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Multinationals Should Consider Adding 'Competent Authority Processes' to Their Tax Strategies

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Takeaways

- Transfer pricing uncertainty has increased with U.S. tax reforms and an OECD proposal establishing a new approach to determining the jurisdiction where income is recognized.
- The "competent authority processes" created by standard tax treaties offer cost-effective ways to resolve tax disputes and plan for the future.
- One procedure (MAP) allows taxpayers to initiate negotiations among multiple jurisdictions to resolve transfer pricing and double taxation problems.
- Through another one (APA), companies can obtain advance approval of transfer pricing policies — authorizations that can extend for years.

As the global tax landscape evolves, multinational enterprises (MNEs) in many jurisdictions increasingly find themselves subject to double taxation or conflicting transfer pricing rules. Fortunately, long-standing tax treaties provide administrative procedures to resolve disputes and obtain guidance for the future — processes that have been underutilized and even overlooked but are important options for taxpayers now, as the accepted rules and interpretations change.

A host of new cross-border intercompany issues have been raised by recent tax reforms in the United States, including the 2017 Tax Cuts and Jobs Act (the largest overhaul of U.S. tax law regarding overseas corporate income in over 30 years) and the spate of 2021 proposals. Meanwhile, the Organization for Economic Cooperation and Development (OECD) has won broad international support for reforms aimed at addressing taxation of the digital economy and nexus issues — *i.e.*, where income should be recognized when the taxpayer has little or no physical presence in jurisdictions from which it derives revenue. These reforms would require MNEs to revisit their transfer pricing systems. (See our June 16, 2021, client alert "Is Tax Competition Dead?")

As a consequence of these developments and financial anomalies resulting from the COVID-19 pandemic, MNEs face more controversies involving international taxes and transfer pricing issues and find it more difficult to plan. That makes it increasingly important to consider the "competent authority" mutual agreement process (MAP) and advance pricing agreements (APAs) as alternate ways to head off and resolve disputes.

Overview of the Competent Authority Process

The term "competent authority" derives from widely adopted model tax treaties, which typically establish the MAP and APA processes.

MAP allows companies to seek relief from double taxation and taxation inconsistent with treaty terms by initiating negotiations among the governments that are parties to a treaty. Each country has its own set of internal procedures for implementing the process.

Taxpayers are not directly involved in negotiations between the tax authorities. Instead, they launch the proceeding through their home jurisdiction's competent authority, providing the necessary factual and legal information. U.S.-based parents with international subsidiaries submit a request to the Internal Revenue Service and each subsidiary applies to the relevant foreign tax authority.

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In addition to addressing transfer pricing disputes, the MAP process can be used to resolve double taxation arising from other treaty issues, such as foreign tax credits, permanent establishment and withholding tax.

While MAPs come after an assessment, an APA looks forward, establishing a formal agreement between a taxpayer and one or more tax authorities to determine the transfer pricing methodology for future intercompany transactions. Like MAP, the APA process begins with a request by the taxpayers to the relevant competent authorities and can be multilateral. APA approvals typically run five years or more, with possible renewal and rollbacks (authorizations for past years when returns have already been filed).

Benefits Include Efficient Resolution With Multiple Jurisdictions

Competent authority processes offer many benefits compared to traditional methods of resolving international tax disputes, such as domestic tax administrative remedies and litigation.

First, the competent authority process is effective and efficient. Because MAP is bilateral or multilateral, involving the taxing authorities of the relevant jurisdictions, taxpayers can simultaneously resolve transfer pricing adjustments in multiple countries on consistent terms. In contrast, dispute resolution channels in a single jurisdiction usually do not provide relief from double taxation because actions undertaken in one country may not be available in another, or different outcomes may be reached.

In addition, companies have a high success rate with the MAP process, making it a better alternative to litigation. For instance, in 2020, of the 209 transfer pricing MAP cases resolved by the IRS, 105 concluded in an agreement that fully eliminated double taxation, 14 resulted in the IRS granting unilateral relief from double taxation and 25 were withdrawn by the taxpayer, according to OECD data.

Taxpayers also have the option to manage their transfer pricing arrangements proactively through bilateral or multilateral APAs, which provide up-front certainty about methodology and avert the risk of double taxation.

Second, the competent authority processes tend to be amicable, less costly and less time-intensive compared to administrative remedies or litigation. The cost of submitting the request and providing the necessary information, though considerable, is usually a fraction of the expense of depositions, experts and so on in litigation.

Third, where appropriate, competent authorities can consider the OECD guidelines when interpreting applicable domestic law. Depending on the facts at issue, that may provide common ground where domestic laws or rule interpretations conflict.

Fourth, the competent authority process is flexible. Taxpayers can usually submit a MAP request after an unsuccessful examination or alternative dispute resolution. Moreover, companies may request that the terms of a MAP resolution be extended to subsequent tax years when a return was filed but not yet audited.

Finally, the outcomes are not judicial rulings, so the parties are not bound by the competent authorities' proposed determinations, and those do not constitute precedent for future disputes. Thus, if a proposed MAP settlement is unsatisfactory to the taxpayer, it can pursue litigation. And, if an advantageous APA preapproval cannot be obtained, the taxpayer can simply wait for an assessment and deal with the issue at that point.

Considerations To Weigh

The decision to pursue a MAP or APA involves many factors, including the materiality and complexity of the issues and the sophistication and experience of the relevant tax authorities. Similarly, business considerations may make the competent authority process less attractive. For example, some MNEs may hesitate to disclose details about their business and transactions to certain authorities.

On balance, however, the competent authority process serves as an effective remedy for relief from double taxation, and MNEs should consider these avenues as alternatives to domestic channels of tax dispute resolution.