

# IRS requires collaboration between LB&I examiners and APMA on transfer pricing audits

April 22, 2019

## In brief

The Commissioner of the IRS Large Business and International Division (LB&I) on February 19 issued a memorandum for employees of LB&I, entitled “Interim Guidance on Mandatory Issue Team Consultations with APMA for Examination of Transfer Pricing Issues Involving Treaty Countries.” The memorandum requires LB&I Issue Teams that examine transfer pricing issues that could generate adjustments involving a treaty partner to consult with the Advance Pricing and Mutual Agreement (APMA) office.

The memo applies to LB&I Issue Teams that are examining LB&I taxpayers (those with assets equal to or greater than \$10 million) that must file Forms 5471 or 5472 with their federal income tax returns. Under this new procedure, the LB&I Issue Teams must collaborate with the APMA office with respect to transfer pricing issues under audit. The consultation will address procedural and substantive matters, including whether a taxpayer’s intercompany transactions are in line with the arm’s-length standard. The apparent goal of this mandatory consultation procedure is to ensure that transfer pricing adjustments proposed or asserted by IRS examination teams that are likely to be subject to the competent authority proceedings under a tax treaty are based on well-grounded and principled positions that APMA is willing to advocate to treaty partners.

## In detail

### Background

LB&I executives for years have expressed the view that positions taken by the IRS in transfer pricing examinations should be informed by and aligned with the principles and approaches espoused by the IRS in competent authority proceedings. The February 19, 2019 memorandum mandating that examination teams consult with the APMA office on treaty-

country transfer pricing issues aims to make this goal of alignment between examination and competent authority more of a reality.

### Procedure

The new procedure instructs LB&I Issue Team managers to initiate the consultation by providing APMA with a brief description of the transaction, taxpayer, year, and country involved in the transfer pricing issue. APMA management then

is to identify the appropriate APMA office personnel to participate and schedule a consultation to take place within two weeks of receiving the consultation request.

### Timing of APMA involvement

In the past, APMA has become involved in IRS transfer pricing audits only when a taxpayer files a mutual agreement procedure (MAP) request or an advance pricing agreement (APA) request with APMA.

Under the new memorandum, LB&I Issue Teams must collaborate with APMA whether or not a MAP or APA case on the issue is currently pending in APMA. In addition, the collaboration must occur whether or not APMA has an “active relationship” with the counter-party tax treaty country.

The memorandum recognizes that the early involvement of APMA during the audit process is “an important step.” APMA’s guidance should assist the LB&I Issue Team in its choice of transfer pricing issues to develop during audit.

### Impact

This memorandum provides a means for APMA personnel to become involved in transfer pricing examinations long before a MAP request is filed, thereby providing IRS examination teams with an understanding of the perspective of the US competent authority on the potential transfer pricing issues early in the exam process. APMA generally seeks to resolve cases based on principled positions that are not necessarily result-oriented, in part because APMA often deals with the same treaty partner on a range of cases involving similar issues in both inbound and outbound transactions.

**Observation:** The early involvement of APMA could lead to a reduction in cross-border disputes by forestalling US-initiated adjustments not consistent with existing transfer pricing principles or expected competent authority outcomes. Where an examination does lead to a proposed transfer pricing adjustment, APMA’s early involvement also may streamline the ensuing competent authority process by more closely aligning the adjustment with the principles APMA has applied in its bilateral transfer pricing resolutions.

### Scope of APMA involvement

The APMA office will share with LB&I its background and experience dealing with the treaty partner country so that Issue Teams can “properly risk assess the issue.” The involvement of APMA will assist LB&I Issue Teams in their audits so that adjustments are consistent with the Section 482 regulations and double taxation tax treaties between the United States and relevant foreign countries. A goal is to align adjustments with the arm’s-length standard. The consultation will focus on the specific intercompany transactions and issues under consideration in the audit.

APMA will consult on both procedural and substantive matters arising during the transfer pricing audit. APMA may provide historical information with respect to specific transfer pricing issues being considered and with respect to specific treaty partners, along with experience in particular MAP or APA negotiations. The settlements of MAP and APA cases also may be considered during the risk assessment of the issues. In addition, APMA can consult on the preferred approach to develop facts and arguments with respect to a particular issue. APMA also will express its opinion on LB&I’s initial conclusion as to whether to make a transfer pricing adjustment.

As stated in the memorandum, another purpose of the consultation is to give APMA the opportunity to learn from the LB&I Issue Team. The LB&I Issue Team can provide APMA with information on intercompany activities of taxpayers in specific treaty partner countries that may not have been raised during a MAP or APA proceeding in the past.

As the audit progresses, the LB&I Issue Team may further consult with APMA on the transfer pricing issues.

**Observation:** The consultation with APMA should increase the LB&I Issue Team’s ability to evaluate whether a transfer pricing adjustment should be made, giving consideration to the arm’s-length standard, and whether such adjustment would be sustained if the taxpayer files a MAP request. The latter point is important for LB&I Issue Teams to consider because, as pointed out in a recent report by the US Government Accountability Office (“Opportunities Exist to Improve IRS’s Management of International Tax Dispute Resolution,” p. 21), a high percentage of adjustments proposed by the IRS in examinations have been fully withdrawn by APMA. For example, APMA fully withdrew 74% of IRS proposed adjustments in 2017.

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### The takeaway

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Where LB&I Issue Teams are conducting audits on transfer pricing issues involving countries with which the United States has a double tax treaty, the LB&I Issue Team must consult with the APMA office on substantive and procedural issues in the audit before issuing a transfer pricing adjustment. This new early-involvement procedure could be a positive development for both taxpayers and the IRS, as utilization of APMA’s expertise on transfer pricing issues should reduce unnecessary disputes.

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**Let's talk**

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For a deeper discussion of how this issue might affect your business, please contact:

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