NEW YORK STATE BAR ASSOCIATION
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April 1, 2014

The Honorable Mark Mazur
Assistant Secretary (Tax Policy)
Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20220

The Honorable John Koskinen
Commissioner
Internal Revenue Service
1111 Constitution Avenue, NW
Washington, DC 20224

The Honorable William J. Wilkins
Chief Counsel
Internal Revenue Service
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Re: <u>Notice 2013-78 – Mutual Agreement Procedure</u>

Dear Messrs. Mazur, Koskinen, and Wilkins:

This letter[1] provides comments on Notice 2013-78,[2] which proposes to issue a new revenue procedure that relates to the Mutual Agreement Procedure (the "MAP Notice") for mitigating double taxation under income tax treaties entered into between the United States and other countries. This letter does not specifically comment on the accompanying Notice 2013-79 (the "APA Notice"),[3] which was issued on the same day as the MAP Notice and which sets forth procedures for Advance Pricing Agreements.

We appreciate that, in the resource-constrained environment in which the U.S. Competent Authority operates, it is important to make sure that the Competent Authority procedure operates in an efficient manner. It is evident that, in light of that environment, the Internal Revenue Service (the "Service") is seeking in the MAP Notice to enhance the efficiency of the Competent Authority procedures and to make that procedure more consistent with the procedure

[1] The principal drafter of this letter was David Hardy. Helpful comments were received from Michael Schler, Stephen Shay, Stephen Land, Eric Sloan, Elizabeth Kessenides, Ansgar Simon, Marsha Henry, Steven Dean and Jennifer Lee. This letter reflects solely the views of the Tax Section of the New York State Bar Association and not those of its Executive Committee or House of Delegates.

[2] 2013-50 I.R.B. 633.

[3] 2013-50 I.R.B. 653.

relating to advance pricing agreements.[4] At the same time, we believe that the taxpayer relief nature of the Competent Authority determination is (and should remain) an important element of our treaties' protections against double taxation. Certain of the recommendations made below are designed to ensure that, in implementing the new procedures and the desired efficiency and transparency, the taxpayer protective relief opportunity that the United States negotiated in its bilateral tax treaty agreements is not diminished.

For the reasons set forth below we recommend that:

(i) Open Year Requirement. The expiration of the statute of limitations or other time constraints should not automatically preclude the taxpayer from requesting MAP. Instead, the taxpayer should identify any such expiration, and the Competent Authority should exercise its discretion in determining whether its treaty-based powers permit it to entertain the matter and fashion an appropriate resolution.

(ii) Automatic Extension of Statute of Limitations. The initial written request for MAP should be deemed to be a consent to extend the statute of limitations and other extendable time limitations. We think such an automatic extension would be helpful and appropriate because the expanded information and conference requirements for invocation of MAP under the MAP Notice will extend the time to initiate MAP and could otherwise cause the relevant time limits to expire.

(iii) Taxpayer Withdrawal Right. When a taxpayer properly invokes a MAP for a particular issue in a particular tax year and the U.S. Competent Authority expands the scope of the proceeding to include additional years, countries or issues, the taxpayer should retain the right to terminate the particular proceeding by withdrawing its request for MAP. The Service would retain all its existing audit and treaty-based consultation powers, as well as the power to initiate a MAP under the terms of the MAP Notice.

(iv) Taxpayer Initiated Adjustments. The MAP Notice permits the taxpayer to invoke MAP for adjustments to tax initiated by the taxpayer, presumably after the timely filing of its income tax returns. It would be helpful if the Service clarified whether the taxpayer-initiated adjustment MAP is limited to adjustments the taxpayer would otherwise be permitted to make under domestic law, including under Section[5] 482 and, in particular, under the limitations currently imposed on taxpayer-initiated changes by Treasury Regulation §1.482-1(a)(3).

Background

The United States income tax treaty network is composed of bilateral agreements between the United States and its trading partners. Under these income tax treaties, the United States and a counterparty country agree to allocate primary taxing jurisdiction regarding persons or transactions between them in an effort to minimize the adverse economic impact of double taxation on trade and commerce. While the tax treaties contain very specific rules regarding the taxation of investment returns and the allocation of business profits, all the major treaties drafted in conformity with the U.S. Model Income Tax Convention of November 15, 2006 (the "U.S. Model Treaty") and the Model Income Tax Treaty of the Organization of Economic Cooperation and Development (the "OECD Model Treaty") contain additional provisions to protect against occurrences of double

[4] We note that the Competent Authority procedures are in some sense quite different from the procedures relating to advance pricing agreements. The former procedures generally relate to an effort to close out issues for past taxable years and the latter procedures generally relate to an effort to create predictability for future taxable years.

[5] Unless indicated otherwise, all section references are to the Internal Revenue Code of 1986, as amended.

taxation that might still arise. *See, e.g.*, Articles 23 (foreign tax credit), 24 (non discrimination), and 25 (mutual agreement procedure) of the U.S. Model Treaty.

Article 25 of the U.S. Model Treaty allows taxpayers to invoke a procedure for collaboration between the governments to avoid the taxpayer paying tax twice. That article provides:

> Where a person considers the actions of one or both of the Contracting States result or will result for such person in taxation not in accordance with the provisions of this Convention, it may… present its case to the Competent Authority of either Contracting State.

In a simple example, where Country A finds that a corporation from Country B has operated in Country A through a permanent establishment, Country A may attribute to that permanent establishment certain amounts of the enterprise's worldwide profits. If the corporation has already reported the same income to Country B, double taxation may arise. Thus, a substantial audit adjustment by Country A to increase profits attributed to the corporation's permanent establishment in Country A would represent a "government action" (that is, an "action" of one of the Contracting States) that would cause the corporation to incur double taxation (that is, taxation not in accordance with the provisions of the Convention). In such instances, the taxpayer generally is permitted to request a MAP between Competent Authorities of Country A and Country B pursuant to which such Competent Authorities can determine between themselves which jurisdiction will impose tax on the income.[6] It is often said that, in this context, the corporate taxpayer is merely a stakeholder in an interpleader action allowing the two disputing parties to determine whether the taxpayer should pay Country A or Country B, but not both.

As has been frequently reported, MAP cases have been increasing dramatically in recent years due to the increasing internationalization of our trading patterns as well as increasing cross border tax controversies spawned by the sophistication of taxpayers and tax authorities.[7] The OECD's publication of its action plan on Base Erosion and Profit Shifting (the "BEPS Action Plan") in the summer of 2013,[8] likely will increase recourse to bilateral and multilateral tax resolution, further increasing the likely recourse to MAP. These developments make the updating of the U.S. Competent Authority procedures important as well as timely.

<u>MAP Notice Changes</u>

Currently, the United States MAPs are governed by Revenue Procedure 2006-54 (the "Existing MAP Rev. Proc.").[9] The MAP Notice would update and supersede the Existing MAP Rev. Proc. in important ways that would regularize and expedite MAP resolution. Among other changes, the MAP Notice would:

- Require that a pre-filing conference precede all taxpayer-initiated MAP cases;
- Require a pre-filing memorandum from most taxpayers;

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[6] It is important to recognize that the taxpayer is not entitled to a Competent Authority decision (other than in respect of the binding arbitration provisions in some recent treaties); that is, the Competent Authority retains the discretion to accept or reject the taxpayer's request.

[7] Michael Danilack comments to the N.Y.S. Bar Tax Section on January 28, 2014 and the Pacific Rim Tax Institute of January 31, 2014.

[8] OECD Publishing (2013). The report indicates the existence of a multi-lateral consensus among the major developed countries to assure that multi-national corporate taxpayers are paying appropriate amounts of tax on trading profits to one jurisdiction or another and have not been abusively utilizing intangible transfers, aggressive transfer pricing techniques, stripped distributor arrangements and hybrid instruments and entities to inappropriately reduce their global effective tax rates.

[9] 2006-2 C.B. 1035.

- Include much more specificity regarding required information to be submitted in advance of the MAP (all of which could presumably be shared with the other Competent Authority that is involved);

- Permit the provision of informal advice by the Competent Authority to the taxpayer;

- Clarify that Competent Authority assistance generally will not be accepted if barred by tax treaty provisions limiting assistance or if the statute of limitations has expired; and

- Permit the U.S. Competent Authority to expand, without the consent of the taxpayer, the scope of issues considered in MAP cases and to roll-forward the MAP resolution to other taxable years.

In some of the newer U.S. income tax treaties, binding arbitration mechanics have been introduced to settle long unresolved Competent Authority matters.[10] Section 12 of the new MAP Notice provides new procedures relating to the arbitration, which should facilitate the effectiveness of the arbitration.

The proposed changes to MAP will tend to conform the MAP to the procedures utilized for bilateral Advance Pricing Agreements. In addition, allowing a MAP result to be rolled forward to subsequent taxable years will in many cases be regarded as favorable to taxpayers by allowing them greater prospective certainty in their tax payment and compliance obligations. These provisions will also increase efficiency, as the Competent Authority will resolve complex issues affecting multiple years in a single proceeding rather than over a course of successive audits. Under the new resource constraints imposed upon the Service by budgetary reductions, this efficiency is clearly an important result.

Relief Nature of MAP Elements

The commendable improvements in the MAP procedures should be considered in relation to the character of the MAP relief itself. The MAP procedure is in general a taxpayer relief opportunity provided by a negotiated tax treaty.[11] The taxpayer is not actually involved in the deliberation process, since the flexibility of the process requires both jurisdictions to operate in confidence without strict regard to the limitations imposed under their respective domestic laws. Consistent with the relief nature of the procedure, the taxpayer may withdraw its consent at any time and the process ceases.

A taxpayer generally initiates MAP relief after an extended unsuccessful negotiation with the local country government audit staff. In such circumstances, the determination of the appropriate transfer pricing method may have been the subject of varying views of economists. A taxpayer seeking resolution of its tax obligations in one country may have multiple non-tax regulatory or excise tax regimes giving rise to the transfer pricing or business profit allocations on which its tax reporting is based. For such a taxpayer, the MAP may represent a last opportunity to achieve efficient resolution of its double tax concerns in a manner that recognizes the interest of the various countries in which the taxpayer operates. For such a taxpayer, the treaty's opportunity for MAP relief may be frustrated if a jurisdiction imposes conditions upon MAP that extend, complicate or deny access to the procedure.

1. Open Year Requirement. The Existing MAP Rev. Proc. requires that a taxpayer have preserved its statute of limitations for adjustment in both relevant jurisdictions in order to access MAP.[12] Without the

[10] *See, e.g.*, Article 26, paragraphs 6 and 7 of the Canada and United States Income Tax Treaty (2007). We believe that these provisions should help to prevent backlogs.

[11] As discussed above, the taxpayer's invocation of MAP is an opportunity and not a legally protected procedural right.

[12] *See* paragraph 4.05(8) of the Existing MAP Rev. Proc.

statutes of limitations of both jurisdictions for the taxable year remaining open, the MAP would not represent a true balanced negotiation between two Competent Authorities, each having the full power and authority to effectuate the resolution of the matter by the issuance of refunds with interest. Some treaties impose further time constraints.[13] The MAP Notice would continue to make any domestic or treaty based time bar a preclusion to MAP.[14]

Article 25, paragraph (1) of the U.S. Model Treaty allows the U.S. Competent Authority to grant relief "irrespective of the remedies provided by the domestic law of those States, and the time limits prescribed in such laws for presenting claims for refund."[15] In cases where a similar provision is operative, it may not be necessary to limit MAP to cases where the statute of limitation remains open since the Competent Authority may have the power within its treaty-based authority to make a cash payment or other adjustment to a prior year's tax liability without regard to a treaty time-constraint or other provision of domestic law. Accordingly, we believe that the expiration of the statute of limitations should not automatically bar a taxpayer from requesting MAP relief. However, in this event, it seems appropriate to require the taxpayer to identify any time constraints imposed by the treaty or domestic law that may not be satisfied and permit the Competent Authority to determine whether MAP relief might still be granted.

2. Automatic Extension of Statute of Limitations. The MAP Notice contains substantial information requirements that are considerably more extensive and detailed than those set forth in the Existing MAP Rev. Proc.[16] Similarly, the MAP Notice's requirement of the compilation of specific information, the filing of a pre-filing conference memorandum and the obtaining of such a conference may extend substantially the time required to introduce the Competent Authorities to the matter.

The detailed information can be useful to both the U.S. Competent Authority and the foreign Competent Authority to help them understand the matter and to facilitate their informed negotiation of the tax allocation. However, in the context of a taxpayer-initiated MAP, the taxpayer may have already have been involved in a multi-year audit procedure with the Service and may have submitted voluminous information in various formats to the Service in the hopes of helping it to understand the facts and the tax issues. In light of the additional time involved, we recommend that, if the taxpayer properly invokes Competent Authority by a written request to the U.S. Competent Authority and/or the other jurisdiction, the request be treated as a consent to toll the relevant U.S. time periods for so long as the taxpayer pursues the MAP.[17]

3. Taxpayer Withdrawal Right. Section 2.08 of the MAP Notice would grant to the U.S. Competent Authority the unilateral right to extend the MAP resolution to other issues, subsequent years, and other countries.[18] In general, once the U.S. Competent Authority and a foreign country's Competent Authority has agreed to a particular royalty rate or business profits allocation, in many cases it would be efficient for all parties, including the taxpayer, to extend that same resolution to subsequent years and avoid the necessity of reconsidering the very same issue in later years. While such a roll-forward authority may be appropriate in some

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[13] *See, e.g.*, U.S. / Canada Treaty, Articles 26, paragraph 2 (within six years of the end of the taxable year).

[14] *See* MAP Notice Sections 3.04(2) and (3).

[15] Since MAP resolutions have generally been confidential, allowing the exercise of "extra-legal" powers without criticism, the Competent Authorities are uniquely able to determine whether relief opportunity exists. MAP Notice Sections 10.02 and 13.01.

[16] *See, e.g.*, MAP Notice Section 3.05.

[17] Presumably temporal restrictions imposed on the Competent Authorities pursuant to the relevant treaties, *e.g.*, U.S. / Canada Treaty, Articles 26, paragraph 2, would be given effect.

[18] The provisions of Section 2.08 of the MAP Notice would also permit the U.S. Competent Authority to itself initiate a MAP procedure and to require the taxpayer to comply with the information requirements of the MAP Notice. We note that, unlike an audit by the Service, a MAP procedure initiated by the U.S. Competent Authority would automatically expose the results to other countries.

cases, changes in the taxpayer's business arrangements or economic environment could cause a roll-forward of the resolution to be inappropriate in other cases.

In light of the relief nature of the MAP, one could reasonably conclude that the taxpayer should be able to determine the taxable years that are subject of the MAP. We note in this regard that the circumstance and rationale of a taxpayer seeking MAP are often quite different than a taxpayer seeking prospective treatment in an advance pricing agreement. On the other hand, it is reasonable for the U.S. Competent Authority to impose limitations on the expenditures of its energy in a Competent Authority matter. Moreover, paragraph (3) of Article 25 of the U.S. Model Treaty allows the Competent Authorities to cooperate independent of a taxpayer's request, as they can for resolving dual residency or limitation on benefit issues.

When a taxpayer properly invokes a MAP for a particular issue in a particular tax year and the U.S. Competent Authority expands the scope of the proceeding to additional years, countries or issues, the taxpayer should retain the right to terminate the particular proceeding by withdrawing its request for MAP. The Service would retain all its existing audit and treaty-based consultation powers, as well as the power to initiate a MAP under the terms of the MAP notice.

The withdrawal of a taxpayer's consent would have normal consequences for the taxpayer. For example, in determining the credibility of any foreign tax paid, the U.S. taxpayer is required to have pursued all effective and practical remedies to reduce foreign tax, "including invocation of Competent Authority procedures available under applicable tax treaties."[19] Large taxpayers with significant foreign tax payments generally would not have carried out the exercise of practical remedies where they have deliberately withdrawn from a Competent Authority proceeding, and therefore may not qualify for foreign tax credit.

4. Taxpayer Initiated Adjustments. The MAP Notice would clarify and expand the availability of Competent Authority to taxpayer-initiated adjustments. It would be helpful if the Service further clarified whether the taxpayer-initiated adjustment MAP is limited to adjustments the taxpayer would otherwise be permitted to make under domestic law, including under Section 482 and, in particular, under the limitations currently imposed on taxpayer-initiated changes by Treasury Regulation §1.482-1(a)(3).

The Existing MAP Rev. Proc. specifically states that "there is no authority for the U.S. Competent Authority to provide relief from U.S. tax … unless such authority is granted by a Treaty." Since the U.S. treaties consistently follow the model in requiring that treaty offending double tax arise from "the actions of one or both of the Contracting States," many practitioners have assumed that MAP was not available where the taxpayer seeks to change the manner in which it previously reported its taxable income. However, Section 2.02 of the MAP Notice states that "MAP issues may arise as a consequence of taxpayer-initiated positions" unless the request evidences "after-the-fact tax planning."[20]

The permission granted by the MAP Notice for a taxpayer-initiated adjustment may assume that the taxpayer's claim of non-arm's length pricing would in any case come before the Competent Authority if the increased U.S. tax were coupled with a decreased foreign tax that is likely to be challenged by the other jurisdiction. Nevertheless, absent an action by the other jurisdiction, the taxpayer-initiated adjustment for which MAP approval is sought could be viewed as outside the literal scope of MAP relief under paragraph (1) of Article 25 of the U.S. Model Treaty. Even so, however, we assume that expansion would be consistent with the ancillary powers granted to the Competent Authority for self-initiated procedures under paragraph (3) of Article 25 of the U.S. Model Treaty.

[19] Treasury Regulation §1.901-2(e)(5)(i).

[20] *See* Section 6.12 of the MAP Notice.

Under Treasury Regulation §1.482-1(a)(3), a taxpayer may invoke Section 482 to adjust a price actually charged in a controlled transaction in accordance with arm's length principles on a timely filed return. "Except as [so] provided … Section 482 grants no other right to a controlled taxpayer to apply the provisions of Section 482 at will or to compel the district direction to apply such provisions." This language, as interpreted by Revenue Procedure 99-32,[21] prevents a taxpayer from affirmatively using Section 482 on an amended return to decrease its taxable income. Thus, under U.S. domestic practice, the taxpayer does not have the right to self-initiate a U.S. tax-reducing transfer price adjustment after a timely filed return.

The MAP Notice's permission for taxpayer initiated adjustments might be read as limited to such adjustments as are otherwise permissible under U.S. law. In that case, a taxpayer could adjust prices to increase U.S. tax.[22] On the other hand, if the Notice seeks to extend the MAP to certain taxpayer-initiated adjustments notwithstanding Treasury Regulation §1.482-1(a)(3), a clear statement of that expansion would be helpful. And, if the Notice allows taxpayer-initiated adjustments through a MAP, notwithstanding Treasury Regulation §1.482-1(a)(3), some further detail would be helpful.

Respectfully submitted,

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Chair

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[21] 1999-2 C.B. 296

[22] *See* Revenue Procedure 99-32, 1999-2 C.B. 296 ("If the adjustment results in an increase in taxable income, the increased income may be reported by the taxpayer at any time.").