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Hong Kong to Introduce a Statutory Transfer Pricing Regime

Subsequent to joining the OECD's inclusive framework under the Base Erosion and Profit Shifting (BEPS) project in June 2016 and publishing the outcome of a consultation on BEPS in July 2017, the Hong Kong SAR government gazetted long-awaited draft legislation Inland Revenue (Amendment) (No. 6) Bill 2017 (Amendment Bill) on 29 December 2017 and introduced the bill to the Legislative Council for a first reading on 10 January 2018.[1]

[1] https://www.legco.gov.hk/yr17-18/english/bills/b201712291.pdf

In addition to the expected introduction of a statutory transfer pricing regime and transfer pricing documentation requirements based on action 13 of the BEPS project, the 162-page Amendment Bill includes measures that will enable Hong Kong to meet the four minimum standards under the OECD's BEPS project,[2] and significantly empower the Inland Revenue Department (IRD) to combat tax avoidance through transfer pricing. If approved, the Amendment Bill generally will become effective from 1 April 2018 (that is, year of assessment 2018/19), except for the country-by-country (CbC) reporting requirement, which will apply from 1 January 2018.

This article highlights the proposed transfer pricing changes in the Amendment Bill and the potential impact on taxpayers.

Statutory transfer pricing rules

Rather than defining the arm's length principle by way of comprehensive provisions, the Amendment Bill indicates that Hong Kong will use the revised OECD transfer pricing guidelines adopted on 10 July 2017, and the 2014 version of the OECD model tax treaty for determining profits attributable to a permanent establishment (PE) of a nonresident.

The Amendment Bill focuses on the circumstances under which the IRD would be empowered to make a tax adjustment, the mechanisms for a taxpayer to request relief from double taxation, and taxpayer obligations. The following proposals are worth noting:

- The IRD would be empowered to adjust a taxpayer's profits upward/losses downward if the taxpayer has entered into transaction(s) with an associated person,3 and the pricing of the transaction(s) differs from transactions between independent persons (that is, the transactions are not on arm's length terms) and the transaction results in a Hong Kong tax advantage.
- The transfer pricing rules would apply to cross-border and domestic transactions, as well as transactions involving tangible and intangible assets, services, financing, and other business arrangements;
- Transactions between different parts of an enterprise (for example, between a head office and its branch/permanent establishment) would be subject to the arm's length requirement.
- The term "Hong Kong tax" would mean tax imposed under the Inland Revenue Ordinance (IRO); thus, in addition to profits tax, the arm's length requirement would apply equally to salaries tax and property tax.
- If a transaction between a Hong Kong taxpayer and an associated person produces offshore-source income, and the associated person is not subject to Hong Kong tax, the IRD would not be empowered to make an adjustment even if the transaction is not on arm's length terms because there would not be a Hong Kong tax advantage.
- There would not be any safe harbor provision for arm's length results, which means that taxpayers generally would have to establish their arm's length position based on one of the five transfer pricing methods (the comparable uncontrolled price method, the resale price method, the cost plus method, the transactional net margin method, and the transactional profit split method) provided under the OECD transfer pricing guidelines.
- If the IRD makes a transfer pricing adjustment under a domestic transaction on an advantaged person,4 the disadvantaged person5 that has income or losses arising from the transaction for Hong Kong tax purposes can request that the IRD make a corresponding adjustment of its income/losses consistent with the adjustment made on the advantaged person. However, the tax impact of a transfer pricing adjustment by the IRD may not be neutralized unless both taxpayers have the same tax profile in the tax year in which the adjustment applies and overall no incremental cash tax is payable.
- Because a tax advantage is defined as a decrease in income or an increase in losses, if two Hong Kong associated persons both have tax losses, the IRD still would be able to make a transfer pricing adjustment to

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[2] The four minimum standards are: (i) countering harmful tax practices (action 5); (ii) preventing tax treaty abuse (action 6); (iii) introducing transfer pricing documentation and country-by country (CbC) reporting requirements; and (iv) improving cross-border tax dispute mechanisms (action 14).
[3] Two persons generally are considered associated when one person directly or indirectly participates in the management, control, or capital of the other person, or a third person participates in the management of both persons.
[4] An advantaged person is the party with a Hong Kong tax advantage conferred under related-party transaction(s) that do not follow the arm's length principle.
[5] A disadvantaged person is the other party to related-party transaction(s) affected by adjustments made by the IRD under the proposed transfer pricing rules.

reduce the losses of the advantaged person whose losses have been increased on the basis that the transactions between the two associated persons do not follow the arm's length principle. Nevertheless, the disadvantaged person should be able to request a corresponding adjustment to increase its tax losses in a manner consistent with the transfer pricing adjustments made by the IRD.

- Specific market value provisions would cover the (i) appropriation of trading stock for non-trade purposes; (ii) non-trading stock reclassified as trading stock; (iii) trading stock disposed of other than in the course of a trade; and (iv) trading stock acquired other than in the course of a trade above, with "stock" defined to include both movable and immovable property.
- The IRD would be empowered to impose penalties not exceeding 100 percent of the amount of tax undercharged resulting from a transfer pricing adjustment, unless it can be demonstrated that reasonable efforts were made to determine the arm's length price for the transaction(s).

Comments

The proposed provisions would significantly empower the IRD to counter tax avoidance arrangements and/or transfer pricing noncompliance with respect to domestic transactions, cross-border related-party transactions, and transactions between a head office and its branch or PE.

However, clarification may be needed on whether the new transfer pricing rules would apply to existing transactions and those entered into on or after 1 April 2018.

Value contribution relating to intellectual property

A new provision specifically would link transfer pricing outcomes to value creation contributions for intellectual property (IP), in particular, activities and/or assets relating to the development, enhancement, maintenance, protection, or exploitation (DEMPE functions/ assets) carried out/deployed by a Hong Kong taxpayer in relation to IP purported to be owned by a non-Hong Kong associate (associated IP owner). In brief, the new provision would deem royalty income and license fees accruing to the associated IP owner but attributable to the DEMPE functions performed and assets deployed in Hong Kong, to be a taxable receipt of the Hong Kong taxpayer.

Comments

This provision primarily would affect taxpayers using non-Hong Kong entities to own IP and receive royalty income and license fees, when most or all the DEMPE functions are carried out and/or assets deployed by an associated Hong Kong resident. In those situations, the IRD would be authorized to impose tax on a portion or all of the royalty income and license fees accruing to the associated IP owner, taking into account the extent of the value contributions made to the IP by the Hong Kong entity. While this provision may appear to be superfluous, because the IRD can make adjustments on non-arm's-length transactions between associated persons, the provision may provide a direct and an alternative means for the IRD to counter tax avoidance arrangements in IP transactions, which is one of the focus areas of the BEPS action plan. Further, if the IRD were to impose a transfer pricing adjustment, it generally should follow the transfer pricing methods under the OECD transfer pricing guidelines, which do not readily offer a revenue split approach.

Transfer pricing documentation

One of the most important changes in the Amendment Bill would be the introduction of the three-tiered transfer pricing documentation requirements (CbC report, master file, and local file), in line with the recommendations in the final report on action 13 of the BEPS project.

CbC report

Hong Kong resident ultimate parent entities (UPE) of multinational enterprises (MNEs) with consolidated revenue of at least HKD 6.8 billion in the previous year ("reportable groups") would be required to prepare and submit a CbC report for accounting periods beginning on or after 1 January 2018, generally in the form of an electronic record with a digital signature. The deadline for submission of the CbC report would be 12 months after the accounting year-end; hence, for a reportable group with an accounting year running from 1 January 2018 to 31 December 2018, a Hong Kong resident UPE would be required to prepare and submit the CbC report to the IRD on or before 31 December 2019. A reportable group with a non-Hong Kong resident UPE also would be able to nominate a Hong Kong constituent entity (CE) as the surrogate parent entity in Hong Kong to file the CbC report in Hong Kong.

The CbC report filing obligation would extend to Hong Kong CEs of a reportable group with a non-Hong Kong resident UPE (that is, secondary filing obligation) in the following cases:

- The non-Hong Kong resident UPE is not required to file the CbC report in the jurisdiction in which it is resident;
- The UPE’s tax jurisdiction does not have an automatic exchange of information arrangement with Hong Kong; or
- There is a systemic failure to exchange the CbC report with the IRD by the tax authorities in the UPE’s jurisdiction.

Nevertheless, Hong Kong CEs could be exempt from filing the CbC report if a nonresident surrogate parent entity of the reportable group filed the report in another tax jurisdiction that has the necessary exchange mechanism in place with Hong Kong.

Hong Kong allows for voluntary CbC report filing as a transitional arrangement for accounting periods commencing between 1 January 2016 and 31 December 2017.

The Amendment Bill proposes to use the Multilateral Convention on Mutual Administrative Assistance in Tax Matters (the Multilateral Convention) as the main platform for exchanging CbC reports with other jurisdictions.[6]

In addition to the CbC report preparation and filing obligations, the UPE or the surrogate parent entity in Hong Kong of a reportable group would have to file a written notice with the IRD within three months after the end of a reporting period (*e.g.* a notification deadline of 31 March 2019 for a reportable group with an accounting year-end on 31 December 2018), setting out the relevant details of the entity that would be filing the CbC report. In the case of a secondary filing obligation, to relieve taxpayers from the burden of multiple filing obligations amongst different Hong Kong CEs of a reportable group, a Hong Kong entity would not be required to file a notification if another Hong Kong CE of the group filed a valid notice to the IRD by the notification deadline.

Penalties could be imposed on reporting entities and service providers engaged by a reporting entity to carry out CbC report filing for offences such as failure to file the report or notification; providing misleading, false or inaccurate information; or omitting information in the CbC report.

Master and local files

All enterprises that carry on a trade or business in Hong Kong and that are engaged in transactions with associated enterprises would be required to prepare master and local files for accounting periods beginning on or after 1 April 2018, unless they qualify for either of the following exemptions:

Exemption based on the size of business: An enterprise that satisfies two of the following three conditions would not be required to prepare a master file or a local file:

1. Total annual revenue not exceeding HKD 200 million;
2. Total assets not exceeding HKD 200 million; and
3. Employs on average no more than 100 employees.

Exemption based on related-party transactions: If the amount of a category of related-party transactions for the relevant accounting period is below the proposed threshold, an enterprise would not be required to prepare a local file for that category of transaction:

1. Transfers of property (other than financial assets and intangibles): HKD 220 million;
2. Transactions of financial assets: HKD110 million;

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[6] The Chinese government, in principle, has granted approval for extending the application of the Multilateral Convention to Hong Kong. A separate amendment bill was gazetted in October 2017 that would empower the Hong Kong Chief Executive in Council to give effect to the Multilateral Convention.

3. Transfers of intangibles: HKD 110 million; and
4. Any other transactions (*e.g.*, services and royalty income): HKD 44 million.

If an enterprise is fully exempt from preparing a local file (that is, its related-party transactions in all categories are below the prescribed thresholds), it would not have to prepare a master file either.

The local file obligation would apply to each individual taxpayer, whereas the master file obligation would apply to the group to which the taxpayer belongs. Hence, while there may be multiple companies within a group obligated to prepare their own local files, each group would have to prepare only one master file, and all other companies within the group would be able to share that master file. The local file would have to be prepared within six months after the end of each accounting period of the entity, whereas the master file would have to be prepared within six months of the corresponding accounting period of the group.

The content requirement for the master file and the local file is consistent with the recommendations in the final report on BEPS action 13, and the filing requirement would apply for accounting periods starting on or after 1 April 2018 (year of assessment 2018/19).

Comments

The proposed documentation rules would result in significantly increased obligations and compliance costs for taxpayers that do not satisfy the exemption criteria. However, these changes are necessary to bring Hong Kong closer to the international standards on transfer pricing rules and related enforcement. Although documentation would not be due until sometime in 2019, potentially affected taxpayers should seek professional assistance on how to prepare for the new compliance obligations, including how to identify intragroup transactions that would be subject to the documentation requirements, and to commission necessary benchmarking studies to establish relevant arm's length prices. Taxpayers should take into account that arm's length pricing would have to exist for more than just transactions subject to the documentation requirements, because the IRD will not confine transfer pricing adjustments to such transactions.

Advance pricing arrangement regime

The existing advance pricing arrangement (APA) regime introduced in March 2012 is provided under IRD Department Interpretation and Practice Notes (DIPN) No. 48, which is not legally binding. Due to the relatively small size of the IRD's competent authority team, and the unavailability of unilateral APAs, only a few APAs have been concluded by the Hong Kong IRD to date.

In anticipation of a rising demand for APAs in the BEPS era and under the new transfer pricing rules, the Amendment Bill proposes to codify the APA regime and to allow unilateral APAs, as well as bilateral and multilateral APAs. The Amendment Bill would grant the Commissioner the power to revoke, cancel, or revise an already concluded APA, but this power would be restricted to cases where (i) critical assumptions are not met; (ii) the applicant fails to comply with its obligations; or (iii) the applicant makes an incorrect statement, provides incorrect information, or omits a statement or fails to provide information, and the misstatement is material.

The Commissioner also would be allowed to charge fees for an APA based on the hourly rates of the IRD officers involved in the APA process.

Comments

The extension of the APA regime to allow for unilateral APAs will be welcomed by taxpayers. Clarification is needed, however, on the thresholds and the period covered for APA applications, because it is not clear whether they would remain the same as those provided under DIPN 48.

Mutual agreement procedure and foreign tax credits

With a view to putting in place a full-fledged statutory mechanism to ensure timely, effective, and efficient resolution of cross-border tax disputes, as intended under Hong Kong's comprehensive double taxation arrangements (DTAs), the Amendment Bill proposes the following changes:

- Claims for a foreign tax credit;
- Extending the period for claiming a tax credit to the later of six years after the end of the relevant year of assessment and six months after the relevant assessment is issued from the current two years;
- Requiring a taxpayer to take steps to minimize its foreign tax liability by making full use of all other available relief under the DTA and the local legislation of foreign jurisdictions before resorting to tax credits; and
- Requiring taxpayers to notify the IRD of any adjustment to their foreign tax payments that could result in an excessive tax credit being granted within three months after such adjustment, so that the IRD could make additional assessments, if necessary, to account for the excessive tax relief granted within the prescribed time limit.
- The IRD would be required to give effect to solutions and agreements reached in a mutual agreement procedure (MAP) despite any time limit provided under the IRO. This essentially would mean that, once a taxpayer files a MAP application under an applicable DTA, a solution reached under the MAP would not be subject to the statute of limitations in the IRO; and
- The use of arbitration to resolve MAP deadlocks, thereby enhancing the means for taxpayers to obtain double taxation relief, subject to the availability of an arbitration clause in the relevant DTA.

The Amendment Bill signifies Hong Kong's determination to step up transfer pricing enforcement in the BEPS era. Taxpayers should review their related-party transactions to understand the arm's length requirements and potential implications, and seek professional advice if necessary, to begin scoping and benchmarking transactions subject to the transfer pricing documentation requirements and ensure compliance with the new rules.

Due to the complexity of the proposed rules, the IRD is likely to issue/update DIPNs to provide additional guidance.[7]

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Transfer pricing implications of India's Union Budget 2018

India's finance minister on 1 February presented the Union Budget 2018. The budget includes proposals that would clarify India's rules for the implementation of country-by-country (CbC) reporting.

Background

For past few years, the Organisation for Economic Co-operation and Development [OECD] and G20 countries have actively engaged in the base erosion and profit shifting [BEPS] project. The G20 and OECD released their recommendations on 15 BEPS actions on 5 October 2015.

As a member of the G20 and an active participant in the BEPS project, India is committed to the BEPS project. To implement the BEPS actions, India has been amending its domestic tax law as well as its tax treaties.

The BEPS-related transfer pricing amendments proposed in the Union Budget 2018 are discussed below.

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[7] The Amendment Bill includes provisions on other tax matters not related to transfer pricing, such as revising requirements relating to profits tax concessions and providing a definition of a PE and profits of Hong Kong branch offices, etc. These provisions will be addressed in a future tax analysis.

Country-by-country reporting

As an active participant in the BEPS initiative, India was among the jurisdictions that introduced the three-tiered transfer pricing documentation requirements recommended by the OECD's final report on BEPS Action 13.

In May 2016, India introduced core elements of the country-by-country (CbC) reporting requirement and the concept of master file in the Income Tax Act through Finance Act 2016, effective 1 April 2016. Recently, the Indian government released the final rules on CbC reporting and the master file requirement in India.

Certain provisions of the Indian CbC reporting requirements were not aligned with the BEPS Action 13 recommendations. For example, the OECD recommends that the CbC report be filed within 12 months from the end of the reporting accounting year, whereas India requires filing the CbC report by the due date of filing of the income tax return. Additionally, various clarifications were required on aspects such as applicability and definition of the term agreement.

The Finance Bill 2018-19 has now proposed certain amendments to the CbC reporting provisions under Section 286, to align with the OECD BEPS Action 13 recommendations. These amendments are analyzed below.

For Indian-headquartered international groups

A parent entity resident in India will be required to file the CBC report in India by the extended due date of 12 months from the end of the reporting accounting year, rather than by the due date for filing the income tax return.

The due date was already extended to 31 March 2018 for financial year 2016-17, now applicable for all years going forward.

The master file due date continues to be the due date for filing the income tax return – 30 November.

For overseas-headquartered international groups

An additional condition has been introduced that mandates Indian constituent entities of overseas-headquartered groups to file their CbC reports in India, when the parent has no obligation to file the CbC report in its jurisdiction.

Under the original provisions of sec 286(4), an Indian filing requirement was not triggered if there existed either an agreement referred to in section 90 (1) or 90A (1), between India and the parent's jurisdiction, or a notified agreement for the exchange of CbC reports. The budget proposed to amend the definition of "agreement" to include a combination of both, an agreement such as a bilateral income tax treaty and an agreement for the exchange of CbC report notified by the central government.

The due date for furnishing the CbC report has been changed to 12 months from the end of the reporting accounting year, compared to the earlier income tax return filing due date.

The master file due date continues to be the due date for filing the income tax return – 30 November.

When an Indian constituent entity is required to file the CbC report in India and the group has appointed an "alternate reporting entity" (ARE), in addition to satisfying the specified conditions, the ARE was required to file the CBC report in its jurisdiction before the India due date to avoid a secondary filing obligation in India. It has now been clarified that if the ARE files the CbC report before the due date prescribed in its own jurisdiction, it would not be required to file the CbC report in India.

The proposed amendments reflect a positive move showing India's intent to align the Indian requirements with BEPS Action 13 and global standards. These proposed amendments have been regarded as clarificatory in nature, though a few of them are essentially retroactive amendments resulting in changes to the law (on applicability, compliance, etc). Thus, these amendments could create new ambiguities for taxpayers.

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International tax implications of US tax reform

Congress has approved and President Trump has signed into law a massive tax reform package that lowers tax rates on corporations, passthrough entities, individuals, and estates, and moves the United States toward a participation exemption-style system for taxing foreign-source income of domestic multinational corporations, with some of the cost of that tax relief offset by provisions that scale back or eliminate many longstanding deductions, credits, and incentives for businesses and individuals. The unoffset costs – roughly $1.46 trillion for the 10-year budget window covering 2018 – 2027, according to a revenue estimate from the Joint Committee on Taxation (JCT) staff – will be added to the deficit.

The legislation was approved in the House of Representatives and the Senate on December 20, 2017. As expected, the floor votes in both chambers were a partisan exercise. House and Senate Democrats remained in lockstep against the legislation, but Republicans mustered enough votes from within their own ranks to ensure success.

The president signed the measure into law on December 22, 2017.

Overview

The newly enacted law, officially known as An Act to provide for reconciliation pursuant to titles II and V of the concurrent resolution on the budget for fiscal year 2018 (the Act), is an amalgam of two competing tax reform measures – one approved in the House on November 16, 2017, and the other approved in the Senate on December 2, 2017 – although in some significant ways it tracks more closely with the Senate bill.

The new law makes significant changes to the taxation of corporations, passthroughs, individuals, and estates. In terms of international taxation, the Act moves the United States from a worldwide tax system to a participation exemption system by giving corporations a 100 percent dividends received deduction for dividends distributed by a controlled foreign corporation (CFC). To transition to that new system, the Act imposes a one-time deemed repatriation tax, payable over eight years, on unremitted earnings and profits at a rate of 8 percent for illiquid assets and 15.5 percent for cash and cash equivalents.

The Act generally follows the Senate-passed structure in establishing new base erosion prevention provisions, with modifications. It does not adopt proposals in the House and Senate bills that would have made permanent the lookthrough rules for CFCs under section 954(c)(6); nor does it include a proposed new section 163(n) that would have placed a further limit on interest deductions of multinational corporations by measuring US interest expense and equity against the similar ratios for the worldwide group.

A more detailed discussion of the Act’s international tax provisions follows.

International Tax Issues

Transition to territoriality

Dividends received deduction: The Act provides for a 100 percent dividends received deduction for the foreign-source portion of dividends received from specified 10-percent-owned foreign corporations by domestic corporations that are US shareholders. For this purpose, an amount received by a domestic corporation that is treated as a dividend under section 1248 is treated as a dividend for purposes of the DRD (provided the holding period requirements are satisfied). In addition, if the gain is recognized by a lower-tier CFC and characterized as a dividend under section 964(e), then such amount is included in subpart F income for the year of the sale but the US shareholder can claim a DRD with respect to such amount.

No foreign tax credit or deduction is allowed for taxes paid or accrued with respect to such dividend that qualifies for the DRD.

In addition, consistent with the Senate legislation, the bill provides: (1) a limitation on the DRD for any dividend received if the foreign corporation receives a deduction (or other tax benefit) from taxes imposed by a foreign country (hybrid dividend) and (2) an expanded holding period requirement.

Finally, the conference committee explanation provides that any hybrid dividend received by a CFC is treated as subpart F income for the taxable year such dividend was received.

Limitation on losses with respect to 10-percent-owned foreign corporations:

The basis in foreign corporations with respect to which the dividends received deduction applies is reduced by the amount of any such dividend, but only for purposes of computing loss on the sale or exchange of that stock.

Taxation of deferred foreign income upon transition: Consistent with the House bill and the Senate bill, a US shareholder of a foreign corporation must include in income for the subsidiary's last tax year beginning before January 1, 2018, the shareholder's pro rata share of undistributed and previously untaxed post-1986 foreign earnings. Earnings and profits (E&P) is only taken into account to the extent it was accumulated during periods when the foreign corporation was a CFC or was a non-CFC foreign corporation that had at least one domestic corporation as its US shareholder.

The amount of such E&P is the greater of the amounts determined as of November 2, 2017, or December 31, 2017, unreduced by dividends (other than dividends to other specified foreign corporations) during the taxable year to which the provision applies.

The mandatory inclusion generally may be reduced by foreign earnings and profits deficits (including hovering deficits) that are properly allocable to that person. In addition, unlike the Senate bill, the mandatory inclusion may be reduced by the pro rata share of deficits of another US shareholder that is a member of the same affiliated group.

For purposes of this provision, the E&P is classified as either E&P that has been retained in the form of cash or cash equivalents, or E&P that has been reinvested in the foreign subsidiary's business (for example, property, plant, and equipment). The portion of the E&P comprising cash or cash equivalents is taxed at a reduced rate of 15.5 percent, while any remaining E&P is taxed at a reduced rate of 8 percent.

Rules will be provided to avoid the double counting of cash assets. In addition, the Act grants regulatory authority to the Treasury to issue regulations to prevent the avoidance of the rules, including through a reduction of earnings and profits, through changes in entity classification, or accounting methods, or otherwise.

Limitation on assessment extended: Consistent with the Senate bill, the Act extends the assessment statute of limitations for taxpayers reporting a mandatory inclusion. The assessment statute of limitations is generally extended to six years from the date upon which the return was filed that initially reflects the mandatory inclusion.

Special rules for expatriated entities: Consistent with the Senate bill, the enacted legislation increases the rate of tax imposed on the deferred earnings of a specified foreign corporation if within 10 years of the date of enactment, the US shareholder of such corporation engages in an "inversion transaction" subject to section 7874.

Other provisions: In addition, the legislation provides: (1) that foreign tax credit carryforwards are fully available, and foreign tax credits triggered by the deemed repatriation are partially available, to offset the US tax; (2) that at the election of the US shareholder, the tax liability would be payable over a period of up to eight years; (3) special rules that would apply with respect to S corporations and their shareholders, as well as REITs; and (4) an election not to apply any net operating loss deduction against the amount taken into account under the transition tax rules.

Rules related to passive and mobile income

Global intangible low-taxed income: The enacted legislation largely adopts, with modifications, provisions in the Senate bill designed to tax currently global intangible low-taxed income (GILTI). Under the provision, a US shareholder is required to include in gross income the amount of its GILTI. However, the US shareholder is allowed a deduction equal to 50 percent of the GILTI and the amount treated as a dividend by reason of the US shareholder claiming a foreign tax credit as a result of the inclusion of the GILTI amount in income ("section 78 gross up").

GILTI is the excess of the shareholder's net tested income over the deemed tangible income return, which is defined as the excess of 10 percent of the shareholder's basis in tangible property used to produce tested income less the amount of interest expense allocated to net tested income. The reduction of this amount by allocated interest expense is a change from the original Senate bill and more closely follows an approach adopted by the House Ways and Means Committee with respect to their proposal.

Tested income for this purpose is the gross income of the corporation determined without regard to the following exceptions: (1) the corporation's effectively connected income under section 952(b); (2) any gross income taken into account in determining the corporation's subpart F income; (3) any gross income excluded from foreign base company income or insurance income by reason of the high-tax exception under section 954(b)(4); (4) any dividend received from a related person (as defined in section 954(d)(3)); and (5) any foreign oil and gas extraction income and foreign oil related income, over deductions (including taxes) properly allocable to such gross income under rules similar to the rules of section 954(b)(5).

Consistent with the Senate bill, the amount of GILTI included by a US shareholder is allocated across all of such shareholder's CFCs, based on each CFC's proportionate share of tested income. In addition, the shareholder can claim a foreign tax credit for 80 percent of the taxes paid or accrued with respect to the tested income of each CFC from which the shareholder has an inclusion.

Deduction for foreign-derived intangible income: In addition to the immediate inclusion of GILTI, the Act allows a domestic corporation a deduction for 37.5 percent of the foreign-derived intangible income and a 50 percent deduction of the GILTI plus the section 78 gross up, as discussed above. These deductions are reduced to 21.875 percent and 37.5 percent, respectively, in taxable years beginning after December 31, 2025.

Foreign-derived intangible income is an amount equal to the corporation's deemed intangible income multiplied by an amount equal to the corporation's foreign-derived, deduction-eligible income over its total deduction-eligible income.

Deduction-eligible income is the gross income of the corporation determined without regard to: (1) the subpart F income of the corporation under section 951; the GILTI of the corporation; (3) financial services income; (4) any dividend received from a CFC with respect to which the corporation is a US shareholder; (5) any domestic oil and gas income of the corporation; and (6) any foreign branch income (as defined in section 904(d)(2)(J)) of the corporation, over the deductions (including taxes) properly allocable to such gross income.

Deemed intangible income is the excess of a corporation's deduction-eligible income over 10 percent of the basis in its tangible depreciable property used to produce deduction-eligible income.

Foreign-derived, deduction-eligible income means with respect to a taxpayer for its taxable year, any deduction-eligible income of the taxpayer that is derived in connection with (1) property that is sold by the taxpayer to any person who is not a US person and that the taxpayer establishes to the satisfaction of the Secretary is for a foreign use, or (2) services provided by the taxpayer that the taxpayer establishes to the satisfaction of the Secretary are provided to any person, or with respect to property, not located within the United States. For this purpose, the terms sold, sells, and sale include any lease, license, exchange, or other disposition of property.

Unlike the Senate bill, the Act does not provide a rule presumably intended to incentivize the onshoring of intangible property, by providing that if a CFC holds intangible property on the date of enactment, the fair market value of the property on the date of any distribution is treated as not exceeding its adjusted basis.

Treatment of hybrid transactions

The Act includes the provision from the Senate bill that would deny the deduction for any disqualified related- party amount paid pursuant to a hybrid transaction or by or to a hybrid payment. A disqualified related-party amount is any interest or royalty paid or accrued to a related party to the extent that: (1) there is no corresponding inclusion to the related party under the tax law of the country of which such related party is a resident for tax purposes, or (2) such related party is allowed a deduction with respect to such amount under the tax law of such country.

A hybrid transaction is any transaction, series of transactions, agreement, or instrument one or more payments with respect to which are treated as interest or royalties for federal income tax purposes and which are not so treated for purposes of the tax law of the foreign country of which the recipient of such payment is resident for tax purposes or is subject to tax.

A hybrid entity is any entity that is either: (1) treated as fiscally transparent for federal income tax purposes but not so treated for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or is subject to tax, or (2) treated as fiscally transparent for purposes of the tax law of the foreign country of which the entity is resident for tax purposes or is subject to tax but not so treated for federal income tax purposes.

Base erosion proposals

The Act adopts the Senate bill's provisions related to base eroding payments, with certain modifications. Accordingly, a corporation (other than a RIC, REIT or S corporation) with excess base erosion payments for the taxable year must pay a tax equal to the excess of 10 percent (5 percent for taxable years beginning in 2018) of its taxable income (determined without regard to deductions attributable to base erosion payments) over its regular tax liability reduced by the excess of credits allowed under Chapter 1 against the regular tax liability over the sum of the R&D credit plus 80 percent of the sum of the low-income housing credit, the renewable electricity production credit determined under section 45(a), and the energy property investment credit determined under section 48.

For purposes of this provision, a base erosion payment generally means any amount paid or accrued by a taxpayer to a foreign person that is a related party of the taxpayer and with respect to which a deduction is allowable, including any amount paid or accrued by the taxpayer to the related party in connection with the acquisition by the taxpayer from the related party of property of a character subject to the allowance of depreciation (or amortization in lieu of depreciation). A base erosion payment also includes any amount that constitutes reductions in gross receipts of the taxpayer that is paid to or accrued by the taxpayer with respect to: (1) a surrogate foreign corporation which is a related party of the taxpayer, but only if such person became a surrogate foreign corporation after November 9, 2017, and (2) a foreign person that is a member of the same expanded affiliated group as the surrogate foreign corporation. A surrogate foreign corporation has the meaning given in section 7874(a)(2).

A base erosion payment does not include: (1) any amount paid or accrued for services if such services meet the requirements for eligibility of the services cost method in Treas. Reg. sec. 1.482-9, without regard to certain requirements of that section and provided the payments are made without a mark-up, and (2) a "qualified derivative payment." In addition, a corporation is not subject to the provision if it has average annual gross receipts for the three-taxable-year period ending with the preceding taxable year of less than $500 million or its base erosion percentage is less than 3 percent. (The term base erosion percentage means for any taxable year, the percentage determined by dividing the aggregate amount of deductions attributable to base eroding payments by the total amount of all deductions allowable to the taxpayer during the taxable year, without regard to deductions under sections 172, 245A or 250, any deduction for services which are not treated as base eroding payments, and any deduction for qualified derivative payments. In the case of a bank or registered securities dealer, the 3 percent base erosion percentage threshold is lowered to 2 percent.)

Information reporting requirement: The Act provides for increased information reporting under sections 6038A and 6038C to require certain taxpayers subject to the new base erosion provisions to report information such as base erosion payments, information for determining the base erosion minimum tax, and other information deemed necessary by the Secretary of the Treasury. In addition, it increases the penalty from $10,000 to $25,000 for failure to comply with section 6038A and increases the penalty for failure to comply within 90 days after IRS notification to $25,000 for each 30-day period thereafter.

Interest expense limitation

Section 163(j): The general limitation on interest deductibility contained in section 163(j) is modified and generally follows the proposal included in the Senate bill. Details on this provision are included in the discussion of corporate tax issues elsewhere in this report.

Section 163(n): The provisions that were originally included in both the House and Senate bills addressing interest expense incurred by domestic corporations that are members of an international group were not included in the enacted legislation.

Other international provisions

Codification of Rev Rul. 91-32: The bill adopts the Senate proposal with respect to Rev. Rul. 91-32. Accordingly, gain or loss from the sale or exchange of a partnership interest is effectively connected with a US trade or business to the extent that the transferor would have had effectively connected gain or loss had the partnership sold all of its assets at fair market value as of the date of the sale or exchange. The Act requires that any gain or loss from the hypothetical asset sale by the partnership be allocated. In addition, the transferee of a partnership interest is required to withhold 10 percent of the amount realized on the sale or exchange of a partnership interest unless the transferor certifies that the transferor is not a nonresident alien individual or foreign corporation.

Although the provision applies to sales or exchanges on or after November 27, 2017, the portion imposing the withholding tax obligation applies to sales or exchanges occurring after December 31, 2017. The Treasury Department and IRS, however, announced in Notice 2018-08 (released December 29, 2017) that withholding is suspended pending the issuance of further guidance.

In addition, the Act includes provisions to:

- Modify the definition of a US shareholder to include any US person who owns 10 percent or more of the total value of the foreign corporation (as opposed to vote);
- Modify the definition of section 936(h)(3)(B) to include workforce in place, goodwill, and going concern value;
- Impose a limitation on claiming lower rates on dividends from certain corporations subject to section 7874;
- Impose a separate foreign tax credit limitation category for branch income;
- Repeal the fair market value method for allocating interest expense;
- Eliminate foreign base company oil-related income as a category of subpart F income;
- Provide for an inflation adjustment to the *de minimis* rule;
- Repeal subpart F inclusions based on the withdrawal of previously excluded subpart F income invested in foreign base company shipping operations;
- Eliminate the limitation on attribution of stock from a foreign person to a US shareholder;
- Eliminate the requirement that a foreign corporation must be a CFC for an uninterrupted period of 30 days for subpart F to apply;
- Repeal the section 902 credit and application of the section 960 credit on a current-year basis; and
- Change the source rules for the sale of inventory property.

Finally, and unlike the prior versions of the bill, the Act does not repeal section 956, does not make permanent section 954(c)(6), and does not accelerate the election to allocate interest expense on a worldwide basis.

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Indonesia releases implementation regulation on country-by-country reports

Indonesia's Directorate General of Taxes (DGT) has issued a long-awaited implementation regulation on country-by-country reports (CbCRs).

DGT Regulation No. 29/PJ/2017 (PER-29) regarding "Procedures for the Management of CbCR," follows the release of the CbC reporting requirements in early 2017 through Minister of Finance (MoF) Regulation No. 213/PMK.03/2016 (PMK-213).

Both PMK-213 and PER-29 broadly align with the reporting requirements and implementing guidelines prescribed by the Organisation for Economic Co-operation and Development (OECD) through action 13 of the base erosion and profit shifting (BEPS) project and subsequent guidance issued by the OECD for the purpose of implementation of CbC reporting.

PER-29 provides detailed guidance broadly on the following matters:

1. Which business groups/multinational business groups are required to file the CbC report in Indonesia;
2. What is required to be prepared and submitted as part of CbC report filing; and
3. Timing for preparation and filing of the CbC report in Indonesia.

PER-29 is effective from 29 December 2017 and covers the Indonesian CbC report filing requirement from fiscal year 2016 onwards. The key points of PER-29, and insights on the Indonesian CbC reporting requirements for taxpayers in Indonesia are summarized below.

Which Business Groups/Multinational Business Groups are required to file a CbC report in Indonesia?

Consistent with PMK-213, any local taxpayer that meets the following criteria will be required to prepare and submit a CbCR in Indonesia:

- A parent entity[8] of a business group with consolidated gross revenue of at least IDR 11 trillion (the "primary filing mechanism"). Under the primary filing mechanism, PER-29 clarifies, the option of surrogate filing is not available for a local taxpayer that is the parent entity of a business group. This indicates that the local parent entity should prepare and submit a CbCR in Indonesia, because it cannot appoint another entity in Indonesia or in an overseas jurisdiction to meet the former's CbC reporting obligation.

Or

A constituent entity[9] whose parent entity is located in a foreign jurisdiction, and the country of the parent entity:

- Does not require the filing of CbCR; or
- Does not have an agreement with the government of Indonesia on the exchange of information under a Qualifying Competent Authority Agreement (QCAA)[10]; or
- Has an agreement but the CbCR cannot be obtained by the government of Indonesia

(The "secondary filing mechanism"). In the case of the secondary filing mechanism, PER-29 limits the CbCR filing requirements only to those local taxpayers if certain specific criteria of parent and constituent entity are met. The criteria are provided in the table below:

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[8] A "parent entity" is a member of a business group that is (a) not directly or indirectly owned by one or more other members in the business group, or (b) owned directly or indirectly by another entity but the latter is not obligated to prepare consolidated financial statements for that parent entity.
[9] A "constituent entity" is the parent entity and the member(s) of a business group covered in the CbCR
[10] An agreement between the competent authority (CA) of the government of Indonesia and the CA of the partner country/jurisdiction that requires the automatic exchange of CbCR between the parties.

Criteria for Parent Entity	Criteria for Constituent Entity
A parent entity having consolidated gross turnover in the relevant fiscal year (based on the consolidated financial report) of at least: 1. Equal to EUR 750 million (according to the functional currency exchange rate of the parent entity as of 1 January 2015) if the parent entity's country/jurisdiction does not require the filing of CbCR); or 2. The threshold of the consolidated gross turnover set by the jurisdiction where the parent entity is located that serves as the basis for determining the requirement to submit CbCR.	1. Every separate business entity that is a member of a multinational business group and is included in the consolidated financial statements of the parent entity or is excluded merely due to business scale or materiality considerations; and/or 2. Every permanent establishment of the business entity above having separate financial statements.

PER-29 further provides an exemption to a local taxpayer with an overseas parent entity to file CbCR in Indonesia under the secondary filing mechanism, if the parent entity assigns a surrogate parent entity[11] and fulfils the following conditions:

1. The local taxpayer submits a notification regarding the surrogate parent entity to the DGT; and
2. The country/ jurisdiction in which the surrogate parent entity is domiciled:
   a. Requires the filing of CbCR; and
   b. Has a QCAA and the CbCR can be obtained by the government of Indonesia.

As an example of the above, if the parent entity is resident in the United States but nominates a subsidiary in a country meeting the conditions, such as the United Kingdom (UK), to file the multinational business group's CbCR in the UK, then the local taxpayer would not be required to file the CbCR in Indonesia.

What is required to be prepared and submitted as part of CbCR filing?

PER-29 introduces a notification filing requirement through a CbCR notification form.[12] The form generally requires the local taxpayer to provide a statement on whether it has the obligation to submit a CbCR. The table below summarizes the type of documents that must be filed by each of the business groups/multinational business groups.

Entity	Documents
An Indonesian parent entity of a business group that must submit a CbCR in Indonesia	• Notification form • CbCR • Working paper of the CbCR (referring to Appendix E of PMK-213)
An Indonesian constituent entity (when the parent entity is located in a foreign jurisdiction) that does not have to submit a CbCR in Indonesia	• Notification form
An Indonesian constituent entity (when the surrogate parent entity is located in a foreign jurisdiction) that does not have to submit a CbCR in Indonesia	• Notification form
An Indonesian constituent entity (when the parent entity is located in a foreign jurisdiction) that must submit a CbCR in Indonesia	• Notification form • CbCR
An Indonesian taxpayer that has related-party transactions but that is not required to file CbCR in Indonesia	• Notification form

[11] When a parent entity that is a foreign tax subject has appointed a foreign constituent entity as a substitute of the parent entity.
[12] The format for such notification has been provided as an attachment to the regulation.

PER-29 has clarified that only an Indonesian parent entity of a business group has to submit the working paper of the CbCR.

The above documents should be submitted via DJP Online (DGT's official website) or manually, if DJP Online cannot be used. PER-29 also stipulates that submission should typically be made electronically, using Extensible Mark-up Language (XML) file extension that the OECD has recommended as part of BEPS Action 13 for exchanging the information between tax authorities, as well as to receive information from the reporting multinational business groups.

Upon the filing of the notification and/or the CbCR, the taxpayer will receive a receipt, which must be attached to the annual corporate income tax return. The receipt of the CbCR submission may be attached to the income tax return as a substitute of the CbCR. Thus, the CbCR itself does not need to be attached to the income tax return.

Timing for preparation and filing of the CbCR

The CbCR must be available within 12 months after the end of the fiscal year of the local taxpayer. Both the notification form as well as the CbCR (along with the working paper, when required) should be filed simultaneously within the following period:

- 16 months after the end of the fiscal year for FY 2016; and
- 12 months after the end of the fiscal year for FY 2017 and thereafter.

PER-29 mentions that the obligation to file the CbCR in Indonesia should be based on the parent entity's fiscal year starting in 2016.

PER-29 also notes that in cases where the government of Indonesia cannot obtain the CbCR, the local taxpayer must submit the CbCR within three months after the DGT's announcement (in its website) of the list of countries/jurisdictions with which the DGT has a QCAA but the CbCR cannot be obtained. If the local taxpayer fails to submit the CbCR within the three-month period, the DGT will issue a formal request letter, with a filing deadline of 30 days from the date of the letter.

Other considerations

Penalties: PER-29 does not specifically clarify the penalties or consequences that may arise in case of a failure to submit the CbCR within the required time frame. However, not attaching the required receipt for filing the notification form and/or the CbCR to the income tax return may cause the return to be considered incomplete, and the taxpayer may be subject to a fine of IDR 1,000,000 up to 50 percent of any unpaid tax.

CbCR exchange under QCAAs: Indonesia has so far signed QCAAs with 46 countries, based on the December 2017 update of the activated exchange relationships. So far, 68 countries have signed the OECD's Multilateral Competent Authority Agreement on the Exchange of CbCR (MCAA).13 However, it should be noted that for certain countries (such as Singapore and Brazil) the exchange of CbCR is effective only for taxable years starting on or after 1 January 2017, or even 1 January 2018 (for Malaysia and Switzerland, for example). Under such circumstances, the OECD recommends that the parent entity of a multinational business group resident in that jurisdiction should be allowed to voluntarily file its CbCR for the fiscal periods commencing on or after 1 January 2016 in its jurisdiction of tax residence. This would help to meet the timeline to file CbCR in the local country jurisdiction imposing local filing under the secondary filing mechanism. However, PER-29 makes no such reference. Accordingly, the local taxpayer should discuss with its parent entity the latter's filing status and requirement.

In other cases, there could also arise a timing issue in terms of the taxable year-end between the parent entity and the local taxpayer for the purpose of filing CbCR in Indonesia. PER-29 has not provided any guidance on the local filing obligations that may arise during such a period, or provided any transition relief to address this issue.

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[13] Based on the OECD's website http://www.oecd.org/tax/beps/country-by-country-exchange-relationships.htm (on Country-by-Country exchange relationships)

Further, PER-29 does not provide any flexibility regarding the date for filing the notification requirement, as recommended by the OECD in its implementing guidelines on CbCR.

CbCR exchange with US: The US has not signed the OECD's MCAA and to date, has not entered into a bilateral competent authority agreement with Indonesia for purpose of exchanging CbCR[14]. Accordingly, all US based Multinational Business Groups with subsidiaries in Indonesia may be required to file the CbCR under the Secondary Filing Mechanism or appoint a Surrogate Parent Entity which fulfils the conditions (mentioned above) for not having to file the CbCR in Indonesia.

Conclusion

The issuance of PER-29 reflects the DGT's continuing efforts to bring clarity regarding the new transfer pricing rules set forth by the OECD through action 13 of the BEPS project. The release of this regulation by the DGT was anticipated, and it is much-needed guidance considering the impending deadline to meet the compliance requirement for CbCR filing.

When an overseas parent entity exceeds the threshold of EUR750 million and operates in a jurisdiction that is not a party to the MCAA, it is not known whether the exchange can still occur under bilateral agreements, including Indonesia's tax treaties and tax information exchange agreements. Accordingly, multinational business group should prepare to file their CbCRs in Indonesia by the 16-month deadline for FY2016. Alternatively, they could appoint a surrogate parent entity to file in another jurisdiction (that has entered into a QCAA with Indonesia) to obtain an exemption from having to file the CbCR in Indonesia.

Based on the conditions set forth in this regulation, it is amply evident that Indonesia is committed to the OECD's BEPS project. This new regulation on the implementation of CbCR lays out a clear path for local taxpayers to understand the compliance requirements in regard to CbCR filing. Considering that the first CbCR filings for financial year 2016 will start to be due in April 2018, it is imperative for taxpayers to be proactive in ensuring that compliance requirements are met, and to coordinate efficiently with the responsible parties within the business group/multinational business group to collate and prepare the necessary information.

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Brazil's CbC reporting requirements for exchange relationships activated after 2017

A Brazilian constituent entity (BCE) that designated its foreign ultimate parent entity (UPE) as the country-by-country (CbC) reporting entity when filing its 2016 income tax return may be required to amend the return to file a CbC report within 60 days of 31 December 2017, if the relevant bilateral exchange relationship with the UPE's country of residence was not activated by 31 December 2017 (or is not effective for taxable periods beginning on or after 1 January 2016).

Background

The Brazilian tax authorities introduced CbC reporting obligations in Brazil effective for FY 2016 (the 2016 calendar year) through Normative Ruling (NR) 1,681/2016, issued on 29 December 2016. The rules provided that a BCE would be required to file a CbC report with its 2016 corporate income tax return (as a surrogate entity) if a competent authority agreement (CAA) for the exchange of CbC reports had not been concluded between Brazil and the country where the UPE is resident by the due date for the 2016 tax return (31 July 2017).

[14] Based on the latest update provided in the US Internal Revenue Service (IRS) website (last updated as on 12 January 2018) https://www.irs.gov/businesses/country-by-country-reporting-jurisdiction-status-table

NR 1,681/2016 was amended on 25 May 2017 to allow a BCE to designate its foreign UPE as the reporting entity for FY 2016 on a conditional basis in cases where, for FY 2016, the UPE jurisdiction does not have a CAA in force with Brazil but the UPE jurisdiction allows for the voluntary filing of CbC reports.

Brazil's tax authorities issued additional guidance on 26 July 2017, providing that if a foreign UPE is designated as the reporting entity for FY 16, but the relevant CAA is not signed between the UPE jurisdiction and Brazil by 31 December 2017, the BCE is required to amend its 2016 corporate income tax return (which would have been due by 31 July 2017) within 60 days of 31 December 2017, to file the CbC report on behalf of the entire group (or designate an adequate surrogate entity).

The July 2017 guidance introduced an additional requirement that, for a designated UPE to be considered the reporting entity for FY 2016, the CAA between the UPE jurisdiction and Brazil that must be activated by 31 December 2017 also must be effective from 1 January 2016. CAAs in force that applied to fiscal periods beginning in 2017 would have had to be made retroactive to 1 January 2016 by 31 December 2017 to meet this requirement.

The BCE could be required to file the CbC report within 60 days of 31 December 2017 if the CAA that was activated by 31 December 2017 is not retroactive to 1 January 2016 and the UPE jurisdiction applies a "reciprocal" rule, that is, the UPE jurisdiction requires a local constituent entity that is part of a multinational group controlled by a Brazilian UPE to file a CbC report in that jurisdiction for FY 2016 if no CAA is in force with Brazil for 2016 by 31 December 2017.

Current status of exchange relationships

Of the 67 jurisdictions (in addition to Brazil) that had signed the Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports as of 19 December 2017, 50 jurisdictions appear on the OECD's list of CbC exchange relationships as having activated exchange relationships with Brazil as of December 2017.

Brazil and the United States entered into a bilateral CAA on the automatic exchange of CbC reports on 20 July 2017, which is effective 1 January 2016.

Summary of reporting rules

The rules for determining whether a BCE that designated a foreign UPE as the CbC reporting entity when filing its 2016 income tax return may be required to amend its return to file a CbC report within 60 days of 31 December 2017 can be summarized as follows:

Did the UPE country sign a CAA with Brazil by 31 December 2017? (68 jurisdictions)	Was the CAA in force/activated by 31 December 2017? (51 jurisdictions)	Was the CAA effective for taxable periods beginning on or after 1 January 2016 by 31 December 2017?	CbC reporting outcome
Yes	Yes	Yes	BCE that designated UPE as reporting entity with return is not required to file CbC report
Yes	Yes	No	BCE that designated UPE as reporting entity with return may be required to file CbC report within 60 days of 31 December 2017 if UPE jurisdiction applies reciprocal rule
Yes	No	N/A	BCE that designated UPE as reporting entity with return is required to file CbC report within 60 days of 31 December 2017

Did the UPE country sign a CAA with Brazil by 31 December 2017? (68 jurisdictions)	Was the CAA in force/activated by 31 December 2017? (51 jurisdictions)	Was the CAA effective for taxable periods beginning on or after 1 January 2016 by 31 December 2017?	CbC reporting outcome
No	N/A	N/A	BCE that designated UPE as reporting entity with return is required to file CbC report within 60 days of 31 December 2017

Comments

Multinational groups with BCEs should review the FY 16 CbC reporting requirements in Brazil, bearing in mind that the BCE may be required to file a CbC report within 60 days of 31 December 2017 (by amending the FY 16 income tax return filed) if the UPE jurisdiction applies a reciprocal rule (when the CAA was active by 31 December 2017, but not effective for taxable periods beginning on or after 1 January 2016). In cases when no CAA was in force/activated by 31 December 2017, the FY 16 income tax return must be amended accordingly.

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IRS issues directives that bring changes to audits of transfer pricing issues

On January 12, 2018, the IRS issued five Large Business & International Division (LB&I) Directives instructing LB&I examiners on transfer pricing audits. These directives are applicable to LB&I taxpayers.[15] Taken together, the five directives signal a major realignment in how the IRS will pursue transfer pricing enforcement going forward.

A summary of the five directives, four of which are very taxpayer-friendly, follows:

- **Interim Instructions on Issuance of Mandatory Transfer Pricing Information Document Request (IDR) in LB&I Examinations:** Transfer pricing IDRs will no longer be automatically issued; rather, they will be issued only for audits subject to campaigns or to which a transfer pricing specialist has been assigned.
- **Instructions for LB&I on Transfer Pricing Selection and Scope of Analysis – Best Method Selection:** IRS examiners must use the taxpayer's method, unless they obtain approval from an internal IRS committee to use an alternate method.
- **Instructions for Examiners on Transfer Pricing Issue Selection – Cost-Sharing Arrangement Stock Based Compensation:** IRS examiners may no longer make adjustments pertaining to the issue in dispute in *Altera v. Commissioner* until the 9th Circuit rules on that case.
- **Instructions for LB&I on Transfer Pricing Issue Selection – Reasonably Anticipated Benefits in Cost Sharing Arrangements:** Until further guidance is issued on the matter, IRS examiners may no longer challenge taxpayers who assert that an acquisition-specific reasonably anticipated benefit (RAB) share can be used when calculating the acquisition price method (APM) for platform contribution transaction (PCT) payments for cost sharing arrangements.
- **Instructions for Examiners on Transfer Pricing Issue Examination Scope – Appropriate Application of IRC §6662(e) Penalties:** The IRS may be looking to increase the application of penalties in the transfer pricing audits that they do push forward.

[15] Taxpayers who have assets equal to or greater than $10,000,000 and who are required to file Forms 5471 or 5472 with their original annual US tax return.

Issuance of Mandatory Transfer Pricing Information Document Request (IDR)

The IRS will no longer issue mandatory transfer pricing IDRs in all cases. Mandatory transfer pricing IDRs will be issued only in the following situations:

1. Examinations from approved LB & I campaigns. IRS examiners will follow the specific guidance, under the campaign, for the issuance of Mandatory Transfer Pricing IDR, and if no guidance was provided, procedure under #2 below will apply.
2. Examinations with initial indications of transfer pricing compliance risk and that have either a member of the Transfer Pricing Practice and/or the Cross Border Activities Practice Area assigned as a consultant or team member to the case.

Observations: This represents a major realignment of how the IRS will pursue transfer pricing enforcement. It seems like the IRS may need to cut back on the scope of its transfer pricing enforcement to focus its limited resources only on those issues that are of most concern to it, and for which it believes it has the highest probability of success.

This scaling back may be an attempt to ensure that IRS resources are focused on increasing IRS Exam's sustention rate in IRS Appeals, which has historically been very low as a result of the IRS's poor track record in transfer pricing litigation.[16]

When a Mandatory Transfer Pricing IDR is issued, the IRS is likely to audit the transfer pricing issues.

IRS Selection of Best Method

This directive is applicable to LB&I taxpayers and taxpayers in the Advance Pricing Agreement (APA) Program.

LB&I Examinations: If a taxpayer has timely provided IRC §6662(e) documentation that both clearly states the best method and the analysis that supports the conclusion, then IRS examiners must receive approval from the Treaties and Transfer Pricing Operations (TTPO) Transfer Pricing Review Panel before the IRS examiners can change the taxpayer's selection of the best method. No approval is required to change the application of the taxpayer's best method.

If the taxpayer uses an unspecified method as the best method, the taxpayer has the burden to establish that none of the specified methods in the regulations was likely to result in an arm's length price. The taxpayer must make a reasonable effort to evaluate the potential applicability of the specified methods.

Advance Pricing Agreements: The APA team must receive approval before it can change the taxpayer's best method. No approval is required to change the application or the assumptions of the taxpayer's best method.

Once the APA team has formal negotiations with a competent authority on a bilateral APA, the approval process in this directive is not required.

TTPO Transfer Pricing Review Panel: The TTPO Transfer Pricing Review Panel (the Review Panel) consists of the TPP director or APMA director, a senior advisor to the TTPO director, and the Income Shifting Practice Network manager. The Review Panel will focus on these key questions: "Why the taxpayer's method is unreliable, whether the taxpayer's method can be adjusted to make it more reliable, and if not, what method is more reliable and why."[17]

Takeaways and Observations: This directive may indicate that the IRS is concerned with excessive deviation from a taxpayer's selected method without good cause for such deviation. The solution of having a committee review deviations from the taxpayer's method may be an attempt to ensure that IRS resources are focused on increasing IRS

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[16] Treasury Inspector General for Tax Administration, "Barriers Exist to Properly Evaluating Transfer Pricing Issues," Reference Number 2016-30-090, September 28, 2016.
[17] LB & I Directive dated January 12, 2018: Instructions for LB&I on Transfer Pricing Selection and Scope of Analysis – Best Method Selection.
URL: https://www.irs.gov/node/54596

Exam's sustention rate in IRS Appeals, which has historically been very low as a result of the IRS's poor track record in transfer pricing litigation.[18]

Only time will tell what effect the committee may have on IRS examiners deviating from the taxpayer's chosen method.

IRC §6662(e) documentation should both clearly state the taxpayer's best method and the corresponding supporting analysis. If the IRS seeks to change the taxpayer's best method, it must seek internal approval.

Reasonably Anticipated Benefits (RAB) in Cost Sharing Arrangements (CSA) for Subsequent Platform Contribution Transactions (PCTs)

When the US participant acquires another company with valuable intangible property (IP), the US participant makes the acquired IP available to a foreign CSA participant through a subsequent PCT contribution to the CSA, which may result in applying different RAB shares in calculating the subsequent PCT contribution or the cost-sharing payments.

IRS examiners have taken the positon that Treas. Reg. §1.482-7 requires the use of a single RAB share for such subsequent PCTs. The IRS is currently reviewing this issue to determine an IRS-wide position, as well as (i) how to incorporate subsequent PCTs into the RAB share of an existing CSA and (ii) how to determine what RAB shares should be allowed under all PCT valuation methods. Pursuant to the directive, examiners will still examine whether the multiple RAB shares taxpayers use are appropriate based on facts and circumstances.

Observations: The guidance provided in this directive may have been a result of the fact that a taxpayer could have significantly different PCT payments depending on whether they contributed acquired intangibles into a CSA devoted to just those acquired intangibles as compared to contributing those intangibles to a larger CSA with all intangibles the taxpayer owned. For example, if the foreign benefit split was 5 percent as compared to 95 percent US benefit, then a CSA devoted to just those acquired intangibles would have a much different PCT payment for such intangibles than would a CSA with a RAB share of 50/50 where the foreign cost sharing participant would have to pay 50 percent of the acquisition price for the target (as compared to 5 percent of the acquisition price). This divergence in the arm's length price for identical assets simply based on the form of the transaction seems inconsistent with the arm's length standard.

This directive (in conjunction with the analysis above) may provide additional support and authority for using an acquisition-specific RAB share when using the APM to calculate PCT payments for CSAs

Stock-Based Compensation: Cost-Sharing Arrangement

The IRS will not examine stock-based compensation issues under a cost-sharing arrangement (CSA) until the outcome of the *Altera* appeal is known. LB&I will reconsider this directive and will issue further instructions at that time.

If the IRS examination team is already developing the stock-based compensation issue, and if the taxpayer agrees to extend the statute of limitations until the outcome of the *Altera* appeal is known and for any additional development work thereafter, then the IRS examiner will stop developing the issue. If the taxpayer does not agree to extend the statute of limitations, then the IRS examiner will continue to develop the issue.

Because taxpayers are likely to contest inclusion of stock-based compensation in services costs on the same grounds as presented in *Altera*, examination teams should consult with LB&I Division Counsel to determine whether the development of those issues is appropriate.

Observations: A taxpayer under examination for the stock-based compensation in a CSA issue may consider whether the duration of the requested statute extension is appropriate.

This directive may provide additional support for the position that stock-based compensation costs may be excluded from both Treas. Reg. §1.482-7 transactional analysis and Treas. Reg. §1.482-9 transactional analysis.

[18] *Id.*

Application of IRC §6662(e) penalties

Transfer pricing documentation pursuant to §6662(e) of the Internal Revenue Code (IRC §6662(e) documentation) is documentation that was both prepared prior to filing of the US tax return and provided to the IRS within 30 days of request.

Having contemporaneous IRC §6662(e) documentation does not automatically protect taxpayers against penalties. The IRS may impose a penalty if the taxpayer does not have *adequate, reasonable, and timely* transfer pricing documentation pursuant to IRC §6662(e). The factors for adequate IRC §6662(e) documentation are listed under Treas. Reg. §1.6662-6(d)(2)(iii). Items that might result in penalties include the following: "inaccurate inputs, failure to adequately search for or consider material information, failure to follow best method rule in selecting and applying the method, results that differ significantly from the arm's-length result and that are sizable in relation to the controlled transaction, etc."[19] Specifically, IRS examiners are directed to probe what data and information the taxpayer had access to or should reasonably have identified and considered at the time of the transaction.

Penalties might apply if the IRS selected a different best method *or* if the IRC §6662(e) documentation does not explicitly include a best method analysis and conclusion *and* the resulting aggregated adjustments are in excess of the threshold amount.[20]

Penalties might be waived if the taxpayer meets the reasonable cause exception. To meet the reasonable cause exception, taxpayers must document the best method analysis and the application of the best method in the controlled transaction.

Observations: Taxpayers must have adequate and reasonable IRC §6662(e) documentation that was prepared prior to the filing of the US tax return.

This directive may indicate that, for those transfer pricing audits that the IRS does pursue, they will be more aggressive in seeking penalties and trying to ensure that the application of penalties is successful.

IRC §6662(e) documentation must include the documentation requirements under Treas. Reg. §1.6662-6(d)(2)(iii), the best method analysis, and the application of the best method in the controlled transaction.

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OECD updates Model Tax Convention

The Organisation for Economic Co-operation and Development (OECD) on December 18 released a revised version of its model income tax convention (the 2017 OECD Model). The 2017 OECD Model provides the basis for negotiation and application of bilateral tax treaties between countries to prevent tax evasion and avoidance. Though not binding on any country, the 2017 OECD Model provides a means for settling common problems that arise in the field of international double taxation when bilateral tax treaties are negotiated.

[19] LB & I Directive dated January 12, 2018: Instructions for Examiners on Transfer Pricing Issue Examination Scope – Appropriate Application of IRC §6662(e) Penalties.
[20] Threshold amount is defined as the net IRC §482 adjustment is 200 percent or more (or 50 percent or less) of the price for related party property transfers or services claimed on the return for substantial valuation misstatement penalty or 400 percent or more (or 25 percent or less) of such for gross valuation misstatement penalty.

The 2017 OECD Model primarily reflects a consolidation of the treaty-related measures resulting from the work on the base erosion and profit shifting (BEPS) project under action 2 (Neutralizing the Effects of Hybrid Mismatch Arrangements), action 6 (Preventing the Granting of Treaty Benefits in Inappropriate Circumstances), action 7 (Preventing the Artificial Avoidance of Permanent Establishment Status), and action 14 (Making Dispute Resolution More Effective).

Of particular note to transfer pricing practitioners are changes to the commentaries to Article 7 (Business Profits), the commentaries to Article 9 (Associated Enterprises), and both the text and commentaries to Article 25 (Mutual Agreement Procedure). A discussion of those changes is provided below.

Summary of changes to Articles 7 (Business Profits), 9 (Associated Enterprises), and 25 (Mutual Agreement Procedure)

The language and overall approach to each article generally has remained the same. The text of Articles 7 and 9 has not been changed, but as noted above, the commentaries have been modified. The most important modifications address certain issues such as taxpayer-initiated adjustments and time limits during which an adjustment may be made. In addition, certain conforming changes take into account the work on the BEPS project.

Article 25 has been subject to the most revisions. The text of Article 25.1 has been broadened so that now an application for competent authority relief may be made to either country, not just the country of which the person is a resident or national (as applicable). The rules in Article 25.5 related to arbitration have also been modified, and the commentaries to Article 25 have been substantially revised. Many of the revisions to the commentaries merely reflect the changes made to Articles 25.1 and 25.5. Other revisions, however, reflect changes resulting from the work on the BEPS project and the changes made to other articles, such as Articles 7 and 9.

Changes to Article 7 (Business Profits): The language and overall approach of Article 7 has remained the same as the prior version of the OECD Model from 2014 (2014 OECD Model). That approach is referred to as the "Authorized OECD Approach" (AOA). Under the AOA, when an enterprise of one country carries on business in the other country through a permanent establishment (PE), the profits attributable to the PE are those that the PE might be expected to make if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, assets used, and risks assumed. Any transactions with associated enterprises attributed to the PE are priced in accordance with the OECD transfer pricing guidelines, and those guidelines are applied by analogy to dealings between the PE and the other parts of the enterprise.

Even though the text of Article 7 has remained the same, the commentaries have been updated to take into account changes made by the BEPS project. For example, conforming changes have been made to take into account the restriction in scope to Article 5.4(d), which deals with the exception for fixed places of business of PEs.

In addition, new language has been added to the commentaries to Article 7 discussing (i) taxpayer-initiated adjustments; and (ii) a limitation on the length of time during which an adjustment may be made (*see* new paragraph 59.1 and the new language in paragraph 62 of the Article 7 commentaries). As discussed below, the same changes have been made to the commentaries to Article 9 (modified as appropriate in the context of each article).

Changes to Article 9 (Associated Enterprises): As with Article 7, the language of Article 9 has remained the same. Nevertheless, two changes have been made to the commentaries – one concerning taxpayer-initiated adjustments and another including additional language to the paragraph concerning the length of time during which an adjustment may be made. The details of those changes are as follows.

New paragraph 6.1 of the commentaries to Article 9 includes a discussion regarding taxpayer-initiated adjustments. The new paragraph affirms that competent authorities are able to eliminate double taxation in situations whereby a taxpayer makes an adjustment to amend a previously filed return. The commentaries explain that such adjustments, when made in good faith, may facilitate the reporting of taxable income by taxpayers in accordance with the arm's length principle. In those situations, the competent authorities may meet to determine whether the taxpayer-initiated adjustment meets the conditions of the arm's length standard and, if so, the appropriate adjustment that should be made in the other country. This change is consistent with the new language concerning taxpayer-initiated positions under the US rules for competent authority procedures (*see* section 2.01(2) of Rev. Proc. 2015-40, 2015-35 I.R.B. 236).

The second change involves new language added to paragraph 10 of the commentaries to Article 9 concerning the length of time during which an adjustment may be made. As with the 2014 OECD Model, the 2017 OECD Model leaves open the question whether there should be a period of time after the expiration of which one country would not be obliged to make an appropriate corresponding adjustment following an upward revision of profits by the other state. Nevertheless, new language in paragraph 10 recommends a provision that should be included by countries that consider an open-ended commitment to be unreasonable. If a country wishes to impose such a time limit, the 2017 OECD Model now recommends that the following paragraph be added after Article 9.2:

> 3. A Contracting State shall not include in the profits of an enterprise, and tax accordingly, profits that would have accrued to the enterprise but by reason of the conditions referred to in paragraph 1 have not so accrued, after [bilaterally agreed period] from the end of the taxable year in which the profits would have accrued to the enterprise. The provisions of this paragraph shall not apply in the case of fraud, gross negligence or willful default.

As discussed above, conforming changes have been made to the commentaries to Article 7 for this rule too.

Changes to Article 25 (Mutual Agreement Procedure): Overall, Article 25 of the 2017 OECD Model maintains the same policies and procedures as the version of this article in the 2014 OECD Model. Nevertheless, as noted, the text of Article 25 of the 2017 OECD Model has been modified, as have the commentaries. The changes to the text of Article 25 generally expand on policies that were present in the 2014 OECD Model, as well as implement changes resulting from the work on the BEPS project. Similarly, the changes to the commentaries of Article 25 make conforming revisions based on changes to the text of Article 25, changes to the commentaries to other articles of the 2017 OECD Model, and on changes resulting from the other BEPS action items.

The first change to the text of Article 25 occurs in Article 25.1. It states that a person seeking competent authority relief may now present his or her case to the competent authority of either country. Under the 2014 OECD Model, the case had to be presented to the country of which the person was a resident (or, in the case of a nondiscrimination claim under Article 24.1, the country of which the person was a national). This change, as explained in new paragraph 17 of the Commentaries to Article 25, is intended to reinforce the general principle that access to the mutual agreement procedure should be as widely available as possible. In addition, this change is intended to ensure that the decision of whether a case should be discussed is open to consideration by both competent authorities.

The other changes to the text occur in Article 25.5, and they concern the rules relating to arbitration. Article 25.5 now specifies that the commencement date for arbitration should begin two years from the date when “all the information required by both competent authorities” has been presented to both competent authorities. In contrast, Article 25.5 of the 2014 OECD Model merely stated that the time frame would begin from the “presentation of the case” to the other competent authority. The new language provides a more precise way to determine the commencement date. In addition, Article 25.5 now specifies that a request for arbitration must be in writing.

Finally, the text of the 2017 OECD Model has deleted a footnote from Article 25.5 that was included in the 2014 OECD Model. That footnote discussed when it would be appropriate for a treaty to include an arbitration provision. As explained in new paragraph 65 of the commentaries to Article 25, the footnote was deleted in recognition of how important the OECD considers arbitration to be.

The commentaries on Article 25 have been revised as well. As discussed above, many of the changes are conforming revisions based on the changes to the text of Article 25. Other revisions conform the commentaries on Article 25 to changes that have been made to the commentaries on other articles. For example, new language has been added regarding taxpayer-initiated adjustments, and this parallels the changes made to the commentaries on Articles 7 and 9. Other revisions represent changes resulting from the work on BEPS. As explained in new paragraph 75 of the commentaries to Article 25, for instance, the sample mutual agreement on arbitration has been revised to reflect a process that is similar to the one used in Part VI of the BEPS Multilateral Instrument.

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Australian tax authorities issue final compliance approach for cross-border related-party debt funding

The Australian Taxation Office on 18 December 2017 released the final version of the Practical Compliance Guide PCG 2017/4. The PCG sets out the ATO's risk assessment framework for related-party financing arrangements. The ATO's approach to the risk framework remains similar to that outlined in the draft version released on 16 May 2017. (For prior coverage, see Global TP Alert 17-018).
URL:
https://www.ato.gov.au/law/view/document?Mode=type&TOC=%2203%3APractical%20compliance%20guidelines%3A2017%3A%230004%23PCG%202017%2F4%20-%20ATO%20compliance%20approach%20to%20taxation%20issues%20associated%20with%20cross-border%20related%20party%20financing%20arrangements%20and%20related%20transactions%3B%22&DOCID=%22COG%2FPCG20174%2FNAT%2FATO%2F00001%22
URL: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-global-transfer-pricing-alert-17-018-17-may-2017.pdf

The PCG makes it clear that the risk-rating exercise is a separate exercise than determining whether a transfer pricing benefit has been obtained under the transfer pricing law, and it is not a safe harbor in that it does not relieve taxpayers of the legal obligation to self-assess their compliance with the transfer pricing laws.

Key changes to risk factors

While the underlying ATO risk indicators remain similar to those listed in the draft PCG 2017/D4, one major change in approach is that the ATO has split the scoring table into "pricing" risk factors and "motivational" risk factors. The pricing and motivational risk factor scores combine to generate an overall risk rating, aligned with a color zone, from "low" to "very high" risk. Some arrangements could be considered to be at least "moderate risk," irrespective of the interest rate being applied. Although provided in the context of risk assessment, the deeming of certain indicators as being motivational risk factors could be seen to imply an unfair presumption by the ATO of a tax motive to an arrangement.

There have been some important changes to the scoring of the risk indicators, including:

- If certain features have *not* been factored into the interest rate, then taxpayers can score a '0' for that indicator. For example, if a loan is subordinated, but the subordination feature is not taken into account in pricing the instrument, a '0' can be scored.
- The interest cover ratios used by the ATO have been reduced to what could be considered to be more realistic outcomes. For example, if interest coverage is 2.5x, this would score 3 points, whereas in the draft PCG 2017/D4, this would have scored 10 points. Note, however, that there is no carve-out for asset-owning companies in development or construction phase (*e.g.*, infrastructure, property) where interest coverage can commonly be very low or negative in the early years, although the ATO recognizes that an interest cover ratio may not be indicative of the underlying risk of these types of investments, and an application may be made by such companies for a white zone assessment if interest cover is the only reason why they fall outside of the green zone.
- Funding from a global treasury operation can now yield a '0' score, irrespective of whether it is in a low-tax jurisdiction (provided there is sufficient substance, evidenced through sufficient senior employees and capital).
- Further definitional guidance on "traceable third party debt," relevant third-party debt, and global group cost of funds. In addition, the definition of "leverage" has been more closely aligned to that in the thin capitalization rules (that is, tax debt/total Australian assets).

It is noted that "exotic features," which attract a high score of 10, include interest deferral clauses, promissory notes that do not provide rights to foreclose or accelerate payment, and differences between the borrowing currency and operating currency. Currency mismatches appear in both the "pricing risk scoring table" as well as the "motivational risk scoring table," which seems punitive.

Intercompany Agreements

The final PCG confirms the ATO's expectations regarding intercompany agreements, and notes that such agreements are recommended and will be the starting point of the ATO's review. Furthermore, the ATO notes (para 20): "The agreements do not need to be as extensive as arrangements involving independent parties, but should include the key terms and conditions that borrowers and lenders would require to enter into the arrangements."

Impact

Notwithstanding some favorable changes in the scoring tables, many taxpayers are still likely to fall in the high or very high risk zones. The ATO is putting such taxpayers on notice that it will seek to commence reviews as a matter of priority, and for red zone taxpayers (very high risk), the case might proceed directly to audit, and the taxpayer may be subject to formal powers for information gathering and will not be eligible to access the advance pricing agreement (APA) program.

The ATO's 18-month "amnesty" for transitioning existing arrangements into the "low risk" zone still applies, in that the Commissioner is willing to remit penalties and interest if taxpayers make a voluntary disclosure and adjust both the historic and prospective pricing into the green zone. The 18-month period commences on the PCG's date of publication – 18 December 2017.

The PCG applies from 1 July 2017, with additional schedules for related-party derivative financial arrangements and interest-free loans between related parties expected to be released in draft form in March 2018.

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Kazakhstan introduces CbC reporting, master/local file documentation requirements

Kazakhstan's State Revenue Committee on 23 December 2017 released final regulations that introduce three-tiered documentation requirements (master file, local file, and country-by-country (CbC) report) in accordance with action 13 of the BEPS project.

Under the new CbC reporting rules, which apply retroactively from 1 January 2016, a multinational enterprise (MNE) group that has aggregate annual income (for the fiscal year before the reporting year) of not less than EUR 750 million must file a CbC report.

The following MNE group entities that are included in MNE group consolidated financial statements, or that would be if equity interests in that MNE group business unit were traded on a public securities exchange, are affected by the rules:

- The ultimate parent company of the group that is a resident of Kazakhstan;
- Resident entities that are members of the MNE group and are not a parent entity or constituent entity (subject to certain conditions);
- Kazakhstan residents that are constituent entities; and
- Nonresidents of Kazakhstan that are constituent entities and that operate in Kazakhstan through a permanent establishment.

The master and local file requirements will apply from 1 January 2019. A master file will have to be prepared if the MNE group's consolidated revenue (for the fiscal year before the reporting year) is not less than EUR 750 million. Preparation of a local file will be required if the group's revenue (for the fiscal year before the reporting year) is not less than EUR 27 million.

In addition, from 1 January 2018, a qualified local member of the MNE group must notify the Kazakh tax authorities of its participation in an MNE no later than 1 September of the year following the reporting year. The first notification must be submitted by 1 September 2018.

Penalties will apply for failure to submit transfer pricing documentation or for submitting inaccurate information.

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IRS substantially increases advance pricing agreement user fees

The Internal Revenue Service on February 6 released a new schedule of substantially increased user fees to request a unilateral, bilateral, or multilateral advance pricing agreement (APA). The schedule amends the user fee schedule contained in the existing IRS procedure to request an APA (section 3 of the Appendix to Rev. Proc. 2015-41).

The increase in user fees will be implemented in two phases. The first phase will apply to APA requests filed after June 30, 2018 and the second phase will apply to APA requests filed after December 31, 2018. The current user fee schedule and the user fee schedule for each phase is set forth in the table below.

APA Request User Fees	**APA Requests Filed Through June 30, 2018**	**APA Requests Filed After June 30, 2018**	**APA Requests Filed After December 31, 2018**
New APA Request	$60,000	$86,750	$113,500
Renewal APA Request	$35,000	$48,500	$62,000
Small Case APA Request	$30,000	$42,000	$54,000
APA Amendment	$12,500	$17,750	$23,000

As shown in the table, APA user fees will almost double from the existing user fees beginning in 2019. In raising APA user fees, the IRS stated that the law requires federal agencies to charge a user fee to recover the cost of providing certain services to the public that confer a special benefit to a recipient. The IRS indicated the increase in user fees is an effort to bring those fees in line with the associated full cost to the IRS.

Under Rev. Proc. 2015-41, if multiple APA requests are filed by the same controlled group within a 60-day period, the maximum total fee charged is $60,000, plus $30,000 for each foreign competent authority involved (if any) beyond the first two. Thus, under the current procedure, the maximum fee is the user fee for a new APA request plus 50 percent of the same amount for each additional competent authority involved (if any) beyond the first two. The information released by the IRS did not indicate whether the maximum fee for multiple APA requests filed by the same controlled group within a 60-day period would change.

Taxpayers expecting to file an APA request within the next year are advised to consider accelerating the APA request filing to take advantage of the current user fee schedule. In addition, under Rev. Proc. 2015-41, taxpayers also have the option of paying the APA request user fee prior to filing the complete APA request, as long as the complete APA request is filed within 120 days of the payment date. In that scenario, the IRS considers the complete APA request as having been filed on the date of payment. For example, if a taxpayer pays the correct user fee under the current schedule on June 30, 2018, then the taxpayer has until October 28, 2018, to file the formal APA request (plus a possible 30-day extension of for “good cause” if the taxpayer requests it and the IRS agrees).

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