Mutual Agreement Procedure

The intent of entering into a Double Tax Avoidance Agreement (DTAA) between two countries is to reduce the impact of double taxation by allocating between the two jurisdictions, the rights to tax an assessee. The Mutual Agreement Procedure (MAP) is a methodology prescribed in an article of a DTAA. The Competent Authorities interact with each other with the intention to resolve taxation disputes of a taxpayer and to ensure lawful implementation of the provisions contained in the said DTAAs. MAP is a big relief to taxpayers in terms of the time saved *vis-à-vis* the time frame taken to go through appellate proceedings. Once an application is filed for a MAP, the Competent Authorities mutually discuss the merits of the case at hand and consider whether the case is to be considered and accepted in the first place or not. Once an application is accepted, it is at the Competent Authority's discretion whether to call for more information from the taxpayer or not.

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Double Tax Avoidance Agreement

A Double Tax Avoidance Agreement (DTAA) is an agreement entered into between two countries. It provides a means of determining a standard to settle issues on double taxation levied on the international front.

Most DTAA's comprise the followings:

- Scope of the DTAA (indicating the source of income it covers)
- The resolution as to how much tax each jurisdiction can levy, and the basis of determination of such taxability

In a MAP, representatives from each of the contracting states are designated and are referred to as Competent Authorities.

- Procedure of how a mutual agreement procedure (MAP) may be followed between the jurisdictions to settle disputes
- Provisions comprising commencement, applicability and termination of the DTAA.

The intent of entering into a DTAA between two jurisdictions is to reduce the impact of double taxation by allocating between the two jurisdictions the rights to tax an assessee. These rights could be allocated on the basis of type of income, residence of the assessee etc.

It is important to note that in most legislations, transfer pricing adjustments are the best example of economic double taxation. Say, for example, an Indian company pays royalty of ₹15 crore to its parent company in the USA for use of the latter's technical know-how. When an Indian Transfer Pricing Officer (TPO)/Assessing Officer (AO) determines that the royalty ought to have been paid is only ₹10 crore as per arm's length rate of royalty, the differential ₹5 crore is brought under the tax net in India. What cannot be forgotten is that the whole amount of ₹15 crore was treated as income by the parent company, and tax was paid on the same. Now this adjusted amount of ₹5 crore has been doubly taxed; once in each of the two jurisdictions. This is when an assessee requires a mutual agreement to be entered into between the two jurisdictions, to ensure that it does not face the brunt of the aggressive tax policy of both these jurisdictions. And so MAP comes into play. In the case at hand, a plea would be made to either withdraw the tax adjustment in India to the tune of ₹5 crore, or to adjust and reduce the same amount from the parent company's taxable income.

What is MAP?

The Mutual Agreement Procedure (MAP) is a methodology prescribed in an article of a DTAA. In a MAP, representatives from each of the contracting states are designated and are referred to as Competent Authorities. The competent authorities of the said jurisdictions interact with each other with the intention to resolve taxation disputes of a taxpayer and to ensure lawful implementation of the provisions contained in the said DTAAs.

The typical areas covered under a MAP are as follows:

- Double taxation that could arise from a transfer pricing adjustment
- Dispute on the characterisation of income
- Dispute in relation to existence of a Permanent Establishment (PE) in one of the contracting States
- Issues relating to attribution of profits to a PE in the other State
- Issues pertaining to determination of residential status under the tax treaty
- Interpretation of provisions of tax treaty

Who is the Competent Authority?

A Competent Authority is a person specifically designated by a State to whom issues pertaining to a MAP would exclusively be referred. The Competent Authorities would attempt to discuss together the concerns raised by a taxpayer, and mutually reach a consensus. It is important to note though, that there is nothing in the treaty to compel them to reach a decision and to ensure resolution of the tax dispute.

As per Rule 44H of the Income-tax Rules, Competent Authority means any officer so authorised by the Central Government. Currently, there are two Joint Secretaries holding positions as Competent Authorities in India, based on geographies of the tax treaty partners.

Making a MAP Request

When a taxpayer believes that a tax adjustment has been made by the revenue authorities, causing an impact not in consonance with the provisions of the tax treaties, the former may request the Competent Authority under the relevant article of the treaty, to undo the approach followed by the revenue. In transfer pricing cases, where an adjustment is made affecting associated enterprises in two or more jurisdictions, it is advisable to make an application to Competent Authorities in both/all jurisdictions.

It is important to ensure that adequate information is provided in a MAP application, such that the concerned Competent Authorities are in a position to take a justified view on the issue at hand. At the same time, the application should not be unnecessarily burdened with complex information, not relevant to/ not pertaining to the tax adjustment made.

Why MAP?

MAP is a big relief to taxpayers in terms of the time saved *vis-à-vis* the time frame taken to go through appellate proceedings. Following is an analysis of the

difference between MAP and the regular appellate proceedings:

Particulars	MAP	Appellate Proceedings
Expected Time Frame	2-3 years	8-12 years on an average
Taxpayer's participation	Generally the taxpayer is not allowed to participate in the discussion. The Competent Authorities mutually discuss the approach between themselves	The taxpayer is extensively involved in the process. In fact, the onus lies on the taxpayer to evidence that no tax has been evaded
Nature of decision	Judgment from a MAP is binding on the revenue. The taxpayer, however, has the opportunity to disregard the same, and go through the regular appeal process	This is binding on the taxpayer, though the option of filing objections/ appeals before higher appellate authorities exists
Alleviation of double taxation	One of the important benefits of MAP is to alleviate double taxation	The exposure to double taxation always exists till a 100% relief is granted in the state where a tax adjustment is made
Stay of demand	Generally a Memorandum of Understanding exists as an addendum to treaties, to suspend collection of tax till the MAP proceedings are concluded. For example, such an MoU was entered into between India and U.S.A. on 25th September, 2002	A stay of demand needs to be filed with the revenue authorities. If accepted by the revenue, temporary relief may be granted and demand be kept in abeyance

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Advantages of MAP

- Time span relatively less
- Decision of Competent Authorities override those pronounced by domestic appellate authorities
- Stay/abeyance on demand easily granted
- Right to domestic appeal not hampered
- Higher chance of reaching a middle-path/ compromise than that seen in the regular appeal process

Disadvantages of MAP

- Limitation of time prescribed under certain treaties. A MAP application has to be filed post completion of the specified time span of the first notification of the action to make a tax adjustment *i.e.* assessment order after which an appeal may not be filed with the Competent Authorities. In case of the India USA DTAA, the specified time is three years
- Taxpayer personally not involved in the MAP process
- Might turn out to be a time consuming process under certain treaties. As of today, only the Indo-US and the Indo-UK treaty prescribe a mandatory time limit of two years to conclude MAP
- Cost of filing a MAP is huge. A bank guarantee is also required, which is usually a multiple of the actual adjustment amount proposed
- Penalty issues cannot be determined through the MAP

Steps involved in a MAP

Once an application is filed for a MAP, the Competent Authorities mutually discuss the merits of the case at hand and consider whether the case is to be considered and accepted in the first place or not. Ideally, an application may be rejected in the following circumstances generally:

- Insufficient information provided by the taxpayer in the MAP application
- The resolution pleaded by the taxpayer would be in contravention of the tax laws of either of the resident countries
- Application barred by the limitation of time rule prescribed in the Act

- Taxpayer is guilty of fraud or has consciously evaded tax.

Once an application is accepted, it is at the Competent Authority's discretion whether to call for more information from the taxpayer or not. They might also involve the taxpayer to evidence his stance in certain exceptional circumstances. Following is a summary of the steps involved in MAP:

1. Making a MAP request
   - Taxpayer makes a request to the home country Competent Authority
   - Request can be made where there is double taxation, inconsistent with the treaty etc.
2. Admission of Application
   - Application may be admitted by the Competent Authorities on basis of a mutual decision
   - Competent Authority may call for supplementary information from tax payer, if found indispensible
3. Consultation between Competent Authorities
   - Where issue cannot be resolved unilaterally/ independently by the home country Competent Authority, the host country Competent Authority may be called upon for resolving the matter.
   - The matter may be discussed over the phone/ video conferencing etc. The Competent Authorities of contracting states generally meet around twice a year. Applications are then considered across the table and endeavoured to be resolved by mutual consultation
4. Representation
   - Tax payer may be asked to provide further data in case of inadequate information available on record to reach a conclusion
   - In certain cases, where found necessary, the taxpayer may also be called upon to represent the matter before the Competent Authorities
5. Negotiations and Resolution
   - Competent Authorities initiate negotiation and attempt to reach an amicable solution
   - The proposed agreement will be communicated to the taxpayer

Presently, there are two joint secretaries holding positions as Competent Authorities in India.

In transfer pricing cases, where an adjustment is made affecting associated enterprises in two or more jurisdictions, it is advisable to make an application to Competent Authorities in both/all jurisdictions.

   - Solution to be given effect to within 90 days if the taxpayer consents to agreeing with the said decision of the Competent Authorities

MAPs concluded in India

In June 2010, negotiations were carried on between the Competent Authorities in India and USA as regards an application for software service providers. During audit proceedings for the financial year 2004-05, the arm's length Net Cost Plus profitability margin (*i.e.* ratio of Net Operating Profit to Total Operating Expense) was proposed at about 24%. The resolution reached post the AP proceedings, was an arm's length profitability of 17.5%.

Similarly, around December 2010, discussions were held between the two Competent Authorities, wherein it was mutually decided that for mid-category companies in the software development business, the arm's length profitability was determined at 27.5%.

The following general trend that has been observed with the Indian Competent Authorities:

- Determination of principle issues alone. Computation of revised arm's length profitability/ tax adjustment is usually remanded to the first level officers (*i.e.* TPO's/AO's)
- The taxpayer applying for the MAP is anticipated to compromise to a certain extent and not expect a 100% relief to all tax adjustments proposed
- In a MAP application, the taxpayer has to specify if there are judicial precedents on similar issues either in India or abroad. The Competent Authorities are generally hesitant to pronounce a judgment that may not be in consonance with such judicial precedent
- Stay of demand possible only in cases of MAP applications where the two contracting states are either India and US or India and UK, since India has entered into an MOU only with these two pertaining to abeyance of demand until disposition of the matter. ■