Bloomberg BNA

Daily Tax Report®

APAs

BEPS Concerns Could Drive Increase In APA Applications, IRS Official Says

The number of taxpayers seeking deals with the IRS to lock in their transfer pricing jumped nearly 70 percent in 2015, according to an agency official, who attributed some of the increase to concerns about changes in international tax rules.

Hareesh Dhawale, director of the Advance Pricing and Mutual Agreement Program (APMA), said the Internal Revenue Service received 183 applications for advance pricing agreements in 2015 compared with 108 such filings in 2014.

Speaking on a March 9 webcast sponsored by Deloitte Tax LLP, Dhawale said the increase was partly due to taxpayer concerns about an international effort to combat base erosion and profit shifting, which has led tax authorities worldwide to revisit their transfer pricing rules.

''I'm not sure how much is driven by concerns about BEPS, but probably some of it could be attributed to BEPS,'' he said.

Another, more immediate explanation for the increase is that the IRS changed its revenue procedure for APA requests last year, and taxpayers were rushing to submit applications before the changes took effect.

Kerwin Chung, a partner with Deloitte, told Bloomberg BNA that the new revenue procedure (Rev. Proc. 2015-41) applies to APA requests filed after Dec. 29, 2015 (156 DTR G-4, 8/13/15).

''Under the new procedures, the IRS user fee is higher and the disclosure requirements are higher. Consequently, a lot of taxpayers filed at the end of last year to get grandfathered under the prior revenue procedure,'' Chung said.

Although the figure for 2015 is a spike, Chung said, he expects the upward trend for APA filings to continue.

More Bilateral APAs. An informal survey of participants in the webcast—about 1,700 individuals—supports that expectation. About 42 percent of participants said they expect their companies to request more bilateral APAs as a result of changes to transfer pricing rules and the new requirement for country-by-country reporting under BEPS.

The Organization for Economic Development and Cooperation has been working for several years to develop the new guidelines under the 15-point BEPS action plan. Actions 8, 9 and 10 dealt with the OECD's transfer pricing guidelines; Action 13 covered transfer pricing documentation—of which country-by-country reporting is a component.

The action plan also called for improvements to the mutual agreement procedure (MAP) under international tax treaties—a process that allows tax authorities to jointly resolve double-tax disputes.

Dave Varley, another partner with Deloitte, said the BEPS guidance provides a ''clear delineation of a six-step process for looking at a transaction''—of which the fourth step focuses on the contractual allocation of risk.

Under the BEPS guidelines, for an entity to be entitled to a return on intellectual property, it must control the operational risks. Operation is defined as development, enhancement, maintenance, protection and exploitation—so-called DEMPE functions.

Thus, the guidelines make clear that to allocate operational risk to a location, a company must have qualified decision makers on the ground— ''people in that location,'' said Varley, a former acting director of transfer pricing with the IRS Large Business and International Division.

''I know Treasury views the change in guidance as largely in accordance with current Section 482 regulations,'' Varley said. ''I think step four gives tax authorities greater latitude for when they can ignore contractual relationships.''

Impact of New Guidance. He asked how APMA plans to apply the new guidance in APA and MAP cases.

Dhawale said it is ''too early for us to have had actual discussions involving new guidance the OECD has provided'' and that he hasn't yet seen any cases where a treaty partner was making arguments based on the revised guidance.

However, Dhawale said he could foresee disputes arising over situations where a foreign subsidiary is taking on significant risks.

''I can see arguments being made that if a taxpayer has priced that subsidiary using a transactional net margin method—a one-sided method—I can see a tax authority coming and saying 'no, a profit split is more appropriate.' ''

Going forward, Dhawale said, taxpayers will have to make more careful analyses of the comparables used to benchmark their transfer pricing.

Varley said the IRS has historically focused on ''getting the price right'' rather than on the ''people functions.'' He asked whether APMA is beginning to apply the DEMPE functions analysis.

Donna McComber, assistant director of APMA, said the program already looks at those functions to a degree.

''We see a lot of times people using TNMM and then assuming limited risk,'' she said. TNMM—the transactional net margin method—looks at the ratio of net profit to a base such as sales, costs or assets employed.

''You can look at our previous stats, and know how much we do use TNMM. It's an easy method for taxpayers to use and use every year rather than go through a whole profit split application,'' McComber said.

However, she said, ''if we look at IP returns, nothing jumps out that we will start doing differently. We have to make sure we are focusing very carefully on our functional analyses.''

By Dolores W. Gregory

To contact the reporter on this story: Dolores W. Gregory in Washington at dgregory@bna.com

To contact the editor responsible for this story: Molly Moses at mmoses@bna.com

  DTR ISSN 0092-6884