

Global Tax Pie:

With globalisation and evolution of MNCs and TNCs, tax jurisdiction of every country has become more aggressive and sophisticated in their drive to protect their revenue base. The issues of taxability of permanent establishment and resident, invocation of source rule, and stringent transfer pricing policies led to taxpayers finding themselves exposed to double taxation. There is also an increasing complexity of taxing of e-commerce revenue. Taxpayers are obliged to litigate the actions of tax administration with all the disadvantages and uncertainties that such a situation entails. Such developments affect global trade in goods, services, funds and intangibles.

In the above scenario, the Mutual Agreement Procedure (MAP) assists the taxpayers in resolving the issues of double taxation by mutual agreement procedure and at the same time keeping the legal remedies alive. The complexities of issues and aggressive tax policies have given added importance to the concept of mutual agreement procedure between two tax administrations.

Basic concept :

MAP is a well established means through which taxpayers and tax administrations of the countries, through designated Competent Authorities (CAs), enter into a dispute-resolving mechanism on an amicable basis. The procedure is used to eliminate double taxation that could arise and also aims to solve the tax disputes between taxpayers and the tax administrations concerning issues mainly involving the concepts of

permanent establishment, source of revenue, resident and discrimination.

Most of the tax conventions contain the article on MAP. Normally, the procedures are used in three different areas. The first area includes instances of "taxation not in accordance with the provisions of the Convention" and is covered in paragraphs 1 and 2 of the Article and are initiated by taxpayer. The two areas dealt with in paragraph 3 do not necessarily involve taxpayer and deal with questions of "interpretation or application of the convention" and elimination of double taxation. Paragraph 4 of the article delegates power to the CAs for the effective implementation of MAP.

Operation of MAP :

A taxpayer can opt for MAP even in cases where the taxation appears at a risk which is not merely possible but probable. Normally a taxpayer is required to present its case to the CA of the State where he is a resident within three years of the first notification of action not in accordance with the convention. The CA is under an obligation to consider whether the objection of the taxpayer is justified and to take action on it.

Article

Navigating mutual agreement procedure (with particular reference to Adjustments under Transfer Pricing)

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The taxpayer is also required to undertake other protective measures e.g. filing of return for refund of claim, right to appeal before the lapse of time, etc.

If the CA is satisfied, the issue of taxability within that State can be resolved without resort to MAP with CA of the other tax jurisdiction. In other cases of elimination and double taxation, the CAs prepare position paper on the issues involved. In case of foreign initiative adjustment, the CA of the foreign country (adjusting country) will explain the basis of adjustment in the form of a position paper. The position papers are then exchanged at the time of meeting of the CAs.

The CA is not required to wait for the final adjudication of the appeal proceedings if any, preferred by the taxpayer. However, in practice, the implementation of MAP necessarily takes into account the concerns of CA to avoid any contradiction with the decision of the Court. The CA proceedings are confidential and strict secrecy is maintained for the data and information gathered by CA, though there have been concerns expressed recently for the pending litigation in USA for publishing of CA resolution entered into in the last decade.

Negotiation vis-à-vis solution :

It is to be noted that MAP does not compel the CAs to reach an agreement and resolve their tax disputes. The duty of the CAs is to find a solution — *pactumde contrahendo* — and not to reach a solution. A CA acts as a conciliator and not as an advocate for the country which it represents. The CA is expected to take principled position on the issues referred to it which may or may not always be in the best fiscal interest of its tax administration. If the application of rules or provisions preclude any agreement, the CA may agree to decide the issue on the principles of equity.

The advantage of the MAP is also that the terms of the settlement agreed to between the CAs is normally not binding on the taxpayer. (Moreover, the taxpayer, by opting for MAP, is not deprived of the ordinary administrative and legal remedies available to it). As stated earlier, the CA's process is not governed by an 'agreement to agree' but an endeavor to reach an agreement. However, it has been experienced that at the end, an agreement or solution is normally reached though some times in the form of a compromise. But, that is the most important result of negotiation under MAP. Expert assistance, if necessary, to solve an impasse is also taken.

Environment — Effective MAP :

Issues which are required to be addressed for an effective agreement procedure are :

(i) Time limit :

Extension of time limit under the domestic law for finalising

the taxpayer's tax liability is necessary so as to make corresponding adjustments meaningful. Many of the treaties provide that agreement reached in pursuance of a MAP can be implemented regardless of any time limit in the domestic law in the contracting States.

Another time limit which is a matter to be considered is the three-year time limit within which the aggrieved taxpayer must invoke MAPs. This three-year period commences from the time the tax administration has notified taxpayer proposed adjustment. However, the time limit is normally regarded as minimum and is to be interpreted in the way most favourable to the taxpayer. Bilateral convention can provide for a longer limit.

(ii) Duration of Mutual Agreement Proceedings :

The complexity of issues referred to for consideration to the CAs some times makes it difficult to reach for a solution within a definite time frame. Practically, some times, distances make it difficult to hold frequent meetings and correspondence cannot be a substitute for face-to-face discussions. Moreover, differences in language, procedures and legal and accounting systems may lead to extension of the duration process.

Duration of time is reduced by reducing formalities required to operate the procedure. Normally, senior officers known for their professionalism and competence are designated as CAs to engage in mutual agreement procedure. Tax officers responsible for development of appropriate

adjustment are normally not placed in charge of the proceedings but are expected to advise and participate in the proceedings to enforce independent role of the CA. Normally, no time limit is placed on the completion of the proceedings since the complexities of the issues involved may differ.

(iii) Participation of taxpayer :

Under the mutual agreement procedure, the taxpayer has no right to participate in the process though he has a right to initiate the procedure. It is to be noted that mutual agreement procedure is not a process of litigation but is a process to avoid double taxation. While input from the taxpayer in some cases can be helpful to the procedure, the taxpayer's ability to participate is subject to the discretion of the CAs. However, the taxpayer can initiate participation in the process by giving CAs all the factual information that is relevant to the issue in a timely manner. The data should be furnished as far as possible in accordance with internationally accepted accounting standards so that the data provided have some uniformity and objectivity. The taxpayers are also kept informed about the progress of the discussions between the CAs.

(iv) Administrative framework :

It would be necessary to have an effective administrative framework for the operations of the CAs so as to enable the taxpayers to be aware of their rights and obligations under MAP. Such administrative framework provides for scope of MAP, general terms and conditions for the applicability

of the process, form and time for submitting request for procedure, etc. The Rules and Procedures need not be rigidly structured and should have the necessary flexibility to facilitate consultation and agreement. The description of the procedures should be as complete as feasible and also be published.

(v) *Extension of the statute of limitation/suspension of recovery proceedings:*

An important consideration for making MAP effective is to allow suspension of Statute of Limitation in the case of a taxpayer who has referred an issue for consideration to the CAs. Such procedure can be adopted subject to right to seek security/protection against possible default by the taxpayer.

MAP and transfer pricing:

The mutual agreement procedure is widely opted for by various taxpayers/tax administrations in the case of double taxation as a result of transfer pricing adjustments.

Double taxation means inclusion of the same income in the tax base by more than one tax administration which may be in the hands of different taxpayers (economic double taxation for associated enterprises) or inclusion of income in the hands of same juridical entity by different tax jurisdictions. (Juridical double taxation for Permanent Establishment).

The article on Associated Enterprises under the tax treaty gives specific power to the competent authorities for resolving such economic and juridical double taxation.

Corresponding (correlative) adjustments:

Corresponding adjustments, in practice, are undertaken as a part of the MAP in those cases where one tax administration increases a company's taxable profits (by making a primary adjustment) by applying the "arm's length principle" to transactions involving an associated enterprise in the second tax jurisdiction. Corresponding adjustment in such case is the downward adjustment to the tax liability of the associated enterprise in tax administration of the second jurisdiction so as to prevent occurrence of double taxation.

The commentary on Article 25 of OECD Model Tax Convention expressly states that the MAP can be applied to the transfer pricing adjustment even in the absence of the specified provisions in the Article of Associated Enterprises to that effect. Under the Article of Associated Enterprises, corresponding adjustment may be made by the other contracting State whereby they recalculate the profits subject to tax in the Associated Enterprises in that country using the relevant revision of price or alternatively give relief to tax paid in that State for the additional tax charged to the associated enterprises by the adjusting State. However, normally this is not prevalent and the former method is conventionally used by OECD member countries.

It may however be noted that corresponding adjustments are not arbitrary or automatic and the tax administration will agree to make corresponding adjustment if they consider primary adjustments to be justified in

principle and thereby the tax amount. Besides, mandatory nature of corresponding adjustment may lead to an invitation to make large number of initial adjustments.

Once the corresponding adjustment is agreed to by other tax jurisdiction, the issues for adjustment for the payment of interest/penalty also arise and are resolved under MAP.

In some cases taxpayers express fear that their cases may not be settled within time or may be settled not on individual merits but by reference to balance of the results in other cases. Similarly, there may be a fear of retaliation or offsetting adjustments by the country from which the corresponding adjustment has been requested. For example, National Tax Administration (NTA) in Japan has taken retaliatory measures against US initiated adjustment on Japanese companies.

Advance Pricing Arrangements:

An Advance Pricing Arrangement (APA) is an arrangement that determines, in advance, an appropriate set of criteria for the determination of transfer pricing for controlled transactions for a fixed period of time (e.g. method, comparables and appropriate adjustments thereto.)

APA is formally initiated by the taxpayer and requires negotiations between the taxpayer and one or more associated enterprises and one or more tax administrations. Arrangements can be made unilaterally (between taxpayer and tax jurisdiction) or can be bilateral or multilateral (including two or more, tax

jurisdictions). An APA gives certainty to the taxpayer and can help in avoiding double taxation and it also leads to saving of compliance cost of documentation and audit. It provides confirmation to the taxpayer that no transfer pricing adjustment will be made as long as the taxpayer follows the terms of the arrangements. However an APA is to be differentiated from a limited private ruling which tends to address questions of legal nature, whereas APAs generally deal with factual issues.

Reliability of the greater use by APA depends on the nature of the criteria used. e.g. It would not be reasonable to state that arm's length borrowing rate for a taxpayer will be 6 percent during the next three years. It can be more appropriate to predict that the rate will be LIBOR plus a fixed percentage. Similarly, profit splits formula between two associated enterprises can be used as criteria so long as function between two remains stable.

For successful negotiations of APA it is necessary that Associated Enterprises co-operate with the authorities and provide them with a detailed information and documentation in support of the reasonability of their proposal with details of market, uncontrolled business transactions, detailed functional analysis, etc.

From the taxpayer's point of view, to be able to participate in a negotiation with APA is an advantage over the conventional MAP.

APA provides for possible revision or cancellation of the

arrangement for future years when business operations change significantly or when uncontrolled economic circumstances critically affect the reliability of the methodology used in the arrangement. In case of fraudulent use or misrepresentation of information during APA negotiation, the arrangement can be cancelled with retrospective effect. Annual Reports are required to be submitted by the taxpayer demonstrating the extent of its compliance with the terms and conditions of the APA and the continuing validity of the critical assumptions. Tax administration must also on its own verify the annual reports and the accuracy and consistency of the report submitted by the taxpayer.

Bilateral APA calls for opting for the MAP though such arrangements are not explicitly mentioned. Normally, the MAP indicates that the CAs may consult each other in cases of double taxation. APAs can make this provision possible because their aim is to avoid occurrence of double taxation. The Exchange of Information Article of a Treaty can be validly applied as it requires co-operation between the CAs by exchange of information.

One disadvantage of APA is that sometimes, in the case of unilateral arrangement, the other tax jurisdiction may not agree for the avoidance of double taxation or corresponding arrangement if the result arising out of the APA is inconsistent in its view.

APA is found to be particularly useful in issues relating to profit allocation or income attribution in the context of global

securities and commodity trading operations and also in handling multilateral cost contribution arrangements. Issues relating to determination of business profit for a permanent establishment can be resolved using the concept of APA.

CA Process — Practice in other countries:

In most of the member countries of OCED, detailed administrative mechanism has been laid down. Countries which are actively involved in the MAP are US, Canada, UK, France, Japan and Australia. After the initial reluctance, Germany is also resorting to CA process under the MAP.

The Competent Authority at US is Assistant Commissioner (International) and he has been given wide powers to enter into MAP for the purpose of avoidance of double taxation. Revenue procedure 96.13 lays down detailed administrative framework for the functioning of Competent Authority. A request by taxpayer normally results in suspension of the administrative and judicial proceedings in US. Request by a taxpayer is evaluated by an analyst and an examination team within the CA and the analyst is not bound to follow US law, the aim being to strive for a compromise so as to prevent double taxation.

Some of the members provide for arbitration in case CAs fail to reach an agreement. (e.g. Member States of European Union). However, this procedure is not widely practised.

As per the statistics available for the fiscal year 1999, there was a pendency of 212 cases under

CA's office in US at the beginning of the fiscal year 1999. During the year, 93 cases were received and 110 cases were disposed of. Average process time for the cases was 821 days.

It is significant to note that in the fiscal year 1999, US has achieved cent percent result on finalising APA at the request of the taxpayers at an average of 439 days. In the cases of APA processed, there was an advent of roll back to the pending disputes for prior years.

The CA at US is also very actively providing technical assistance to other Governments on matters of the tax administration. The Tax Administration Advisory Services (TAAS) Group in the CA's office is responsible for providing advice and recommendations to other governments, particularly those with newly developed tax regimes, on the most efficient and effective way to administer their tax systems. Recently, assistance has been provided to Saudi Arabia, Indonesia, Greece, Turkey and the Philippines.

Indian scenario :

Under the Tax treaties entered into by India, a separate article on MAP has found its place. CA has been defined to mean Ministry of Finance, Government of India or any other person delegated by such authority. At present, such authority is vested in the Joint Secretary, Foreign Tax Division

in the Ministry of Finance.

Under the treaty, a taxpayer resident in a contracting State can request for CA procedure within 3 years from the date of notification of action giving rise to taxation.

It is relevant to note that the agreement reached with the CA can be implemented notwithstanding any time limit or other procedural limitation in the domestic law of India. The treaty empowers the CA to develop through consultation appropriate bilateral procedures, conditions, methods and techniques in the implementation of the procedure provided in the article. In addition, the CA is also empowered to devise appropriate unilateral procedures to facilitate the above mentioned bilateral actions.

Recently, issues for source rule of taxation for e-commerce transactions in cases of credit card companies and companies providing Airlines Reservation System are being disputed by the taxpayers. As per press reports, some of the aggrieved taxpayers have opted for MAP.

It will be interesting to see as to how the issues are resolved under MAP as this will be the first time that such major issues will be discussed under the CA process in India.

It is felt that India should have internal guidelines and a detailed administrative framework delineating roles and

authority of assessing officers and CA. It may be necessary to evaluate such procedure so as to correspond with such procedures developed by major trading partners and investors in India. It will be advisable to keep such procedures widely publicised so as to make MAP effective in India. One of the steps which may be necessary is to consider extension of the statutes of limitation for completion of the assessment and suspension of the recovery proceedings in the case of completed assessment to allow negotiation between CAs.

Conclusion :

It is expected that in future, MAP will become increasingly important due to aggressive stand of various tax jurisdictions. Ultimately, the tax jurisdictions have to decide on the sharing of the revenue from the taxpayers and not the taxpayers themselves. Effective mechanism of MAP will be necessary to eliminate double taxation, whenever possible, so as not to constitute a potential barrier to the development of international trade and investment flow.

The importance of MAP will be increasingly felt in India as it integrates its economy with the global economy and issues of double taxation and source rule will become important not only to foreign MNCs operating in India but also to the increasing number of Indian MNCs especially in the software and pharmaceutical sectors.

Talent is that which is in a man's power; genius is that in whose power a man is.

— J. R. Lowell