

## Preparing for Competent Authority Cases—Strategy

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The docket of **competent authority (CA)** cases, arising under the **Mutual Agreement Article of Organisation for Economic Co-operation and Development (OECD), United Nations or United States Model Income Tax Treaties** is increasing around the world. Many Multinational Enterprises (MNE) have had long experience with the CA process. For others, it can be an interesting new world.

The CA process is a dispute resolution process. But it is far different than what most companies and practitioners are accustomed to in a domestic U.S. process. In the CA world, the MNE and its advisors in essence sit between two tax authorities (at least in bilateral cases) and the task is to bring the authorities to reach agreement that does not result in double taxation or—far worse—litigation on both sides.

We are frequently asked about the strategy that an MNE should develop in considering a CA process. In order to achieve its objectives, an MNE will need to work with its tax authorities (on both sides) to assist in defining the issues to be addressed, and narrowing the range of differences between the tax authorities, so that a CA agreement can be reached in an efficient and effective manner.

This result can often be achieved by facilitating the development of a consensus between the tax authorities as to the following:

1. Agreement on the critical factual and economic matters pertinent to the situation in question, which may include the overall business, functional responsibilities, risk assumption and capacity, economic and financial results reported and achieved, and tax principles pertinent to the situation.
2. Development of a realistic transfer pricing or other technical issue mechanism that can be accepted by both tax authorities, consistent with their respective theoretical principles (such as the comparable profits method approach typically preferred by the Internal Revenue Service), which will produce a legally and economically justifiable level of remuneration for each party to the transfer pricing matter.
3. Exercise care in responding to questions from either or both tax authorities. It is critical to achieve effective resolution of CA matters to provide responses to such questions that consistently tie back to the MNE's strategy for the matters in question. A common problem that we encounter in handling such cases is where an MNE's team responds to such questions without establishing a technical framework and consistent connection of all answers

to that framework. Subsequent responses are then keyed to the framework. If there is response without such consistent tying, a hodge-podge can result, allowing each tax authority to pick and choose (cherry-pick) as they see fit among the various responses in establishing their own factual and technical positions. It is also helpful if the same people prepare responses, reaffirming consistency in approach. If there are multiple rounds of questions, problems in this regard can evolve geometrically if the responses are not handled without such tying or by a variety of different responders.

4. Avoidance of extreme negotiating positions being taken by either tax authority, which generally encourages the taking of similar positions by the other tax authority, ultimately making the process more difficult and time-consuming.
5. Consensus on the appropriateness of resolving the proposed adjustment in a manner that will eliminate the risk of double taxation, consistent with the pertinent treaty.

Each tax authority will be seeking to defend its own tax base and application of its theoretical imperatives, but at the end of the day, the respective tax authorities may take the same essential position as their own taxpayers.

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