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The Basics of Managing Multilateral Controversy—Part 1

Multilateral tax issues are on the rise, and not just in headline-grabbing Base Erosion and Profit Shifting—BEPS—2.0 developments. Changes in how businesses and tax authorities operate have led to increased reliance on, and scrutiny of, operating models in which ostensibly bilateral transactions in fact implicate more than two jurisdictions. Such operating models are common, although the issues they raise are not always framed as multilateral issues by tax authorities. This article lays out a number of common scenarios and describes the strategies and best practices we have found successful in approaching tax controversies with multilateral dimensions. 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.

Increasing Controversy

Innovations from the initial BEPS project have fueled controversy in recent years. Country-by-country reports have been used as the basis for transfer pricing adjustments, notwithstanding the clear direction of BEPS Action 13 that these reports should only be used for risk assessment. Guidance on the relevance of functions related to the development, enhancement, maintenance, protection, and exploitation of intangible property—better known by the acronym DEMPE—has led to disputes based on the location and movement of key employees, an issue which the Covid-19 pandemic threatens to exacerbate.

Recent developments are poised to build upon the controversy growth from the BEPS project. Tax reform discussions in the U.S. have been coupled with talk of significantly increasing the IRS's enforcement budget. In Mexico, President Andrés Manuel López Obrador recently publicly touted large tax settlements with multinational companies, suggesting the perceived noncompliance by multinational taxpayers is a key political issue. In Saudi Arabia, where there was historically little or no transfer pricing enforcement, we are now directly aware of several examinations. Even Her Majesty's Revenue & Customs (HMRC), traditionally regarded as a tax authority willing to accept principled taxpayer-favorable resolutions, has become more aggressive in the transfer pricing and diverted profits tax, or DPT, space.

Multilateral Developments

The rise in multilateral controversies has been driven in large part by increasing complexity in value chains. While global operating models have been common for decades, few companies today rely on a simple hub-and-spoke structure in which each foreign affiliate transacts directly with a central headquarters entity. Multiple principal structures have become common, and even in structures with a single principal, transactions that implicate the interests of several entities and jurisdictions are commonplace.

At the same time, the mutual agreement procedure—MAP—and advance pricing agreements—APA—under bilateral tax treaties are increasingly available to address controversies. Foreign counterparties, especially those with regional principal or cost sharing participants, are generally located in jurisdictions, like Ireland and Switzerland, that have tax treaties with the United States and other key developed economies. MAP itself has become more viable as a dispute resolution tool, as peer reviews and statistical reporting under BEPS Action 14 push tax authorities around the world to take their treaty obligations seriously.

Yet the historical paradigm of unilateral (i.e., domestic) or bilateral (i.e., treaty-based) dispute resolution is ill-equipped to deal with the rising number of controversies that implicate more than two jurisdictions, and approaching these controversies through that paradigm creates double tax risk.

This year saw the launch of the OECD's International Compliance Assurance Program, or ICAP, as a permanent program after two rounds of pilots. Although not a dispute resolution process *per se*, ICAP provides a voluntary multilateral forum in which multiple tax authorities come together to review and evaluate a participant's tax positions, thus providing valuable comfort to taxpayers concerning the issues that have been reviewed and addressed.

The OECD's October 2020 blueprint on Pillar One of the BEPS 2.0 project laid out an intriguing proposal for multilateral dispute prevention, which would involve a consensus-based review process backstopped by a quasi-arbitral determination panel.

The October 2021 Inclusive Framework statement outlining agreement on Pillars One and Two provided that mandatory binding dispute prevention and resolution would be available for Amount A and related disputes. Although it remains unclear whether a final BEPS 2.0 solution will be implemented, or if Pillar One will ultimately be successful, the dispute prevention

proposals that have surfaced during the course of the BEPS 2.0 project may prove influential going forward.

One need not wait for a multilateral framework to be agreed and implemented to effectively address controversies that implicate more than two jurisdictions. Below, we summarize a number of common multilateral fact patterns, and share lessons learned from our experience in handling such controversies.

Multilateral Controversy: Comments and Best Practices

The common thread woven throughout many of the most complex fact patterns is the need for multilateral engagement by the tax authorities. Unfortunately, outside of a few contexts and jurisdictions, the procedures and history of multilateral controversies is fraught with uncertainty, confusion, inefficiency, and even bad outcomes. We have set forth below some best practices which, in our experience, will reduce the likelihood of a bad experience.

One important note: This area is moving fast, both generally and due to BEPS 2.0 dispute resolution on the horizon, so the experiences and recommendations set forth below may change rapidly in the years ahead.

Is There Typically a 'Multilateral' Option?

The short answer is “Maybe.” Although many tax authorities are trying to change this, and true multilateral procedures do certainly exist, for the most part tax treaties and associated procedures are set up to accommodate bilateral or unilateral cases. For example, in most countries, there is no formal multilateral APA or MAP process. The current U.S. revenue procedures govern-

ing APAs and MAP cases are generally set up for bilateral matters, as well as unilateral APAs.

As a practical matter, “multilateral” APAs and MAP cases are often operated by the tax authorities as merely a web of two, three, or more bilateral cases which they attempt to coordinate.

The lack of clear procedures is complicated by the use of intermediary countries—either for tax planning or for business reasons—which may not have direct treaty relationships with all the countries implicated in the multilateral controversy, or with any of them. Sometimes this may include low-tax jurisdictions.

In Part 2, we'll take a deeper dive into procedures and best practice recommendations. 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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