

The United States-Canada tax regime: advance pricing agreement, competent authority resolution and arbitration

Canada-United States Law Institute
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8-10 April 2010

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Today's agenda

- The use of bilateral advance pricing agreements (APAs) to assist in resolving IRS and CRA audits
- The steps to successfully negotiate an APA
- Utilizing competent authority relief for resolving cross-border pricing controversies
- Understanding the application of the arbitration provisions in the US-Canada Income Tax Treaty

Develop and implement a strategy for pre-controversy management

- In developing a pre-controversy tax risk strategy, multinationals should consider the following actions:
 - Identify the company's medium to long term goals and strategy
 - Evaluate the tax risk for each business line, as well as the risks inherent in each jurisdiction in which the multinational is subject to taxation
 - Implement mitigating controls over tax processes that provide for regular review, sign-off and spot-checks for accuracy
 - Determine what level of organizational change is required to implement and sustain these processes
 - Continuously monitor and reformulate the tax risk strategy to take into account emerging trends, performance gaps, tax policy and business developments

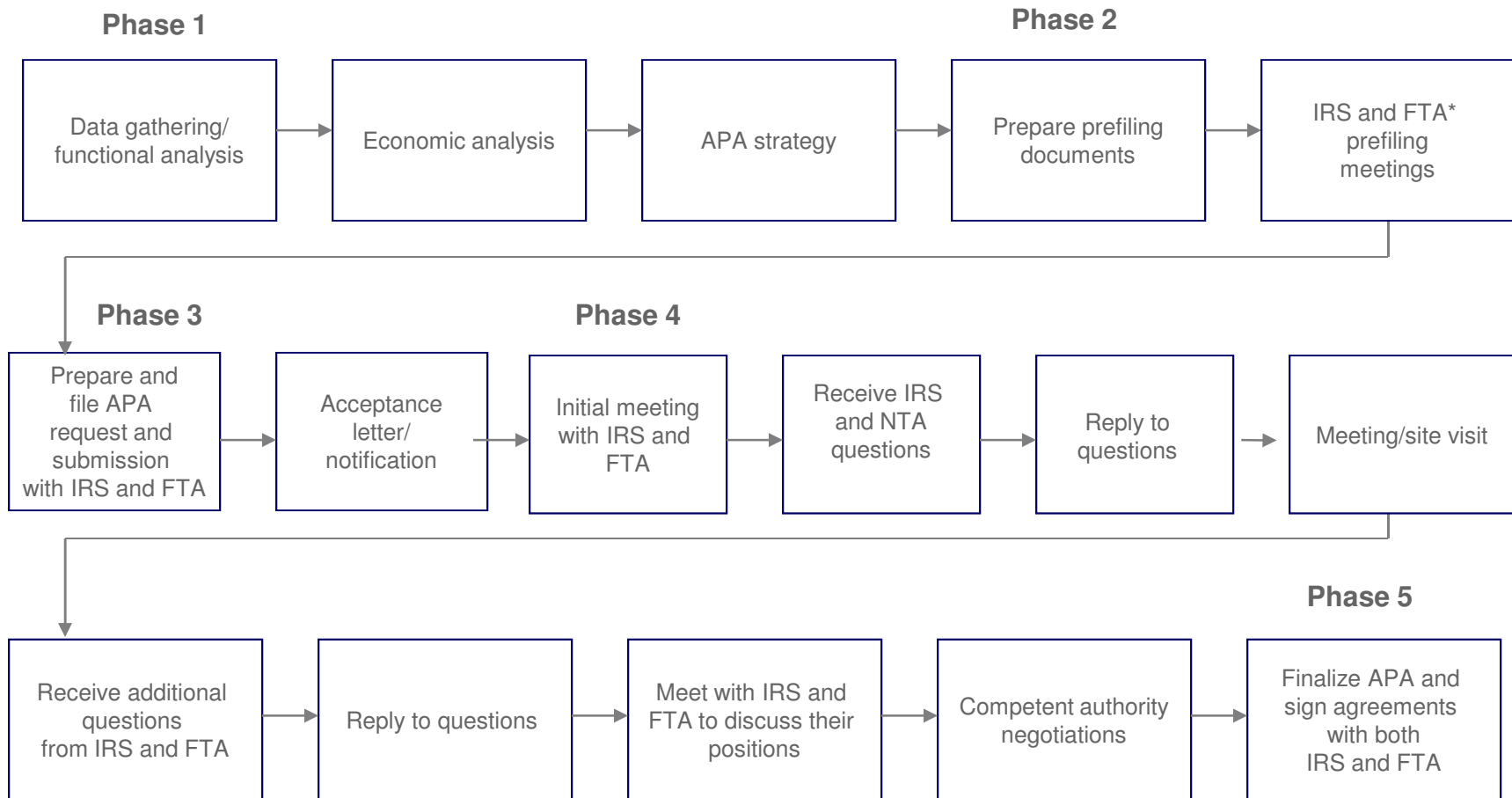
What is an APA?

- Contract between taxpayer and IRS or CRA or both (and possibly other foreign tax authorities) regarding:
 - Facts
 - Transfer pricing methodology (TPM)
 - Arm's-length range of results
- APA result satisfies the arm's-length standard
- Typically five years — renewable
- APA can be applied to previous years (rolled back)
- Critical Assumption — release IRS and taxpayer from APA
- Canada — IRS Revenue Procedure 2006-2009

The APA process

- Phase 1 — APA analysis and strategy
- Phase 2 — pre-filing conference
- Phase 3 — APA request
- Phase 4 — negotiation
- Phase 5 — drafting and administration

The APA process — bilateral APA timeline



*Foreign Tax Authority

Phase 1 — analysis and strategy

- Prepare documentation
- Organize taxpayer APA team
- Prioritize goals
- Develop negotiation approach
 - Anticipate issues
 - Prepare and prioritize issues
 - Develop walk-away strategy

Phase 2 — pre-filing conference (PFC)

- Purpose
 - Evaluate government reaction
 - Clarify information required
- Anonymous PFC available
- PFC submission
 - Raise important issues to avoid subsequent surprises and delays
- Agree covered transactions
- Agree comparables updates and timing
- Agree rollback availability
- Roles
 - Taxpayer
 - Government

Phase 3 — The APA request

- Timing — before return filed; 120-day rule
- Statute of limitations
- Content — complete filing recommended
- User fees — \$22,500-\$50,000 US
\$25,000 varies based on travel cost

Phase 4 — negotiations

- Purpose — government due diligence
- APA case plan
- Time frame
- Working groups

Phase 5 — drafting and administration

- Drafting the agreement
- Administration
 - Annual report
 - Compensating adjustments
 - Recordkeeping
 - Revocation, cancellation or revision
- Renewal

Key strategy for APAs

- Smaller, coordinated teams
- More involvement of taxpayer personnel
- Attempts to standardize filings
- More frequent calls to government

Strategies for successful APA negotiations

- Treat APA same as any business negotiation
- Be patient
- Include all relevant information in APA request
- Demonstrate your flexibility
- Tell the government what you want
- Do not make negotiations adversarial
- Do not misrepresent facts
- Do not fail to raise important issues
- Do not undermine the team leader
- Do not issue ultimatums

Situations that encourage or discourage APAs

Situations that encourage APAs

- High-tax foreign countries
- Treaty with United States
- Increased governmental interest and ability in APAs
- High-profile issue (e.g., cost sharing)
- Poor exam relationship
- Taxpayer facts and issues can present a compelling story

Situations that discourage APAs

- Changed facts and economic circumstances preclude rollback
- Significant non-TP issues
- Known IRS opposition to proposed approach
- Inflexible taxpayer position

Long-standing reasons

- Certainty of tax treatment
- Freedom from penalty
- Freedom from a TP adjustment by the IRS
- Freedom from double taxation
- Freedom from full-blown examination
- Avoid penalties for prior years
- APA treated as qualified amended return
- APA submission likely meets documentation requirements
- Primary adjustments in amended return filed, and related payments made, within 90 days of signing APA
- Resolve TP issues for prior taxable years (rollbacks)
 - Not available for unilateral APA if rollback would decrease US taxable income

Long-standing reasons

APAs may save money

	<u>Exam</u>	<u>APA</u>
TP documentation	\$\$	\$\$
User fee	0	\$22.5k -\$50k
Taxpayer involvement	\$\$	\$\$
Professional fees	\$\$	\$\$
Penalties and interest	??	0
Annual update cost	\$\$	Minimal

Rollback APA to prior tax years (vs. examination)

Recent reasons

- Increased global TP enforcement
- More than 52% of respondents to Ernst & Young's 2007 TP survey have undergone a TP examination (more than 23% resulted in adjustments)
- Sarbanes-Oxley
- APAs prevent exposure to material weakness in taxpayers' financial statements
- Certainty, regarding TP methodology and arm's-length range, greatly reduces required internal controls surrounding TP

Recent reasons (cont)

- FIN 48
- With an APA, the recognition test is met and the TP-related tax position is recognized, without reduction (100% certainty for measurement test)
- Merely filing a well-supported APA request can help support a reduction in existing or proposed tax reserves
- Support global TP approach
- Increasingly, corporations follow a globally consistent TP approach
- APA with leading countries in America, Europe, Asia create strategic support for defense in other countries

Background of competent authority

- The US Competent Authority assists taxpayers regarding matters covered in the mutual agreement procedure articles of the income tax treaties to which the United States is a party.
- US income tax treaties designate the Secretary of the Treasury as the US Competent Authority. This responsibility has been delegated to the Deputy Commissioner (International), Large and Mid-Size Business Division, who serves as the US Competent Authority in administering the operating provisions of tax treaties, including reaching mutual agreements in specific cases and interpreting and applying tax treaties.
- The IRS Office of Tax Treaty serves as the staff for the US Competent Authority on tax treaty matters by administering the MAP process.

Reasons for competent authority assistance

- Reasons for requesting competent authority assistance:
 - US tax treaties permit taxpayers to request competent authority assistance when they consider that the actions of the United States, the treaty country, or both, result or will result in taxation that is contrary to the provisions of the treaty.
 - The most common reason for requesting competent authority assistance is to relieve economic double taxation arising from a transfer pricing adjustment under section 482 of the Internal Revenue Code or an equivalent provision under the laws of a treaty country.
- Competent authority assistance may also be requested with respect to other issues as provided in the tax treaties, including residency and withholding tax issues and discretionary determinations whether a taxpayer is entitled to the benefits of a treaty under the limitation on benefits articles.

Letter to request competent authority assistance

- ▶ A request for competent authority assistance must include:
 - ▶ Applicable treaty reference
 - ▶ Identification of taxpayer and related party
 - ▶ Description of the issues for which relief is requested
 - ▶ Description control and business relationships
 - ▶ Tax years and amounts at issue
 - ▶ IRS office with jurisdiction over the taxpayer
 - ▶ Requested relief
 - ▶ Status of statute of limitations
 - ▶ Relevant domestic and foreign proceedings involving the taxpayer
 - ▶ Other relevant domestic and foreign proceedings
 - ▶ Relevant advance pricing agreements
 - ▶ Power of attorney and contact person
 - ▶ Prior discussions with IRS appeals
 - ▶ Protective claim pursuant to Section 9.02 of Rev. Proc. 2006-54
 - ▶ Competent authority consent to disclosure statement
 - ▶ Penalties of perjury statement
 - ▶ Other required information

Competent authority

- If agreement is not acceptable to taxpayer, may withdraw
- If agreement not reached among competent authorities, taxpayer may withdraw, or APA team may negotiate a unilateral APA
- IRS/CA agree to mutual exchange of information on any subsequent modifications, cancellations, renewals, evaluations of annual reports, etc.
- Bilateral APAs typically provide for simultaneous filing of annual report with IRS and other country

Advantages and disadvantages of competent authority

- Advantages
 - High success rate
 - Generally small additional taxpayer effort
- Disadvantages
 - Often a slow process
 - Taxpayer excluded from negotiations
 - Taxpayer generally must accept outcome
 - Does not cover secondary adjustments

Simultaneous competent authority and appeals

- Joint CA-Appeals consideration and preparation of US negotiation position
- Advantages
 - Avoids “will only endeavor” problem of paragraph 7.05 of Rev. Proc. 2006-54
- Disadvantages
 - CA simply adopt IRS exam position

Arbitration and US-Canada Income Tax Treaty

- ▶ Subparagraph 3(f) of Article 27 of the Protocol pertains to Article 21 of the Protocol, which implements the new arbitration provisions. An arbitration proceeding will generally begin two years after the date on which the competent authorities of the contracting states began consideration of a case. Subparagraph 3(f), however, makes clear that the arbitration provisions shall apply to cases that are already under consideration by the competent authorities when the Protocol enters into force, and in such cases, for purposes of applying the arbitration provisions, the commencement date shall be the date the Protocol enters into force. Further, the provisions of Article 21 of the Protocol shall be effective for cases that come into consideration by the competent authorities after the date that the Protocol enters into force. In order to avoid the potential for a large number of MAP cases becoming subject to arbitration immediately upon the expiration of two years from entry into force, the competent authorities are encouraged to develop and implement procedures for arbitration by 1 January 2009, and begin scheduling arbitration of otherwise unresolvable MAP cases in inventory (and meeting the agreed criteria) prior to two years from entry into force.

Bio and contact information

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- E. Miller Williams, Jr., is a Partner/Principal with Ernst & Young LLP's National Transfer Pricing Group. In this role, Mr. Williams advises with multinational corporate clients on a national basis regarding complex TP matters with an emphasis on international TP controversy, APA, competent authority and TP planning and structuring.
- Mr. Williams has more than 17 years of transfer pricing advising experience (5 with the government and 12 in private practice) with companies in a variety of industries. His industry experience includes work with paper and pulp, building products, pharmaceutical, semiconductors, software, packaging, retail, consumer products, motor vehicles, automotive parts, heavy equipment and industrial machinery. Mr. Williams is a frequent speaker at Council for International Tax Education Seminars and other tax seminars, and has authored a number of transfer pricing articles.
- Prior to joining Ernst & Young LLP, Mr. Williams headed the Southeast transfer pricing practices of a previous Big 5 Firm and of one of the current Big 4 Firms in Atlanta. Prior to private practice, Mr. Williams served as a Senior Attorney in the Office of Associate Chief Counsel (International) for the IRS in Washington, D.C. working on a variety of TP and international tax matters. As a member of that office, he worked in the APA Program where he acted as lead attorney on many APA cases and as advisor to the Director on APA procedures.
- Mr. Williams received his LLM in Taxation from Emory University, his JD from Stetson University College of Law and his undergraduate degree from Vanderbilt University. Prior to working for the IRS, Mr. Williams served as an officer and attorney in the United States Army Judge Advocate General's Corps where he held positions as a prosecutor, defense attorney and administrative law attorney. He is a member of the Georgia Bar Association and the American Bar Association Tax Section, and is a board member and officer of the Georgia Council for International Visitors and board member of the Atlanta Area Council of the Boy Scouts of America.