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The Basics of Managing Multilateral Controversy—Part 2

Multilateral controversies will increase significantly in the coming years, and it will be important for taxpayers to understand how to effectively engage with tax authorities on these issues. In Part 1, we considered the context of these controversies, and discussed the need for multilateral engagement by the tax authorities. In Part 2, we take a look at procedures and best practice recommendations.

Multiple Bilateral Approach

As noted above, many “multilateral” cases are, as a practical matter, a series of bilateral cases where the tax authorities assist the taxpayer in coordinating the positions and resolutions with the aim of achieving no or minimal double taxation. Historically, one of the best ways to address a multilateral controversy is through one or more bilateral cases. For example, one vital strategy to address ongoing controversies is the use of APAs with rollback, which address multiple years—both prospective and past—in a single proceeding. In the multilateral context, one main advantage of APAs is the possibility of using critical assumptions to address the profit allocated to a third country.

Similarly, in a MAP case, the two parties must deal with the profitability allocated to one or more third-country entities. While the critical assumption concept is not present in MAP cases, the objective is the same: to have the tax authorities who are actually at the table reach an agreement with respect to the profitability of the entities in their jurisdiction, as well as the profitability of the entity in the third country.

For both APAs and MAP cases, the ability to coordinate the multiple bilateral cases, ensure consistency and avoid double taxation, is an art rather than a science, but taxpayers should expect that two coordinated cases will cost more and take longer to ultimately resolve than two standalone cases.

Informal Competent Authority

If a multilateral issue arises, but adding one or more bilateral APAs or MAP cases is either too expensive, not feasible, or not even possible due to lack of effective treaty access, another strategy can be employed: a single bilateral APA or MAP case with informal involvement of the “other” country.

That is, the taxpayer’s advisers can closely coordinate with the third-country tax authority regarding the progress of the case, and hopefully ensure that the resolution of the bilateral MAP or APA case does not result

in double taxation in the third country. This involvement is often a best practice in cases involving a third country where there is a sophisticated tax authority and treaty relationships with the other parties.

The key here is that the tax authority not directly implicated in the case should be involved “early and often.” The more frequent the involvement of the other tax authority, and the more information that can be provided, the better. This is often antithetical to the desires of the taxpayer, which may wish to avoid the complexity of getting another tax authority involved and potentially “messaging up” the case. If there are tax attributes that can absorb the impact of an adjustment or, due to tax-efficient structuring, there is not much risk of double taxation, then this view may be justified. In contrast, double taxation is such a disastrous outcome that if it is a potential result, then the involvement of another tax authority and a certain level of disclosure is often a risk worth taking.

One note: While unilateral APAs are typically frowned upon, and unilateral Competent Authority relief is still relatively unusual outside of a few fact patterns, the use of a unilateral APA can lead to a successful result in certain situations. For example, if a bilateral APA covers two entities in a multiple principal structure, but a third entity would also be affected by the outcome of the bilateral APA, an alternative to a multilateral solution may be a combined bilateral/unilateral APA approach, in which the third entity would seek a unilateral APA to address prospective risk. While there is a bit more risk to this approach, it may be useful depending on the particular facts and risks involved.

Specific Best Practice Recommendations

While the principles above should be followed as best practices, they can be distilled into a number of distinct recommendations.

Communication and Coordination

- Taxpayers should engage early and often with the relevant tax authorities—including informal involvement.
- Taxpayers should proactively coordinate all related proceedings to ensure consistency and avoid misunderstandings. In appropriate cases, this can include joint meetings and joint fact-finding in which all relevant tax authorities participate.
- Regardless, best practice is for taxpayers to ensure that all tax authorities have the same information and all the critical information necessary to resolve the case.

Forward-looking Engagement at the Examination Level

- While taxpayers will of course be invested in defending their positions and achieving the best possible results in an examination, it is also important to look forward to the next stage of a dispute.
- It is rarely too early to engage in high-level thinking about available procedural options, including consulting with outside advisers.
- Informal discussions at the examination level regarding the implications of a potential adjustment should begin when there is a significant possibility of an adjustment.
- When it is clear that a material adjustment with multilateral implications will be issued by a tax authority, the taxpayer should engage with the exam team to determine the allocation of the adjustment among all affected counterparties. For example, the IRS is tasked with issuing pattern letters that identify any treaty countries affected by an adjustment and allocate the adjustment among countries. However, the IRS sometimes does not send these letters without a taxpayer request.

Avoiding Procedural Issues

In addition, it is often best practice to take early action to avoid procedural issues down the line.

- While many treaties specify presentation time frames (e.g., three years from first notification of the adjustment) during which a MAP case must be brought, some treaties, such as the U.S. treaties with Canada and Mexico—among others—impose notification deadlines. Failure to comply with these notification requirements can foreclose effective MAP relief.
- Unlike presentation time frames, these notification time frames generally run from the tax year—or tax return filing date—at issue. Long and contentious examinations may result in the issuance of an adjustment after the deadline has expired. For this reason, best practice is to provide the required notification as soon as it appears that an adjustment may result from an examination.
- Not all treaties provide that MAP outcomes can be implemented, notwithstanding domestic limitations—such as statutes of limitations for the payment of re-

funds. Where appropriate, it is important to follow domestic procedures—such as the filing of a protective claim in the United States—to keep refund statutes open.

■ Taxpayers do not always consider the consequences of secondary adjustments that result from a resolution. These consequences may be significant. Early modeling is recommended to understand how best to structure secondary adjustments, taking into account the rules of all relevant jurisdictions.

The Future of Multilateral Controversy

Many Competent Authority offices, including the U.S. IRS Advance Pricing and Mutual Agreement, or APMA, office, have expressed the desire to do more multilateral cases and work them more efficiently. In fact, based on its public statements, the IRS APMA appears to have become more open to addressing Competent Authority issues, either unilaterally or bilaterally, when it is not directly involved but is ultimately impacted. That can perhaps mitigate the need for a multilateral case. In light of the increased global controversy already taking place, as well as the actions undertaken by national tax authorities and intergovernmental organizations such as the OECD, there is a clear need for effective multilateral solutions moving forward.

For a more in-depth treatment of these issues with specific examples, refer to the [authors' companion piece](#) in *Tax Management International Journal*.

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