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Focus on Tax Controversy

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Company Jet Audit Issues: A Word to the Wise

Once a business attains a certain level of success, an aircraft often becomes a valued asset. Public and closely held private companies alike find that the use of a private aircraft—whether possessed via whole or fractional shares, and whether owned, leased or chartered—fosters secure and efficient transportation for owners and executives. However, this benefit does not come without a price, and it is not unusual for the tax deductions with respect to the typical flight department to run in the $20 to $30 million range. These significant amounts, and the fact that the deduction and other tax rules are so complex and often subjective, have caused company aircraft to catch the attention of the Internal Revenue Service (IRS). A new Information Document Request (IDR), IRS Form 4564, has recently been employed on audits of companies with business aircraft, providing a roadmap for how to prepare for an IRS audit.

Overview

In order for a business to deduct substantial aircraft-related costs, several complicated tax issues must be vetted, including: (1) the proper depreciation schedule for the aircraft and equipment; (2) the new Internal Revenue Code (Code) Section 274 entertainment disallowance rules; and (3) the passive activity rules. Any actual or deemed payments for use of the plane also may be subject to a 7.5 percent excise tax. Finally, the executives flying may have more imputed income for flights not properly documented as being primarily in the interests of the business rather than an individual benefit. The new IDR requests information that would allow the IRS to determine whether these tax requirements are satisfied.

The Business Deduction

In preparing the business tax return, taxpayers historically simply deducted all the expenses of the business aircraft on the basis that the aircraft was used within the scope of the company's business and thus met the deduction rules of Code Section 162. However, since October 22, 2004, there has been a "take away" from that deduction under Code Section 274 for any use that is considered personal "entertainment, amusement, or recreation." Unfortunately, many businesses are unaware of this rule, or if they are aware of it, they do not follow the now-final Treasury Regulations promulgated pursuant to Code Section 274 regarding how to properly calculate the "take away."

In short, under these rules, if a business has $20 million of aircraft expenses, and 25 percent of the aircraft usage was for personal entertainment travel, $5 million of the expenses are not deductible on the business tax return.

The IRS is aware of some easy adjustments vis-à-vis the Code Section 274 deduction disallowance that applies to virtually all companies owning aircraft. The new IDR asks for the Code Section 274 calculation performed by the company. The IDR separately asks for the total expenses of the aircraft, including the following:

- Catering fees
- Depreciation
- Interest expense
- Lease payments
- Charter payments
- Management fees
- Other costs
- Crew and maintenance salaries
- Crew meal and lodging expenses
- Takeoff and landing fees
- Maintenance flights
- Hanger fees
- Fuel
- Tires
- Insurance
- Registration

The IDR also asks for all information that would be on the flight logs, and requires the name of each passenger and specification of whether each passenger was travelling for business, personal reasons or personal entertainment.

On audit, the IRS is making significant adjustments based on the information obtained in response to the IDR for a variety of reasons, including that the business was not able to show it did the Code Section 274 calculations, or did them incorrectly, or did not substantiate the specific use by each passenger.

Depreciation

The cost of purchasing an aircraft can be taken as a tax deduction surprisingly rapidly, typically over five years. Although the Obama administration raised the specter of lengthening the period for depreciation, at the same time it enacted "bonus" depreciation that allowed for 50 percent to 100 percent of the entire cost deduction to be taken in the year a new aircraft is placed in service, rather than in later years over the normal five-year period.

A threshold test for using bonus depreciation for closely held companies is satisfying Code Section 280F, which requires a complicated two-step 25 percent and a 50 percent business use test in order to qualify. Code Section 280F is a "when," not a "how much," test and is often misinterpreted by taxpayers. The IRS is taking a hardline approach where an aircraft is leased to a related company, arguing that even business use by an owner will not allow the Code Section 280F test to be satisfied, commonly referred to as the "leasing company trap." *See* IRS Tech. Adv. Mem. 200945037.

On an alternative basis, bonus depreciation in the amount of $11.25 million for an aircraft purchased and actually flown in 2003 was attacked by the IRS in the recent case of *Brown v. Commissioner*, T.C. Memo. 2013-275. There, the issue was that the aircraft was not being placed in service in 2003 for the specific purpose intended, when the taxpayer indicated that a conference table and big screen TV were integral to his specific intended business use. In response to the taxpayer's substantiation of the business use, the Tax Court stated, "this is just not believable" and assessed a 20 percent understatement penalty pursuant to Code Section 6662. Of interest in the case is the Tax Court's reference to Ernest Hemingway's reply to F. Scott Fitzgerald: "the very rich are different from you and me . . . [T]hey have more money." This statement is indicative of the general attitude of the IRS and the courts with respect to audits of aircraft.

Passive Activity

Passive activities as defined in Code Section 469 are endeavors with insufficient "material participation" conducted by an individual or by flow-through businesses, such as subchapter S corporations or partnerships, and are generally not of concern in the C corporation context. The problem with passive activity historically was that passive activity losses could only be offset by passive activity income, and therefore passive activity income itself was not in any way a problem. However, the interest in avoiding passive activity characterization has increased with the new Code Section 1411 that applies a 3.8 percent tax to "net investment income" generated from passive activities.

The typical context in which passive activity issues arise is where an aircraft is held in one entity and leased to a second entity. Leasing is *per se* a passive activity. Note that passive activity leasing refers to a so-called "dry lease" of the aircraft (that is, without a pilot), not the "wet lease" or charter that refers to use of the aircraft with a pilot provided by the lessor.

There is a solution around the application of the passive activity rules where an aircraft is dry leased and used by a second business that is related to the lessor business. To avoid the passive activity rules, the taxpayer can do a passive activity grouping election before the auditor comes knocking. The mechanics of the election are provided by Revenue Procedure 2010-13, 2010-1 C.B. 349, and the timeframe to make the election has been extended at a minimum through 2014.

Federal Excise Tax

Just as many businesses that own aircraft are not aware of the new entertainment deduction disallowance, many also are unaware of the Federal Excise Tax imposed by Code Section 4261 that can apply to payments received or deemed to be received for use of their piloted aircraft, even where the aircraft operates under Part 91, the Federal Aviation Administration authority for non-commercial use. It is simplest to think of this tax as a type of sales tax. Code Section 4261(a) imposes a 7.5 percent tax, plus a small leg tax, on the amount paid for taxable transportation that begins and ends in the United States. Therefore, if a U.S. business accepts a cash reimbursement for domestic travel on its "corporate jet," it may be obligated to collect and pay over the excise tax, a tax normally associated only with commercial air travel.

There has been a tremendous amount of audit activity related to this little-known excise tax. For example, the battle over the Federal Excise Tax as applied to fractional ownership resulted in congressional action to change the rules. Where a taxpayer owned a partial interest (referred to as a "fractional" share in the world of air travel) and a company provided management services, the IRS's position was that the taxpayer was actually leasing the aircraft to the management company, which then chartered the aircraft. In effect, the IRS claimed that the owner was chartering its own aircraft to itself and owed the 7.5 percent excise tax on those payments. Billions of dollars were involved, and Code Section 4261 was amended to exempt fractional interests. To make up the tax gap, Congress increased the fuel tax.

After the fractional interest debacle, the IRS did not give up. In virtually all audits of aircraft across the United States, the excise tax was asserted in instances where the taxpayer owned its own whole aircraft but, instead of having a flight department and its own pilots, employed a commercial aircraft management company to provide those services. On April 19, 2013, the National Business Aviation Association (NBAA) referenced prior favorable guidance on the issue, stating the following in a letter to the IRS:

> Finally, the Chief Counsel Advice (CCA) memorandum (Number: 201210026, released March 9, 2012) ignored this conflicting guidance and took the approach that virtually all amounts paid by an aircraft owner to a management company are subject to FET. Since the publication of the CCA, NBAA and NATA have observed that virtually any business aviation company engaged in providing aircraft management services is subject to audit. The expense incurred by the Service to undertake these audits, and by the taxpayer to defend the audits, is significant and clearly not the best use of resources by either party.

Code Section 4282(a) provides that the tax imposed does not apply to amounts paid by one member of an affiliated group to another member of that group for air transportation. In Private Letter Ruling 200123002 (January 2, 2001), the IRS declared that the exemption did not apply where the group members were not corporations. Thus, where an affiliated group of companies share an aircraft, the Code Section 4261 7.5 percent tax will apply on the fair market value of the aircraft use even where a cash payment is not made, unless the usage is corporation to corporation.

The new IDR seeks information pertaining to any payments made for use of the aircraft by individuals. The IRS is seeking ammunition to apply the excise tax to reimbursements made by executives, typically in public company situations where the executive reimburses so as not to have the value reported on the proxy statement, *e.g.*, PLR 200705010 (the IRS ruled that where a former CEO reimbursed the employer for use of the aircraft, the employer was obligated to collect the Code Section 4261 excise tax from the CEO).

Imputed Income

It is safe to say that everyone wants to avoid "imputed income," which refers to a situation where the taxpayer did not actually receive cash, but his tax return must show income expressed in dollars for the accretion in wealth he was deemed to experience. Usage of company aircraft is rife with imputed income opportunities that employment tax auditors eagerly pursue. Owners of partnerships receive imputed income as a guaranteed payment on their Form K-1. Independent contractors, such as directors, will see it on the Form 1099, and employees, including Subchapter S owners, will receive it on their Form W-2 subject to typical employment tax withholdings.

A flight that is primarily for the business of the entity providing the aircraft will not result in imputed income. This would seem to be an easy determination, but it is not. In *Flowers v. Commissioner*, 326 U.S. 465 (1946), the Supreme Court of the United States held that the taxpayer must be away from the tax home to deduct travel expenses. The "tax home" must be identified and has nothing to do with state tax residency, but is a federal income tax determination of the location where the individual performs most of his work, makes most of his money, and where the most important work is performed, based on all the facts and circumstances. This determination is becoming more difficult with the advent of telecommuting and the fact that the sophisticated executive may not spend the bulk of his time in any one location. The concept of a tax home is still developing, and the IRS challenges it frequently on audit. The determination of tax home was favorably decided, for example, in *Snellman v. Commissioner*, T.C. Summ. Op. 2014-10; No. 13186 125. In that case, an unemployed individual living in Florida obtained a job in Missouri for less than one year, and the Tax Court determined that all his travel, lodging and meals in the job location were excluded from income as travel away from home.

The general rule for imputed income for personal travel is to refer to the arms-length charter rate for the same flight, but the regulations under Treasury Regulations Section 1.61-21(g) allow for use of the Standard Industrial Fare Level (SIFL) rates, which are only approximately $1 per mile for the highest paid employees, officers and owners. If an auditor catches the taxpayer not imputing income for a flight that the auditor determines is personal, the far higher charter rate amount will be used.

In addition to commuting trips that do not start from the tax home, the IRS examines two other areas: spousal travel and business entertainment. In short, gone are the days when the cost to bring a spouse along on a business trip qualified as a deductible ordinary and necessary business expense. Not only will the IRS impute income for the "tag-along" spouse, there is a very real danger that the spouse's presence will cause the entire trip to be viewed as personal rather than business, resulting in imputed income for the employed spouse as well.

Business entertainment is a favorite for the IRS auditor to reverse treatment, impute income, and impose penalties and interest. Unless the entertainment is in a clear business setting, such as a gala to celebrate an office opening, the entertainment must be associated with or directly related to the active conduct of the taxpayer's business. Generally, this means that the taxpayer and its potential customers or clients cannot simply enjoy one another's company while engaging in an entertainment activity, such as golf, skiing, fishing, dining or sightseeing. Rather, there must be actual business conducted that can be substantiated by focused and documented business discussions of specific, not general, topics, recorded for later IRS review.

Summary

The IRS has refined its audits of business-owned aircraft and is expressing tenacity in getting the maximum federal tax dollars from miscalculated tax deductions, incorrect imputed income and nonpayment of excise tax. Companies that own aircraft should know the rules and document, document, document.

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International Taxation Controversy: The Coming Storm

There is a revolution underway in the world of international taxation. The current essential treaty and substantive taxation rules were developed shortly after the end of World War I using England and India—denominated "imperial" and "colony"

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countries, respectively—as a model. The purpose of these treaty and substantive rules was to repatriate income from the colony country to the imperial country to facilitate repayment of war debts. As a result, the model treaties that formed the basis of the current Organisation for Economic Co-operation and Development (OECD) and United Nations models essentially allowed source countries to tax only a limited share of the overall (combined) income, and allocated the residual income to the "residence" country (England, or the imperial country).

The central flaw in this approach was the treatment of interim holding companies as "residence" countries. The assumption was that all countries would ultimately adopt the same taxation regimes and rates. Needless to say, this never happened. A related flaw was the framework of the transfer pricing rules promulgated under the model treaties. In this context, "transfer pricing" refers to the mechanisms for allocating income between affiliates located in different jurisdictions. In order to allocate residual income to the residence country, the primary transfer pricing methods were so-called "one-sided" methods, which tested the source country entity. A combined or "two-sided" approach (profit split) was typically the lowest priority method.

These two critical issues have undergirded multinational enterprise (MNE) global income tax planning for generations. In mid-2013, the G-8 and G-20 countries expressed concern about the perception that MNEs do not pay their fair share of tax in their respective countries, and directed the OECD to study the matter.

OECD BEPS Project

On July 17, 2013, the OECD released its contemplated Base Erosion and Profit Shifting (BEPS) Action Plan. The Action Plan identified 15 subjects to be addressed, which for present purposes can be categorized as follows (with parenthetical references to the Action number assigned by the OECD):

1. Transfer Pricing Matters
    a. Intangibles transfer (Action 8)
    b. Risks and capital (Action 9)
    c. Non-third-party arrangements (Action 10)

        With respect to this action item, the details suggest a need to "(ii)[c]larify application of transfer pricing methods, in particular profit splits, in the context of global value chains; and (iii) provide protection against common types of base eroding payments, such as management fees and head office expenses." In other words, the OECD is concerned about the mechanics of base erosion.
    d. Re-examination of documentation (Action 13)
2. Treaty Matters
    a. Treaty abuse—commissionaire-type arrangements (Action 6)
    b. Permanent establishment definition (Action 7)
    c. More effective dispute resolution (Action 14)
    d. Development of a multinational instrument to amend treaties (Action 15)
3. Backstop matters
    a. Digital economy (Action 1)
    b. Hybrid mismatch (Action 2)
    c. Country foreign corporation rules (Action 3)
    d. Interest and financial payment deductions (Action 4)
    e. Substance for preferential regimes (Action 5)
4. Information Exchange and Documentation
    a. Disclosure of rulings on preferential regimes (Action 5)
    b. Disclosure of aggressive tax planning arrangements (Action 12)
    c. Collection and evaluation of data about BEPS (Action 11)

The critical issues for most MNEs are the transfer pricing and treaty-related matters (items 1 and 2 above).

Challenges of the BEPS Project

There are a variety of elements that all parties must consider in evaluating the BEPS Action Plan and the way forward.

Limits of OECD Authority

The OECD itself has no mandate to change the law, even with the broad public endorsement of the G-8 and G-20. Accordingly, any actual change in treaty or transfer pricing policy will depend on take-up from interested sovereign states. Therein lies the fundamental problem for an initiative such as this: it relies on domestic implementation on a country-by-country basis.

Because there inevitably will be variation in how states adopt the OECD proposals, there will never be a perfectly coordinated, supra-national action on BEPS. In practical terms, the process envisioned by the Action Plan will be a starting point to address perceived shortcomings of the current principles of international taxation.

The difficulties of sovereign country action is perhaps best illustrated by the United Kingdom's newly introduced "patent box," which from one perspective could be interpreted as a base-eroding tactic in favor of the UK fisc. The OECD cannot force the United Kingdom to abandon the patent box regime, and, given the regime's relatively recent appearance on the statute books, it seems highly unlikely that the United Kingdom would remove it voluntarily. In addition, the regime almost certainly was enacted with due consideration of the OECD's public and prominent work in the BEPS space, in which the United Kingdom is a leader.

On the other hand, there has been recent governmental cooperation across a broad spectrum of domestic systems and points-of-view in other areas of international tax compliance. For example, there has been broad international cooperation with the U.S. initiative addressing investment income reporting, framed by the U.S. Foreign Account Tax Compliance Act.

Prior OECD Initiatives

A related practical reality is that the BEPS Action Plan is not the first time that the OECD has undertaken broad-based efforts to address perceived tax base erosion matters. In May 1996, OECD ministers called upon the OECD to "develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases . . . ." The heads of state of the then-current G-7 countries endorsed this request, urging the OECD "to vigorously pursue its work in this field, aimed at establishing a multilateral approach under which countries would operate individually and collectively to limit the extent of these practices." While the project started off in a similar manner as the BEPS Action Plan, the net result after several years of what became the Harmful Tax Competition initiative was a broad-based expansion of information exchange agreements. The takeaway for the BEPS process is that the study may or may not result in concrete proposals that would materially affect the effective tax rate (ETR) planning of many MNEs.

Posture of BRICS and Non-Member Source Countries

A third practical element relates to the posture of Brazil, Russia, India, China and South Africa (BRICS) and other non-OECD-Member countries. The BRICS in particular have been outspoken critics of the OECD model treaty and its transfer pricing guidelines for many years. Indeed, the BRICS even have suggested the possibility of developing their own model treaty. The background of this situation is an interesting element of tax policy history, as noted above.

For most MNEs, the most serious current international taxation issue is the difficulty of implementing global ETR plans in the BRICS and other source countries. While the BRICS members of the G-8 and G-20 have endorsed the BEPS Action Plan process, it should be kept in mind that reaching high-level political agreement to a plan of action is a far cry from subscribing to, and implementing, the more granular proposals that may be forthcoming.

Nonetheless, the apparent trend of thinking in the BRICS and source countries seems to coincide with what can be anticipated from the BEPS Action Plan process. The issues likely to be most important to the BRICS and other non-OECD-Member countries could be along the following lines:

- Preference for two-sided (versus one-sided) transfer pricing testing to ensure that source country functional activities are appropriately taken into account in allocating residual income
- Permanent establishment of limitations in the current model treaties
- Expansion of the definition of "intangible" assets to include a broad range of local market synergies (so-called China premium)
- Backstopping of transfer pricing and domestic tax enforcement, tax base protection requiring:
    - Exit taxes
    - General anti-avoidance principles
- Extra-territorial reach (so-called Vodafone issue in India)

Several of the BRICS have suggested a potential need for a new "source" country model tax treaty, at least for purposes of framing discussion in future treaty deliberations. The BEPS Action Plan clarifies that it is "not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income," which means that MNEs should expect that the BRICS countries may continue to pursue their respective agendas outside the context of the OECD's BEPS project.

Coordination

The European Union has undertaken its own action plan to "strengthen the fight against tax fraud and tax evasion." If both the EU and OECD action plans continue, coordination will be necessary at some point.

Other OECD initiatives also are underway that could have an impact on any ultimate BEPS proposals. For example, the intangibles project involves many elements of the transfer pricing portion of the BEPS Action Plan. In addition, the first Action Plan item is the digital economy, which the OECD tried to address in its 2010 update of the model treaty, although that update probably created more issues than resolutions.

Transition

Another issue that must be considered in-depth as the process evolves is how transition from the status quo will be addressed with respect to any specific action ultimately undertaken by one or more countries. Oddly enough, the Action Plan seems to discourage this reality, as it calls in several places for concerted and coordinated action. The likelihood that some states will wish to move faster and more comprehensively than others is almost inevitable.

Nonetheless, if there is material change in specific treaties or transfer pricing guidelines, there will be a grandfathering process of effective dates and other items, which will provide a transitional period to adapt the ETR planning of MNEs.

Comment

The European Union has undertaken its own action plan to "strengthen the fight against tax fraud and tax evasion." If both the EU and OECD action plans continue, coordination will be necessary at some point.

Areas of Likely Concern for MNEs

As noted, the BEPS Action Plan can be broken down into four areas of focus. We will use the same format to highlight the areas of likely concern.

1. Transfer Pricing Matters
    a. Intangibles transfer (Action 8)
    Basis of Concern: Continued expansion of "soft" intangibles concepts, reflecting posture of BRICS and source countries. The revised draft intangibles guidelines further this area of concern.
    b. Risks and capital (Action 9)
    Basis of Concern: It is likely that "risk-taker" concepts will be under attack, as opposed to functions having substantial people content.
    c. Non-third-party arrangements (Action 10)
    Basis of Concern: Continued focus on two-sided transfer pricing (profit splits) confirmation or elevated status.
2. Treaty Matters
    a. Treaty abuse—commissionaire-type arrangements (Action 6)
    Basis of Concern: All "global principal"-type structures likely will receive greater scrutiny, perhaps to be tested as noted above.
    b. More effective dispute resolution (Action 14)
    Basis of Concern: Could be trade-off for more assertive transfer pricing.
3. Backstop Matters
    a. Digital economy (Action 1)
    Basis of Concern: How will it be addressed from sourcing standpoint?
    b. Substance for preferential regimes (Action 5)
    Basis of Concern: What about regimes like the UK "patent box"?
4. Information Exchange and Documentation
    a. Country-by-country reporting of financial information to disclose combined financial information to all countries in a uniquely specified manner (Action 12)
    b. Disclose aggressive tax planning arrangements (Action 12)
    Basis of Concern: Definition.

MNE Planning Considerations

These trends related to BEPS and BRICS suggest that epochal change in treaty and transfer pricing policies may be on the horizon. If there is enough political will to push through even some of the changes envisaged by the BEPS Action Plan, then, in view of the rather short proposed timeframe, MNEs should engage proactively with the principles and policies underlying the Action Plan's stated aims. MNEs also should be vigilant in keeping fully abreast of developments in this sphere and in considering potential implications of the evolving process on their global value supply chains, particularly their global ETR planning. An important element on the global tax agenda of all MNEs should be consideration of how ETR planning will be affected by any or all of the evolutions noted above. In this respect, all MNEs engaged in cross-border business should address at least two questions as the BEPS Action Plan process evolves:

- What does the project mean to my company? The likely outcomes of the BEPS process are as noted. These elements should be reviewed in terms of their importance to a specific MNE and its ETR plan.
- What should we be doing as the BEPS process evolves, recognizing that it is a political process that ultimately reflects competing governmental interests? The answer should include the following elements:
    - Establish a simplified spreadsheet version of the ETR plan.
    - Evaluate the likely impact of each of the elements noted above.
    - Identify which elements are material to the ETR plan and which are not.
    - For those that are material, evaluate steps that could be taken, consistent with overall business plans, to mitigate adverse consequences of such elements if they should become reality. In essence, create contingency plans.
    - Such plans then can be taken into account as business decisions are made over time.
    - Consider transitionary issues.
    - Determine home country tax authority coordination, as needed.

In practice, modeling such matters is a relatively straightforward process. For example, it is a process that is regularly undertaken with respect to resolution of substantive tax or transfer pricing disputes, either administratively or in Competent Authority, Advance Pricing Agreement or litigation contexts. In all of these contexts, likely outcomes are evaluated to develop contingency plans or business plan adaptations.

As is true in any type of material evolution, legacy structures may need to be revisited, especially where anticipated tax benefits accrue annually and the existing planning will be affected by that evolution.

A specific approach could be along the following lines. In evaluating a potential transaction, the in-house tax audit manager would prepare mock Information Document Requests (IDRs) from the relevant tax authorities. An external accounting or law firm could respond to these mock IDRs, perhaps in such a manner as to ensure attorney-client privilege. From these responses, a risk matrix can be prepared, which should list the various outcomes, quantify them using tax software and compute a risk weighted value for the respective outcomes. Once that risk matrix is evaluated, the transaction could be revised to mitigate the risk, be scrapped or tabled, or proceed.

There are a number of ways to arrive at the risk quantifications. One is the "Las Vegas bookie" approach. External advisors, not involved in the transaction, would be provided with the pertinent data and asked to place a wager, which will establish a betting line. If the final betting line is 3 to 2, meaning that one would need to wager $3 to win $2, it would translate into a 60 percent chance of prevailing on the tax position.

Another approach is "role playing," in which an external tax expert would be asked whether he or she wants to represent the taxpayer or the Internal Revenue Service (IRS) on the case, with the winner receiving a $1 million fee. This may determine the level of opinion that could be issued. Depending on this result, the process could continue with a change in the stakes—*e.g.*, if the external adviser represented the taxpayer and would receive $1 million for a win, a fee appropriate for an IRS victory could be determined. Presumably it would be much higher.

Not surprisingly, the risk established by these two approaches can be materially different from the posture of the external advisor's opinion.

It is appropriate that privilege issues be addressed in such a process.

Comment

We are entering an exciting and challenging time for MNEs. The G-8, G-20 and OECD have made it clear that they seek a fundamental rewrite of the international taxation principles laid down almost a century ago.

The ultimate value of the BEPS Action Plan will be determined by its implementation. Given that the current opportunities for international tax planning and BEPS are largely a consequence of the rules on international tax enacted by states (rather than anything MNEs have created on their accord), it is possible that little may come of the Action Pan if those states ultimately determine to protect their own interests, as occurred with the Harmful Tax Competition process.

That said, it seems possible that BEPS has gained sufficient political momentum for some form of change to occur in due course, which would justify the internal evaluation process noted above.

In any event, the likelihood of an ever-escalating international tax controversy docket for all MNEs is high, for a variety of reasons:

- The list of countries focusing on transfer pricing and other perceived means of base erosion has grown (encouraged by international finance and related organizations, with more than 70 countries requiring transfer pricing documentation).
- The volume of transfer pricing controversies and mutual agree procedure (MAP) cases is growing steadily in all countries.
- In many countries, the treaty dispute resolution process (so-called MAP cases under the pertinent articles of treaties) is slow, inefficient or non-existent.
- BEPS Action Item 4 is dispute resolution, but this item is vague and probably the least likely element to result in serious improvement of the unfortunate situation that exists in many countries.
- MNEs will be well advised to undertake the self-examination process noted above and to press their home country tax authorities to focus on dispute resolution (double or multiple taxation avoidance) as a critical element of their own tax base defense.

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McDERMOTT TAX CONTROVERSY HIGHLIGHTS

Join us for McDermott's TEI Midyear Conference Reception
McDermott invites you to join us on March 24 for art appraising and cocktails inspired by the Smithsonian. Grand Hyatt Washington, Constitution Level, Wilson & Roosevelt Rooms, 6:30-8:30 pm. To RSVP and for more information, please contact mcdermottevents@mwe.com.

Questions concerning the information contained in this newsletter may be directed to your regular McDermott Will & Emery lawyer or the editor listed below:

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