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# *IRS finalizes new procedures for APAs, adding new disclosure and procedural requirements*

*August 24, 2015*

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## *In brief*

The IRS on August 12 issued final guidance significantly revising prior procedures for requesting and obtaining an advance pricing agreement (APA) from the Advance Pricing and Mutual Agreement (APMA) program. The new guidance, Revenue Procedure 2015-41 (the New Procedure), was issued after the IRS released a proposed version in November 2013 (Notice 2013-79) and considered a number of public comments from the business community and advisors, including PwC. Similar to the proposed procedure, the New Procedure was released in conjunction with final guidance for filing competent authority requests under the provisions of US income tax treaties, contained in Rev. Proc. 2015-40.

The New Procedure incorporates the same basic principles that have guided the APA process in the past and generally reflects the IRS's continuing commitment to the APA process as a mechanism for resolving transfer pricing issues. The New Procedure also sets forth certain new provisions, some of which merely formalize existing practices of the APMA program and some of which impose significant requirements not currently part of the process. In certain respects, the new guidance is influenced by the current global tax environment, including the Organization for Economic Cooperation and Development's (OECD's) base erosion and profit shifting (BEPS) project.

All new APA requests are to be filed under the New Procedure. At the taxpayer's election, however, a new APA request may be filed under the procedures of Rev. Proc. 2006-9 (the Prior Procedure) if a substantially complete request is filed under those procedures no later than December 29, 2015.

Importantly, the New Procedure modifies the Prior Procedure by:

- imposing significantly more disclosure requirements and, in some cases, requiring mandatory pre-filing conferences and memoranda
- formally providing APMA with the authority to condition continuance with the APA process upon the agreement of the taxpayer to expand the scope of the APA to include certain 'interrelated matters' (as APMA previously has required in certain cases)
- encouraging, and in some cases mandating, rollback of the transfer pricing method (TPM) adopted in the APA

- requiring taxpayers to extend the statute of limitations for each year of the APA term, and clarifying the type of extensions that may be required (again, reflecting in some respects informal APMA practices under existing procedures)
- clarifying that an APA request may be a ‘factor’ in satisfying the documentation requirements under Section 6662, and
- reinforcing the IRS’s strong preference for bilateral APAs by permitting unilateral APAs only in limited circumstances.

## ***In detail***

Rev. Proc. 2015-41 supersedes Rev. Proc. 2006-9 and thus represents the first significant update to APA revenue procedures in nearly a decade.

Discussed below are the key ways in which the New Procedure differs from the Prior Procedure while highlighting the importance of these differences for companies.

### ***Coverable issues***

The Prior Procedure defined the controlled transaction or transfer that was the subject of the APA as a ‘covered transaction.’ The New Procedure instead uses the term ‘coverable issues.’ The new terminology reflects the expansion, in 2008, of the APA office’s jurisdiction to address not only Section 482 transfer pricing issues arising from intercompany transactions or transfers, but also certain other issues dependent upon the transfer pricing analysis.

Thus, in addition to any issue arising under Section 482, a ‘coverable issue’ may include issues arising under Section 367(d), issues arising under permanent establishment (PE) articles of US tax treaties, and issues regarding effectively connected US-source income, to the extent that those issues depend on the application of transfer pricing principles (such as the attribution of profit to a PE under certain tax treaties).

In addition, other ancillary issues (e.g., interest on refunds and deficiencies and penalties with respect to US-initiated transfer pricing adjustments) also can be addressed in an APA under the New Procedure.

### ***Interrelated matters***

The New Procedure also introduces the concept of ‘interrelated matters’ when evaluating a taxpayer’s proposed coverable issues.

Under the New Procedure, APMA may “consider additional, interrelated issues, additional taxable years... or additional treaty countries (collectively, interrelated matters) in order to reach a resolution that is in the interest of principled, effective and efficient tax administration.”

APMA may decide that it cannot address the taxpayer’s proposed coverable issues without further considering the interrelated matters. The rules require APMA to inform taxpayers of this concern and include the interrelated matters only after consulting the taxpayers and when applicable, treaty partners.

### ***Observations***

In practice, APMA increasingly has questioned the scope of APA requests. The New Procedure reflects APMA’s decision to establish the appropriate scope for each APA, and the New Procedure provides some examples that appear to address concerns about possible inconsistent treatment of related transactions.

The examples involve: (1) the license of intangible property that had been

acquired (and valued) in an earlier related-party transaction, (2) intercompany services related to earlier transferred intangible assets, (3) a cost-sharing platform contribution transaction and the related sharing of costs under the cost-sharing agreement, and (4) the sale of goods from a manufacturer to a distributor when the latter sells primarily to related parties.

Further, as part of a complete APA request, taxpayers are required to (1) identify any non-covered issues that APMA might reasonably consider in analyzing the scope of the request and (2) discuss why such issues need not be covered.

Accordingly, companies should invest time in carefully planning the scope of their APA requests and should prepare to discuss with APMA all potential coverable issues and interrelated matters.

### ***Pre-filing memoranda and conferences***

The Prior Procedure provided that pre-filing conferences were held at the discretion of the taxpayer, and were not mandatory under any circumstances.

The New Procedure requires pre-filing conferences and memoranda when taxpayers seek:

- a unilateral APA to cover an issue that could be covered under a bilateral or multilateral APA,
- an abbreviated APA request (discussed below), or

- an APA request that involves the license or other transfer of intangibles relating to an intangible development agreement; a global trading agreement; a business restructuring, or intangibles relating to business restructuring; or unincorporated branches, pass-through entities, hybrid entities, or entities disregarded for US tax purposes.

### *Observations*

The new rules clearly frontload the APA process so APMA can provide early guidance on issues APMA considers particularly complex or uncertain.

While a burden on taxpayers at the outset, such procedures should streamline the overall process. Providing additional information upfront should help avoid unsettling the process later on through the introduction of new questions or ideas about related issues or transactions.

A pre-filing conference also should allow a company to get early feedback from APMA on its proposed approach and to refine that approach, if necessary, before submitting the full APA request.

Note that the New Procedure provides no definition of ‘business restructuring,’ so there may be uncertainty as to whether a pre-filing conference is required for certain transactions. It is possible that APMA will look to the definition in Chapter IX of the OECD Transfer Pricing Guidelines.

### *Abbreviated APA requests*

The New Procedure provides that taxpayers may, with the prior permission of APMA, file an ‘abbreviated APA request’ in which the taxpayer omits some of the

documentation required in a full request.

Circumstances in which an abbreviated request might be appropriate include (1) an expansion of a competent authority request, (2) an APA renewal, and (3) a small-business APA. In the case of renewals and competent authority cases, an abbreviated request may be filed when the issues and circumstances surrounding the proposed APA years are ‘reasonably expected to be substantially the same’ as in the years covered by the original APA or by the competent authority case. To seek APMA’s permission to file an abbreviated request, the taxpayer must file a pre-filing memorandum and, in appropriate cases, have a pre-filing conference.

### *Observations*

The abbreviated APA option may be particularly useful for companies with existing APAs that may wish, in pursuing a renewal, to seek APMA’s permission to omit from the renewal request some of the substantial new information called for under the New Procedure.

### *Mandatory rollbacks and legal effect*

The Prior Procedure allowed taxpayers to request, at any time during the APA process, a rollback of an APA TPM to resolve the same issue in a prior tax year. The Prior Procedure also ‘encouraged’ IRS examination teams to apply the APA’s TPM to resolve the issue in those open tax years.

The New Procedure provides that a rollback request generally should be included in the taxpayer’s APA request, but that APMA may, at its discretion, consider a later written request for a rollback. In addition, the New Procedure provides that, even when the taxpayer does not request a rollback, APMA may in appropriate

cases require a rollback when “there is sufficient similarity in relevant facts and circumstances across the proposed prospective years and the taxpayer’s open back years.” In such a case, if the taxpayer refuses to accept a rollback, APMA may not initiate the APA process, or suspend or terminate the process if it has begun.

The New Procedure also provides that taxpayers may be encouraged, but not required, to extend the scope of a competent authority resolution to future tax years through the APA process.

### *Observations*

In a welcome administrative simplification, the New Procedure provides that an agreed resolution of rollback years can be documented in the APA itself and does not require a separate resolution document. In this regard, the New Procedure supersedes and retroactively amends the Prior Procedure to give legal effect to rollbacks in an APA. Certain APAs in the past have purported to address rollback years but the legal authority for this form of rollback resolution was unclear.

Finally, the New Procedure, unlike the Prior Procedure, does not ‘encourage’ IRS examination to accept a rollback; rather it indicates that after “coordinating and collaborating with other offices within the IRS, APMA will inform the taxpayer whether its rollback request has been accepted for consideration,” presumably leaving the question of rollback acceptance to an collective judgment process not well defined in the New Procedure.

### *Preference for bilateral APAs*

While the New Procedure allows taxpayers to pursue a unilateral APA, it emphasizes APMA’s strong preference for bilateral and multilateral APAs when available. When a treaty process is available, taxpayers are required to submit a

pre-filing memorandum requesting APMA's permission to file a unilateral APA request and explaining why the request is justified.

The New Procedure further provides that, if a unilateral APA is signed, APMA may later decline a competent authority request if the issue 'reasonably and practically' could have been covered through a bilateral or multilateral APA.

In contrast, the Prior Procedure specifically provided that a unilateral APA would not preclude later competent authority negotiations on the matter; rather, it merely warned that the ability to reach a mutual agreement might be hindered.

#### **Increased information requirements**

The New Procedure significantly expands the information required to be included in an APA submission.

Taxpayers must include worldwide gross revenue of the controlled group, including for non-covered issues.

Taxpayers also must include graphic representations of their transactions — covered issue diagrams — identifying executive-level functional or occupational roles and personnel names within the business units of the covered group, as well as headcounts for the business units.

Further, taxpayers must explain why, in the interest of principled, effective, and efficient tax administration, they chose not to cover any issue that APMA 'might reasonably consider' an interrelated issue or interrelated matter.

The covered issue diagrams must contain, at a minimum, the entities involved in the covered issues and the intercompany transaction flows between the entities, including the

role of any third parties (i.e., customers).

#### **User fees and other administrative items**

The New Procedure makes several administrative changes to the APA process, including the following notable modifications:

- Increases the user fees for new APA requests to \$60,000 from \$50,000, for small-case APAs to \$30,000 from \$22,500, and for each amendment to an APA to \$12,500 from \$10,000. The fee for a renewal APA remains \$35,000. Taxpayers making multiple APA requests within a 60-day period will be required to pay a maximum \$60,000, plus \$30,000 for each competent authority involved (if any) beyond the first two.
- Requires consent agreements to extend the period of limitations for assessment of tax for each proposed APA year and each proposed rollback year.
- Signals that the IRS will be more receptive to restricted extensions (limiting the extension to the issue under review), which it has been reluctant to consider in the past.
- Requires bilateral and multilateral APA requests to be filed within 60 days of filing equivalent requests with foreign tax administrations.
- Allows for email communication between IRS and taxpayers.
- Clarifies that a complete APA request will be a factor in determining whether a taxpayer has met the documentation requirements of Section 1.6662-6(d)(2)(iii) for the proposed APA years.

- Clarifies that mandatory arbitration may apply to certain bilateral or multilateral APA requests if available under the applicable US tax treaty.
- Alters the small-case APA requirements to apply only if sales revenues of the controlled group are less than \$500 million in each of the group's three most recent years, and to preclude the small-case procedures when the covered issue involves intangible property arising from or related to an intangible development agreement.

#### **Observations**

The requirement that bilateral and multilateral APA requests be filed within 60 days of filing the foreign APA request may accelerate the administration of requests involving certain treaty partners.

Further, taxpayers are advised to continue to prepare Section 6662 documentation even if they have an APA request pending, given that a 'complete APA request' is relevant, but not dispositive, for purposes of meeting the requirements of Section 1.6662-6(d)(2)(iii).

#### **The takeaway**

Although requiring more information and factual development upfront, the New Procedure introduces a number of new provisions that may result in a more streamlined and collaborative APA process.

It will take time, however, to see how the New Procedures will be implemented in practice. In the interim, taxpayers contemplating or progressing towards submitting APA requests should consider filing before December 29, 2015, to take advantage of the grace period for filing APA requests under the Prior Procedure.

## Let's talk

For more information, please contact:

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