

The Benefits Of Competent Authority In Int'l Tax Disputes

By **David Farhat and Eman Cuyler** (December 13, 2021)

Transfer pricing and international tax issues have recently come into focus due to sweeping tax reforms globally.

Tax reforms in the U.S., including the 2017 Tax Cuts and Jobs Act, which marked the largest overhaul of the U.S. international tax system in over 30 years, and the recent swath of tax proposals in 2021, have all brought global intercompany transactions into focus.

Similarly, outside the U.S., the Organization for Economic Development has proposed implementation of certain actions, under the base erosion and profit shifting, or BEPS, initiative and proposals such as Pillar 1 and Pillar 2, aimed at addressing taxation of the modern digital economy and nexus issues.

These developments, combined with the aftermath of the COVID-19 pandemic, are resulting in taxing authorities and multinational enterprises experiencing increased levels of uncertainty and tax controversy with respect to international tax and transfer pricing issues.

In such a climate, in our opinion, it is increasingly important to consider the competent authority procedure — the mutual agreement process, or MAP, and advance pricing agreements, or APAs — as a viable alternative to resolving tax disputes that are within the scope of a treaty.

Below is a brief overview of the MAP and the APA procedures, followed by key reasons why multinational enterprises are well advised to consider such methods to resolve double taxation issues.

Brief Overview of the Competent Authority Process

The competent authority process is useful in that it provides multinational enterprises a means to resolve potential disputes resulting in double taxation and taxation not in accordance with a relevant treaty through negotiations between tax authorities of treaty partner jurisdictions.

The objective of the MAP process is both to negotiate an arm's length position that is acceptable to the relevant tax authorities and to avoid double taxation for taxpayers. Importantly, in addition to addressing transfer pricing disputes, the MAP process can also be used to resolve double taxation arising from other treaty-related issues, such as foreign tax credits, permanent establishment and withholding taxes.

The MAP is a government-to-government dispute resolution mechanism where the taxpayer's role is limited to initiating the MAP proceedings and providing the necessary information on the factual and legal issues underlying the competent authority request.

Each country has its own set of Internal procedures that generally differ from country-to-country for implementing the MAP process.[1] In the U.S., MAP cases are usually resolved in the following different ways, which are generally similar to other jurisdictions.



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The competent authority can unilaterally provide relief by either a full withdrawal of the adjustment in the case of a U.S.-initiated adjustment, or correlative relief in the full amount of a foreign-initiated adjustment.

If the U.S. competent authority cannot unilaterally provide full relief, there are generally four outcomes that would provide full or partial relief:

1. The adjusting jurisdiction fully withdraws the adjustment;
2. The nonadjusting jurisdiction provides full correlative relief in the full amount of the adjustment;
3. The adjusting jurisdiction partially withdraws the adjustment and the non-adjusting jurisdiction provides partial correlative relief in an amount equal to the remaining adjustment, so that no double taxation remains; or
4. There is some partial withdrawal of adjustment, some partial correlative relief, or both, but some double taxation remains.

In addition, under some treaties, if the competent authorities are unable to resolve a case by complete agreement, taxpayers generally may request arbitration to resolve the case. Generally, in arbitration, a case is resolved by an arbitration board composed of members selected by each of the respective competent authorities.

An APA is a formal agreement between a taxpayer and one or more tax authorities to determine transfer pricing methodology for intercompany transactions. APAs are typically effective for five years or more with the possibility of renewal and rollback.

Like the MAP process, the objective of the APA procedure is to eliminate double taxation in a manner that is reliable and fair for both the taxpayer and the taxing authorities. The procedures differ, however, as MAP cases are initiated post-assessment whereas APA requests are submitted for prospective years that have not yet been audited and are designed to provide certainty to the taxpayer and tax authorities on a prospective basis.

Benefits

The competent authority process offers many benefits compared to traditional methods of resolving transfer pricing disputes such as domestic tax administrative remedies and litigation in some cases.

First, the competent authority procedures are efficient and amicable methods to avoid double taxation. The MAP is a bilateral or multilateral process involving the taxing authorities of the relevant jurisdictions, meaning taxpayers can simultaneously resolve transfer pricing adjustments in multiple jurisdictions on consistent terms.

In contrast, domestic channels for dispute resolution usually do not provide relief from double taxation as actions undertaken in one jurisdiction may not be available in another jurisdiction, or such action may lead to different results in each jurisdiction.

Likewise, taxpayers also have the option to manage their transfer pricing arrangements proactively through bilateral or multilateral APAs, which provide up-front certainty

concerning the agreed upon transfer pricing methodology while preventing future disputes and can also avert the risk of double taxation.

Moreover, using the competent authority process, whether MAP or APA, allows tax authorities and taxpayers to work in a less adversarial manner and reach the most agreeable option for both parties.

In addition, the MAP process is generally successful. Globally, in 2020, based on OECD data, around 75% of MAP transfer pricing and other cases were fully resolved.[2]

In the U.S., in 2020, of the 209 transfer pricing MAP cases resolved by the U.S. competent authority, 105 of those cases concluded in an agreement that fully eliminated double taxation, 14 of those cases concluded in the U.S. competent authority granting unilateral relief from double taxation and 25 of those cases were withdrawn by the taxpayer.[3]

In 2019, of the 142 transfer pricing MAP cases resolved by the U.S. competent authority, 115 of those cases concluded in an agreement that fully eliminated double taxation, 10 of those cases concluded in U.S. competent authority granting unilateral relief from double taxation, and eight of those cases were withdrawn by the taxpayer.[4]

Second, the competent authority procedures tend to be less costly, and less time-intensive compared to administrative remedies or litigation. Even though it requires a diversion of resources to submit the request and provide the necessary information for taxpayers, the cost associated is minimal when compared to the astronomical costs of depositions, experts and other costs related to litigating a transfer pricing dispute, which can stretch over many years.

Similarly, for tax authorities, the competent authority process permits the parties to resolve tax issues for multiple tax years in one setting, resulting in an efficient tax administration for the government while providing better results for taxpayers.

Third, where appropriate, competent authorities can consider the OECD guidelines when interpreting applicable domestic rules, which, depending on the facts at issue, may provide common ground where domestic laws or interpretations of rules are in conflict.

For example, since treaty partners are not bound by U.S. regulations, in the bilateral context the Internal Revenue Service may also look to the OECD guidelines when interpreting U.S. regulations under Section 482 of the internal Revenue Code during competent authority negotiations.

Finally, the competent authority process is flexible. Taxpayers can usually submit a MAP request after an examination or alternative dispute resolution. Moreover, taxpayers may request that the terms of a MAP resolution be extended to cover subsequent tax years for which a tax return has been filed but has not yet been audited through the accelerated competent authority procedure.

Considerations

There are certain considerations taxpayers should assess when considering MAP or APA including the materiality and complexity of the issues, and the sophistication and experience of the competent authorities involved.

The competent authorities may decline to accept a MAP or an APA request if the request is

defective — for example, lacking required information. Moreover, there might also be business considerations — e.g., multinational enterprises might be hesitant to disclose details about their business and transactions to treaty partners — that might render the competent authority process less attractive.

Tax authorities should also consider whether they have sufficient resources to handle the constantly increasing competent authority caseload, and whether they are better off handling some of these issues before they reach the competent authority stage through other methods.

Conclusion

On balance, the competent authority process is an efficient and effective remedy for relief from double taxation, and parties are well advised to consider such avenues as opposed to only relying on domestic channels of dispute resolution as they navigate a constantly evolving and uncertain tax landscape.

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[1] See Rev. Proc. 2015-40; Rev. Proc. 2015-41.

[2] <https://www.oecd.org/ctp/dispute/mutual-agreement-procedure-statistics.htm>.

[3] <https://www.oecd.org/tax/dispute/2020-map-statistics-united-states.pdf>.

[4] <https://www.oecd.org/tax/dispute/2019-map-statistics-united-states.pdf>.