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IRS Releases Advance Pricing Agreement Revenue Procedure



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The Internal Revenue Service on August 12 released Revenue Procedure (Rev. Proc.) 2015-41 (the final APA procedures), which provides guidance on the process of requesting and obtaining an advance pricing agreement (APA). Rev. Proc. 2015-41 updates and supersedes Rev. Proc. 2006-9, as modified by Rev. Proc. 2008-31 (the prior APA procedures). The final APA procedures were issued concurrently with Rev. Proc. 2015-40, the final competent authority procedures, which provides guidance on the process of requesting assistance from the U.S. competent authority under the provisions of U.S. tax treaties. Many of the changes in the final APA procedures are consistent with similar changes in the final competent authority procedures.

A proposed version of Rev. Proc. 2015-41 was released for public comment in November 2013 in Notice 2013-79. The IRS received numerous comments on the notice and subsequent comments in finalizing Rev. Proc. 2015-41. The final APA procedures reflect consideration of those comments. The final APA procedures also reflect structural changes that occurred after 2012. Before 2012, the former APA Program was part of the Office of the Associate Chief Counsel International. In 2012, the APA Program merged with that portion of the Office of the U.S. Competent Authority that resolves transfer pricing cases under the mutual agreement procedures of the United States' bilateral income tax conventions. APAs are now processed under the Advance Pricing and Mutual Agreement (APMA) office, which is part of the Office of the Deputy Commissioner International, Large Business and International Division (LB&I).

In addition to reflecting these structural changes, the final APA procedures update – and in many instances depart from – current APA practices. New APA requests and renewal APA requests with substantial changes in facts, transactions, or methods will require substantial additional effort, compared to prior APA procedures. In other instances -- renewal APAs with no material changes from the prior APA, or APA requests that involve similar facts and issues currently under competent authority consideration -- the final APA procedures provide for an “abbreviated APA request” that would reduce that burden substantially if APMA provides explicit authorization to use the abbreviated format. The procedures do not indicate how widely abbreviated APAs will be authorized or, if authorized, the extent to which items otherwise required in a complete APA request will be waived.

Taxpayers may file their APA requests under the prior APA procedures if the APA request is filed after August 31, 2015, and the substantially complete APA request is filed no later than December 29, 2015. Taxpayers seeking to cover calendar year 2014 as the first APA year will lose a few weeks of preparation time,

because the substantially complete APA submission would normally be due in mid-January 2016.

Summary

A summary of the salient changes under the final APA procedures is provided below.

APA Scope

Coverable Issues. An APA can cover issues arising under IRC section 482,¹ other issues where transfer pricing principles are relevant, such as IRC section 367(d), competent authority issues under the business profits and associated enterprise articles of U.S. tax treaties, the determination of effectively connected income of a U.S. trade or business, and ancillary issues. The definition of ancillary issues includes the repatriation of funds arising from an APA adjustment, and explicitly provides for addressing interest on refunds and deficiencies (i.e., statutory interest) and penalties. The prior APA procedures did not address statutory interest and penalties, and treatment of those items was inconsistent in practice. Thus, the inclusion of statutory interest and penalties as a coverable issue is a welcome addition and likely to be helpful for bilateral and multilateral APAs.

If a covered issue is the transfer of intangible property (which does not constitute a platform contribution transaction) the APA may provide that such transfer will not be subject to periodic adjustments, during or after the APA term, under Treas. Reg. §1.482-4(f)(2) or (6). If a covered issue is a platform contribution transaction, the APA may provide that such transaction will not be treated as a “trigger PCT” within the meaning of Treas. Reg. §1.482-7(i)(6)(i) for purposes of making periodic adjustments, during or after the APA term, under Treas. Reg. §1.482-7(i)(6).

Scope Expansion. The final APA procedures state that in some cases the IRS may need to consider additional, interrelated issues (including additional APA covered transactions), additional taxable years, or additional treaty countries to reach a resolution that is in the interest of principled, effective, and efficient tax administration. The IRS will endeavor to communicate to the taxpayer any concern about interrelated matters, and any possible need to expand the scope of the APA, as early as possible in the APA process. The IRS, after considering the taxpayer’s and the foreign competent authorities’ views, may condition its acceptance, continued consideration, or resolution of an APA request upon the agreement of the taxpayer (and, if applicable, of the foreign competent authorities) to expand the scope of the APA. The final procedures provide some helpful examples of situations in which the IRS may be inclined to expand an APA’s scope.

Rollbacks

Expanding the definition of an “APA term” to include “rollback years” is a taxpayer-favorable development. Now an APA term includes both “prospective years” and “rollback years.” The prior APA procedures allow for rollbacks, but the implementation of the rollback was handled separately through a closing agreement that frequently involved different IRS personnel than those drafting the APA. Additionally, a special provision amends Rev. Proc. 2006-9 to provide similar treatment of rollback years under prior APA procedures; accordingly, taxpayers with currently pending APA requests can include rollback years in the executed APA. By including rollback years in the APA term, the final APA procedures create an additional annual reporting burden in that APA annual reports must be filed for both prospective and rollback years, whereas the prior APA procedures require the filing of such reports only for prospective years.

As noted above, APMA can request expanding the scope of the APA request to include rollback years. More so than under the prior APA procedures, a taxpayer contemplating an APA must consider the implications of an APA on open tax years, and consider whether there are distinguishing features between the APA years and the open tax years on which the IRS might impose a rollback.

¹ Internal Revenue Code references are to the Internal Revenue Code of 1986 and the regulations thereunder, as amended.

The final APA procedures are coordinated with the final competent authority procedures. Because rollback years are frequently the subject of ongoing or anticipated competent authority matters, APMA seeks to achieve substantive and procedural consistency under APA procedures and competent authority procedures. Depending on the facts, APMA may encourage a taxpayer seeking an APA to expand the APA to include a rollback. Conversely, APMA may encourage (but not require) a taxpayer requesting competent authority assistance to request accelerated competent authority procedure (ACAP) to extend the competent authority resolution and in some cases may encourage (but not require) the taxpayer to request an APA.

Prefiling Procedures

The final APA procedures include extensive prefiling requirements that under certain circumstances are required before an APA request will be accepted. As in the past, APMA will allow informal consultations on an anonymous basis (although a second prefiling conference on a named basis may be required).

Prefiling Memorandum. A prefiling memorandum must be filed if: (i) the taxpayer wishes to file a unilateral APA request that could be covered under a bilateral or multilateral APA; (ii) the taxpayer seeks to file an abbreviated APA request; or (iii) the covered issues involve the license or other transfer of intangibles in connection with an intangible development arrangement (for example, a cost sharing arrangement or similar), a global trading arrangement, a restructuring, or unincorporated branches, passthrough entities, hybrid entities, or entities disregarded for U.S. tax purposes. A taxpayer not required to file a prefiling memorandum may still file such a memorandum.

The prefiling memorandum must have length and content appropriate to the size and complexity of the covered issues proposed by the taxpayer. Additionally, the prefiling memorandum must state whether the taxpayer seeks a prefiling conference, the issues expected to be covered, three possible dates for the conference, and covered issue diagrams. If the prefiling memorandum seeks an abbreviated APA request, it must include the proposed content of an abbreviated APA request, arguments to support filing an abbreviated APA request, and in the case of a renewal APA, a presentation of the results under the current APA and a summary of proposed changes from the current APA.

Prefiling Conference. If a prefiling conference is granted, the taxpayer should be prepared to discuss the relevant facts and circumstances, the covered issues, proposed method(s), and terms and conditions it proposes to cover in the APA. If APMA declines the taxpayer's prefiling conference request or decides that no prefiling conference is required, APMA will direct the taxpayer as to how to proceed with its APA request.

Preference for Bilateral and Multilateral APAs

Both the final and prior APA procedures express a preference for bilateral and multilateral APAs over unilateral APAs. A taxpayer requesting a unilateral APA must explain in a prefiling memorandum why a unilateral APA is appropriate. Acceptable reasons are that there is no applicable treaty for a bilateral APA, or that a bilateral APA is not practical to cover the issue (for example, if the transaction is small in magnitude in each country but large in magnitude on an aggregate basis).

In a departure from the prior APA procedures,² the final APA procedures indicate that APMA may decide to decline a competent authority request in the event of a foreign-initiated adjustment involving issues covered by a unilateral APA. Accordingly, taxpayers need to be cautious about entering into unilateral APAs with the IRS. For example, historically some taxpayers have sought separate bilateral and unilateral coverages as part of one APA request. In seeking an APA under the final APA procedures, taxpayers may consider obtaining explicit assurance in the unilateral APA that in the event of a foreign-initiated adjustment

² See Rev. Proc. 96-53, §7.08 (Under regular competent authority procedures on settled issues at that time, the IRS would not seek to change the outcome of a settled issue and would seek to obtain only correlative relief; however, such limitations did not apply to unilateral APAs.). Rev. Proc. 2004-40, §6.07; Rev. Proc. 2006-9, §7.07.

covered by the unilateral APA, the IRS agrees not to reject its competent authority request.

Restricted Consents to Extend the Limitations Period for Assessment

The final APA procedures provide additional guidance on the circumstances under which the IRS will allow a restricted consent. Specifically, a taxpayer may request a restricted consent if there are no issues other than the covered APA issues under examination by the IRS. Further, requests for a restricted consent must be made no later than 15 months before the end of the remaining period of limitations, and the taxpayer must provide an explanation as to why a restricted consent is appropriate.

User Fees

Under the final APA procedures, user fees increase from \$50,000 to \$60,000 for new APA requests. For APA requests qualifying as “small case APAs,” the new user fee is \$30,000. The definition of a small case APA is much narrower than the definition of a “small business taxpayer request” under the prior APA procedures. An APA request is eligible for the small case APA user fee only if all of the following apply:

- The controlled group has sales revenues of less than \$500 million in each of its most recent three back years;
- The aggregate value of the proposed covered issue(s) is not expected to exceed \$50 million in any given year of the proposed APA years;
- The aggregate value of any transfer of rights in, or rights to use, intangibles is not expected to exceed \$10 million in any given year of the proposed APA years; and
- No proposed covered issue involves intangible property arising from, or otherwise related to, an intangible development arrangement.

The prior APA procedures provided for (i) a small taxpayer APA request for multinational enterprises with worldwide revenues less than \$200 million and (ii) a small transaction APA request for transactions that did not exceed \$50 million in total and \$10 million with respect to intangible property transactions. In practice, very few requests under the prior APA procedures qualified as small business taxpayer requests, but instead qualified as small transaction APA requests.

Notwithstanding the increase in the revenue threshold from \$200 million to \$500 million for small business taxpayers, substantially fewer APA requests are expected to qualify as small case APAs under the final APA procedures compared to the prior APA procedures. The practical impact is that APA requests that previously would have qualified for small business taxpayer APAs will now be subject to substantially higher user fees: (i) for new APA requests, \$60,000 under the final APA procedures compared to \$22,500 under the prior APA procedures; and (ii) for renewal APA requests, \$35,000 under the final APA procedures compared to \$22,500 under the prior APA procedures.

Time for Filing an APA Request

To cover a prospective year, a complete APA request must be filed no later than the “applicable return date” (the later of (i) the actual return filing date or (ii) the return due date without regard to extensions). Additionally, for a bilateral or multilateral APA request, the APA request must be filed with the corresponding competent authority within 60 days. Otherwise, the first proposed APA year will be treated as a rollback year. The purpose of this new requirement is to better coordinate the timing of discussions between the competent authorities.

As in the past, the final APA procedures permit “dollar-file” requests whereby a taxpayer pays the user fee by the applicable return date and files a complete APA request within 120 days of such date.

Complete APA Requests

The final APA procedures clarify when the APA request is considered complete and explicitly allow for minor deficiencies to be cured. Curing such deficiencies

will relate back to the time of the original filing of the APA request. A similar approach is taken for incorrect user fees.

Similar to the proposed procedures, the final procedures provide a detailed list, included in the Appendix to Rev. Proc. 2015-41, of the items to be included in a complete APA request. The prescribed format and required items represent a substantial change from current practice and will increase the burden on taxpayers.

Unlike the prior APA procedures, the final APA procedures place a strong emphasis on presenting the entire value chain in relation to the covered transactions. Accordingly, a complete APA request includes “covered issue diagrams,” which are relevant tax, legal, and management structures and the value chain relating to the covered issues. Taxpayers are asked to use the format used in the diagrams accompanying the case studies “Alpha” through “Foxtrot” of the Joint Committee on Taxation’s report “Present Law and Background Related to Possible Income Shifting and Transfer Pricing.”³

Conforming Adjustments

When there is an adjustment arising from an APA (an “APA primary adjustment”), a further adjustment is needed to conform the account of the affected members of the affiliated group. If the taxpayer desires, the conforming adjustment may be made by a repatriation of funds between the affected group members. Unlike the prior APA procedures, the final APA procedures require taxpayers seeking a bilateral or multilateral APA to request competent authority repatriation before a tentative competent authority resolution is reached, although the procedures are not clear as to whether this requirement applies to uncompleted years or completed years for which the APA primary adjustment has not yet been computed. Taxpayers may wish to address repatriation issues before completion of competent authority negotiations.

For unilateral APAs, taxpayers must follow Rev. Proc. 99-32; for bilateral and multilateral APAs, taxpayers must follow the repatriation rules in the final competent authority procedures.

Same Information to All Competent Authorities

The final APA procedures require taxpayers to provide both (or all) competent authorities with any written responses, analyses, or other documents they provide to one competent authority, whether such materials are provided in response to a request from a competent authority or are submitted voluntarily by taxpayers in support of their APA requests.

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³ Joint Committee on Taxation, Present Law and Background Related to Possible Income Shifting and Transfer Pricing (JCX-37-10), July 20, 2010.

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