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Demystifying Competent Authority

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Overview

• Mutual Agreement Procedure
  – Scope
  – Procedures
  – Practical issues
  – Future outlook

• Other Competent Authority Functions
  – Exchange of information
  – Other international coordination
Mutual Agreement Procedure
Competent Authority Jurisdiction

• Conclusion of mutual agreements
  – To address “difficulties or doubts” regarding the “interpretation or application” of the treaty
  – To “eliminate” double taxation in “cases not provided for” by treaty

• Exchange of information

• Discretionary grant of treaty benefits

• Arbitration proceedings (where provided)
Current Competent Authority Inventory

- Number of cases decreasing -- 705 as of FYE 9/30/10, compared to 724 as of FYE 9/30/09
- For FY 2010, 97% of potential double tax fully relieved, less than 2% partially relieved, less than 2% no relief
- Average time to resolve cases closed during FYE 2010 was 29 months for mutual agreement cases, 19 months for bilateral APAs after APA program handing off to Treaty office
Current Competent Authority Inventory

• 78% of mutual agreement cases are foreign-initiated
• More cases involving PE, withholding tax, and other issues
Scope of Mutual Agreements

• Competent authorities may conclude agreements on “allocation” issues:
  – Allocation of income, deductions, etc. between persons
  – Attribution of income, deductions, etc. to a PE
  – Approximately 2/3 of agreements concluded by U.S. Competent Authority address these issues
Scope of Mutual Agreements

• But they may also address other issues, including but not limited to:
  – Residence of a taxpayer (i.e., “tie-breaker” determination where company or individual is resident of both countries under domestic law)
  – Characterization, source, and timing of particular items of income (e.g., whether a royalty income or business profits)
  – Characterization of persons (e.g., whether a company or a partnership)
Scope of Mutual Agreements

• Other Issues (cont’d)
  – Existence or non-existence of a PE
  – Pension arrangements entitled to benefits
    (e.g., deferral of tax on accruals and waiver of
tax on rollovers under pensions articles of
some treaties)
  – The meaning of any term used in the treaty
Discretionary Benefits

• U.S. competent authority may also allow treaty benefits at its discretion where treaty so permits
  – Unilateral determination, although treaty partner consultation generally required
  – Taxpayer required to represent that it does not satisfy other treaty LOB tests
  – Rarely granted in practice in recent years
Scope of Mutual Agreements

• Agreements may be general in application or taxpayer-specific
• A general agreement may be requested by a taxpayer or a group, or may be initiated by the competent authorities
• General agreements are published at [http://www.irs.gov/businesses/small/international/article/0,,id=137376,00.html](http://www.irs.gov/businesses/small/international/article/0,,id=137376,00.html)
Scope of Mutual Agreements

• Examples of general mutual agreements:
  – Collection suspension—India (2002)
  – Meaning of “investment bank”—Japan (2005)
  – Treatment of fiscally transparent entities—Mexico (2005), New Zealand (2005), Spain (2006)
Scope of Mutual Agreements

- Competent authority not limited by U.S. domestic law or policy
- Agreement may reduce or eliminate U.S. tax on U.S. citizens or residents because not subject to treaty “saving clause”
Limitations

• However:
  – Concurrence of IRS Associate Chief Counsel (International) is required on matters of treaty interpretation or application.
  – Competent authority function not intended to contravene Congressional tax policymaking prerogative or to substitute for IRS Appeals function
Limitations

• U.S. Competent Authority has general policy of rejecting requests if the transaction concerned:
  – Includes an issue pending in a U.S. Court, or designated for litigation, unless competent authority consideration is concurred in by the U.S. competent authority and the Associate Chief Counsel (International);
  – Is a listed transaction for purposes of Treas. Reg. §1.6011-4(b)(2) and §301.6111-2(b)(2); or
  – Involves fraudulent activity by the taxpayer.
Limitations

• Competent authority may also reject case if the taxpayer fails to:
  – Comply with Rev. Proc. 2006-54;
  – Cooperate with the IRS during the examination of the periods in issue and such failure significantly impedes the ability of the U.S. competent authority to negotiate and conclude an agreement; or
  – Cooperate with the U.S. competent authority (including failing to provide sufficient facts and documentation to support its claim of double taxation or taxation contrary to the treaty) or otherwise significantly impedes the ability of the U.S. competent authority to negotiate and conclude an agreement.
Negotiation Process

• Normally includes—
  – Follow-up questions to taxpayer
  – Exchange of “position papers”
  – One or more rounds of face-to-face discussions between governments
  – Exchange of letters confirming agreement

• Note that—
  – Taxpayer does not participate in government-to-government discussions
  – But may consult with competent authorities
Periods Covered

• Competent authority agreements typically cover specified past taxable periods and have no legal relevance for other periods

• May cover current and future periods instead of, or in addition to, past periods
  – However, current IRS administrative policy limits disposition of current and future years to transfer pricing issues covered by APAs
  – IRS Chief Counsel has jurisdiction over prospective agreements on other issues, but Prefiling Agreements and competent authority procedures may be coordinated
Periods Covered

• However:
  – Competent authority may conclude general interpretive agreement with prospective effect
  – Also, agreements for past periods may have informal effect on tax administrations’ treatment of other periods
Procedures

• Generally governed by
  – Applicable treaty
  – IRS Rev. Proc. 2006-54
  – General U.S. law provisions and corresponding foreign provisions
  – OECD guidance (Commentary on Article 25 of OECD Model Convention, Manual on Effective Mutual Agreement Procedures)
Timing

• Many treaties set deadline for filing of request
• Some treaties require earlier notification of potential dispute
• Some countries apply domestic statute of limitations on claims for refund where treaty is silent
Timing

• IRS generally encourages filing of requests as early as possible, where taxation not in accordance with the treaty or double taxation seems probable
• However, if IRS adjustment is at issue, need Notice of Proposed Adjustment first
• Other countries may require final written assessment
• If no examination, more flexibility in timing
Who May File

• IRS generally requires filing by U.S. person (within meaning of §7701(a)(30)), except where treaty permits non-U.S. persons to file
• Parallel request may be required in the other country
Who May File

• Treaties do not, however, always require that there be a resident in each treaty country
• Mutual agreement proceeding to eliminate double taxation may address, for example, attribution of profits between two PEs
Substance of Request

• Request for U.S. competent authority assistance should follow provisions of Rev. Proc. 2006-54
• Substantial information required—see §4.05
• Any requirements of other country must also be satisfied and information provided should be consistent
• U.S. competent authority encourages transparency
Issues Not Covered

• U.S. Competent Authority does not waive penalties
  – But agreement may reduce or eliminate penalty by reducing taxable income

• U.S. Competent Authority does not generally waive interest on underpayments
  – But year of adjustment may be open to discussion in some circumstances
Issues Not Covered

• Foreign exchange gain or loss may not be taken into account in optimal jurisdiction from taxpayer’s perspective
  – Usual U.S. approach is to require repatriation pursuant to mutual agreement in the currency of the transaction(s) at issue.
Whether to Invoke

• Considerations:
  – Potential effect on availability of U.S. foreign tax credit under Treas. Reg. §1.901-2(e)(5)
  – Materiality and cost-benefit analysis
  – FIN48 implications
Practical Issues

• Need to keep other options open in case mutual agreement procedure fails
  – Some countries lack active program
  – Some are becoming intransigent on certain issues
  – There may be an unresolvable difference of views

• Need for trilateral (or multilateral) agreement in some cases
Future Outlook

• Need for a principled approach
• Effect of arbitration provisions
Other Competent Authority Functions
Exchange of Information

• Increased use as tax compliance and enforcement tool

• Standards applied by IRS in responding to foreign requests for information
  – UTP information
  – Other return information
Exchange of Information

• Joint audits
• Simultaneous audits
• Simultaneous criminal investigation procedures ("SCIPs")
• JITSIC
Other International Coordination

- OECD Working Parties
- OECD Forum on Tax Administration
- G-20
- Bilateral discussions