MUTUAL AGREEMENT PROCEDURE

Bombay Chartered Accountants Society
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Background

NEED & IMPORTANCE OF RESOLVING INTERNATIONAL TAX DISPUTES

- Major concern for business and government
- Disputes have increased in number and complexity… this trend will continue
- Need a more effective procedure to resolve disputes
...Background

INTERNATIONAL TAX DISPUTE REDRESSAL MECHANISMS

- Before Dispute Arises
  - ADVANCE PRICING AGREEMENTS (TRANSFER PRICING)
  - AUTHOURITY FOR ADVANCED RULING

- After Dispute Arises
  - MUTUAL AGREEMENT PROCEDURES (MAP)
  - ARBITRATION – COMPULSORY or OPTIONAL
  - INTERNATIONAL LITIGATION – INTERNATIONAL COURT OF JUSTICE
    EUROPEAN COURT OF JUSTICE (ECJ)
...Background - MAP

- If taxation not in accordance with tax treaty, taxpayer may need to litigate in one or both of contracting states.

- Inbuilt mechanism for tax treaty dispute resolution on bilateral basis (also unilateral?).

- Resolution of disputes through Competent Authorities (‘CA’) of Contracting States (‘CS’).

- Remedy under MAP is available irrespective of remedies available in domestic tax laws.

- Potential of a negotiated settlement (may agree to disagree)
  - Mandatory resolution if arbitration clause exist.
Art. 25 – OECD MC

1. Where a person considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident or, if his case comes under paragraph 1 of Article 24, to that of the Contracting State of which he is a national. The case must be presented within three years from the first notification of the action resulting in taxation not in accordance with the provisions of the Convention.
2. The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the domestic law of the Contracting States.
3. The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.
4. The competent authorities of the Contracting States may communicate with each other directly, including through a joint commission consisting of themselves or their representatives, for the purpose of reaching an agreement in the sense of the preceding paragraphs.
5. Where,

a) under paragraph 1, a person has presented a case to the competent authority of a Contracting State on the basis that the actions of one or both of the Contracting States have resulted for that person in taxation not in accordance with the provisions of this Convention, and

b) the competent authorities are unable to reach an agreement to resolve that case pursuant to paragraph 2 within two years from the presentation of the case to the competent authority of the other Contracting State,

any unresolved issues arising from the case shall be submitted to arbitration if the person so requests.
5. These unresolved issues shall not, however, be submitted to arbitration if a decision on these issues has already been rendered by a court or administrative tribunal of either State.

Unless a person directly affected by the case does not accept the mutual agreement that implements the arbitration decision, that decision shall be binding on both Contracting States and shall be implemented notwithstanding any time limits in the domestic laws of these States.

The competent authorities of the Contracting States shall by mutual agreement settle the mode of application of this paragraph.
MAP – Treaty Model Differences

- UN and OECD MC are similar except that:
  - UN model additionally commits the CA to jointly or unilaterally develop procedures for implementing MAP

- US Model differs from the UN / OECD in the following ways:
  - Any agreement reached between the CAs to be implemented notwithstanding any time limits as well as *procedural limitations*,
  - Time period of 3 years not prescribed for taxpayer to present the case, and
  - Even for the cases involving issues related to Art. 24(1), MAP can be initiated with CA of the country of which he is resident.
  - For CA initiated MAP, US model illustrates the matters that could be included in such MAPs.

- Competent Authority (CA)
  - **India:** Officer Authorised by Central Government – Rule 44G / 44H
  - **Other Countries:** Ministry of Finance or Apex tax authority or Tax Commissioners or Directors as their representatives
Mechanics of MAP

TAX DISPUTE

Applicant approaches the CA in country of residence / Nationality (Home Country)

Dispute capable of unilateral resolution?

NO

Should be resolved by consultation

MAP

YES

Should be resolved by CA of country of residence.
STEPS INVOLVED IN MAP APPLICATION

1. Filing Application with CA
2. CA to admit application
3. Reference to CA of host country
4. CA of Home Country & Host Country to consult

- Representations to CA of Host Country
- MAP resolution issued by CA of home & host country
- Implementation of Solution

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MAP – Some Aspects

- What is MAP?
- Who can apply for MAP?
  - Taxpayer initiated MAP Vs. CA initiated MAP?
- Who is Competent Authority? What is its role?
- In what situations can MAP be invoked?
  - Interpretation?
  - Application?
  - Transfer pricing?
- What is the time limit within which one has to apply for MAP?
  - Possibility or probability of action Vs. Actual Action?
  - First notification [how to establish]?
- Whether Mutual Agreements under MAP are published?
...MAP – Some Aspects

- What is the procedure involved in MAP?
  - Application procedure and form?
  - Representation by taxpayer?
  - Payment of taxes – before, during or after MAP application?

- Whether CA may refuse to refer a specific case to MAP?
  - Circumstances – (a) tax avoidance (b) domestic law impossibility

- What is the time frame for settlement of disputes under MAP?
  - Experience so far?

- What is the participation of the taxpayer in the MAP?
  - Without arbitration cases
  - Arbitration cases

- Can there be multilateral MAP involving more than two countries – triangular cases?
…MAP – Some Aspects

- Is MAP binding on the revenue authorities and the taxpayer?
  - Can taxpayer reject MAP result?
- Can MAP results be implemented after expiry of the domestic time limits prescribed for altering a tax assessment?
  - What about procedural aspects?
- Whether taxpayer can defer acceptance of MAP results if dispute is pending in the Competent Court of either Contracting States?
- Can the taxpayer file an appeal after MAP?
  - Cable News Network LP Vs. ADIT [2010-TIOL-20, ITAT Del]
- Can taxpayer pursue domestic law remedy and MAP simultaneously?
Can MAP override domestic court decisions?

Is there any alternative mechanism available when no solution is reached under MAP?
  - In cases where treaty provides for arbitration clause
  - Treaty do not provide for arbitration clause

What are the shortcomings of MAP?

What are the advantages of MAP?

Confidentiality of information provided or exchanged in MAP?

Can MAP be invoked where action of authority does not result into double taxation?

Can MAP orders be revised?
MAP – Some Aspects

- MAP and Transfer pricing
  - Can MAP be initiated for transfer pricing cases?
  - For what type of TP cases:
    - Quantum of adjustment?
    - Quality of adjustments – such as factual position?
    - Corresponding adjustments
  - Can advance pricing agreements be executed through MAP?
Categories of disputes...

- Broad categories of disputes that could be resolved under MAP:

**Case / Taxpayer Specific Disputes**
- Includes specific cases of taxation not accordance with treaty.
  - Scope only limited to treaty and not domestic tax laws.

**General interpretive or application related**
- Includes issues relating to interpretation or application of terms under treaties.
  - General in nature and are initiated suo-moto by CA.

**Eliminations of double taxation not provided in treaty**
- Elimination of double taxation in cases not provided in treaty.
  - Eg. Determination of residential status for dual tax residency cases not resolved under tier breaker rules (individuals + corporates)

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Categories of disputes

- Common disputes currently resolved under MAP in India:
  - Existence of Permanent Establishment (PE)
  - Attribution of income, expenses, deductions, credits, etc. to PE
  - E-Commerce transactions
  - Categorisation of income [e.g. royalty / FTC Vs. Business Income]
  - Common meaning of terms
- Application of domestic laws to penalties, fines, interest inconsistent with treaty
- Transfer Pricing issues
Practical issues under MAP

Some practical issues faced in India:

- Success of MAP as alternate dispute resolution
- Repetitive procedures for subsequent years
- Time limit under domestic tax law provisions for tax officer to give effect to MAP order
- Time limit for filing of MAP application under certain treaties
- MAP resolution limited to the determination of principle issues, leaves income computation to tax officers
- Availability of tax credit in respect of taxes under a MAP settlement
- Issues resolved under MAP contradictory to subsequent decision of court
- Stay of demand – only possible where MAP negotiation US or UK or Denmark
MAP - Arbitration

- Amendment in 2008
- Issues not resolved by CAs themselves
- Taxpayer’s choice to request for arbitration
- Arbitration can be invoked only for actual cases [not for probabilities]
- Can be invoked only after 2 year from reference to host country CA
- Results of arbitration are binding on CAs only if accepted by taxpayer
- Consensus on suspension of collection of tax during MAP process
- No arbitration if domestic court in either CS rules on the same issue
- CS need to agree bilateral on mechanics of Arbitration process
MAP- Indian Statutory Regime

- Rule 44G – for residents
  - Residents aggrieved by action of any Foreign Country resulting in taxation not in accordance with tax convention to apply to CA in Form. No. 34F

- Rule 44H – for non-residents
  - CA in India to examine reference received from CA outside India
  - CA in India to endeavor for resolution and communicate to CCIT or DGIT
  - AO to give effect to MAP within 90 days of receipt of the same by CCIT or DGIT, subject to conditions fulfilled.
  - Tax, interest or penalty to be adjusted as per MAP in accordance with the provision of the Income tax Act 1961 irrespective of time barring of proceedings

- Visakhapatnam Port Trust (144 ITR 146) (A.P.)
  - MAP available in addition to and not in substitution of the domestic remedies
MAP Example: Indo - US DTAA

- **Article 27**
  - Stipulates a time limit of three years for all references
  - Encompasses elimination of double taxation in cases not provided for in DTAA
  - Provision for joint commissions or representatives

- **Article 3(1)(h) : Competent Authority**
  - India : Central Government in the Ministry of Finance (Department of Revenue) or their authorised representative
  - USA : Assistant Commissioner (International) and for interpretative issues in concurrence with Associate Chief Counsel (International) of the Internal Revenue Service.
MAP Example: Indo - US DTAA

- India-U.S. Competent Authority Agreement
  - Suspends tax assessment and collection for taxable years that are the subject of mutual agreement procedure cases under DTAA between USA and India
  - Security to be provided for the additional tax demand subject to mutual agreement procedure
  - Resolve or close the case within two years
  - Taxes covered include tax on assessment reassessment, withholding tax, advance tax, interest and penalty.
MAP Example: Indo - US DTAA

- Indo US Technical Explanation
  - Clarifies that remedies available under domestic laws need not be exhausted
  - Three years time limit runs from the receipt of formal notification
  - Recourse can be taken to US Model for list of examples
  - Competent Authorities entitled to consult each other
  - Communication between Competent Authorities can be direct or through representatives
MAP- New Protocol

- MOU with U.K.
- MOU with USA
- MOU with Denmark

- First MAP in India was refused by the tax payer in 2009
- First MAP was signed with USA on transfer pricing dispute in 2010.
MAP cases statistics

- OECD published data for calendar year 2006 & 2007

MAP Statistics
Part 2
Non discrimination – Article 24
ARTICLE 24 NON-DISCRIMINATION

1. Nationals of a Contracting State shall not be subjected in the other Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are not residents of one or both of the Contracting States.

2. Stateless persons who are residents of a Contracting State shall not be subjected in either Contracting State to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which nationals of the State concerned in the same circumstances, in particular with respect to residence, are or may be subjected.

3. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.
4. Except where the provisions of paragraph 1 of Article 9, paragraph 6 of Article 11, or paragraph 4 of Article 12, apply, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

5. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

6. The provisions of this Article shall, notwithstanding the provisions of Article 2, apply to taxes of every kind and description
- Non-Discrimination on Nationality
- Non-Discrimination of PE
- Non-Discrimination on ownership
Non-Discrimination on Nationality

Article 24(1)
The component and scope
Non-discrimination on Nationality

- **Nationals** of a Contracting State shall not be subjected in the other Contracting State to any **taxation** or any **requirement connected** therewith, which is **other or more burdensome** than the taxation and connected requirements to which nationals of that other State in the same circumstances, in particular with respect to residence, are or may be subjected. This provision shall, notwithstanding the provisions of Article 1, also apply to persons who are **not residents of one or both** of the Contracting States.
Nationality

- Defined in Article 3(1)(f) to mean
  - Any individual possessing nationality of Contracting State
  - Any Legal Person, Partnership or Association deriving its status as such from the laws in force in a Contracting State
Nationality…

- Nationality should be a decisive factor
  - Ex: Sec 80R, 80RRA — *Chohung Bank - 102 ITD 45 (Mum)*
  - Sec 80M deduction is not allowed for foreign company – no discrimination on nationality - *Credit Lyonnais - 94 ITD 401 (Mum)*

- Individual – National of more than one country
- Partnership Vs Partners
- PE is not a legal person. Merely part of an enterprise. Enterprise as a whole may invoke.
Corporate Entities are Nationals

- Corporate Entities – Whether Nationals?
  - US defines it as individuals, UK does not define, many toe OECD lines
- **Standard Chartered Bank – 39 ITD 57 (Mum)**
  - No definition of term ‘national’ in Indo UK DTAA
  - Reliance on SC in State Trading Corp – Corporations have nationality
  - Refers to the Jural relationship of nationals and citizens
  - Held that Companies are nationals and have capacity to invoke non-discrimination clause under the Indo UK DTAA
Corporate Entities – Not Nationals

- Chohung Bank – 102 ITD 45 (Mum)
  - 'legal person' side by side with individual
  - Principal of 'Nocitur-a-soccii'

- P No.6 of 1995 – 234 ITR 371 (AAR)
  - Para (1) Vs Para (2) – Para 2 would be redundant if para (1) incl a company
    - Interpretation on the term ‘national’ in Article 4(2)(c) & (d) being used in relation to individuals
  - Distinguishes ratio of State Trading Corp
‘In the same circumstances’

- ‘*in particular with respect to residence*’
  - Difference in residential status can’t lead to discrimination
  - Chohung Bank – 102 ITD 45 (Mum)
- Non-resident Non-national can get nonresident national treatment, if the national and non-national are resident of the same state.
- Preference to serving public bodies
- Benefit to Charitable Institutions
- More favorable treatment may be given to non-nationals
‘In the same circumstances’

✧ Possible discrimination
  ✧ Whether sec 115E could be discriminatory for LTCG arising from transfer of unlisted securities?
  ✧ Whether section 115H could be discriminatory in respect of ‘requirement connected with’ taxation?

✧ There may be several other examples, it needs a study group to go in to this..
'Taxation'

- 'Taxation' or any requirement connected therewith covers –
  - Basis of Charge
  - Method of assessment
  - Rate levied
  - formalities (filing returns, payment of taxes etc)
- None of the above can be more burdensome
‘Higher rate of tax – whether hit?’

**Chohung Bank – 102 ITD 45 (Mum)**

- DTAA does not override Annual Finance Act
- ‘Taxation’ cannot mean rate of tax
- What is explicit in UK DTAA is implicit here
- Retrospective insertion of Explanation to section 90(2) clarifying that charging higher rate of tax on foreign company shall not be regarded as less favorable charge or levy of tax.

**Sakura Bank – 100 ITD 215 (Mum)**

- non-discrimination clauses i.r.o tax rates – rendered ineffective
Other Judicial Precedents

- Provision for bad debts u/s 36(1)(viia)** should be allowed to foreign companies – else discriminatory
  - *Standard Chartered Bank - 39 ITD 57 (Mum)*

** under old provisions
Non-Discrimination of PE

Article 24(4)
Non-Discrimination of PE

- The taxation on a PE which an enterprise of a Contracting State has in the other Contracting State shall not be less favorably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This provision shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, relief and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.
Non-Discrimination of PE

- Not based on nationality, but on situs of enterprise
- PE Can –
  - Claim deduction of expenses without restrictions
  - Claim depreciation incl. accelerated depreciation
  - Claim Special exemptions and deductions
Judicial Precedents in PE

- Restriction on HO expenses u/s 44C are discriminatory unless it is accepted in the Protocol - *Metchem Canada Inc* - 100 ITD 251 (Bom.)

- No discrimination when artificial disallowances are made – Reverse discrimination also not possible - *Mashreqabank Psc* – 108 TTJ 554 (Mum)

- Not allowing deduction u/s 80HHE to branch of a foreign company – not discriminatory – *Automated Securities Clearance (Pune)* – 2008 TIOL 443 ITAT
Judicial Precedents in PE

- Activities of Indian Bank and Korean Bank are only similar and not the same – *Chohung Bank* – 102 ITD 45 (Mum)

- WDV should not be reduced by Depn allowed outside India – Else, discriminatory
  - *Foramer SA* - 52 ITD 115 (Del)
Allowability of payments to non-residents

- Interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State.
Other Judicial Precedents

- **Herbalife Intl India – 101 ITD 450 (Del)**
  - Disallowance u/s 40(a)(i) for payments to non-residents – Discriminatory
  - Can the Indian company invoke this non-discrimination clause?
Some foreign rulings on NDC

- *UnionBanCal Corp v Comr of Internal Revenue* (2002) 5 ITLR 912 US
- *Delaware case* (Case No IR 699) Federal Tax Gazette (2004) Part II 1043 *German*
- *NEC Semi-Conductors Ltd v Revenue and Customs Comrs* (2007) 9 ITLR 995
- *S A Andritz* (French Supreme Administrative Court - 2003)
- *FCE Bank plc Vs Commissione* (2012) EWCA Civ 1290
Non-Discrimination on Ownership

Article 24(6)
Non-Discrimination on ownership

- Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.
On ownership…

- Non-Discrimination only for enterprise and not for assessment of owners.
- TP Norms - non-discriminatory.
- ‘Capital’ – signifies all types of capital
- ‘Capital’ owned – could also apply for partnerships taxed as such w/out pass thro.
- Allowance of benefits of corporate reorganization to companies with domestic stake would be discriminatory
General observations

- Law on non discrimination in tax treaties in India is still in early stages; not many decisions from the Hon’ble High Courts as yet.

- Take recourse to NDC only when you find genuine discrimination vis-à-vis a resident, you are sure that it is not express or intended, and you find that FE has no measures to assume a level playing field.

- If you hit the wall, then NDC provides a way out. After all, equality before law does matter ....
Thank you