

# IRS Implements Final Changes to Competent Authority Process

Skadden

09/02/15

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

**Robert H. Green**

Washington, D.C.  
202.371.7840  
robert.green@skadden.com

**Matthew S. Kramer**

Palo Alto  
650.470.4597  
matthew.kramer@skadden.com

**John M. Breen**

Washington, D.C.  
202.371.7385  
john.breen@skadden.com

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

Four Times Square  
New York, NY 10036  
212.735.3000

**skadden.com**

On August 12, 2015, the IRS issued Rev. Proc. 2015-40, which revises the procedures for obtaining competent authority (CA) assistance concerning issues arising under U.S. income tax treaties. This revenue procedure replaces current guidance, which was last updated almost 10 years ago, in Rev. Proc. 2006-54. Revisions to the former revenue procedure were proposed in IRS Notice 2013-78, issued in November 2013. See Skadden Alert dated Jan. 10, 2014. *The procedures and requirements in Rev. Proc. 2015-40 do not have immediate effect but apply to CA requests filed on or after Oct. 30, 2015.*

Before 2012, the U.S. Competent Authority (USCA) was under the director of the International, Large and Mid-Size Business (LMSB) division and the Advance Pricing Agreement (APA) Program was under the associate chief counsel of the International division in the Office of IRS Chief Counsel. In 2012, the functions of USCA and APA were unified under the deputy commissioner of the Large Business and International (LB&I) division. The office now consists of the Treaty Assistance and Interpretation Team (TAIT) and the Advance Pricing and Mutual Agreement (APMA) Program, the latter office under the director of the Transfer Pricing Operations (TPO) division. Revenue Procedure 2015-40 and a separate document that applies to the APMA Program, Rev. Proc. 2015-41, provide final guidance concerning taxpayer interaction with these offices. In recent years, tax treaties with several major trading partners were revised to provide for mandatory arbitration of transfer pricing disputes. This development, which affects a substantial number of cases, required certain procedural changes.

In general, the new revenue procedure refines the substantive and procedural rules applicable to CA requests. The document also imposes a number of additional requirements on taxpayers with regard to prefiling conferences, structure and content of requests for CA assistance, and submission of information while the request is under consideration. On several key points, the IRS took account of and adopted public comments received on the earlier discussion draft. The final revenue procedure concerning the APMA Program is addressed in a separate client alert.

## Improved Coordination With Other IRS Functions

### Interaction With IRS Examination

The 2013 draft revenue procedure proposed fundamental changes to the relationship between USCA and IRS Exam with regard to transfer pricing matters. For example, the draft revenue procedure required extensive coordination between USCA and Exam, and it provided for advance review by USCA of virtually all Section 482 allocations that involved a treaty jurisdiction. Most of these provisions have been deleted from the final revenue procedure. In particular, the complex “examination resolution notification” mechanism has been eliminated. Under the final revenue procedure, if a taxpayer executes a Form 870 with Exam, the IRS will not reject the request for CA assistance, but it will seek only to obtain correlative relief for the underlying adjustment. Clearly, USCA has a strong interest in presenting well-supported cases to its treaty partners. As the final guidance recognizes, this goal can be met without involving USCA in day-to-day administration of all transfer pricing audits that may be subject to CA requests.

### Correlative Adjustments

In the event of a primary Section 482 allocation, the U.S. regulations require correlative allocations and conforming adjustments, which will produce secondary tax effects. Historically, USCA has permitted taxpayers to apply the principles of Rev. Proc. 99-32, a revenue procedure that permits conforming adjustments without secondary tax effects. The final revenue procedure adopts a new term (“competent authority repatriation”) for

# IRS Implements Final Changes to Competent Authority Process

such treatment. Subject to some minor exceptions, taxpayers can continue to use the principles of Rev. Proc. 99-32 for adjustments to conform their cash accounts to adjustments agreed in MAP. As under current practice, interest on intercompany accounts payable may be modified or eliminated under the terms of the CA resolution; this treatment is retained in the final revenue procedure.

## Simultaneous Appeals Procedure

Consistent with the draft revenue procedure, the final guidance contemplates an expanded role for the simultaneous appeals procedure (SAP). Specifically, SAP provides the exclusive means to obtain concurrent review of a disputed issue by both IRS Appeals and CA. SAP has been available for many years, but few taxpayers used it. The revenue procedure adopts the same concepts as Notice 2013-78, although the implementing rules have been substantially simplified. The positions that result from SAP review are not binding on the taxpayer, USCA or Appeals. Rather, they provide a nonbinding view, which USCA may or may not take into account in negotiating with the treaty partner. Under the circumstances, it is not clear that a taxpayer will utilize this complex procedure to obtain what amounts to an advisory view of its case from IRS Appeals.

## Severing Issues From Appeals Consideration

Consistent with existing rules, USCA will not take jurisdiction of a matter that is under active consideration by Appeals. The final revenue procedure allows a taxpayer to sever an issue from consideration by Appeals, provided that the taxpayer files a CA request within 60 days of the opening Appeals conference (changed from 30 days after the opening conference in Notice 2013-78) and provided that the request also meets other procedural requirements. A taxpayer cannot sever an issue from Appeals, however, once the taxpayer has invoked an alternate dispute resolution mechanism under Appeals jurisdiction. The IRS reminds taxpayers that, where a foreign-initiated adjustment is in issue, severing a case from CA consideration and seeking consideration in IRS Appeals may affect the availability of foreign tax credits under Treas. Reg. § 1.901-2(e)(5) and Rev. Proc. 92-75, 1992-2 C.B. 197.

## Fast Track Settlement

The draft revenue procedure required USCA to be named as a participant in any Fast Track Settlement (FST) procedure (which is under the jurisdiction of LB&I), and it also required that USCA agree in writing to any resolution that resulted. Unless both conditions were met, the resolution could not be subject to a subsequent CA request. In this area, the final revenue procedure has been revised to provide more flexibility. Importantly, no per se exclusion from CA applies to a matter that is resolved in FST without the active involvement of USCA. Instead, FST resolutions are analyzed under the same rules that apply to other

resolutions reached while a case is under Exam jurisdiction. For example, if a case is resolved in FST, USCA would accept the case, but it might seek only correlative relief from the treaty partner, which could result in the taxpayer being subject to double taxation in whole or in part.

## Extension of the Statute of Limitations

The final revenue procedure requires taxpayers to keep the U.S. statute of limitations open for tax years subject to pending CA requests. USCA may decline to accept a CA request for a particular tax year if the taxpayer fails to extend the statute of limitations. A refusal to extend the statute is also identified as one of the actions that may be considered to undermine or prejudice the CA process and that may warrant rejection of the CA request or termination of an active CA proceeding. This provision is inconsistent with the position in the final revenue procedure that states that USCA will accept an initial CA request for a closed year provided that the taxpayer has complied with all timing and procedural requirements of the applicable treaty (such as notification) with regard to that year.

## Measures to Increase Coverage and Efficiency

### Taxpayer-Initiated Adjustments

The final revenue procedure adopts many of the proposed rules regarding taxpayer-initiated adjustments. Historically, CA procedures were geared to adjustments initiated by the United States or by a treaty partner but did not address taxpayer-initiated adjustments. The final revenue procedure acknowledges that such adjustments are properly subject to a request for CA assistance. Taxpayer-initiated adjustments are subject to mandatory prefiling procedures and are ineligible for the “small case” CA procedure, but in other respects they are treated much the same as traditional adjustments. When a taxpayer-initiated adjustment is presented, the taxpayer prepares the initial position paper to describe the adjustment and the support for it.

### Interrelated Issues

Under the proposed revenue procedure, in appropriate cases USCA could require the taxpayer to expand the CA request to include related issues, additional countries or subsequent tax years. If the taxpayer declined to expand the scope, USCA could reject the initial request or terminate an ongoing proceeding. The final revenue procedure takes a more balanced approach in the interest of maintaining broad taxpayer access to CA procedures. Under the final rules, USCA may request in writing that the proceeding be expanded to include additional issues or additional years, and it may request information relating to years outside the scope of the initial request. The taxpayer determines how it will respond to such requests. If the taxpayer declines to expand the scope or to provide additional information, USCA may

# IRS Implements Final Changes to Competent Authority Process

take that into account in negotiating the case, but it will not terminate an ongoing case because the taxpayer declines the request.

## Reliance on ACAP/Referral to APMA

The IRS continues to seek ways to realize the efficiencies projected when the decision was made to merge US CA and APA-related functions under a single management structure. To this end, the final revenue procedure retains many features of the Accelerated Competent Authority Procedure (ACAP) in Rev. Proc. 2006-54. In effect, this procedure allows a CA resolution to be “rolled forward” to subsequent tax years for which tax returns have been filed and which involve similar facts and circumstances. The draft revenue procedure allowed the USCA to invoke ACAP on its own initiative, but this provision was deleted from the final guidance. Consistent with the draft revenue procedure, the final guidance does not require the concurrence of IRS Exam to ACAP, which historically was required under Rev. Proc. 2006-54 and its predecessors. Under the final revenue procedure, a taxpayer can include the ACAP request in the initial CA request or may submit it any time before it receives the tentative CA resolution. Similar to other provisions that address expansion of the scope of the CA request, USCA may request a taxpayer to include additional years under ACAP, but the taxpayer has final discretion whether to do so. This parallels the treatment under Section 5.05 of Rev. Proc. 2015-41, which provides that the APMA program may propose that an APA proceeding be extended to include ACAP or rollback years. In fact, the AMPA Program has broader latitude and may terminate a proceeding if the taxpayer declines to accept a proposed rollback.

## Foreign Tax Credits and Informal Consultation

The final revenue procedure emphasizes that U.S. taxpayers should take steps to ensure they qualify for foreign tax credits in connection with CA matters. For example, taxpayers are invited to consult with the CA staff concerning foreign tax credit issues, although any informal advice that results from such consultation is not binding on the IRS. Taxpayers also are reminded that, if CA negotiations fail in whole or in part, it may be necessary for them to pursue administrative or judicial remedies in the foreign treaty jurisdiction (and, for that reason, the statute of limitations in the treaty country should be kept open). These and other provisions confirm that USCA views enforcement of the foreign tax credit rules, in particular the requirement to exhaust all “effective and practical remedies” in the treaty jurisdiction, as a priority.

## Tentative CA Resolution

The final revenue procedure explains the steps involved in closing a case after negotiations have concluded. The guidance introduces the notion of a “tentative CA resolution,” a document

reflecting the outcome of the negotiations, which is presented to the taxpayer for its consideration. This process, which is familiar to most practitioners, was not addressed in the draft revenue procedure or in Rev. Proc. 2006-54. With the consent of the competent authorities, the taxpayer may accept the tentative CA resolution for specific issues or specific tax years, while rejecting it for others. In addition, USCA may consult with the taxpayer concerning the tentative resolution. The purpose of these consultations, however, is to facilitate implementation, not renegotiation, of the CA resolution.

## Mandatory Arbitration

An increasing number of U.S. tax treaties provide for mandatory, binding arbitration of unagreed CA cases. The final revenue procedure contains procedural rules for determining when a CA request is complete. Filing of a materially complete submission fixes the proceeding’s “commencement date,” which in turn is the start date for the period until submission to arbitration is required. The provisions in the final revenue procedure are quite general. Detailed procedures for arbitration under specific treaties are contained in the arbitration articles of the treaty or in an Exchange of Notes or a Memorandum of Understanding (MOU) executed in connection with the specific treaty.

## New Procedural Requirements

The final revenue procedure adopts several new filing requirements and calls for increased consultation with the IRS and periodic updates of information already submitted to the IRS. Overall, these provisions seem intended to increase the quality and uniformity of CA requests and to ensure that they contain all information necessary for USCA to begin substantive review of the case. As noted above, the submission of a materially complete request takes on increased importance when mandatory arbitration is present. In that event, neither country can afford to spend months obtaining essential data, given the limited amount of time available to conduct negotiations before the case is referred to arbitration.

## Additional Detail and Uniformity

The final revenue procedure adopts more extensive requirements concerning the format and timing of the initial CA request. In general, these requirements have parallels under existing practice, but Appendix A provides additional detail concerning the required format and organization of CA requests. Taxpayers are required to provide to each CA copies of any information provided to the other CA, which restates existing practice. One new item relates to transfer pricing documentation for the transaction, which must now be submitted with the CA request.

# IRS Implements Final Changes to Competent Authority Process

---

## **Additional Prefiling Procedures**

The final revenue procedure reduces the categories of cases to which mandatory prefiling procedures apply. Under the final guidance, a prefiling conference is mandatory only with respect to taxpayer-initiated adjustments, and this requirement applies without regard to the amount of the adjustment at issue. In contrast to the draft revenue procedure, prefiling conferences are only “recommended” for several other categories cases, including foreign-initiated adjustments in excess of \$50 million and cases that involve novel or complex issues, intangible development arrangements or global trading. Under the draft revenue procedure, each of these categories of cases was subject to a mandatory prefiling conference requirement.

## **Rejection of CA Request/Duty to Update**

The USCA has discretion to deny a request for assistance if it finds that the taxpayer failed to comply with procedural requirements or engaged in conduct prejudicial to the CA process. Examples of such behavior include “acquiescence” in a foreign-initiated adjustment or entering into a unilateral APA when the CA issue could “reasonably and practically have been covered” if the taxpayer had pursued a bilateral APA. The latter provision is a new addition to the final revenue procedure. Although USCA has long had authority to deny access to CA procedures, the standard under the final revenue procedure is somewhat more expansive. The final revenue procedure also calls for more active participation by taxpayers. They must update and correct submissions in

real time, provide information to each tax authority “at approximately the same time,” and refrain from any action that could prejudice the CA process or the interest of either tax authority. Although similar requirements applied under existing practice Rev. Proc. 2006-54, they were not always followed.

## **Assessment of the Revenue Procedure**

The final revenue procedure modifies existing practice in an effort to capitalize on the recent organizational changes at the IRS. The final document indicates that the IRS gave careful consideration to the public comments submitted on the initial draft revenue procedure. In many cases, the IRS revisited procedural issues and, where possible, sought to increase the availability of CA procedures to taxpayers. A limited trade-off exists in the sense that the relief available to taxpayers may be limited, particularly in situations where the taxpayer has pursued (or seeks to pursue) alternative remedies outside the CA process. Several of the initial proposals have been modified to be more in line with practical tax administration concerns. It remains to be seen whether, in an environment of sharply increased case volume, these final rules will produce more effective and more timely relief for taxpayers.