

Global View

IRS Modifies and Clarifies Competent Authority Procedures with Rev. Proc. 2015-40

By Robert J. Misey, Jr.

An integral part of all U.S. income tax treaties is a Competent Authority procedure that provides a mechanism for relief from double taxation. The taxpayer may request Competent Authority assistance when the actions of the United States, the treaty partner or both would result in income subject to tax in two countries.

Suppose, for example, that USCo sells widgets for \$100 to CanSub, its Canadian distributor, for resale throughout Canada. The Canada Revenue Agency (CRA) reduces the price from USCo to CanSub to \$90 and assesses tax on the \$10 adjustment. Double taxation occurs because \$10 of income (the difference between the \$100 USCo reports as revenue and the \$90 the CRA allows as a cost of goods sold to CanSub) is taxed by both countries. If requested, the Competent Authorities of the IRS and the CRA will negotiate with each other to determine who will tax the \$10.

New Rev. Proc. 2015-40,¹ which updates and revises Rev. Proc. 2006-54,² clarifies several open issues regarding the Competent Authority procedures. The U.S. Competent Authority for transfer pricing matters is the Director of the Advance Pricing and Mutual Agreement (APMA) Program.³ In addition to resolving double-tax issues, APMA is responsible for negotiating Advance Pricing Agreements (APAs) with taxpayers and foreign tax authorities. The IRS simultaneously issued Rev. Proc. 2015-41,⁴ which updates the IRS procedures for APAs, with Rev. Proc. 2015-40.

The new revenue procedure for Competent Authority retains the basic Mutual Agreement Procedure (MAP) and both the Simultaneous Appeals Procedure (SAP) and the Accelerated Competent Authority Procedure (ACAP) while clarifying various procedural aspects.

The Mutual Agreement Procedure

Rev. Proc. 2015-40 contains a chart⁵ detailing the required contents of the request to Competent Authority, which includes any transfer pricing documentation prepared pursuant to Code Sec. 6662(e). Rev. Proc. 2015-40 does not mention whether the required contents will include any country-by-country reporting



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under the new regulations for the Base Erosion and Profit Shifting (BEPS) initiative. Similar to the pre-filing conference available when filing for an APA, Rev. Proc. 2015-40 makes available informal consultations on either a named or an anonymous basis for matters that could be subject to the MAP.

Rev. Proc. 2015-40 expands the MAP to taxpayer-initiated positions.⁶ Taxpayer-initiated positions could occur when a taxpayer has to take an inconsistent position regarding a transaction on both a U.S. return and a foreign return. Suppose again that USCo sells widgets to CanSub. Double taxation on \$10 of income would occur if under U.S. transfer pricing law, USCo must report revenue for an arm's-length price of \$100, while under Canadian transfer pricing law, CanSub would deduct an inconsistent arm's-length price of \$90 as a cost of goods sold. Accordingly, USCo can now pursue the MAP on this taxpayer-initiated position, but must adhere to mandatory pre-filing requirements, which includes the submission of a pre-filing memorandum.

There are many interesting twists and turns with Rev. Proc. 2015-40, although the three basic programs—the Mutual Agreement Procedure, the SAP and the ACAP—all remain intact.

Rev. Proc. 2015-40 provides for a more streamlined procedure for a smaller taxpayer as a Small Case Competent Authority Request.⁷ Rev. Proc. 2015-40 increases the Small Case procedure by expanding the dollar thresholds for taxpayers to corporations with fewer than \$5 million in adjustments and individuals with fewer than \$1 million in adjustments. The Small Case procedure permits the U.S. taxpayer to consult with APMA to reduce the scope of information in a MAP request.

The Competent Authority may now deny assistance when the taxpayer's conduct has been prejudicial to the MAP.⁸ Examples of prejudicial behavior include the taxpayer acquiescing to a foreign-initiated adjustment, entering a unilateral APA with the foreign tax authority, entering a unilateral APA with the IRS when a bilateral APA would be more practical or rejecting a request to extend the statute of limitations for tax assessments. However, Rev. Proc. 2015-40 does not mention whether being dilatory in responding to the IRS's request for

information constitutes grounds for denying a request to Competent Authority.

Simultaneous Appeals Procedure

Rev. Proc. 2015-40 continues to try to clarify the roles of APMA and the Appeals office.⁹

Taxpayers may seek Appeals and Competent Authority consideration of an issue simultaneously under the SAP, which allows taxpayers to reduce the time required to resolve U.S.-initiated adjustments by allowing taxpayers and Appeals a more proactive involvement. Rev. Proc. 2015-40 confirms that issues accepted by Competent Authority are not subject to concurrent jurisdiction and that Competent Authority has sole jurisdiction over the SAP.

For example, suppose that the IRS increases the arm's-length price of widgets by \$10 to \$110, which correspondingly increases USCo's receipts. Double taxation on \$10 of income occurs because CanSub's cost of goods sold deduction remains only \$100. Under the SAP, USCo may seek a resolution with Competent Authority that includes Appeals working with the taxpayer.

However, when Appeals has jurisdiction, Rev. Proc. 2015-40 clarifies that Competent Authority will not consider an issue unless the taxpayer severs the issue from Appeals and files a request to Competent Authority.

Accelerated Competent Authority Procedure¹⁰

Unlike the ACAP's previous limitation to U.S.-initiated adjustments, Rev. Proc. 2015-40 expands the ACAP to foreign-initiated adjustments.

Suppose now that USCo sells widgets to CanSub in 20X1 and the CRA's adjustment results in \$10 of income subject to double taxation for 20X1. In 20X4, the taxpayer makes a request to Competent Authority. If USCo has filed returns containing the same issue for 20X2 and 20X3, USCo may seek the ACAP to efficiently add 20X2 and 20X3 to the request.

Other Matters

Rev. Proc. 2015-40 contains provisions for both protective claims¹¹ and satisfying the discretionary limitation on benefits provision in treaties.¹²

A taxpayer should make a protective claim if the taxpayer thinks that the imminent act of a foreign tax authority is likely to result in the double taxation of income, but the U.S. statute of limitations may expire before the foreign

tax authority conclusively acts. Rev. Proc. 2015-40 specifies that the IRS will provide a template of a letter suitable for making a protective claim as an alternative to all the requirements of a Competent Authority request.

All U.S. tax treaties provide limitation on benefit requirements that a taxpayer (most typically, a foreign corporation) must satisfy to obtain the benefits of the treaty (e.g., reduced withholding rates). Typically, the last resort for satisfying the limitation on benefits article (after several objective tests) is a discretionary grant by the Competent Authority. Rev. Proc. 2015-40 specifies that Competent Authority will not consider a limitation on benefits request for a hypothetical transaction and that the Competent

Authority has the sole authority to make a discretionary grant, without any opportunity for the taxpayer to appeal.

Conclusion

There are many interesting twists and turns with Rev. Proc. 2015-40, although the three basic programs—the MAP, the SAP and the ACAP—all remain intact. Considering that Rev. Proc. 2015-40 applies to all Competent Authority requests filed on or after October 30, 2015, tax practitioners will want to closely review this new revenue procedure before filing Competent Authority requests to eliminate double taxation on income.

ENDNOTES

¹ Rev. Proc. 2015-40, IRB 2015-35, 236.

² Rev. Proc. 2006-54, 2006-2 CB 1035.

³ For nontransfer pricing matters, the U.S. Competent Authority is the Director of the Treaty Assistance and Interpretation Team.

⁴ Rev. Proc. 2015-41, IRB 2015-35, 263.

⁵ Rev. Proc. 2015-40, IRB 2015-35, 236, at Section 18.

⁶ *Id.*, at Section 3.02.

⁷ *Id.*, at Section 5.

⁸ *Id.*, at Section 7.02.

⁹ *Id.*, at Section 6.04.

¹⁰ *Id.*, at Section 4.

¹¹ *Id.*, at Section 11.

¹² *Id.*, at Section 3.06(2).

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