# TRANSFER PRICING LITIGATION: HOW COULD THE PORTUGUESE TAX AUTHORITY IMPROVE ITS SUCCESS RATE?

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**Abstract**

**Purpose:** Between 2011 and 2019, 52 transfer pricing cases were decided in tax arbitration courts in Portugal. The Portuguese tax authority prevailed in only seven. The research question that this paper seeks to address is: "What strategic and operational measures can the tax authority implement in order to improve its success rate in transfer pricing litigation?".

**Approach:** This paper is based on a blend of the case study method and legal research approach. Six decisions made during 2011 to 2019 are analyzed in detail in order to find similarities in court reasoning that can be used as a basis for the proposed changes to tax audits.

**Findings**: The main conclusions drawn from the research relate to the need for changes to performance metrics, careful planning for transfer pricing audits, solid analysis of comparability issues in auditing work, more intervention by senior staff acting as filters in respect of unsubstantiated audit reports, and the dissemination of best practices in audit and litigation procedures.

**Implications:** By considering the arbitration court case outcomes, strategic and operational procedures can be applied in the planning, execution, and follow up of transfer pricing tax auditing.

**Originality:** The tax authority's performance in transfer pricing arbitration court cases between 2011 and 2019 is discussed and forms the basis for recommendations to enhance the tax authority's litigation success rate. Transfer pricing is a globally litigated matter, with modest success rates for tax authorities. Thus, the conclusions presented in this paper are useful for policymakers worldwide.

**Keywords:** Portuguese Tax Authority, Transfer Pricing, Litigation.

## 1. INTRODUCTION

Tax authorities (TAs) have been adopting strategic goals and managing daily practices that are increasingly based on quantitative metrics (OECD, 2017). New management trends and the capabilities of information systems are important reasons for this (Scott & Robbins, 2010).

TAs use management tools with the aim of enhancing citizens' and businesses' engagement with tax collection in order to reinforce voluntary compliance. According to the OECD (2014), "compliance, and by extension revenue, flows from taxpayers' belief in the willingness (trust) and ability (confidence) of the revenue body to conduct its business fairly and objectively" (p. 77). The perception of the benefits of active tax compliance has been highlighted in the literature (Serem et al., 2017). Several studies emphasize the importance of trust in relation to taxpayers' willingness to cooperate and comply with TAs (De Widt & Oats, 2022; Gobena &

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Van Dijke, 2016). Others focus on the relationships between tax equity, tax morale, and tax compliance (Castañeda, 2019). Nevertheless, auditing activity in order to control compliance is a major area of interaction between businesses and TAs.

The number of audits carried out and the subsequent additional assessed revenue earned play central roles in the evaluation of a TA's goals (Serra, 2005). Given the pressure on tax collection, multinational businesses are increasingly being audited by TAs for transfer pricing (TP) used in related party transactions (Bradley, 2015; Muhammadi et al., 2016; OECD, 2017). The arm's length rule is the basis of TP legislation and the benchmark used by taxpayers, TAs, and courts when litigation arises.

The OECD (2020) addressed some practical questions relating to the application of the arm's length principle in the context of the COVID-19 pandemic. The OECD guidance focuses on four issues: "(i) comparability analysis; (ii) losses and the allocation of COVID-19 specific costs; (iii) government assistance programmes; and (iv) advance pricing arrangements (OECD, 2020, p. 1). The OECD emphasizes the consequences of the unique economic conditions that arose as a result of the pandemic for TP analysis performed by multinational businesses and TAs with the main purpose of preventing litigation. In fact, TP audits are mainly directed at multinational companies that have the resources to litigate and courts have often decided on such disputes (Cooper et al., 2016). Following a general trend, the Portuguese TA has been auditing multinational firms and tax adjustments based on TP are quite common (Taborda da Gama, 2013). In Portugal, after tax arbitration was introduced in 2011, courts have ruled on many TP cases (de Sousa da Câmara, 2015).

Martins et al. (2020) studied 32 TP arbitration cases decided in Portugal in the period from 2012 to 2017 and found that the Portuguese TA was successful in only three cases. Using the same methodology for the period 2018 to 2020, we found twenty more TP cases on the website of the Administrative Arbitration Centre (CAAD)[3]. The Portuguese TA won only four of these (there was also a mixed decision).

Several decisions highlight one of the gaps in the audit reports: the TA often misapplies the comparability concept by using operations and prices that do not comply with the requirements established in TP regulations as comparables. The TP methods, e.g., comparable uncontrolled price (CUP) and net margin[4] used were often disallowed by tax arbitrators, because of flawed justifications found in audit reports.

The paper addresses the following research question: What policy measures can the Portuguese TA implement to improve its success rate in TP litigation? Our contribution centers on strategic and operational procedures that can be applied to the planning, execution, and follow up of TP tax auditing with the aim of providing TAs with a more robust foundation in order to improve their position in tax arbitration courts. As TP is a globally litigated matter, with modest success

[3] See Centro de arbitragem administrativa [CAAD] (n.d.) where all tax cases are published (omitting the real names of the litigants).

[4] The traditional transaction methods are the comparable uncontrolled price (CUP) method, the resale price method, and the cost plus method. The transactional profit methods are the transactional net margin method (net margin) and the transactional profit split method (OECD, 2022). The CUP and net margin methods are referred to in next sections. According to OECD (2022), "the CUP method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances" (p. 97). The net margin "examines the net profit relative to an appropriate base (e.g. costs, sales, assets) that a taxpayer realizes from a controlled transaction" (OECD, 2022, p. 113).

rates for TA, we believe that our contribution can be useful for policymakers and TAs worldwide.

The main recommendations derived from the analysis presented in the paper concern modifications in performance metrics (focusing simply on additional revenue may produce skewed audits), careful planning for TP audits, solid analysis of comparability issues in auditing work, improved filtering of unsubstantiated audit reports by senior staff, and dissemination of best practices in audit and litigation procedures.

The paper is organized as follows. Section 2 introduces the literature review, section 3 deals with methodology, section 4 presents data on TP arbitration court outcomes, section 5 develops proposals to improve TA litigation standing, and section 6 concludes.

## 2. LITERATURE REVIEW

### 2.1. Trends in TA Management

Many countries' public sectors have adopted a managerial, results-oriented approach by implementing enhanced accountability and performance measurements, and setting explicit targets (Schedler & Scharf, 2001; Scott & Robbins, 2010). Given their public relevance and daily interactions with citizens and businesses, TAs have been significantly influenced by this trend (Péteri, 2008; Yilmaz & Beris, 2008). The achievement of efficiency is one of a TA's imperatives.

The TA is usually the visible face of tax policy, one of the most important government policies. It is expected to act with transparency, guaranteeing legal certainty, improving the quality of service, and collecting revenue. It is expected to foster voluntary compliance, at a minimum cost, with proper respect for the rights of taxpayers (Beesley, 2008; OECD, 2017).

TAs in various countries have been subject to a number of changes. Robbins et al. (2015) report that the introduction of the Revenue Online Service, one of Ireland's first e-government resources, reduced the TA's administrative burden in relation to the processing of income tax returns. This burden was transferred to citizens and accounting/tax practitioners, but did not increase their compliance costs, thanks to the TA's use of online filing and payment processes. Unger (2014) sustains that taxpayer charters and ethic codes introduced in Australia and the United Kingdom are relevant references for TAs elsewhere. Closs-Davies et al. (2021) show how the introduction of a performance management system redirected workers within United Kingdom's TA towards organizational targets, making them follow rigid scripts, with the result that they scorned citizen's real needs.

Some countries have introduced semi-autonomous revenue agencies: Peru, for example, established the *Superintendencia Nacional de Administración Tributaria* in 1988.[5] This type of agency differs from the conventional TA, as it is situated outside of the ministerial structure and enjoys independent legal status. In order to exercise their tax collection powers effectively, semi-autonomous revenue agencies are endowed with management autonomy and have their own budgets, materials, and human resources, as well as regulatory and sanctioning powers in respect of tax legislation (von Haldenwang et al., 2014). Another trend is the adoption of customer segmentation practices. This ensures that taxes are properly collected, while focusing

[5] Law 24829, 1988.05.31. Available at https://www.sunat.gob.pe/legislacion/sunat/ley-24829.pdf

on certain taxpayer groups (Tuck, 2013). The literature provides us with some results relating to the comparative efficiency of TAs across multiple countries and emphasizes the importance of measuring TA performance, offering guidelines for best practices and supporting tax design (Alm & Duncan, 2014; Nguyen et al., 2020).

According to the Autoridade Tributária e Aduaneira (2017, 2020), a results-oriented strategy has been increasingly gaining ground within the Portuguese TA. Specific areas in which this strategy has been applied include: the segmentation of taxpayers with a focus on big companies; the application of information technology in order to maximize the effectiveness of audits; the use of monetary incentives related to the detection of taxpayer noncompliance; and the establishment of special services in order to fight sophisticated tax avoidance and evasion.

The evolution of the Portuguese TA may be characterized by its modernization of technical tools, the clearer notion that it has of risky taxpayers, and its intensification of audits related to international tax issues. The TA has also implemented performance metrics, such as audits per service and employee, the amount of monetary adjustments made, and the number of abusive tax planning schemes successfully detected.

In this organizational setting, how is TP auditing evolving in Portugal? On the positive side, the TA's staff have been gaining new capabilities that enable them to challenge taxpayers´ reports. Additionally, certain databases (e.g., SABI, BACH and ORBIS) that the TA requires access to if it is to counter firms' computations of TP adjustments are now also at the organization's disposal.

However, we believe that two factors have been hampering the quality of TP audits in Portugal. Firstly, the pressure to increase the number of audits means that highly complex cases of related party transactions, and their economic and legal bases, are not thoroughly apprehended during tax audits. Therefore, adjustments often rest on fragile justifications. Secondly, performance metrics based on the monetary amount of tax corrections made by the TA mean that tax auditors have a propensity to find flaws in TP reports that are often not well grounded in the law. In particular, the "comparability issue" is frequently overlooked, putting the TA in a weak position when litigating.

Multinational business auditing is a sensitive matter for a TA. The concentration of corporate revenue among large taxpayers, and the tax sophistication of these entities, turn auditing into a challenging task. TP is a prime target for tax auditing, given the monetary amounts usually at stake in transnational transactions (Braithwaite, 2007). van der Hel-van Dijk et al. (2015) emphasize the importance of co-operative compliance between TAs and taxpayers (usually large businesses) to improving compliance.

### 2.2. The Role of Tax Auditing with an Emphasis on TP

Kaplanoglou and Rapanos (2012) state that political factors can heavily impact a TA's behavior when carrying out auditing processes. In many European Union (EU) countries, an excessive reliance on budgets has been a major cause of gaps between revenue estimates and the final amounts collected (Jonung & Larch, 2006). TAs were pressured to comply with revenue goals and auditors were aware that revenue adjustments had to be found during auditing assignments, as their career advancement could be adversely affected if the audits produced no additional income.

G. Yin (2012) states that "effective tax administration must involve some level of real and perceived auditing" (p. 398). However, if the process is seen to be excessively harsh, it can hamper "the development of a positive tax culture" (G. Yin, 2012, p. 398). In China, Li et al. (2019) found "that after firms have been audited they significantly raise their effective tax rates" (p. 91).

In many countries, a number of factors influence the way in which tax audits are conducted, including: the need for tax receipts; the increasing capacity of information technology systems to cross-match third-party data; the growing importance of performance measures for TA staff; the career concerns of auditors; the proximity between TA and legislators; and the positive social feedback due to having a strong hand when fighting evasion (Wolpe, 2015; Zandi & Elwahi, 2016).

The distribution of gains between the entities of a business group, when these entities are located in jurisdictions with different tax rates, affects the sharing of tax revenue between countries. Sikka and Willmott (2010) show that corporate TP policies affect the quality of data held in respect of imports, exports, national income, corporate profitability, and balance of payments, etc.

The problematic effects of TP in the EU have been addressed in many ways. One proposed method was the Common Consolidated Corporate Tax Base (CCCTB), under which domestic TP would become less relevant, i.e., the manipulation of corporate profits by TP would be reduced, and there would be fewer cases of litigation between corporations and TAs. However, as fiscal policy is one of the last sovereign instruments available to member states, there were a number of obstacles that would have needed to be overcome in order to implement a CCCTB and, in 2021, the framework was replaced (European Commission, 2021).

Therefore, the methods used to determine the tax base in each jurisdiction are a major factor in group taxation. In OECD member countries, tax laws and regulations dealing with group transactions are based on the arm's length principle (OECD, 2022). This implies the obligation, when valuing transactions between related parties, to use the same prices that would be charged in comparable operations between independent entities.

Although the principle is simple to grasp, it may be difficult to apply to the day-to-day practices of multinationals. Global companies are, by nature, entities for which the control of TP is difficult (Bradley, 2015). Economies of scale (often the main motivation for investments), the importance of intra-group transactions, geographical diversification, the internationalization of production chains, intra-group service centers, and the uniqueness of intangible assets all create problems in respect of the appropriate computation of TP, because they impact the comparability process (OECD, 2017). This is the reason why, in many cases, conflicts arise between the TA and taxpayers, and litigation follows (Levey & Wrappe, 2013).

In the TP auditing area, the adoption of new management principles based on quantifying and measuring outputs has induced new assessments or tax-based adjustments that potentially increase tax revenue. The career advancement of auditors is perceived to be linked to the amount of tax revenue brought in through new assessments. Moreover, in some cases, regional services within TAs compete to generate the highest amount of additional revenue. Senior managers know that they can use this method to secure more resources and enhance their reputation. Since TP is an area in which significant amounts of money are at stake, it constitutes a common target for tax audits (Levey & Wrappe, 2013).

Multinationals usually have complex business models and geographically extended operations. Any tax audit that is carried out with the main aim of finding additional revenue at any cost will be doubly damaging to the fostering of a healthy relationship between a TA and its taxpayers. Firstly, tax auditors tend to overlook business specificities that could explain the logic of the transactions and prices used, and therefore render assessments unnecessary. Secondly, in a litigation setting, if decisions are taken largely in favor of firms, a feeling of unfairness arises regarding the true purpose of TP audits (Bakker & Levey, 2012).

TP audits require, among other things, access to a wide range of data, the use of selected comparables, risk assessment techniques, financial ratings evaluation, and careful observation of business transactions. The selection of a business to audit is usually made on the basis of some indicators, e.g., net profit or operating margins (Martins, 2017).

There are several instances in which TP law is unclear or did not foresee certain circumstances under which different interpretations may arise. In TP auditing, the need to interpret concepts such as "comparable", "adequate margin", or "similar economic circumstances" often arises. The complexity of TP rules and their execution has led some authors to argue that the whole TP system should be redesigned (Wilson-Rogers & Pinto, 2015).

## 3. METHODOLOGY

This paper is based on a blend of the case study method (R. Yin, 2018) and the legal research approach, the latter of which adopts the evaluative perspective highlighted by Van Hoecke (2011). The case study is an established research tool. In the tax field, case studies have been used by researchers such as Marriott (2017) and Tjen and Evans (2017). In this paper, we discuss the performance of the Portuguese TA in TP arbitration court cases between 2012 and 2020, and use this information to provide recommendations in order to enhance the TA's litigation success rate.

Case studies like the one presented in this paper highlight lessons learned from observation and can be used by public actors, such as TAs, to inform strategic and operational changes. Given TP litigation outcomes around the world, this case study provides insight into court outcomes in TP-related cases.

The legal research method can be used in different contexts when applied to TP rulings. A comparative angle is utilized when studying different country's rules and how they are applied. An interpretative view is employed when courts must apply TP rules to specific cases in order to deal with interpretation complexities (policy recommendations may follow as a result of this analysis). An evaluative perspective can also be used to check whether rules produce efficient economic and social outcomes.

In this paper, given the interpretative margin that TP regulations present, we use arbitration court cases and their specifics, as analyzed in section 4, to substantiate a proposal for a change in TA audit practices in order to obtain more favorable court outcomes. Thus, the empirical side of our legal analysis is related to concrete TP cases that present common traits. These traits inform our policy recommendations, and we use the Portuguese TA as an institutional case study and the TP court cases as raw data.

It is well known that TP requires lengthy rules and regulations given the complexity of the operations of multinational companies. The TA is bound by the legality principle, which

requires a legal basis for audit assessments. The OECD's guidelines (OECD, 2022) are the backbone of TP tax treatments and its base erosion and profit shifting (BEPS) report puts considerable emphasis on the topic (OECD, 2013).

Even if TP regulations are regularly revised and improved, their implementation by tax auditors is a crucial test of their usefulness. If litigation often follows, and the TA loses the majority of the cases, an appraisal of the impact of the legal framework for audit strategies is called for, as is rethinking the existing paradigm (Wilson-Rogers & Pinto, 2015).

## 4. PORTUGUESE TP LITIGATION: TAX RULES AND THE ROLE OF THE ARBITRATION COURTS

### 4.1. A Note on Tax Arbitration

Before 2011, the taxpayers and the TA were obliged to litigate in the judicial courts. However, the conditions that prevailed in state judicial courts, with overextended timelines for reaching a decision, called for the use of alternative mechanisms.

Law Decree 10/2011 of 20th January 2011 provided an alternative option for tax dispute resolution: the CAAD. In most cases, the taxpayer can now decide to use either the judicial tax courts or the CAAD, with the Portuguese TA being forced to accept their choice (Article 4 of Law Decree 10/2011).

In Portugal, there are three levels of judicial tax courts: first level courts, appeal courts, and the supreme tax court. There is no publicly available data for the cases decided in the first level courts. These courts receive and decide the majority of cases. Therefore, it is not possible to examine differences between cases taken to the judicial and the arbitration courts. Nonetheless, two additional observations can be ventured.

Firstly, a petitioner is more likely to choose to take their case to an arbitration court when they want a faster resolution mechanism, as arbitration courts have six months to make a decision—with extensions available of up to one year (Article 21 of Law Decree 10/2011—while a case heard by a first level judicial court could easily take years to resolve.

Secondly, if a TP case focuses on legal interpretation but also has a strong accounting, financial, or statistical angle, an arbitration court will probably be chosen. This is because judges in judicial courts are only legally trained persons. CAAD arbiters can be economists, managers, or chartered public accountants (Article 7 of Law Decree 10/2011). The diverse composition of arbitration courts can, therefore, be a determining factor in the submission of more complex TP cases.

In comparison with the judicial tax courts, arbitration courts must also decide cases in strict accordance with tax law, and they face fewer limitations in terms of claim values and fewer appeal possibilities (de Sousa da Câmara, 2015). In addition, the procedural steps taken within arbitration courts are less formal than those taken in judicial tax courts, and information technology is extensively used for the provision of documental proof and for witness hearings (de Sousa da Câmara, 2015).

Given the backlog in the judicial courts, there is ample room for tax arbitration courts in Portugal. As TP cases often arise in multinational companies, a significant number of these cases are being brought before arbitration courts.

### 4.2. TP Rules, Litigation Principles, and the TA's Organization

We begin by noting that the Mutual Agreement Procedure (MAP) is not commonly used to reduce TP litigation in Portugal. In fact, in our sample, there is not a single case in which the MAP was used before the taxpayer challenged the tax adjustment in an arbitration court.

This is not to say that the MAP is never used. Based on field experience, it is mostly used in cases where a taxpayer located in a foreign country wishes to challenge a TP adjustment related to transactions with a Portuguese affiliated entity with the TA. If, for example, the foreign entity sells products to the Portuguese affiliate for €100, and the foreign TA adjusts to €110, then the Portuguese entity initiates a MAP with the local TA in order to reduce the taxable base (by increasing the purchasing costs) in Portugal. A correlative adjustment may follow.

*Why is the MAP rarely used when the Portuguese TA makes a TP adjustment?*

Firstly, because two different ways of administrative appellation are open (and usually followed): the right to be heard (Article 60 of the General Tax Law[6]) and, if this fails, the hierarchical appellation (Article 80 of the General Tax Law). The first one happens when the taxpayer receives the first version of a tax audit report. The taxpayer may submit a rebuttal of the report's conclusions to the tax auditor. If this is not successful, the taxpayer may submit a formal rebuttal to the highest-ranking officer of the Portuguese TA. The success rate of taxpayers based on these two procedures is very low. When a tax auditor finds a TP adjustment, it is not easy to find, within in the higher levels of TA staff, someone who will contradict the adjustment.

Moreover, Portuguese tax law does not mandate the use of the MAP before litigation (in the judicial or arbitration courts). Therefore, and taking into consideration the fact that the Portuguese tax litigation is merely a nullifying process (if the court finds a flaw in the TA audit, the adjustment is totally nullified), there is an incentive to litigate. If the taxpayer prevails, there is no need to enter a MAP, because the total amount of the previous TP adjustment is disallowed.

The incentive to litigate is greater (and firms' propensity to enter a MAP is accordingly lower) the lower the TA's success rate in TP cases. That is why, in our view, recommendations to the TA—potentially increasing its success rate—may be a factor in using the MAP more frequently.

The use of the MAP implies that the taxpayer wants to discuss potential "middle ground solutions" (for example, that a margin of 3% was corrected by a tax audit to 6% and the firm is open to accept 4.5%). However, by litigating *in the first place*, the whole adjustment may be invalidated and the MAP rendered unnecessary.

The legal basis of the TP regime in Portugal is Article 63 of the Corporate Income Tax Code (CITC) and Regulation 1446-C/2001. These legal rules closely follow the OECD guidelines

[6] Law Decree 398/98 of 17th December 1998.

on TP (OECD, 2022). Article 63 of the CITC establishes the arm's length principle, the situations in which a related party does exist, and the methods used in TP, as well as the reporting obligations that entities with related party transactions must submit to the TA. Regulation 1446-C addresses core issues like comparability, assets, functions, and risks; presents a more detailed characterization of TP methods; and deals with advance price and cost sharing agreements. These sources expressly state that the OECD's guidelines (OECD, 2022) should be referred to when legislation requires interpretative work.

The most common source of litigation is the implementation of TP methods. The comparability principle is often subject to litigation when CMP is used. The net margin method can generate a range of outcomes, depending on factors such as the appropriate arm's length range, the point of the range to adopt (e.g., first quartile, median, or mean), the existence of outliers, and the accounting nature of the profit level indicator.

As previously mentioned, in Portugal, tax litigation in judicial and arbitration courts operates under the so-called *mere nullification principle*. There is typically an "all or nothing" outcome. This means that when the TA conducts an audit and adjusts (increases) the tax base, and the taxpayer challenges the adjustment, if the legal basis upon which the adjustment was made is found to be inadequate or wrongfully applied, the whole amount of the adjustment is disallowed by the court. In fact, under the constitutional principle of the separation of powers, judicial bodies control the legality of government activities. In this context, court decisions assess whether the TA acted in accordance with the legal rules in force; courts cannot replace the executive power, adjusting the tax base (Vieira de Andrade, 2014).

To exemplify, suppose that an audit involving a TP case increases the tax base by €10 million through the application of the CUP method. Let us also assume that the taxpayer used the net margin method and found that no adjustment was called for. If the court finds that the tax audit misapplied the CUP (for example, by using an unacceptable comparable), the whole adjustment of €10 million is disallowed. In another hypothetical case, if by using the net margin method, the taxpayer adjusted their profit level indicator to the first quartile of the range and the tax audit adjusts it to the median, if the court finds that the choice of the median does not have a sound legal basis, the whole tax adjustment made by the TA is cancelled. The court has no obligation to decide on any alternative quantification.

Thus, in this paper, when the taxpayer prevails, it means that the whole amount of the tax adjustment resulting from a tax audit is nullified. When the TA prevails, the court finds that the tax audit meets all legal requirements and is well grounded, and the whole amount stands up to court scrutiny.

The Portuguese TA has a central department that deals with litigation (in the judicial and the arbitration courts). Usually, if a taxpayer challenges a tax audit, the basic working materials for the TA's legal staff are the audit report and the filed petition. In TP, the tax examiner (who usually has an accounting or a financial management background) may be called upon by the department's staff to assist in more complex issues, such as financial valuation, accounting standards concerns, or statistical matters (Article 3 of the Tax Auditing Procedure).[7]

Additionally, the TA (defendant) may designate the tax examiner as a witness. This is understandable, because corporations often designate their chief executive officers, chief

[7] Law Decree 413/98, of 31st December 1998.

financial officers, marketing staff, and even external experts from consulting firms that were involved in TP reports as witnesses.

From our experience, a more intense cooperation between these two sides of the TA would probably strengthen its position in courts. Often, even where legal staff are experienced in interpreting the TP rules, they are not fully trained in relevant subjects, such as financial and management accounting, intangible asset valuation, rating and its interest rate impact, and discounted cash flow models.

### 4.3. Main Reasons to Pursue Litigation and Trends in Court Rulings

According to Correia and Martins (2018), a total of 32 arbitration court cases heard between 2012 and 2017 dealt with TP. The TA won three of these. The total monetary amount related to the cases that the TA won represents 14% of the total litigated value.

Overall, when we consider the data from 2012 to 2017 as well as the cases exhibited in Table 1 (below), it is arguable that, in terms of cases won, the Portuguese TA's success rate is quite low. Even in monetary terms, when considering both periods (almost one decade), the TA did not perform well in arbitration courts as far as TP litigation is concerned. Thus, we believe that it is important for the TA to take strategic and operating measures to improve its success rate.

Comparability issues and TP methods are common reasons for disallowing audit assessments (Martins et al., 2020). Table 1, which relates to the period 2018-2020, shows that the results remained quite unfavorable to the TA. The total amount in dispute in the period was €8,166,915.61. The TA won four cases, which accounted for about 44% of the total litigated amount, excluding the amount involved in the mixed decision. However, Table 1 reveals that a single case (808/2019-T; more than €2 million) heavily influences the percentage of the monetary rate of success for the TA.

As shown in the literature review, the practical application of the comparability concept, and the economic and accounting issues that arise when selecting TP methods are complex areas. When audits are carried out with the overarching purposes of finding additional revenue, they may overlook some details in respect of the application of TP regulations. In court, this is a basis for an unsuccessful position. Thus, the international trend previously documented is also observed in Portugal.

In light of the TP litigation outcomes for the Portuguese TA, the next section analyses a sample of lawsuits. This paper could hardly accommodate a full analysis of all TP cases judged by the arbitral court between 2012 and 2020. Therefore, six cases were selected, based on our judgement rather than at random, as required by the case methodology described in section 3. For this purpose, we established three criteria: the inclusion of foreign companies; the diversity of arguments held by both parties; and the range of issues under discussion (cash pooling agreement[8], investment management fees, loans, intangibles, distribution services, and sales of goods).

[8] This means a system of centralized cash management. A number of companies combine their cash balances to save costs.

*Table 1: Arbitration rulings in TP cases in Portugal (2018-2020)*

| Case | Amount (€) | Decision |
|---|---|---|
| 828/2019-T | 142,406.09 | Taxpayer |
| 808/2019-T | 2,090,550.08 | TA |
| 473/2019-T | 87,252.40 | TA |
| 385/2019-T | 209,751.61 | Taxpayer |
| 381/2019-T | 822,955.85 | Taxpayer |
| 360/2019-T | 32,762.70 | Taxpayer |
| 253/2019-T | 5,131.79 | Taxpayer |
| 196/2019-T | 125,808.93 | Taxpayer |
| 106/2019-T | 377,951.46 | Taxpayer |
| 524/2018-T | 267,879.70 | Mixed |
| 511/2018-T | 740,185.08 | TA |
| 384/2018-T | 815,763.96 | Taxpayer |
| 359/2018-T | 288,053.57 | Taxpayer |
| 337/2018-T | 720,866.70 | Taxpayer |
| 336/2018-T | 157,851.72 | Taxpayer |
| 274/2018-T | 569,310.40 | TA |
| 216/2018-T | 182,248.27 | Taxpayer |
| 162/2018-T | 110,257.82 | Taxpayer |
| 161/2018-T | 287,822.98 | Taxpayer |
| 70/2018-T | 132,104.50 | Taxpayer |

Source: CAAD (n.d.)

### 4.4. An Applied View of Approaches Taken by Litigants and Courts to TP Cases: A Case Study

Six decisions are now analyzed in order to find similarities in court reasonings that can be used as a basis for proposed changes to tax audits.

The first case (55/2012-T) relates to cash pooling. A German parent company and a Portuguese subsidiary (the petitioner) entered into a cash pooling agreement with a financial institution. Given the related party context, the TA claimed that the liquidity surpluses of the Portuguese company, which were deposited into that bank on a daily basis, increased the guarantee effect for the parent company and reduced the interest rate paid on loans. Consequently, the Portuguese company's deposits should be channeled into the cash pooling remunerated in normal market conditions. The TA's audit report sustained that, based on the CUP method, an interest rate agreed between independent entities under comparable circumstances should be applied to this relationship. For this purpose, the TA identified an independent financial institution that offered higher remuneration to the petitioner and introduced a positive adjustment to its taxable income.

The claimant considered this adjustment to be poorly justified considering the methodology used to quantify the additional taxable income. It also argued that, given the special nature of the cash pooling, no comparable situation was found between independent entities, and the CUP was not applicable. Accordingly, only the profit split method would be suitable for this situation. The court concluded that the demanding and strict requirements of the CUP method were not followed by the TA.

When considering the specific conditions of the cash pool agreement, we can see that the audit report fails to reasonably justify the method employed and the comparable price used by the TA, therefore compromising the legality of the assessment. The adjustment to taxable income made by the tax audit (€6,403,689.43) was denied. A flawed use of the comparability principle was at the root of the court's view.

The second case (716/2014-T) relates to investment management fees. The petitioner provided investment management services to an offshore entity. These services were charged at a fixed price on a quarterly basis. A related party relationship was legally existent, leading to the application of the TP rules.

Following the CUP method, the tax audit looked into prices negotiated in presumably comparable transactions between autonomous entities. The TA argued that the fees should be established depending on the value of the assets managed and, for an independent financial institution (bank), it identified that a 0.5% fee should be applied to the average monthly value of the assets under management. This analysis supported significant adjustments being made to the petitioner's taxable income (€1,506,922.16 in 2010 and €1,574,925.47 in 2011).

The petitioner argued that the identified comparable was inadequate. The contractual relationship did not involve a bank and the nature of the service was subcontracting, not a primary contract between a client and a bank with the latter acting as a portfolio manager.

The court did not accept the TA's position, since the comparability analysis was not correctly conducted. Indeed, the agreement established with the offshore company consisted of an investment management firm subcontracting between non-banking financial operators.

Conversely, the comparable selected by the TA was a customer investment management contract with a bank. Once again, the practical use of the comparability principle in tax auditing was considered inadequate by the court.

Case 687/2016-T concerns a loan made by a Dutch parent company to its Portuguese affiliate. The loan (€50 million), which was disbursed in 2013, was payable within 10 years. The annual interest rate charged was 13%. This rate included 8% for country-specific risk, given that Portugal, at the time, was being bailed out by the International Monetary Fund, the European Central Bank, and the European Commission in the wake of the 2008 financial crisis.

The tax audit argued that the CUP method should be used and found that a rate of 5.2% should apply (the arm's length average rate applied by Portuguese banks on loans of above one million euros, when the loan's life was in excess of one year). Additionally, the tax audit mentioned that the financial soundness of the parent company had the consequence of providing implicit support when the affiliate asked for loans to independent entities, therefore enabling them to obtain an interest rate of less than 13%.

The tax court denied the validity of the tax audit report. Firstly, it stated that the 5.2% interest rate found to be comparable did not take variables like the affiliate's rating as a standalone entity into consideration. Secondly, the amount and life of the loan were not comparable to the benchmark used in the audit report. Thirdly, the tax report did not analyze country and sector risks and, therefore, failed to produce the broad economic analysis that the CUP method requires and that is established in the Portuguese TP regulations. Given the flaws in the implementation of the comparability principle, the court ruled in favor of the petitioner.

In case 216/2018-T, a French parent company had stakes in three Portuguese firms: a steel producer (A) and two distributors (B and C). When A implemented a new commercial strategy, the previous distributor (B) was replaced by a new one (C). The Portuguese TA audited B and sustained that B's intangibles (e.g., customer portfolio, trade know-how etc.) were made available to C. As the operation happened between related parties, TP rules were applied. A tax adjustment was made, given that no revenue was recorded by B when the new strategy was implemented.

Litigation followed, because the group sustained that the previous distributor did not hold any intangible assets, there were no comparable operations between independent entities upon which to base an arm's length comparability analysis, and tax auditors applied the wrong financial model when calculating the hypothetical price.

The petitioner also argued that there was a formal defect in the lack of reasoning regarding the methodology used to quantify the taxable adjustment. The tax audit report refers to the CUP method, but the auditors did not use such a method and did not identify a comparable operation. The audit did not show the comparable operation or the comparable price on which the TP adjustment had been based. Instead, the tax auditors quantified the profit lost by B based on its financial statements. That is an ex ante and ex post analysis. The court sided with the petitioner, agreeing that neither internal nor external comparable prices had been used. Thus, it ruled for the petitioner based on the erroneous application of the comparability principle.

Case 106/2019-T involved a limited risk distribution (LRD) activity. The claimant also provided procurement services to the businesses held by the parent company. Within this context, the claimant executed several purchase orders on behalf of a related company,

assuming a mere agent role. The TA alleged that these prices were not the normal market prices between unrelated parties.

The comparable operations used by the TA were the sale and supply of goods between independent companies, neglecting the fact that the specific relationship between the claimant and the related company was supported by a mandatory contract, as provided by the Civil Code. Additionally, the TA applied a 5% net margin to the purchase orders on the basis that soft law—the OECD's guidelines (OECD, 2010)—allows it to choose a margin between 3% and 10%. According to the TA, the OECD guidelines (OECD, 2010) allow for it to dispense with the need to search the market for a comparable competitive margin.

The court ruled in favor of the claimant, arguing that the comparables were not suitable in this case for several reasons. Firstly, a mandatory contract is distinct from an ordinary sale and supply operation. Secondly, although the court recognized that the OECD's guidelines (OECD, 2010) have a major influence on Portuguese legislation, it argued that the two do not overlap. They form a valuable interpretative element that should be carefully adapted in cases where internal law contains different solutions. The OECD guidelines (OECD, 2010) were wrongly applied by the TA, because the TP legal regime in Portugal does not allow for a margin observed in a similar operation to be replaced by a specific value within a given range.

The last case (609/2015-T) concerns the sale of goods and the result was in favor of the TA. The petitioner sold goods to a foreign related company. In the TP file, the net margin method was used to justify the arm's length nature of the transactions. According to the TA, the indicator used by the petitioner did not follow the arm's length principle, although the TA agreed with their use of the net margin method and the selection of the sample (17 companies) to build a range for the net operating margin (-2.19% to 9.48%).

The issue under dispute concerned the application of a net operating margin of 2.91%. The petitioner argued that this net margin respected the full competition principle, because it was included in the range established in the Portuguese TP legislation.

The tax audit included a thorough analysis of the functions, assets, and risks borne by the petitioner and concluded that the petitioner was responsible for much more than a productive function. In fact, purchases, sales management, and financing risk were also in the petitioner's remit.

Therefore, the only point in the range that is appropriate for the TA is the one that economically represents the relationship between functions, assets and risks, and the rate of return. It is not enough to choose any operating margin included in the range and a more accurate analysis should be performed in order to comply with the comparability principle.

The court decided in favor of the TA, mainly quoting OECD recommendations. Briefly, the court sustained that the selection of a value within the range, capturing the specific circumstances of the case, would reflect a more realistic market relationship. Furthermore, the TA performed a strict analysis of the activities carried out by each entity and the risks involved, concluding that a 2.91% margin did not reflect the specific conditions of the operation. Having considered the characteristics of the goods, the contractual terms, the industrial and commercial strategies, and the functions performed, among other conditions, a margin of 5.76%, representing the median of the range, was found to be more appropriate by the TA, and the

court agreed with this. In this case, it is quite clear that the production of a carefully substantiated audit report put the TA in a better position.

## 5. A PROPOSAL FOR IMPROVING THE PORTUGUESE TA'S STANDING IN TP LITIGATION

The overall success rate of the Portuguese TA, both in the judicial courts and in the CAAD, is around 40%, well above the rate found in the sample of TP cases used in this study.[9] In light of what has been shown about TP-related tax litigation, this section submits proposals for improving the TA's standing in such cases.

In recent years, the TA has hired and trained staff who specialize in the TP area, and has sought inspiration from international audit best practices. However, we believe that what follows will be useful from the perspective of an entity, such as the TA, whose task is indisputably difficult. TP's undeniable legal, economic, and accounting complexity helps to explain the low litigation success rates of TAs globally. Nonetheless, if TAs chose certain strategic and procedural options when conducting tax audits, it could have a significant impact on litigation outcomes.

### 5.1. The External Context Faced by the TA and its Impact on TP Audit Control

As shown in Table 2, between 2012 and 2020, Portugal's total public revenue ranged from 42.4% to 4.9% of its gross domestic product (GDP). The TA does not intervene in the collection and monitoring of the entire revenue but, given the size of the state revenue (comparable to the European Economic Area), the role that it plays is quite demanding.

*Table 2: Portuguese Public Finance (2012-2020) as a Percentage of GDP*

| **Variable/Year** | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** | **2020** |
|---|---|---|---|---|---|---|---|---|---|
| Total public revenue | 42.7 | 44.9 | 44.4 | 43.8 | 42.9 | 42.4 | 42.9 | 42.6 | 42.8 |
| Total public spending | 48.9 | 49.9 | 51.7 | 48.2 | 44.8 | 45.4 | 43.2 | 42.5 | 48.4 |
| Deficit | -6.2 | -5.1 | -7.4 | -4.4 | -1.9 | -3.0 | -0.3 | 0.1 | -5.7 |
| Public debt | 129 | 131.4 | 132.9 | 131.2 | 131.5 | 126.1 | 121.5 | 116.8 | 133.6 |

Source: INE/BP/PORDATA[10]

The pressure to reduce the Portuguese public deficit, and the public debt, implies that there are growing demands from tax policymakers in relation to the TA's strategic and daily operations. The use of more resources, the efficient management of existing ones, and regular negotiations

[9] See OECD (2017) for state judicial courts and https://www.caad.org.pt/ (communication area) for arbitration courts.

[10] See https://www.pordata.pt/Portugal/Administra%c3%a7%c3%b5es+P%c3%bablicas+despesas++receitas+e+d%c3%a9fice+excedente+em+percentagem+do+PIB-2788 (2021.03.26) and https://www.pordata.pt/Portugal/Administra%c3%a7%c3%b5es+P%c3%bablicas+d%c3%advida+bruta+em+percentagem+do+PIB-2786 (2021.03.26)

with political leaders, in the context of a strong requirement for fiscal revenue, are important strategic issues.

The demand for tax adjustments, and the increased use of metrics that evaluate performance based on audit and additional assessed revenue, comprise a worldwide trend in tax administration (Serra, 2005).

In addition, as stated by the OECD (2017),

> the challenge of efficient and effective tax administration is not only to raise the revenue needed to fund public services - and increasingly to provide some of those services - but also to minimize burdens on taxpayers. Maintaining trust in the efficient operation and fairness of the tax system is key to its sustainability. (p. 5)

In other words, TAs around the world face multiple challenges when seeking to control taxpayers effectively while carrying out work that is perceived to be equitable and productive. The recent legislative impact of the BEPS project has given greater visibility to TP control, enhancing the role played by global TAs in this area.

The use of TP as an evasive mechanism at the global level has often been the subject of analysis (Chand, 2016; OECD, 2013). Table 3 shows that, in Portugal, between 2012 and 2019, the total number of annual corporate tax returns received increased from 421,430 to 510,158. In the same period, the number of entities opting to be assessed under the special regime of group taxation (with the advantage of offsetting profits with losses in the same tax year) also increased from 3,495 to 4,637. We do not have the data showing how many individual companies were included in groups but if, hypothetically, each group contains an average of five entities, more than 20,000 resident firms would have been assessed under this regime in 2019. This is important, given the number of TP corporate (self) tax adjustments that occurred, as shown in the table.

Table 3 also reveals that the full amount of tax adjustments increasing taxable profit (e.g., provisions, depreciations, impairments, and other accounting expenses that are not tax deductible) fluctuated between €33.3 billion (2012) and €52.4 billion (2014). The last two lines of the table show that TP corporate (self) adjustments were negligible, considering the universe of taxpayers potentially involved in intra-group transactions. In 2019, up to 23 companies adjusted their taxable profit by their own initiative, applying TP tax rules.

In terms of the value, the only year in which there was a significant amount was 2015 (€179 million). Even then, TP self-adjustments accounted for only 0.47% of the total corporate tax adjustments. This may be as a result of companies believing that they had applied fully-fledged prices and there would be no adjustments to be made under TP rules. However, this could cause a TA to engage in intense activity, conducting, for example, audits and internal checks.

What does this data mean for the central thesis of this paper? Given that the Portuguese TA is under pressure to find additional revenue, and in view of the self-declared TP adjustments taking place, it is to be expected that TP tax audits will become more intense. This will probably result in more court cases taking place, because groups have the expertise and the financial means to litigate.

TP litigation cases reinforce the idea that there is much scope for TP tax audit. If this is a foreseeable scenario, it is of paramount importance that TAs prepare their audit reports carefully in order to buttress their court standings.

*Table 3: Annual Corporate Tax Returns in Portugal Showing TP Corrections (2012-2019)*

| **Variable/Year** | **2012** | **2013** | **2014** | **2015** | **2016** | **2017** | **2018** | **2019** |
|---|---|---|---|---|---|---|---|---|
| Total number of tax returns | 421,430 | 424,913 | 421,737 | 452,683 | 464,780 | 475,119 | 492,935 | 510,158 |
| Total number of group tax returns | 3,495 | 3,516 | 3,902 | 4,101 | 4,188 | 4,385 | 4,506 | 4,637 |
| Total amount of (self) corporate adjustments favorable to tax authorities (million euros) | 33,350 | 33,606 | 52,441 | 37,782 | 41,148 | 36,083 | 38,973 | 37,269 |
| Number of tax returns with TP corporate (self) adjustments | 28 | 22 | 20 | 26 | 30 | 32 | 24 | 23 |
| Amount of corporate (self) adjustments (million euros) | 29 | 2 | 2 | 179 | 7 | 5 | 4 | 11 |

Source: Portuguese TA[11]

The improvement of the TA's success rate in TP litigation will not have a big impact on global tax inflows. However, other factors relating to public finance contribute to the argument that the TA should increase its efforts in order to attain a better performance in TP-related court cases.

Firstly, and as previously shown, only a tiny fraction of Portuguese corporations that belong to groups and are involved in related party transactions declare self-adjustments in their corporate

[11] See http://info.portaldasfinancas.gov.pt/pt/dgci/divulgacao/estatisticas/Pages/default.aspx

tax returns. There are many as yet unexplored audit opportunities that, if audited to a satisfactory quality, will generate significant amounts of additional tax receipts. Given the weak state of public finances, this is not an issue to be overlooked.

Secondly, even when corporations declare self-adjustments, if the TA is equipped with good databases and well-trained staff, and follows some sound recommendations when planning and executing TP audits, the final outcome can be more satisfactory to the public finances. Suppose a company uses the net margin method and produces an adjustment of €3 million. The TA consistently challenges the margin, increases the taxable income to €6 million, and the audit is sustained in court. Such an outcome may cause taxpayers to believe that tax auditors are adequately prepared and may take a closer view of other complex areas of corporate taxation, such as exit taxation, or mergers and acquisitions, where important amounts of tax receipts may be at stake.

In this general TP environment, what major potential actions can be highlighted in order to improve the TA's legal standing?

### 5.2. Audit Planning

A procedure that greatly affects the result of a tax audit is the careful selection of targets. Planning procedures aimed at efficient audit targeting should result in the TA choosing targets whose audits are most likely to result in upward adjustments.

According to the OECD (2017), the ability to analyze an increasingly large volume of taxpayer-reported information is a requirement for ensuring TA efficiency. TA management practices should focus heavily on data collection and analysis in order to originate better targeted audits.

In this context, the assessment of tax returns and TP reports (to analyze the reasonableness of the results and margins) as well as TP files constitutes a major step toward the overall preparation of a tax audit report. In this assessment, the following topics are of special interest:

i) A detailed description of business transactions between related parties.

ii) The economic and financial strategies underlying certain operations and their business rationality. To take a hypothetical example, in the relationship between a parent company located in Portugal and a subsidiary based in Slovakia, prices that differ from those of comparable independent entities can be charged, with the justification that the participating company is supporting the strategy of market entrance by the subsidiary. The economic and financial appraisal of such motives, and their full documentation, should be subject to detailed evaluation.

iii) The analysis of the chosen TP method and why it was selected. For example, asserting in a TP file that the CUP method cannot be used (because operations with independent entities are not comparable in terms of distribution channels, payment terms, and technical specifications) calls for a detailed review by the tax auditor. This is rarely consistent with very strict (and tight) auditing deadlines, and the pressure exerted on auditors to find substantiated TP adjustments within a few weeks.

iv) The analysis of the criteria used to choose comparable entities or operations, as well as the justification for the choice of certain indicators (e.g., operating margins) as benchmarks.

v) If the entity has made adjustments, an assessment of whether the legal and statistical basis are appropriate.

vi) Whether the paper proof attached to the TP file is of good quality in terms of documenting transactions, legal obligations, prices, and financial arrangements.

The TA's performance depends on it having a similar level of business knowledge to corporations. If a taxpayer uses an international database when selecting a comparable sample of firms, the TA will be in a complex position when validating such information. Any counterargument in an audit report (or even in litigation) will be more complete if the source of information is comparable.

The additional investment that the TA can make in the continuous development of a model report on TP matters, which includes mandatory aspects to be analyzed and documented, may be very effective in TP litigation. By producing audit reports that are substantiated, carefully reasoned, and based on solid evidence, the TA can improve its chances of success in courts. Quite often, pressure to make a major monetary tax adjustment in order to fulfill assessment targets clouds the reasoning of TA staff, who regard their mission to have been accomplished if an additional (even if superficially detailed) assessment is found. Given the number and complex nature of legal, economic, accounting, and business issues that may emerge in TP litigation, this is an approach that bodes ill for court success.

### 5.3. The Audit Phase: Some Aspects to Emphasize

The duration of an audit is a variable that influences the depth of the analysis and the quality of the evidence presented in TP assessments. The central question of comparability of operations implies, first of all, a clear understanding of the type of transactions and the specifics they may present. Given the complexity of many intra-group operations, their full apprehension is not easily accomplished through superficial analysis and succinct audit reports. Interaction with the audited entity's managers is essential if the nature of the business and the importance of intra-group transactions are to be understood. Their explanations must be carefully scrutinized and not lightly dismissed in order to produce additional revenue assessments (Bradley, 2015).

For example, in an automobile group, controlling certain TP-related transactions requires a prior study of TP's multiple aspects. There are issues related to technology, markets, business strategies, financing sources, pricing, and many other matters, which influence the value of transactions. If a TP audit overlooks some of these factors, the company's lawyers will usually stress the negligible treatment of core issues. In some cases, this is an attempt to underestimate tax auditors' findings. However, in other situations, such incomplete and superficial analysis may actually have been observed and will weaken the TA's standing in the courts.

In addition, during the audit phase, the comparison between the economic, legal, and accounting characteristics of the transactions and the content of the TP file presented by firms is very important. In order to accept or reject the approach taken by the audited entity in its TP file, the TA must conduct a substantial study of, and appreciate, the economic rationale of the transactions under review.

Suppose that an entity in the furniture industry uses the net margin method in its TP file, because it believes that there is insufficient comparability to use the CUP method. If tax

auditors challenge such an approach and conclude that the CUP is the appropriate method, a critical, well-grounded assessment of the approach taken by the entity is required. The burden of proof is then on the TA to disallow the method selected by the taxpayer.

In the event of a dispute, if reasonable doubt arises about the TA's procedures, the court decision is likely to be in favor of the taxpayer. Since the comparability factors are listed in TP tax rules, it is sometimes enough for companies' lawyers to show that one of these factors was neglected by tax auditors, and an entire argumentative effort, which may be solidly described in the TA audit, is nullified by the court.

Intra-group financial transactions also deserve reflection—in particular, the determination of the debtor's rating, the explicit versus implicit support from the parent company, the consideration of the country's risk, and the calculation of the spreads used in determining the interest rates considered to be at arm's length (Bakker & Levey, 2012).

The TA's middle managers, and even its senior directors, play important roles in the process. It is not uncommon for a senior auditor, or a person with experience in the subject, to detect gaps in TP audit reports that, if uncorrected, would considerably reduce the TA's success rate in the event of litigation. The implementation of continuous technical filters may reduce the number of TP cases that come to the courts in which the TA is in a fragile position, especially in respect of issues relating to comparability or methods used.

There are additional reasons for interactions between the various operational levels of the TA to intensify. This is an area in which there is increasing economic, accounting, legal and even statistical sophistication (Bradley, 2015; Martins, 2017). Imagine a case in which the net margin method was used. It is assumed that the sample encompasses ten companies and that one of them has a negative operating margin of -8%. Is this company an outlier and should it be removed from the sample, using the median, the interquartile range, or the lowest value of the sample?

Such discussion includes the definition of outliers in small samples, via several methods, leading to different results (Rousseeuw & Verboven, 2002). The opinion of expert witnesses may prove to be important in court. The TA should be open to this possibility and gather the resources required to follow such a strategy.

Finally, mention should be made of the desirable increase in the dissemination by regional and local TA structures of good audit and litigation practices. If, for example, in a given local TA office, there is a well-grounded audit report that has been proven to be robust in litigation, the dissemination of the methods and procedures used to produce it will be useful. Of course, in TP every case is a case. Nonetheless, disseminating good examples of TA increases the quality of audit reports, hence reducing the likelihood of both litigation and of unfavorable legal decisions.

Instead of making frequent adjustments in TP, it may be preferable for the Portuguese TA to proceed only with those that, in the balanced judgment of the different members of the TA, are well-grounded. There is already a small body of cases in which the courts (judicial and arbitration) have accepted the TA's position. In such cases, the comprehensiveness and consistency of the audit reports (and, indeed, the preparation of the inspection actions) may be used as benchmarks when conducting research on TAs in this complex and uncertain subject area.

## 6. CONCLUSION

The Portuguese TA faces a complex and difficult situation when participating in TP auditing and litigation. The implementation of TP rules is a complicated process and multinationals are prone to litigating. Firms also have the economic and legal resources to seek court decisions on additional audit revenue assessments.

It is true that the Portuguese TA has sought to modernize its performance, in terms of setting strategic goals and quantifiable objectives, making important investments in information technology, hiring new and specialized staff, and providing staff members with training in respect of auditing practices. However, it can also be observed that the pressure placed on auditors to fulfill revenue assessment targets, senior staff resistance to filtering weak audit reports for fear of being regarded as "taxpayer friendly", and the deficient planning of litigation procedures have been producing a string of court rulings that are unfavorable to the Portuguese TA.

Policy suggestions for the management of international TAs focus on modifying performance metrics (as prioritizing additional revenue may produce skewed audits), carefully planning TP audits, enhancing intervention by senior staff in order to filter unsubstantiated reports, and disseminating best practices in audit and litigation procedures.

A limitation of this study is that it focuses only on arbitration courts, ignoring judicial court decisions about TP-related cases. Future research could appraise TP litigation outcomes and assess whether or not the Portuguese TA will adopt some of the changes proposed here with the aim of minimizing its losing streak in this area.

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