



IRS APMA Program issues draft APA template for comment

Global Transfer Pricing Alert 2017-041

The IRS Advance Pricing and Mutual Agreement (APMA) Program on September 19 issued a revised draft advance pricing agreement (APA) template for public comment.¹

The APA template is for use with unilateral or bilateral/multilateral APAs requested under Rev. Proc. 2015-41.² US taxpayers are required to submit a proposed APA as Exhibit 15 to its complete APA request, in a form substantially similar to APMA's current model APA. When finalized, the revised draft APA template would replace APMA's current model APA, which has not been substantially updated since 2004. As noted above, the APA template has been issued in draft, and may be changed based on comments received.

An APA is a signed contract that sets out the terms agreed to between the IRS and the US taxpayer -- in a unilateral APA -- or between the IRS and foreign tax authorities -- in a bilateral/multilateral APA -- including the best method for determining arm's length prices of the "covered issues"³ under IRS section 482 and any other Code sections identified in the APA, the Treasury regulations thereunder, and any applicable tax treaties.

¹ The draft template is not posted on irs.gov, but interested parties can request a copy by emailing lbi.tpo.apma.feedback@irs.gov with the subject line "request."

² Rev. Proc. 2015-41 was released on August 12, 2015, and updated and superseded Rev. Proc. 2006-9, as modified by Rev. Proc. 2008-31.

³ "Covered issues" is the new term contained in Rev. Proc. 2015-41 for what was commonly known as "Covered Transactions" previously.

The revised draft APA template incorporates new changes in the APA process and conforms to language contained in the 2015 revenue procedure. The draft APA template presents a menu of options for selection by US taxpayers, covering a wide range of situations, intended to minimize the need for custom drafting and negotiation over the text of the APA. The explanation to the draft APA template notes that the revision is intended to:

- Facilitate quicker and more accurate drafting of APAs;
- Provide more guidance to taxpayers in preparing the proposed draft APA that is required as part of an APA request;
- Facilitate APMA's review of draft APAs; and
- Facilitate the mutual agreement process for bilateral and multilateral APAs.

The IRS also issued detailed instructions on the template APA, and provided a sample APA, supplemented by explanatory comments.

A summary of the key changes in the draft APA template from APMA's current model APA is provided below.

Key changes

Limitation on assistance

Consistent with language contained in section 2.02(4) of Rev. Proc. 2015-41 and section 7.02 of Rev. Proc. 2015-40,⁴ the draft APA template specifically includes an acknowledgment by the US taxpayer that if the covered issue(s) relate to one or more countries that have a tax treaty with the IRS but are not a party to the mutual agreement implemented by the APA, the IRS may decline to provide competent authority assistance if the foreign tax authority proposes an adjustment relating to the covered issue(s). For example, in the event of a foreign-initiated adjustment covered by a unilateral APA, the IRS may not provide competent authority assistance. Although consistent with the 2015 APA and MAP revenue procedures, this practice was a departure from the prior revenue procedures and highlights that US taxpayers may need to exercise caution about entering into unilateral APAs with the IRS when the covered issue(s) could have been covered by a bilateral APA. In such cases, US taxpayers should consider trying to obtain an explicit assurance from the IRS APMA team in the unilateral APA that in the event of a foreign-initiated adjustment covered by the unilateral APA, the IRS would agree not to reject its competent authority request. Based on the wording in the draft APA template, it is unclear how willing APMA may be now to agree to such a request.

Conforming adjustments and repatriation of funds

If a primary transfer pricing adjustment arises as a result of an APA, Rev. Proc. 99-32 governs the repatriation of funds to conform the accounts,⁵ unless competent authority

⁴ Rev. Proc. 2015-40 provides guidance on the process of requesting and obtaining competent authority assistance under the mutual agreement procedure article of US tax treaties. Rev. Proc. 2015-40 updates and supersedes Rev. Proc. 2006-54, and was issued concurrently with Rev. Proc. 2015-41.

⁵ US Treasury Reg. §1.482-1(g)(3) states that adjustments are required to conform a taxpayer's accounts to reflect allocations made under section 482 allocations. This regulation provides in part: "(i) In general.—Appropriate adjustments must be made to conform a taxpayer's accounts to reflect allocations made under section 482. Such adjustments may include the treatment of an allocated amount as a dividend or a capital

repatriation is requested and agreed to pursuant to Rev. Proc. 2015-41. The executed APA sets out the terms of any repatriation of funds required as a result of an APA primary adjustment. Typically, in a bilateral APA context, the US taxpayer is permitted to establish an account receivable or payable to its related foreign entity in the amount of the APA primary adjustment. That account typically will not bear interest and must be paid⁶ within 90 days of the later of the date for timely filing the federal income tax return (including extensions) for the taxable year to which the APA primary adjustment relates to or the APA's effective date. If any amount of the accounts payable is not paid within the 90-day period, the US taxpayer would face the federal income tax consequences of the secondary adjustments (deemed distribution or capital contribution).

In describing the accounts payable to be established, the draft APA template states in Appendix A: Section 6 (Conforming Adjustments and Repatriation of Funds): "This payable will be treated as indebtedness for all U.S. federal tax purposes, including, but not limited to, Code section 956." This proposed policy seems inconsistent with the Tax Court's decision in *Analog Devices*,⁷ where the court held that an accounts receivable established to repatriate a transfer pricing adjustment under a Rev. Proc. 99-32 closing agreement does not constitute related-party indebtedness between the corporation and its controlled foreign corporation under section 965(b)(3).⁸ Because requesting an APA is a voluntary process, this specific language may cause concern to US taxpayers that may otherwise consider requesting an APA. We anticipate that APMA will receive numerous comments on this proposed language.

Format of draft APA

As noted previously, the draft APA template presents a menu of options for selection by US taxpayers, covering a wide range of situations, with the intention of minimizing the need for custom drafting and negotiation over the text of the APA. While the intention behind such options is appreciated, this format appears to provide less flexibility for US taxpayers than APMA's current model to the extent that the APMA team is reluctant to deviate from the proposed language. For example, Section 6.f. provides a list of options for complying with the financial statements requirement for the APA annual report. APMA's current model APA is less prescriptive regarding how this requirement may be satisfied.

The general instructions to the draft APA template note that options are indicated by square brackets and that an "x" should be inserted between the brackets to indicate the selected option. It is uncertain whether APMA will be unwilling to add bespoke terms to the APA. Options that are not selected should not be deleted but instead should be left in the

contribution (as appropriate), or, in appropriate cases, pursuant to such applicable revenue procedures as may be provided by the Commissioner (see § 601.601(d)(2) of this chapter), repayment of the allocated amount without further income tax consequences."

⁶ Payment must be in the form of money, a written debt obligation payable at a fixed date and bearing interest at an arm's length rate as provided in §1.482-2(a)(2), or through an accounting entry offsetting such account against an existing bona fide debt between the U.S. taxpayer and the related foreign entity.

⁷ *Analog Devices, Inc. v. Commissioner*, 147 T.C. No. 15 (November 22, 2016).

⁸ This decision is a reversal of the court's position in *BMC Software, Inc. v. Commissioner* (BMC Software I), 141 T.C. 224 (2013), which itself was reversed by the Fifth Circuit, 780 F.3d 669 (2015).

text of the draft APA. Although the instructions state that “The term associated with the “x” will be given operative effect in the executed APA,” it is unclear if the executed APA between the IRS and the US taxpayer will still include the extraneous language.

Further, some options are flagged with an asterisk after the square brackets. Taxpayers that select flagged options are required to provide a justification for the selection in the APA request. For example, if a US taxpayer proposes that if an adjustment is required, such adjustment would be made to the nearest edge of the arm’s length range and not the median, the US taxpayer would now be required to include a justification for this proposal in the APA request.

Finally, the draft APA template also contains placeholder phrases consisting of a hashtag followed by one or more words in block capital letters. Generally, the US taxpayer should replace a placeholder phrase with appropriate text; however, if it is not an option chosen by the US taxpayer, then the hashtag should be changed to a caret (^).

While such standardization may be useful to the APMA team, it may result in a longer, more confusing, and potentially more prescriptive APA for US taxpayers. It may also require US taxpayers to include justification for certain proposals that are relatively standard in an APA context.

Critical assumptions

Appendix B of the draft APA template revises the standard critical assumptions contained in the current model APA. The draft APA template splits out the existing critical assumptions into two separate sets of critical assumptions, and expands the current wording to state that “the Covered Entities’...contractual terms, markets, and economic conditions faced in relation to the Covered Issue(s) will remain materially the same as described in the APA Request.” [Emphasis added]

Appendix B also provides that the covered entities will not cause a critical assumption to fail for the purpose of rendering the APA ineffective, unless they have an independent business justification for the action that causes the critical assumption to fail. If one or more of the covered entities do cause a critical assumption to fail for the purpose of rendering the APA ineffective, then the covered entities will not withhold consent to an amendment to this APA to the effect that the APA will continue in force without regard to such failure. In that case, if a covered entity refuses to sign such an amendment, an amendment may be executed without signature and will then have the same force and effect as if the amendment had the signature. It is unclear why APMA believes this explicit provision is necessary.

APA annual report

Section 6.e. of the draft APA template provides clarification that US taxpayers can combine annual reports for multiple APA tax years, provided that all required information for each APA tax year is clearly presented. This is consistent with common

practice now for US taxpayers, and the specific acknowledgement in the draft APA template is appreciated.

Appendix C of the draft APA template sets out the information required to be contained in the APA annual report, which, in general, includes more specific requirements for US taxpayers than the current model APA. For example, US taxpayers would be required to provide more specific information in relation to APA primary adjustments, and detailed numerical explanations of how the results of the application of the covered methods is reflected on the US return, with reference to particular line items on the US return. The draft APA template provides that US taxpayers cannot simply attach a copy of the Schedule M-1 or M-3 and must include the amounts, description, reason for, and financial analysis of any relevant book-tax differences, as reflected on Schedule M-1 or M-3 of the US return. The draft APA template also sets out more specific requirements for the financial analysis that US taxpayers must provide to show their calculations to apply the covered method(s) to the covered issue(s) for that APA covered year. In addition, the draft APA template includes the additional critical assumption language noted above, and would require the US taxpayer to also identify any material differences between the covered entities' contractual terms, markets, and economic conditions.

Effect of certain adjustments by tax authorities and resulting competent authority proceedings

The draft APA template includes provisions relating to situations in which financial data used in one or more covered methods may be affected by adjustments by a tax authority, and provides that the effect of any such adjustments on the financial data would be ignored. It is unclear, based on the proposed wording, what actual impact this would have.

Other provisions

- The draft APA template explicitly notes that the APA does not limit the IRS's authority to audit issues other than the covered issue(s), including issues that arise under Code section 482 and any other Code sections identified in Appendix A to the APA. In addition, the draft APA template provides that the IRS and US taxpayer agree that factual representations made in conjunction with the APA request may be used in judicial and administrative proceedings. While these are not changes in policy, the current model APA is not explicit in this regard.
- Unlike the current model APA, the draft APA template includes specific provisions to address what would occur if an APA is terminated early.
- In the event of a dispute concerning the interpretation or application of the APA, the draft APA template notes that the parties will seek a resolution by the director of Treaty and Transfer Pricing Operations. Under APMA's current model APA, this person is the director of APMA. In practice, it is expected that US taxpayers would continue to approach the APMA director in the first instance to discuss any issues.

The IRS has requested comments on the draft APA template by October 31, 2017. Comments should be in narrative form rather than as a markup of the template APA.

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