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In this article, the authors explain why tax authorities can and should expediently address base erosion and antiabuse tax liability that may arise from taxpayers' use of the advance pricing and mutual agreement program.

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Introduction

In the world of transfer pricing, the advance pricing and mutual agreement program administered by the IRS can offer significant value to large corporate taxpayers. APMA provides taxpayers with various avenues to address their transfer pricing issues, including the advance pricing agreement and the mutual agreement procedure. An APA is a prospective tool by which a taxpayer and one or more competent authorities enter into a contract regarding the taxpayer's transfer pricing method. MAP is a retrospective tool that enables taxpayers that conduct business with a U.S. tax treaty partner to initiate a proceeding after a tax assessment if the taxpayers believe they have been taxed in a way contrary to the principles of an applicable treaty. The competent authorities of the implicated jurisdictions will then review the request and determine whether to unilaterally or bilaterally accept it. If accepted, the competent authorities will deliberate and issue a resolution reallocating the taxpayer's income. Local audit teams then implement the resolution.

Although the APA and MAP programs are powerful tools that taxpayers can benefit from, like all programs, they have their limitations. For example, participation does not completely shield taxpayers from cascading effects on their returns that result from the reallocation of their income by competent authorities. During an APA's negotiation stage or a MAP's implementation stage, taxpayers may be exposed to base erosion and antiabuse tax liability.

BEAT Liability for U.S. Taxpayers

The BEAT is an alternative minimum tax that applies to large corporations with significant base erosion payments. The BEAT seeks to constrain those corporations from shifting income to low-tax jurisdictions. More specifically, if a corporation with annual gross receipts of $500 million or more over the prior three tax years makes certain deductible payments to foreign related parties that equal more than 3 percent of its total deductible payments, it may be subject to BEAT liability. Common examples of deductible payments include interest, royalties, and costs of services. If the taxpayer surpasses the 3 percent cap, it must determine whether its regular tax liability exceeds its potential BEAT liability: a 10 percent tax on the taxpayer's total taxable income after including the base erosion payments. If the taxpayer's BEAT liability is greater than its regular tax liability, it must pay the BEAT instead. As the APA and MAP programs currently operate, taxpayers may find themselves vulnerable to BEAT liability, even if they were not before using those tools.

The following examples illustrate how the BEAT can interact with APA negotiations and MAP resolution implementations and result in BEAT liability.

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APA Negotiations

In the first example, a U.S. taxpayer is negotiating its transfer pricing method with U.S. competent authorities and Country A. As part of the taxpayer's as-filed position, $100 of income from services payments has been allocated to Country A. Country A later argues that $150 should be allocated instead, and the U.S. competent authority agrees. Given that services payments are base erosion payments, the increased allocation has pushed the taxpayer over the BEAT threshold, and the taxpayer is now subject to BEAT liability.

In the second example, a U.S. taxpayer is applying for an APA to cover tax years 1 through 5. The negotiation process begins in year 1 but is not completed until year 3. All parties agree that the APA adjustments for the prior years (years 1 and 2) should be telescoped and take place in year 3. Telescoping is an administrative process that allows a taxpayer seeking resolution for a multiyear tax issue to aggregate its deductions into a single year rather than spread across multiple years. These telescoping adjustments caused the taxpayer to amass enough base erosion payments to cross the BEAT threshold, making it subject to BEAT liability.

MAP Resolutions

The implementation of MAP resolutions also may result in a taxpayer becoming subject to BEAT. In this example, a U.S. taxpayer made a $50 payment to its foreign subsidiary in Country A and received a corresponding $50 deduction from the U.S. competent authority. After a foreign-initiated adjustment, the taxpayer requests a MAP proceeding to resolve its transfer pricing issue. Via a competent authority resolution, the United States and Country A conclude that an additional $50 should be allocated to Country A as income, and local audit teams have been instructed to implement the resolution. The U.S. competent authority then provides the taxpayer with an additional corresponding $50 deduction, which may subject the taxpayer to BEAT liability if the additional income allocated to a foreign jurisdiction (Country A in this example) by the competent authority resolution is a qualifying BEAT payment that pushes the taxpayer over the 3 percent threshold.

More generally, a U.S. taxpayer may also be subject to BEAT liability as a result of telescoping if the aggregation of deductions crosses the BEAT threshold. It is important to note that MAP resolutions may have the opposite effect — if more income is being allocated to the United States, a taxpayer's BEAT liability may be reduced or eliminated.

A competent authority's role is to allocate income. More specifically, competent authorities are empowered to eliminate double taxation by determining which treaty partner has rights to tax certain income. As a result, a competent authority resolution will not change the character of a payment (for example, from a qualifying base erosion payment to a nonqualifying payment).[1] The resolution can only adjust the amount of qualifying base erosion payments, which can either create, reduce, or eliminate BEAT liability.

Relevance

The intersection of BEAT liability with APA and MAP proceedings has not been considered in depth. For example, despite this scenario being brought to Treasury's attention before the issuance of the proposed BEAT regulations,[2] Treasury has yet to address it.[3] In addition, academic literature focuses primarily on whether the BEAT violates the nondiscrimination article of U.S. tax treaties.[4] Given the gap in both Treasury and academia's response to the issue, Treasury should have many reasons to address it, including:

Taxpayer Certainty

When faced with the need to resolve a foreign-initiated transfer pricing adjustment, litigation is

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[1]This statement is not an adoption of the position that a competent authority lacks the authority to characterize the nature of certain payments.

[2]REG-104259-18.

[3]*See, e.g.*, Stewart Lipeles et al., "The Final and Proposed BEAT Regulations: A Favorable Turn," 46 *Int'l Tax J.* 41, 48 (2020).

[4]*See, e.g.*, Rebecca M. Kysar, "Unraveling the Tax Treaty," 104 *Minn. L. Rev.* 1755, 1813-1817 (2020); Alexander M. Lewis, "BEAT Conflict Clouds Future of Pending Tax Treaties," *Tax Notes Int'l*, Aug. 27, 2018, p. 885; Reuven S. Avi-Yonah and Bret Wells, "The BEAT and Treaty Overrides: A Brief Response to Rosenbloom and Shaheen," *Tax Notes Int'l*, Oct. 22, 2018, p. 383; H. David Rosenbloom and Fadi Shaheen, "The BEAT and the Treaties," *Tax Notes Int'l*, Oct. 1, 2018, p. 53; Mark Martin, Sean Foley, and Thomas Bettge, "BEAT's Impact on Transfer Pricing Alternative Dispute Resolution," 33 *Daily Tax Report* 18 (2018).

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an obvious procedural option for U.S. taxpayers. However, it is an option with significant uncertainty in terms of time and resources. Litigation proceedings may drag on for many years and become a perpetual distraction for senior management. The general hazards of litigating in a foreign jurisdiction introduce doubt to predictions regarding the ultimate outcome, and in addition to the potentially large legal fees associated with litigation, accessing foreign courts may require substantial cash deposits that will remain tied up for the duration. Competent authority proceedings provide taxpayers with greater certainty. By design, the resolution of APA and MAP proceedings generally requires less time and thus results in smaller legal expenses. In addition, engaging the U.S. competent authority as an ally to negotiate with a foreign taxing authority serves as a check on the reasonableness of the outcome. However, potential BEAT exposure can eliminate much of this certainty. Depending on the facts, even a small transfer pricing adjustment in an APA or MAP agreement could have a huge impact if it pushes a U.S. taxpayer above the BEAT threshold. Without a guarantee of safety, taxpayers will more seriously consider litigation as a viable option in lieu of negotiating APAs or initiating MAP proceedings. If the purpose of these procedures is to reduce litigation, decreasing certainty by allowing BEAT exposure actively frustrates that purpose.

Taxpayer Certainty vs. Increased Litigation

Relatedly, for taxpayers that continue to engage with these procedures, the competent authority process becomes less efficient because taxpayers will be less willing to negotiate if BEAT liability may result. In this example, assume a U.S. taxpayer is negotiating the transfer price used to make payments to its foreign affiliate in Country X. The competent authority of Country X will settle the matter if an additional amount of income is allocated to Country X (and the U.S. competent authority is willing to agree). This allocation will result in additional income tax owed to Country X (less any offsetting deductions and credits in the United States) of $100. Even though the U.S. taxpayer believes the proposed income allocation is too high to reflect the true arm's-length price, it would ordinarily agree to any adjustment that results in up to $200 of additional global tax liability to avoid the uncertainties of litigating in Country X. However, in this example, assume the income allocation corresponds to a base erosion payment that drives the U.S. taxpayer above the BEAT threshold and results in an additional BEAT liability of $150 in the United States. The U.S. taxpayer rejects the agreement, and the competent authority process breaks down without achieving the most efficient result for all parties.

Administrability

Determining whether to litigate a foreign-initiated transfer pricing adjustment or pursue a competent authority resolution can, depending on the facts, be a complicated undertaking. However, potential BEAT exposure makes the determination significantly more complex. A U.S. taxpayer must make estimations regarding the full range of potential transfer pricing outcomes in litigation as well as its future BEAT position. In scenarios in which a BEAT problem arises, the U.S. taxpayer can then estimate whether it would be economically beneficial to forgo double tax relief in the United States to negate BEAT exposure. These scenarios must then be compared against probable outcomes in a competent authority process and any potential BEAT exposure associated therewith, considering the possibility of telescoping. The modeling process can quickly become impractical. In this way, the potential BEAT exposure associated with competent authority processes imposes an increased and unintended administrative burden on taxpayers.

Taxpayer Knowledge

Taxpayers should have a comprehensive understanding of the BEAT and its implications in competent authority proceedings, but the uncertainty surrounding the application of the BEAT to APAs and MAPs represents a trap for the unwary. By definition, the BEAT combats base erosion payments — that is, payments that erode the U.S. tax base by improperly shifting income to other jurisdictions. Taxpayers engaged in an APA or MAP may assume, understandably, that the U.S. government would never sanction an agreement that impermissibly erodes its own tax

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base. Having engaged with the U.S. competent authority to settle a foreign-initiated transfer pricing adjustment without any discussion of BEAT implications, those taxpayers should not later receive a surprise BEAT assessment when the APA or MAP reaches the local audit team.

Governmental Base Erosion

APA and MAP processes are, fundamentally, negotiations between treaty partners. As a result, in most foreign-initiated transfer pricing disputes, the U.S. competent authority will agree to reallocate some amount of income to the relevant foreign jurisdiction regardless of the true arm's-length price. Although the magnitude of the reallocation may differ in any dispute, an APA or MAP rarely sustains a U.S. taxpayer's as-filed transfer pricing position. As previously discussed, when the U.S. competent authority agrees to reallocate certain payments to a foreign jurisdiction and BEAT liability results, the U.S. competent authority has essentially played an active role in eroding the U.S. tax base. This is fundamentally inconsistent with the congressional intent underlying the imposition of BEAT liability on U.S. taxpayers.

Frequency

Following the OECD initiative regarding base erosion and profit shifting, non-U.S. jurisdictions increasingly look to transfer pricing as a profitable assessment mechanism. APMA officials have noted, for example, that MAP cases are increasing in both complexity and magnitude.[5] In foreign-initiated adjustments, the foreign competent authority will always lay claim to additional income, and at least some of that claim will likely be sustained via the negotiation process in an APA or MAP. Large corporate taxpayers making intercompany payments to foreign affiliates will increasingly face the possibility of being pushed into the BEAT — even if they set transfer pricing policies in good faith.

[5] *See, e.g.*, Ryan Finley, "Rising Stakes Make MAP Cases Harder for IRS to Resolve," *Tax Notes Int'l*, Sept. 20, 2021, p. 1649.

Double Taxation

A primary purpose of the income tax treaties the United States enters into with other jurisdictions is the avoidance of double taxation.[6] In the context of a foreign-initiated transfer pricing dispute, the United States should not be able to tax any intercompany income the competent authorities agree belongs to the foreign treaty partner. This article does not address the general interaction of the BEAT with the U.S. treaty network in situations in which a U.S. taxpayer makes arm's-length payments to a foreign affiliate. However, as previously discussed, in a foreign-initiated transfer pricing dispute, an APA or MAP process generally results in a negotiated settlement regardless of the true arm's-length price. In that scenario, the practical reality of the negotiation process results in double taxation that Congress did not contemplate.

As the IRS continues to advocate for use of these programs and as taxpayers continue to avail themselves of them,[7] it is imperative that the IRS address this issue. According to the IRS, "APMA's mission is to resolve actual or potential transfer pricing disputes and other competent authority matters in a timely, principled, and cooperative manner."[8] Addressing BEAT liability in these processes allows APMA to further its mission of providing principled dispute resolution.

Solutions

Competent authorities are permitted to address the BEAT as an ancillary issue — and should. Section 4.02(2) of Rev. Proc. 2015-40 states that:

> Competent authority repatriation may be addressed as an ancillary issue in a competent authority resolution. When a competent authority resolution makes a primary adjustment to income,

[6] See the preamble of the 2016 U.S. model tax convention.

[7] For example, in 2023 167 APA applications were filed with APMA — 17 were unilateral, 144 were bilateral, and six were multilateral. None was revoked or canceled, 156 were executed, and 558 were pending as of December 31, 2023. The total number of APAs filed decreased slightly between 2022 and 2023 from 183 to 167, while the number of APAs executed increased from 77 to 156. *See* Announcement 2024-16, 2024-16 IRB 909, at 3-5; Announcement 2023-10, 2023-16 IRB 663, at 3-4.

[8] *See* IRS, "Advance Pricing and Mutual Agreement Program" (last updated Sept. 17, 2024).

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deductions, credits, allowances, basis or any other item or element affecting taxable income between two members of a controlled group, the competent authority resolution might also include competent authority repatriation as a means to conform their accounts to reflect the primary adjustment.

Adjustments leading to BEAT liability fall squarely in the set of issues that competent authorities are empowered to address, and for all the reasons previously discussed, doing so benefits both the taxpayer and tax administration.[9]

In addition, educating taxpayers on the interplay between BEAT liability and APA and MAP proceedings will enable them to make more informed decisions.

Conclusion

Competent authorities have the power to address BEAT liability arising in APMA-administered programs. We have laid out both how they can and why they should and hope that this article sheds light on the importance of an expedient resolution by Treasury that encourages taxpayers to continue using such tools. ■

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[9] Rev. Proc. 2015-40, 2015-35 IRB 236, defines ancillary issue as: "A competent authority issue, such as repatriation payments (see section 4.02(2)), interest on refunds and deficiencies, and penalties, that arises out of a competent authority resolution of another, underlying competent authority issue."

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