitted to the tax authority

_____ Non-flexibility in adjusting transfer pricing policy once APA is agreed

_____ Potential misuse of information by tax authority to trigger prior year tax audits

_____ APA upfront and annual cost implication (in terms of time, funds and management resources) is greater than its perceived benefits.

_____ Uncertain outcome associated with APA application and negotiations.

_____ Other (Please state) _____

- (11) If you have an APA(s) or are currently negotiating one, please state the number of agreement(s) /potential agreement(s) for the different class of APA(s) your specific MNE entity is **presently** involved/intend to be involved in (Otherwise skip to question 17).

(Number range {e.g., > x or 0 –x} could be used if exact figure is not readily available).

	<u><i>Unilateral</i></u>	<u><i>Bilateral/Multilateral</i></u>
Currently involved		
Intended		

**Please answer question (12) to (13) with one particular APA in mind under each APA type where Applicable*

- (12) Which of the following types of inter-company transactions does the type of APA cover?
Please check off 'X' to all that are applicable.

<u>Types of Inter-company Transactions</u>	<u>Types of APA</u>	
	<u><i>Unilateral</i></u>	<u><i>Bilateral/Multilateral</i></u>
Transfer or sales of finished goods for resale		
Commission for sales/transfer of goods		
Sales of raw materials or components between group companies		
Licensing of intangible property		
Administrative or managerial services		
Technical services		
Inter-company financing		
Technology cost-sharing agreements		
Other category (<i>Please state</i>):		

- (13) Please identify and rank, from the reasons stated below, your **three most important** rationales behind your specific MNE entity application for this (these) specific APA(s) currently agreed or being negotiated. Give ordinal preference in 1, 2, 3... with 1 being the topmost reason, 2 being the next; and so forth.

<u>Primary Rationales</u>		
	<i>Unilateral</i>	<i>Bilateral/ Multilateral</i>
(a) To avoid tax audit examination and its attendant time and cost implications.		
(b) To obtain greater certainty on existing tax treatment by tax authority.		
(c) To develop a representative arm's length outcome on a fact pattern to be repeated in other countries.		
(d) To take advantage of the APA rollback and/or extension benefits.		
(e) To avoid exposure to double tax and penalties.		
(f) To resolve a tax authority's open transfer pricing disputes.		
(g) To maximize post-tax profitability of the group.		
(h) To regain good working relationship between your MNE and the tax authority(ies) involved.		
(i) Positive experience of prior APAs or other agreements with relevant tax authority(ies).		
(j) To avoid potential negative publicity.		
(k) Other reason(s): please state _____ _____ _____		

N.B. Question (14) and (15) below do not apply to any APA still in negotiation. If all the APAs you have in mind are still currently being negotiated, please skip to Question 16.

- (14) For the top three reasons identified above (based on your ranking) in question 13, how effective has the APA been within the last two years in meeting these objectives? Please indicate the applicable rating for each reason based on the following rating scale for each APA category:

	Not Applicable	Not Effective						Very Effective
	<u>0</u>	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>	<u>7</u>
<u>UNILATERAL</u>								
<i>Foremost Reason:</i>	0	1	2	3	4	5	6	7
<i>2nd Reason:</i>	0	1	2	3	4	5	6	7
<i>3rd Reason:</i>	0	1	2	3	4	5	6	7

(17) From your experience (*In your opinion*), how beneficial is an APA for the following types of transaction? *Please use the following rating scale as applicable.*

	Not Beneficial						Highly Beneficial
	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>	<u>7</u>
<i>Tangibles:</i>							
<i>Intangibles:</i>	1	2	3	4	5	6	7
<i>Services:</i>	1	2	3	4	5	6	7
<i>Financial Transactions :</i>	1	2	3	4	5	6	7

(18) Please add any comment on the existing APA process and how it might be improved

(19) Would you like to discuss the APA process further?

YES _____ (Please send an email to o.avoseh.1@research.gla.ac.uk) NO _____

(20) Thank you for completing this questionnaire. Would you like to receive a copy of the survey results?

YES _____ (Please send an email to o.avoseh.1@research.gla.ac.uk) NO _____

PLEASE RETURN COMPLETED QUESTIONNAIRE VIA THE SELF-ADDRESSED ENVELOPE ENCLOSED.

APPENDIX 5: MNEs' Interview Protocol

Theme 1: Cost and Benefits

➤ HMRC's view is that the availability of pre-application meetings makes it not necessarily costly to begin an APA application. However, our survey results still showed that MNEs continued to reference 'high APA cost' as the main deterrent to making APA applications. *If your organization is to make an application for one, are there any internal and external costs to be incurred which may not be captured within the pre-application meetings?*

- *In this particular case of your MNE, are these costs (either newly mentioned or already obvious ones) not outweighed by what your MNE stands to benefit if regard is given to the size of your entity business?*

Theme 2: TP Audit Experience Relationship with APA Applications by MNEs

➤ Our survey report shows that previous TP audit experience of MNEs does not seem to trigger an APA application. *In dealing with the HMRC in the UK, do you consider tax audit experience a less expensive option to making an APA application in spite of the increasing possibilities of subsequent adverse audits and related adjustment?*

- *Would you maintain similar views on this APA/TP audit relationship for other tax authorities that your organization is involved with in aside HMRC?*

- *If you consider the new positions of different tax authorities to begin to undertake multi-country coordinated audits and simultaneous examination, how would this affect your views of this APA/TP Audit relationship?*

- *What about the possible increase in information sharing that would characterize this process?*

Prompt Question:

- *What sorts of informal consultations short of APA are available to your company in event of TP tax disagreement with HMRC?*

Theme 3: Alternative Dispute Resolution (ADR) Methods available to MNEs

➤ Our survey data indicate that MNEs do face several transfer pricing examinations either unilaterally or in multiple trends. Again, one would have expected an APA to be useful here. *What is your experience of being rejected as an APA applicant if any? Any one with HMRC?*

Prompt Question:

- *Can you shed more light on the reason for such rejection?*

- With the lack of popularity of the APA programme with MNEs, *where necessary, do you find other ADR options more useful than an APA in settling potential TP tax dispute and associated uncertainties?*

Prompt Question:

- **If Yes;** *does this imply that your organization consider these ADR methods as less costly than APAs in settling its outstanding TP audits?*
- **If No;** *Can we then say that perhaps your organization maintains some form of relationship with relevant tax authorities (like HMRC International Division) and as such APAs and ADRs are not necessary? How does this work?*

Theme 4: *Complexity of MNEs' TP Cases*

In consistence with current workings of the OECD Committee on Fiscal Affairs (Working Party 6), MNEs in our survey (51%) consider intangibles (*specifically licensing of intangible property and Technology cost-sharing agreements*) as problematic by perceiving it as most vulnerable to TP tax audits/disputes with HMRC. *What intangibles are involved in your inter-company transfers?*

- *Are these kinds of transactions particularly complex?*
- *Why?*

OR

- *How would you describe the sort of challenges faced when attempting to determine transfer prices (acceptable to the HMRC) for this kind of inter-company transaction?*

Prompt Question:

- *Does this imply that the guidelines that you follow in determining how to assess the most appropriate TP method for intangibles are (OR are not) sufficiently clear?*

Guidelines deemed clear:

- *If your organization finds it clear enough how to assess the most appropriate TP method for intangibles within the company's business, has this anything to do with preference(s) for particular TP methods by the relevant tax authority (HMRC)? OR is it a case of your organization adopting similar TP method for same type of transaction perhaps as a defence strategy?*

Guidelines not deemed clear:

- *If the guidelines are not that clear, how does your organization then attempt to handle the vulnerability that arises from such uncertainties?*

- *Does this vulnerability imply that the MNE globally adopt a similar kind of TP method for same types of intangibles in all the company's businesses?*

Theme 5: Risk Assessment

If applicable based on Theme 3 (i) above: You mentioned earlier of having experienced a rejection for an APA application before, with the indeterminate amount of information requested in an APA application, *how did the MNE seek to manage the cost and risk of having disclosed sensitive information during the review of APA application before the rejection decision?*

If not applicable as in Theme 3(i) above: From your experience in this area, *how easy is it for an MNE to stop an APA application going forward which is already under examination, especially if we consider the amount of sensitive information that would have been provided to the tax authority?*

Prompt Question:

- *In such situations where an APA is being stopped, how is the MNE likely to manage the implications of the tax authority's (HMRC's) alternative interpretations of such discontinuation?*

Theme 6: Volume and Size of MNEs' Cross-border Transactions

With regard to the way the UK APA process is conducted (if not conversant with the UK, then any other familiar APA process), *are you also of the opinion that the amount of information requested is too much as compared with the gains of an APA?*

- **If Yes:** *Would you then say that required information should be restricted when (in the case of UK) probably complex, low volume transactions are the focus of an APA so as to encourage participation by more MNEs?*

- **If No:** *Does this mean that you're indifferent to whatever amount of information requested for an APA application irrespective of the volume or size of the transactions in focus?*

Prompt Question:

- *How do you interpret the volume of transactions in focus? What are the relevant indicators that determine the volume of transactions as far as your MNE is concerned?*

APPENDIX 6: Delphi Questionnaire Package



An Empirical Evaluation of the APA Process in the UK

Delphi Expert Consultation

Oluwaseun AVOSEH (Main Researcher)

(PhD Student in Accounting and Finance, Business School, University of Glasgow, UK)

ACCOUNTING AND FINANCE
UNIVERSITY OF GLASGOW (*June 2011*)



Date: xx/xx/xxxx

Dear Mr Xx,

Many thanks for your willingness to participate in this Delphi exercise. As already noted in my earlier email, this one round exercise represents the final stage of data collection for this project. The primary aim of this work is to evaluate empirically the UK APA process especially from the perspective of attitudes and potential attitudes of the users – (principally the Multinationals (MNEs) towards the process.

Previously, postal questionnaires were administered to tax directors/heads of 269 MNEs based in the UK. Six themes emerged from the analysis of the responses gathered: *Cost and Benefits of an APA to Multinationals; Transfer Pricing (TP) Audit Experience Relationship with APA Applications by MNEs; Alternative Dispute Resolution (ADR) Methods Available to MNEs; Complexity of MNEs' TP Cases; Risk Assessment; and Volume and Size (as indicators of materiality).*

Subsequently, a small number of Group Tax Directors was interviewed to corroborate the findings of the questionnaire. These semi-structured interviews with some of the participating MNEs in this project revealed four new themes namely: *Tax Regime Differences; Clarification of APA Guidelines; Generic APA options; and Distrust and Secrecy.*

The Delphi Questionnaire that follows hereafter aims to collate your views on the findings up to this point. These are open-ended questions which are specifically focused on the four new themes as revealed from earlier interviews. There are 12 questions in all and the actual time taken to answer all questions will largely depend on the level of detail you wish to provide on each of them. Prior experience, however, shows that this should take no longer than one hour. No iterations or request for further participation by you will be made after this.

In addition to the Delphi Questionnaire, a copy of the latest and relevant UK HMRC Statement of Practice on the APA Process (SP2/10) is included with this pack. Also included is a copy of Part 5 of the Taxation (International and Other Provisions) Act 2010 which contains the rewritten rules for the UK APA process at sections 218-230.

It is important to stress at this point that all information you will provide will be strictly confidential and used only for the purpose of the project. Data will only be used in aggregate form and no respondent or individual organisation will be identified by name. To this effect, a signed *guarantee of confidentiality* is included herewith. While participants will be supplied

with the questionnaire and interview reports on the receipt of the completed Delphi, the reports on the Delphi studies will, however, be made available to you upon the completion of the analysis.

Following the Delphi, this researcher hopes to approach HMRC later in the month of July, 2011 with request to discuss thereafter the data collected. This is to have the tax authority's view on the findings from this study in order to explicate properly and link both the demand and supply side of the APA process. This should hopefully provide for a robust assessment for the improvement of the programme.

Once again, thank you very much for taking the time to read this letter and I hope to receive your positive response. If further elaboration is required, please do contact me at any of the below addresses.

Oluwaseun AVOSEH (Main Researcher)

Doctoral Research Student

Business School (Accounting and Finance)

University of Glasgow, UK.

Phone: 0141 330 2672

Email: o.avoseh.1@research.gla.ac.uk



8th June, 2011

Re: Assurance of Confidentiality

This letter serves as affirmation of confidentiality in the storage and use of data obtained from your organization. Documents, individuals, and the organization comprise confidential information, and therefore will not be identifiable in this respect. Particulars relevant to data analyses and results will be done by reference to participants only by function and/or abstract assignment of a letter. Similarly, the organization's identity will not be disclosed other than in general terms (i.e., size, product/service offerings).

Where necessary, feedback to you (the main contact) may be warranted for authentication of findings. We thank you very much for your time and anticipated cooperation.

Sincerely yours,
O. Avoseh

A black rectangular redaction box covering the signature of Oluwaseun O. Avoseh.

Oluwaseun O. Avoseh

Doctoral Researcher

A black rectangular redaction box covering the signature of Dr. Georgios Kominis.

Dr. Georgios Kominis
Research Thesis Advisor

Professor Clive R. Emmanuel

Research Supervisor



DELPHI QUESTIONNAIRE

THEME 1: Tax Regime Differences

In some jurisdictions, the need for an APA is not that powerful because the probability of an MNE entering into transfer pricing abuse is limited when consideration is given to the entire tax regime. Transactions like intellectual property and licensing fees have been identified as commonly subjected to quite significant withholding tax in most countries that counteract any transfer pricing (TP) manipulations.

1. *How does the UK tax regime affect consideration of the benefits of negotiating an APA by MNEs?*

Again, the checks and balances from these withholding taxes and other forms of effective tax rate differentials are reported generally to neutralize any intra-group trade abuse that may be exploitable.

2. *Is tax arbitrage an important consideration in an MNE's application for an APA? Please explain.*

THEME 2: Clarification of APA Guidelines

MNEs perceive APA negotiations as essentially an audit.

3. *In line with the objective of an APA to help to determine a clear transfer pricing methodology in advance, what is your view on the HMRC's process?*

APAs are more suitable for new rather than existing transactions. Revisions of the existing transactions are potentially more costly because the tax authority may not agree with already adopted methods.

4. *From your APA experience, is there any added danger in negotiating an APA for existing transactions as opposed to new transactions?*

There exists a wide ranging consensus that the pricing process for intangibles is complex. This is especially because the guidelines are not deemed clear to ascertain whether the adopted pricing method is acceptable/not acceptable or the most reliable. This is an area perceived as most susceptible to HMRC pricing revision and adjustments.

5. *Given that HMRC will typically look at complex TP cases like intangibles in their APA programme, how can the adopted method be justified if there are no comparables?*

6. *Would it be worthwhile for the guidelines to clarify the relative influence of available comparables and choice of methods?*

THEME 3: Generic APA Options

The most beneficial APA is in the bilateral and multilateral form. However, there is the view that the sensitive nature of information and the complexity of the reports that advisers are required to produce for APA does not make the UK APA a light touch process. This is why MNEs will only apply for transactions regarded as very high risk in enquiry/audit incidence.

7. *How would you react to the adoption of a light touch APA as a basic condition for Double Taxation Agreements?*

A joint tax authority statement between the UK and other relevant tax authorities that set out in some detail the requirements to be complied with for a successful bilateral APA might improve submission rates.

8. *How much benefit can be associated with having a generic bilateral APA in place with transparent and concisely defined details?*

The risk of receiving enquiries or undergoing TP audits for a particular transaction (or a fraction of many transactions) where comparables or method may not be reliable can be perceived as lower than the risk of inherent scrutiny under an APA submission for all the transactions.

9. *Do you regard the recent communications by HMRC of a risk-based approach to all their TP audit procedures as likely to increase the take-up of submissions for an APA? Please explain.*

THEME 4: Distrust and Secrecy

HMRC expect that the existence of a trust relationship between the MNE taxpayer and the Revenue will help to improve the APA process. However, MNEs perceive their ability to withdraw from an APA process after they have already supplied some information to HMRC to be limited. This is especially noted for small MNEs which perceive that HMRC will always question why they want to apply for APAs in the first place.

10. *How much distrust among MNE taxpayers is caused by this 'entrapment' attributed to the UK APA process? Does this have any additional implications for small MNEs in particular?*

11. *Given this 'entrapment' issue, how credible is HMRC's purported willingness to encourage APA application? Please state your views on the UK APA process as related to this 'entrapment' issue for all MNEs.*

Today's HMRC TP inspectors are more specialized by industry and there is the possibility that they may work as tax directors in MNEs at a later stage of their career. MNEs seem wary of supplying full information when the inspector is highly likely to be employed by a competitor MNE in the future.

12. *In your opinion, is this perception about confidentiality as related to the HMRC inspectors' career movement a valid concern?*

APPENDIX 7: HMRC Interview Protocol



Objectives of the Interview:

- (i) To explore the take-up rate of the APA programme (Why MNEs submit/not submit applications)
- (ii) To explore HMRC's views on facilities and processes in encouraging MNEs to apply for APAs

Overarching Theme: *HMRC Facilitating Role in APA Applications*

Sub-Theme 1: APA vs. TP Audit

(1) While data from the APA questionnaire respondents showed no evidence of any positive connection between the tax audit experience of MNEs and their consideration of APA applications with HMRC, some of the Delphi respondents however suggested that there is only a little or no difference in the cost involved in these two processes.

(a) *How would the HMRC react to the APA process being taken as equivalent of an audit?*

Prompt:

- *What costs do HMRC perceive are involved for MNEs when APAs are considered?*

(b) *Is there any concern about the take-up rate of the submission to the APA process?*

1st Prompt:

- *Does that imply that HMRC desire (OR ds not desire) to have all MNEs involved in their APA procedure just like (as opposed to) the Australian Tax Office?*

2nd Prompt

- *Can HMRC handle a large take-up rate for their APA programme?*
OR
- *Is this because there is readily available information to HMRC from other tax authorities and this is influencing the facilitating role of the HMRC in their APA process?*

(c) *What use/confidence does the revenue have about alternative approaches such as MENAP, MAP etc., which might render APA redundant?*

Sub-Theme 2: Clarification of APA Guidelines

(2) Some of the respondents to our questionnaire and the Delphi think that having a generic APA guide may be useful in achieving some convergence between HMRC and other tax authorities in terms of adopting the most reliable methodology to pricing. Others however think this is not possible because the APA process is a case by case procedure.

(a) *Could this sort of contrasting position be due to self-interest on the part of the users?*

(b) *How far would the HMRC's SoP accept Generic APA options for a unilateral APA?*

1st Prompt:

- *Has the new SoP led to more improvement in submission of the APA applications since its introduction?*

2nd Prompt:

- *How much influence do you think that the new SoP has in the facilitating role of HMRC in their APA procedure?*

(c) In the views of some participants, the SoP guidelines need clarifications as small inexperienced MNEs may not find the new guidelines particularly helpful. *What's the Revenue's take on this?*

(d) The new SoP seems to put the burden of determining a TP methodology in advance on the MNE. In terms of the sorts of comparables acceptable to the HMRC, *is there a generic process of recognizing comparables?*

Prompt:

- *Are the acceptable comparables only based on the UK companies or do HMRC accept others?*

(d) Also, in terms of the OECD Guidelines on which method is appropriate where exact comparables may not be available, *do HMRC think that the range of methods of 25%-75% (inter-quartile range) given for indirect TP methods is not too wide or helpful enough as a guide?*

Sub-Theme 3: APA Policies and Impact

(3) Responses from the Delphi exercise suggest that most of the processes and initiatives being put in place by HMRC on their APA programme typically impact more on unilateral APA considerations rather than bilateral/multilateral APAs which the HMRC had been hitherto prominently canvassing for.

(a) Now that there is a shift by HMRC to encourage submissions for more unilateral APA applications, *can you identify the underlying reasons for this change in attitude?*

(b) *How does the HMRC measure the (potential impacts) and effectiveness of their APA policies?*

Prompts:

- How are these communicated to the MNEs?
- Why is this information not communicated publicly (if applicable)?
- What sorts of information would such possible announcement on APA include?

(4) We received a range of reasons/trepidations in relation to why MNEs may not submit applications for APA with HMRC. These include such reasons as entrapment, possibility of being investigated on methods already adopted for existing transactions, duration of time involved, possibility of other transactions being subjected to investigations etc.

(a) *Are these of real issues to HMRC?*

(b) *Do HMRC take these issues into account in their APA policies and processes?*

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