**IRS APMA Program releases draft APA template**

*November 16, 2017*

**In brief**

The IRS’s Advance Pricing and Mutual Agreement Program (APMA) on September 15, 2017, announced the release for public discussion of a draft template for use in drafting an advance pricing agreement (APA). Revenue Procedure 2015-41, released on August 12, 2015, requires taxpayers to submit a proposed APA as part of a complete APA request.

APMA’s draft APA template is “designed to systematize how taxpayers propose terms for their APAs and standardize language used in executed APAs.” Further, APMA hopes its new draft APA template will “improve efficiency in the APA process and enhance consistency in the administration of the APA program.”

The draft APA template would make substantial changes to and replace APMA’s current model APA template. Among the most significant changes, the draft APA template includes:

- A large table of definitions of common terms;
- Enhanced details of financial statements required to be included as part of a taxpayer’s APA annual report;
- Identified optional provisions that may be included in an APA but that require special justification by a taxpayer that proposes to use the optional provisions in its APA request; and
- Further detailed information regarding conforming adjustments and repatriation of funds.

The draft APA template also would explicitly provide that an account established to repay a transfer pricing adjustment under the APA would be treated as debt for purposes of Section 956. Such a provision could result in an APA taxpayer recognizing subpart F income even though the related APA adjustment otherwise would reduce the taxpayer’s US income. Thus, the inclusion of this provision in the draft APA template could undermine the very purpose for pursuing many bilateral APA resolutions.

**In detail**

Rev. Proc. 2015-41, which superseded Rev. Proc. 2006-9, was the first significant update to APA revenue procedures in nearly a decade. Rev. Proc. 2015-41 requires taxpayers to provide more information up front than its predecessor, including a requirement to submit a proposed APA as part of a complete APA request.

APMA’s draft APA template seeks to capture many of the changes made by Rev. Proc. 2015-41.

**Conforming adjustments and repatriation of funds**

Pursuant to Rev. Proc. 2015-41, Rev. Proc. 99-32 governs repatriation of funds in the event of a transfer pricing adjustment to an intercompany
transaction made pursuant to an APA, unless a taxpayer requests, and APMA agrees to apply, ‘competent authority repatriation.’ Competent authority repatriation refers to intercompany repatriation terms agreed to as part of a mutual agreement with another tax authority, such as in the case of a bilateral APA.

Rev. Proc. 99-32 provides generally that any intercompany payable or receivable established to pay a transfer pricing adjustment must bear arm’s-length interest. Section 6 of the draft APA template explicitly incorporates certain provisions of Rev. Proc. 99-32, including sample language for the application of interest to any intercompany payable or receivable established for purposes of satisfying an APA adjustment.

Although Rev. Proc. 99-32 and the corresponding provisions of Rev. Proc. 2015-41 generally require that intercompany payables and receivables bear arm’s-length interest, such interest is not necessarily required if the APA applies competent authority repatriation and the agreed competent authority repatriation terms provide for payment without interest. In practice, it is common for competent authority agreements to provide for repatriation of transfer pricing adjustments without interest.

In a significant departure from current template APA terms, the draft APA template provides explicitly that any intercompany payable or receivable established for purposes of paying an APA transfer pricing adjustment “will be treated as indebtedness for all U.S. federal tax purposes, including, but not limited to, Code section 956.”

**Observations**

The treatment of an intercompany payable or receivable as Section 956 indebtedness would raise some serious concerns. This provision would be applicable primarily when US-based taxpayers resolve a transfer pricing issue involving a controlled foreign corporation (CFC) through a bilateral APA.

Bilateral APAs are based on mutual agreements between competent authorities intended to relieve economic double taxation. When such relief includes the repatriation of funds to a CFC to conform the taxpayers’ accounts to the primary adjustment, the draft APA template language regarding Section 956 could well lead to re-imposition of the very tax relieved via the mutual agreement. The re-imposition of tax would result from the subpart F income that the US taxpayer could be required to recognize because of the Section 956 treatment.

The US competent authority is charged under all US tax treaties with endeavoring to relieve double taxation and has broad authority to do so. So it seems anomalous that the competent authority would conclude that the very tax relieved in the process must be re-imposed due to the construct used to help the taxpayer conform its accounts to the governments’ adjustments and repatriate cash without further tax consequence.

The IRS may believe its position in this regard must be consistent with a similar position it has taken in another context where it has asserted that receivables established under Rev. Proc. 99-32 must be treated as debt for purposes of applying the Homeland Investment Act (Section 965). See **BMC Software Inc. v. Commissioner and Analog Devices, Inc. v. Commissioner**. The IRS continues to litigate this issue, although current judicial precedent has rejected the IRS position.

Even if the IRS believes, as a technical matter, that the deemed payables used to conform taxpayers’ accounts to primary adjustments can be treated as debt for purposes of Section 956, in the context of resolving bilateral tax disputes, where the goal of the US competent authority is to relieve double taxation arising from transfer pricing adjustments, it is difficult to understand why the US competent authority would ever want to invoke that technical position, let alone prescribe it as a general provision to be included in all APAs.

**Required financial information**

APAs require that taxpayers provide US returns, financial statements, and other APA records necessary to verify their compliance with the terms of the APA. With respect to financial statements, the current model APA refers only to US audited GAAP financial statements as the underlying financial information to be used to satisfy this requirement. If taxpayers do not maintain US audited GAAP financial statements, they must negotiate with APMA to allow for alternative financial documentation.

The new draft APA template would provide numerous alternative ways in which taxpayers may satisfy the requirement to provide financial statements to show compliance with the terms of the APA. These alternatives may be particularly helpful to foreign-parented US taxpayers that may not maintain separate US GAAP financial statements.

**Structure of the draft APA template**

APMA designed the draft APA template to “minimize editing by using an options-based format for selecting terms presented in certain sections of the model APA.” The options represent language which APMA considers “standard” or which
APMA has accepted, or is willing to accept, in final APAs.

Taxpayers are instructed to mark an “x” to indicate selected options. Certain options are flagged with an asterisk. If a taxpayer selects a flagged option they must provide justification for the selection as indicated in section 1.02, Part 5, of the Appendix to Rev. Proc. 2015-41.

Limited access to competent authority after unilateral APA

Rev. Proc. 2015-41 provides that APMA may decline to entertain a request for competent authority consideration of a foreign tax adjustment if the issue is covered by a unilateral APA. In this respect, Rev. Proc. 2015-41 provides more caution than its predecessor, which left the door open to competent authority relief in this situation. The draft APA template would memorialize this caution by including a “limitation on assistance” provision in which the taxpayer acknowledges that, if a covered issue in a unilateral APA involves a treaty country, the IRS may decline to provide competent authority assistance concerning taxation by the treaty country related to the covered issue.

Observations

There are situations in which a unilateral resolution of an issue through an APA makes sense for both the taxpayer and the IRS. In such situations, taxpayers would be well advised to discuss with APMA, up front, the benefit of preserving their rights to access competent authority, rather than to surrender those rights through inclusion of this provision in their APA.

Other notable provisions

The draft APA template is more detailed than the current model APA. The greater detail provides greater clarity regarding the expectations of APMA, but may provide less flexibility to negotiate customized APA terms as APMA may be reluctant to deviate from the model language absent special circumstances. Among the other provisions are:

- Language specifying 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 (unrelated to rendering the APA ineffective) for the action that causes the critical assumption to fail.” The language reflects the intent that taxpayers be bound by APAs and not have an election to avoid the terms by deliberately failing to meet a critical assumption.

- Specific language for use in describing transfer pricing methods with different testing frequencies and testing periods, such as term tests that evaluate transfer pricing results over a multiple-year period consisting of the entire APA term.

- Specific language to address the tax consequences of an early termination of an APA that provides for a term test or other multiple-year test. This language apparently would require the taxpayer’s results to be tested over the period prior to the early termination and a true up adjustment made, if necessary. Such terms specifying the impact of an early APA termination generally have not been reflected in prior APAs.

- A robust table of definitions applicable to the APA, including certain measures of profitability and other terms used throughout the draft APA template.

The takeaway

APMA’s stated goal with the draft APA template is to further simplify and streamline the APA process. Availability of a comprehensive model APA template will be an important step in APMA’s achieving its stated goals. The draft APA template includes numerous detailed terms, requirements, and definitions that, if included in the final template, will require careful attention by APA taxpayers to ensure that they work correctly in each taxpayer’s particular circumstances.

The draft APA template also includes some potentially problematic provisions, including its explicit call for payables established to facilitate APA adjustments to be treated as indebtedness for purposes of Section 956.

APMA is collecting comments on this proposed draft APA template until October 31, 2017. Therefore, there likely will be changes before the APA template is finalized.
Let’s talk

For more information, please contact:

**APMA & Transfer Pricing Controversy**

Sean M. O’Connor, Washington DC
+1 202 414 1518
sean.m.oconnor@us.pwc.com

Gregory J. Ossi, Washington DC
+1 202 414 1409
greg.ossi@us.pwc.com

David Ernick, Washington DC
+1 202 414 1491
david.ernick@us.pwc.com

Marco Fiaccadori, Washington DC
+1 202 346 5227
marco.fiaccadori@us.pwc.com

Mike Danilack, New York
+1 646 471 4001
mike.dbanilack@us.pwc.com

Gregory Ossi, Washington DC
+1 202 414 1409
greg.ossi@us.pwc.com

Kathryn O’Brien, New York
+1 202 414 4402
kathryn.obrien@us.pwc.com

Ward Connolly, San Jose
+1 408 817 8234
ward.connolly@us.pwc.com

Carolyn Fanaroff, Washington DC
+1 202 346 5205
carolyn.d.fanaroff@us.pwc.com

Lili Kazemi, Washington DC
+1 202 346 5252
golaleh.kazemi@us.pwc.com

Natalie Hodapp, Washington DC
+1 202 312 7985
natalie.v.hodapp@us.pwc.com

Kathryn Thurber, Washington DC
+1 202 414 1619
kathryn.thurber@us.pwc.com

Stay current and connected. Our timely news insights, periodicals, thought leadership, and webcasts help you anticipate and adapt in today’s evolving business environment. Subscribe or manage your subscriptions at: pwc.com/us/subscriptions

Tune into TP Talks, PwC’s global Transfer Pricing podcast series. Listen to PwC professionals sharing perspectives and the latest insights on today’s key transfer pricing developments around the world.

---

SOLICITATION

© 2017 PwC. All rights reserved. PwC refers to the PwC network and/or one or more of its member firms, each of which is a separate legal entity. Please see www.pwc.com/structure for further details.

This content is for general information purposes only, and should not be used as a substitute for consultation with professional advisors.

PwC helps organisations and individuals create the value they’re looking for. We’re a network of firms in 157 countries with more than 195,000 people who are committed to delivering quality in assurance, tax and advisory services. Find out more and tell us what matters to you by visiting us at www.pwc.com