O.E.C.D. RELEASES MUTUAL AGREEMENT PROCEDURE PEER REVIEW REPORT FOR THE U.S.

Authors
Neha Rastogi
Michael Peggs

Tags
Action 14
Dispute Resolution Mechanism
Mutual Agreement Procedure
U.S. Peer Review Report

The B.E.P.S. Report on Action 14, *Making Dispute Resolution Mechanisms More Effective* ("Action 14 Report"), released in 2015, acknowledged that the actions to counter B.E.P.S. must be complemented with effective dispute resolution mechanisms. Keeping this objective in mind, the Action 14 Report discussed the obstacles that prevented countries from resolving treaty-related disputes under the mutual agreement procedure ("M.A.P.") and recommended measures to overcome such obstacles.

The Action 14 Report introduced a minimum standard on dispute resolution that must be observed by participating countries to ensure that they resolve treaty-related disputes in a timely, effective, and efficient manner. The countries agreed to develop a monitoring mechanism to ensure the effective implementation of the minimum standard. They also agreed to have their compliance with the minimum standard reviewed by their peers.[1]

The peers agreed to review the following elements of a country's M.A.P. regime against the minimum standards to determine how its dispute resolution mechanisms operate:

- Preventing disputes
- Availability and access to M.A.P.
- Resolution of M.A.P. cases
- Implementation of M.A.P. agreements

On September 26, 2017, the O.E.C.D. released the Peer Review Report (Stage 1) relating to the implementation of the minimum standard on improving tax dispute resolution mechanisms by Belgium, Canada, the Netherlands, Switzerland, the United Kingdom, and the U.S.

This Article discusses the Peer Review Report (Stage 1) on the United States, including the areas of improvement and the recommendation by the O.E.C.D.

The U.S. peer review process was conducted through specific questionnaires completed by the U.S., 20 peers, and taxpayers. The U.S. was responsive in the course of the drafting of the Peer Review Report by responding timely and comprehensively to requests for additional information and providing further clarity when necessary.

The U.S. Peer Review Report was also divided into the four key areas mentioned above, which were further divided into subelements, and the same have been discussed below.

---

[1] Members of the M.A.P. Forum of the Forum on Tax Administration.

PREVENTING DISPUTES

Resolution by Mutual Agreement of Difficulties or Doubts as to the Interpretation or Application of Tax Treaties

The competent authority of a jurisdiction must be authorized to resolve, if possible, difficulties of interpretation or application of the tax treaty by means of mutual agreement. This practice may help to avoid submission of M.A.P. requests and/or prevent future disputes from arising. Thus, the O.E.C.D. recommended the U.S. include the first sentence of Article 25(3) of the O.E.C.D. Model Tax Convention ("M.T.C.") in all its tax treaties. The first sentence of Article 25(3) provides the following:

> The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention

The Peer Review Report stated that out of the U.S.'s 60 tax treaties, all except for treaty with U.S.S.R. and Pakistan contain a provision equivalent to the first sentence of Article 25(3) of the O.E.C.D- M.T.C.

Rollback of Bilateral A.P.A.'s in Appropriate Cases

The transfer pricing methodology determined under an advance pricing agreement ("A.P.A.") may be relevant in determining the treatment of a comparable controlled transaction in previous tax years. Therefore, the Peer Review Report suggested allowing the rollback of A.P.A.'s to previous tax years. This would mean that a negotiated position on the pricing of an international transaction reached under an A.P.A. could be applied on a retroactive basis to prior years.

The O.E.C.D. acknowledged that rollbacks are generally available in the U.S. for A.P.A.'s and recommended that the U.S. continue to provide for the rollback of bilateral A.P.A.'s in appropriate cases as it has done thus far.

AVAILABILITY AND ACCESS TO M.A.P.

Access to M.A.P. in Country of Residence Irrespective of Remedies Provided under Domestic Laws

In the Action 14 Report, the O.E.C.D. suggested the inclusion in tax treaties of the language from Article 25(1) of the O.E.C.D. M.T.C. that places emphasis on the importance of the taxpayer's ability to make a request for M.A.P. in its country of residence irrespective of the remedies provided under the domestic law of the treaty partners. Additionally, tax treaties should contain a provision allowing a taxpayer to submit a M.A.P. request within a period of 3 years, beginning on the date of the first notification of the action resulting in taxation not in accordance with the provisions of the tax treaty.

The Peer Review Report noted that three of the U.S. tax treaties do not contain a provision that is equivalent to Article 25(1). It was accordingly recommended that the U.S request the inclusion of the required provision via bilateral negotiations. Further, while 36 of the U.S. tax treaties do not contain any filing period for a M.A.P. request, 20 contain a provision allowing taxpayers to submit a M.A.P. request within a period of three years. The remaining four treaties identified the time limit for filing

a M.A.P. request as four or five years.

Submission of M.A.P. Requests to Competent Authority of Either Treaty Partner

Another element of the minimum standard is that a taxpayer must be allowed to submit a M.A.P. request to the competent authority of either treaty partner. In the absence of such provision, a taxpayer may submit a M.A.P. request to the competent authority of the contracting state where it is a resident, or of which they are a national if their cases come under the non-discrimination article.

In such cases, it was suggested that where the competent authority does not consider the taxpayer's objection to be justified, it should implement a bilateral consultation or notification process which allows the other competent authority to provide its views on the case.

The Peer Review, however, was silent as to whether a taxpayer can make a M.A.P. request to the competent authority of the other contracting state when the competent authority of the first one has already rejected the request.

It was noted that the U.S. has in place a process to notify and consult the other competent authority in cases where its competent authority considers the objection raised in a M.A.P. request to be unjustified.

Access to M.A.P. in Transfer Pricing Cases

The Action 14 Report discussed expanding the scope of the matters to which M.A.P. may be applied. It suggested that M.A.P. may also be applied to the issue of what constitutes arm's length conditions for transactions between associated enterprises.

The U.S. reported that it has in the past provided access to M.A.P. for transfer pricing cases, and proposes to continue doing the same in future.

Access to M.A.P. in the Application of Anti-Abuse Provisions

In the Action 14 Report, the O.E.C.D. recommended that a taxpayer should be allowed to make a request for M.A.P. if they believe that the tax authority has interpreted or applied the tax treaty anti-abuse provisions incorrectly. Additionally, taxpayers should have access to M.A.P. in cases where the application of domestic anti-abuse legislations is in conflict with the provisions of the tax treaty.

Although the U.S. reported that there is no limitation of access to M.A.P. in cases where the application of anti-abuse provisions in tax treaties is challenged by taxpayers, the Peer Review Report observed that the U.S. M.A.P. guidance does not include information on whether taxpayers have access to M.A.P. in cases in which there is a disagreement between the taxpayer and the tax authorities as to whether the conditions for the application of a treaty anti-abuse provision have been met, or as to whether the application of a domestic law anti-abuse provision is in conflict with the provisions of a tax treaty.

Access to M.A.P in Cases of Audit Settlements

The O.E.C.D. holds that taxpayers should have the right to seek M.A.P. even after they have reached an audit settlement with the jurisdictional tax authority. However, if the taxpayer has reached a resolution via an administrative or a statutory

dispute settlement/resolution process that functions independently from the audit and examination function and which is only accessible by taxpayer request, access to M.A.P. may be limited. At the same time, for the benefit of the taxpayers, the jurisdiction's M.A.P. guidance must amply clarify that audit settlements do not preclude access to M.A.P.

The Peer Review Report observed that the U.S. M.A.P. guidance clearly provides that the U.S. competent authority will not reject a M.A.P. request solely on the ground that the taxpayer entered into a settlement agreement with the I.R.S. However, where a taxpayer enters into a closing agreement through the I.R.S. examination function, the U.S. will only endeavor to obtain a correlative adjustment at the level of the treaty partner. In other words, the administrative dispute settlement/resolution process and M.A.P. are mutually exclusive.

The U.S. also indicated that a taxpayer does retain its right to present its case to the administrative appeals office if the taxpayer first submits a M.A.P. request to the competent authority and the issue is not resolved through the M.A.P.

Peers indicated that they did not come across a case where the U.S. denied a taxpayer access to M.A.P. after an audit settlement.

Publish Clear and Comprehensive M.A.P. Guidance and Provide Access to M.A.P if Adequate and Proper Information is Submitted

The countries should publish clear rules, guidelines, and procedures on access to and use of the M.A.P. and include the specific information and documentation that should be submitted in a taxpayer's request for M.A.P. assistance. At the same time, the countries should also publish their M.A.P. guidance on a shared public platform to promote public awareness, transparency, and dissemination of the M.A.P. program. Further, taxpayers should not be denied access to M.A.P. when they have complied with the information and documentation requirements as provided in such guidance.

The U.S. reported that rules, guidelines, and procedures relating to the M.A.P. function are included in Rev. Proc. 2015-40, and the same is easily found on the government website of the I.R.S. The Peer Review Report provided that the Rev. Proc. contains detailed information on the availability and the use of M.A.P. and how its competent authority conducts the process in practice. The U.S. stated and the peers and the taxpayers also agreed that the U.S. has not denied access to M.A.P. where the taxpayers submitted information in conformity to the Rev. Proc.

The Peer Review Report, however, recommended that the U.S. consider including information on whether M.A.P. is available in cases of multilateral disputes, and also on how the process of M.A.P. agreements is implemented, *i.e.*, the steps to be taken, the timing of these steps including actions to be taken by taxpayers, and the timeframe for giving consent to the M.A.P. agreement reached.

Consultation of Competent Authorities for the Elimination of Double Taxation in Cases Not Covered in the Treaty

Owing to the dynamic nature of international tax laws, the O.E.C.D. conceded that it is impossible to conceive and incorporate all possible tax scenarios in a tax treaty. Therefore, it suggested that countries should include in their tax treaties a provision which authorizes the competent authorities to consult together with respect to cases

not provided for in their tax treaties.

Fourteen of the U.S. tax treaties do not include such a provision. However, the U.S. indicated that it intends to implement a provision to this effect in all such treaties.

RESOLUTION OF M.A.P. CASES

Resolution by Mutual Agreement of Cases Where a Competent Authority is Unable to Arrive at a Satisfactory Solution to a Justified Taxpayer Objection

In addition to allowing taxpayers to make a M.A.P. request, tax treaties must also include the first sentence of Article 25(2) of the O.E.C.D. M.T.C., which provides that if a competent authority is unable to arrive at a satisfactory solution to a taxpayer's objection that appears to be justified, then it shall endeavor to mutually resolve the case with the other competent authority.

Out of the U.S.'s 60 tax treaties, 14 treaties do not contain a provision equivalent to Article 25(2) of the O.E.C.D. M.T.C. The U.S. has indicated that it intends to implement the language of Article 25(2) in all its existing tax treaties.

Resolve M.A.P. Cases Within an Average of 24 Months, and Ensure Dedication of Adequate Resources

The Peer Review Report expressed concern about the tax uncertainties involved during the pendency of the M.A.P., and therefore recommended that M.A.P. cases be resolved swiftly.

"The staff in charge of M.A.P. processes should have the authority to resolve M.A.P. cases without being dependent."

It suggested that a period of 24 months is an appropriate time period to resolve M.A.P. cases on average. It also suggested that adequate resources, including personnel, funding, and training, be provided to ensure the proper functioning of the competent authority and the resolution of M.A.P. cases within the timeframe.

The U.S. reported that on an average it needed 32.20 months to resolve attribution/allocation cases and 31.50 months to resolve other cases. This resulted in an average time needed of 32.06 months to finalize all cases. It indicated that although a lack of resources might partly explain the greater than 24-month average, the lengthy resolution of cases is also commonly attributable to other reasons, such as delays in correspondence (*e.g.* sending and receiving position papers), communication difficulties, fundamental differences between treaty partners on points of law or their application to facts, or difficulties in reaching a principled resolution with certain treaty partners.

A peer reported that the communication process in the U.S. is slowed down due to its confidentiality requirements, which mandate that taxpayer data can only be exchanged by mail or fax. Therefore, one suggestion was to allow documents including confidential information to be sent via encrypted e-mail. Another suggestion for reaching resolutions more quickly was to use video conferencing to discuss cases.

M.A.P. Personnel to Have Authority to Resolve Cases in Accordance with the Applicable Tax Treaty

In order to ensure unprejudiced M.A.P. proceedings, the staff in charge of M.A.P.

processes should have the authority to resolve M.A.P. cases without being dependent on the approval or the direction of the tax administration personnel who made the adjustments at issue.

The U.S. reported that although the staff in charge of M.A.P. proceedings communicates with the I.R.S. examination department to secure the necessary extensions of the U.S. domestic statute of limitations for the period a M.A.P. case is pending and to verify or gather the necessary facts for the case under review, the independence of the U.S. competent authority in the M.A.P. cases is ensured.

Performance of M.A.P. Personnel Must Not be Evaluated on the Amounts of Sustained Audit Adjustments

The U.S. stated that its domestic legislation prohibits using quantitative criteria for evaluating the performance of staff in charge of M.A.P., such as number of cases closed or amount of tax assessed, or production quotas or goals. The U.S. reported that it evaluates the performance of the staff in charge of M.A.P. through using qualitative criteria, such as workplace interaction and environment, workgroup involvement, issue identification and resolution, technical knowledge, verbal communication/listening, written communication and interaction, accuracy of the work, and research and analysis.

Transparency With Respect to Position on M.A.P. Arbitration

Jurisdictions must be transparent about their position as to whether arbitration is available as a final stage in the M.A.P. process in their jurisdiction.

The U.S. reported that its domestic law does not have any limitations on including M.A.P. arbitration in its tax treaties. The U.S. M.T.C. includes a mandatory and binding arbitration procedure as a final stage in the M.A.P. process, which provides for last-best-offer arbitration (also known as “baseball arbitration’). It was noted that the U.S. has incorporated an arbitration provision as a final stage to the M.A.P. process in 12 tax treaties, however some are not yet effective as the arbitration provision has not been ratified.

IMPLEMENTATION OF M.A.P. AGREEMENTS

All M.A.P. Agreements Implemented on a Timely Basis

In order to provide certainty to the taxpayers and maintain trust in the M.A.P., all M.A.P. agreements should not only be implemented but they must also be implemented on a timely basis. The O.E.C.D. is of the view that the delay of implementation of M.A.P. agreements may lead to adverse financial consequences for both taxpayers and competent authorities.

The U.S. reported that procedures are in place to ensure that all M.A.P. agreements, once accepted by taxpayers, are implemented. Once an agreement has been accepted, the competent authority instructs the I.R.S. to implement such agreement by means of a letter and a disposition memorandum to the appropriate I.R.S. office. The U.S., however, does not have a mechanism to keep track of whether all M.A.P. agreements reached are actually implemented. Additionally, U.S. domestic legislation has no timeframe in place for the implementation of mutual agreements reached.

Mutual Agreement Implemented Notwithstanding Any Time Limits in Domestic Law

In order to provide certainty to taxpayers, it is essential that the implementation of M.A.P. agreements is not obstructed by any time limits in the domestic law of the jurisdictions concerned. Therefore, the tax treaties should either provide language equivalent to the second line of Article 25(2) of the O.E.C.D. M.T.C., *i.e.*, "any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the contracting states," or alternatively, set a time limit for making adjustments, as in Article 9(1) and Article 7(2), so that late adjustments do not obstruct the granting of M.A.P. relief.

The Peer Review Report indicated that 19 out of 60 U.S. tax treaties contain neither a provision that is equivalent to the second sentence of Article 25(2) of the O.E.C.D. M.T.C. nor the alternative provisions in Article 9(1) and Article 7(2). It was therefore recommended that in such cases, the U.S. should request the inclusion of the required provision or be willing to accept the inclusion of both alternative provisions.

CONCLUSION

The process of peer review was divided into two stages. In the U.S. context, Stage 1 reviewed the implementation of the minimum standard and the Peer Review Report acknowledged that the U.S. has met the Action 14 minimum standard concerning the prevention of disputes. However, in order to be fully compliant with all four key areas of an effective dispute resolution mechanism, the U.S. should amend and update some of its tax treaties.

Among its peers, the U.S. shares the distinction of having received a report card showing many A's and B's. Criticisms of the dispute resolution functions of other tax authorities followed the same broad themes as the U.S. peer review. The need to update treaty provisions to meet the minimum standard, improvements to varying degrees in published M.A.P. guidance, and a decrease in the time needed to resolve M.A.P. cases were also named as areas for improvement for the U.K., Switzerland, the Netherlands, and Canada. The U.S. treaty amendments require relatively more effort from Advance Pricing and Mutual Agreement Program ("A.P.M.A."), given the U.S. has not signed the Multilateral Instrument that would make these treaty amendments *en masse*. A bilateral approach is being followed by A.P.M.A. to achieve similar goals.

Stage 2, which will be due within one year of the adoption of the Stage 1 Peer Review, will review the measures taken by the U.S. to address the shortcomings identified in Stage 1.