

Observations on developments and recent trends from the director of the IRS's APMA program

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In brief

During PwC's recent Global Tax Controversy and Dispute Resolution (TCDR) Conference, David Swenson, Global Leader of PwC's Global TCDR Network, interviewed John Hughes, Director of the IRS Advance Pricing and Mutual Agreement (APMA) program, which carries out MAP and APA negotiating responsibilities on behalf of the office of the US Competent Authority (USCA). The interview included recommendations to taxpayers for achieving favorable results across a number of important topics facing taxpayers in today's dispute prevention and resolution environment.

The interview topics included APMA program developments, MAP and arbitration, APAs and the impact of business disruptions in 2020, and APMA's tools to resolve complex cases. Mr. Hughes explained his views on the increasingly expanding APA and MAP landscape, as well as certain changes made to the APMA program that help the USCA respond to the rigors of today's challenging tax controversy environment. These changes chiefly include internal resource expansion as well as the integration of the previously separate Treaty Assistance and Interpretation Team (TAIT) into the APMA program.

As part of this conversation, Mr. Hughes identified taxpayer best practices for seeking timely case resolution and walked through COVID-19 considerations for corporate taxpayers, focusing on the appropriate procedures and practices taxpayers should follow in their preparation and submission of APA and MAP requests.

Mr. Hughes also provided a general update on APMA's Functional Cost Diagnostic (FCD) model (workbook), which serves as an important tool for collecting and analyzing taxpayer financial data in the most complex of cases where APMA believes that two or more parties may be providing significant value-added contributions to the relevant business operations. The interview also touched on arbitration as an alternative means of dispute resolution and its impact on APMA's approach to case resolution and cooperation with other competent authorities.

In detail

APMA Program update

The most significant challenges to APMA and other competent authorities are inventory and caseload. MAP case inventory around the world is increasing, with over 8,000 open cases, bolstered by more than 4,000 new cases filed in the last 12 months. APMA alone is working with hundreds of pending cases; combined with the pandemic, this has resulted in heightened pressure to resolve cases more quickly and efficiently.

In this regard, Mr. Hughes highlighted the USCA's commitment to sufficiently resourcing its staff. Although the USCA office always has been populated by experienced and skilled professionals, both APMA and TAIT have expanded their ranks in recent months. APMA has added nearly 20 new team leaders and economists to the program, and TAIT has added several experienced analysts and competent authority practitioners. The increase in resources is expected to yield immediate benefits in case support, preparatory analysis, and ultimately case resolution.

In addition to additional team members, the office of the USCA has been restructured to combine APMA and the TAIT group. Mr. Hughes, who will serve as director over this combined, expanded APMA program, believes that the addition of TAIT will serve as an important complement to APMA's legacy responsibilities for transfer pricing matters. TAIT is responsible for handling controversy and disputes related to the areas of Limitation on Benefits (LOB), withholding tax (WHT) cases, permanent establishment (PE) matters, and other non-transfer pricing related issues. Given the interrelated nature of global tax controversies across a number of tax issues, this change is viewed by Mr. Hughes as a significant opportunity to enhance coordination and achieve even greater alignment and synergy on future international tax cases.

Observation: From the taxpayer perspective, many companies have non-transfer pricing issues involving other governments, and stakeholders will benefit from the combined experience of both groups in resolving disputes with other jurisdictions.

In terms of inventory management and the efficient processing of cases, Mr. Hughes stressed that taxpayers should be prepared to assist APMA in the resolution of their respective cases through proactive contributions to the process. Mr. Hughes referenced an example of a recent MAP case where the taxpayer had been unresponsive to APMA inquiries for several years and had failed to keep in communication with the APMA team leader. Although Mr. Hughes emphasized that these circumstances are unusual, the nature of many cases require substantial coordination and cooperation among all stakeholders — including the taxpayer, its advisors, and the governments involved — to reach a timely and efficient resolution of the matter under consideration.

Observation: When requested, timely submission of data and information, as well as constructive, supportive engagement with the competent authority case handler(s) for each side — e.g., periodically requesting case status and ensuring both sides are prepared to negotiate, resolve, and close out the case — is essential to achieving relief in an efficient manner. Effective caseload management requires full buy-in from all relevant stakeholders.

In addition to the number of open APA and MAP cases, APMA also has seen a substantial increase in the size and scale of adjustments proposed in the recent caseload. Some MAP cases involve adjustments of unprecedented magnitude, and there are more countries raising such adjustments. These large and difficult cases require a clear-eyed, fundamental commitment from both competent authorities to upholding OECD norms and conducting evidence-based and principled-based analysis. In this regard, Mr. Hughes emphasized APMA's focus on the specific facts, business activities, and functions, risks, and assets in these cases as the grounding for reaching a principled resolution (which may be a full withdrawal of the adjustment by the competent authority whose tax administration raised the adjustment). Even so, these cases can require a considerable amount of time to resolve, often use substantial resources, and may require direct attention and involvement of senior officials to reach a reasonable resolution.

With respect to trilateral/multilateral MAP cases, Mr. Hughes also mentioned that although these cases can be challenging to administer, they will be increasingly important on a go-forward basis. As adjustments with respect to supply chain and 'sandwich' cases increase — for example, cases where there is a profit allocation among (i) an entrepreneurial entity that transacts with (ii) a routine entity that then (iii) transacts with another routine entity — multilateral consideration will become even more necessary and important to cross-border dispute resolution. These

cases require significant coordination and cooperation among multiple governments and stakeholders, all participating to achieve a reasonable outcome on a principled basis. Revised and more coordinated case submission and processing procedures may be required to facilitate efficient resolution of these cases.

Telescoping

The IRS recently [announced](#) that it has updated parameters that will be followed by APMA when implementing competent authority resolutions reached in MAP and APA cases. As a result of the update, US taxpayers commonly will be required to amend the applicable year's (or years') federal income tax return(s) to reflect changes in taxable income in the year(s) covered by the resolution. Conversely, the circumstances and extent to which US taxpayers will be permitted to "telescope" changes in taxable income into a more current year has been restricted.

Mr. Hughes explained that this update helps minimize distortions to taxable income and tax attributes across tax years that otherwise might arise out of competent authority resolutions, thus furthering the IRS's efforts to promote compliance with changes brought to US tax law by the Tax Cuts and Jobs Act (TCJA). Mr. Hughes added that these updated parameters will continue to be reviewed to ensure the IRS is maintaining balance between the interests of U.S. taxpayers in mitigating the administrative cost of implementing competent authority resolutions and the needs of sound tax administration.

APMA Functional Cost Diagnostic Workbook update

Mr. Hughes also discussed the FCD workbook in relation to the APA and MAP landscape (see PwC's previous [Tax Insight](#) on the APMA FCD workbook). The FCD workbook, which originally was unveiled in early 2019, is an analytic tool developed by APMA for specific cases where there is evidence of material, valuable contributions by different related parties to the relevant transactions under review and where a principled allocation of income (or loss) requires a nuanced review of those contributions and their interrelationships on the basis of specific data and certain quantitative financial information entered into the workbook.

Mr. Hughes indicated that APMA has been working on enhancements to the tool, especially certain features that will expand functionalities in relation to fact patterns that commonly arise in these cases — such as transactions between an entity proposed to be covered by the APA and related parties in the taxpayer's supply chain that are not proposed for coverage or directly involved with the proposed covered APA transactions. Systematically capturing impacts of these external transactions, which can often be material in complex 'supply chain' cases, will make the workbook more comprehensive in its consideration of the transactions contemplated in the APA and the contributions of all relevant parties to those transactions.

Although the FCD workbook may be designed for and applied in a relatively small subset of cases, APMA views it as a useful tool for engaging key principles in the OECD Guidelines, highlighting the multilateral dynamics of these cases, and partnering with competent authority counterparts to address these in a systematic, evidence-based way. Mr. Hughes explained that progress is being made on the enhancements and that updates will be provided when available.

APAs and the impact of COVID-19 business disruption

COVID-19 and economic downturn

It goes without saying that COVID-19 has dramatically impacted our world, our economy, and business practices. Unsurprisingly, COVID-19 has substantially altered business forecasts, and, in turn, has impacted current-year results and near-term forecasts for many APMA cases.

Mr. Hughes recognized taxpayers are focusing on the transfer pricing impacts of the events of 2020 and current economic conditions. He indicated that taxpayers may reach out to APMA regarding COVID-19 matters, referencing an [announcement](#) issued on May 11, 2020. The announcement mentions that APMA will discuss case-specific facts, circumstances, issues, and concerns with taxpayers and applicable treaty partners regarding both executed and pending APAs, subject to APMA's need to organize, prioritize, and coordinate consultation requests.

In this regard, Mr. Hughes explained that generally it is not helpful to APMA (or any competent authority, for that matter) for taxpayers to come forward only with a generalized narrative about difficult circumstances in 2020 as a result of COVID-19. Rather, the taxpayer should present a focused quantitative impact analysis demonstrating the impact of

COVID 19 on the company's operations and why 2020 results may have been more negative (or positive) than expected, why the 2020 circumstances were responsible for those results, and any specific proposal in light of these facts and the expectations for 2021 and future years. As an aside, Mr. Hughes noted that APMA's own ongoing monitoring of economic conditions during 2020, including its preliminary review of certain quarterly data, suggests that impacts on income of taxpayers in the APMA program are likely to be varied, in magnitude and duration, across and within business sectors.

Taxpayers should make a compelling case if they are requesting modification to the terms of an existing APA in the absence of a breach of critical assumptions. After receiving the taxpayer's analysis, APMA will decide whether and when a meeting with the taxpayer would be productive.

For MAPs and APAs filed but still in negotiation, Mr. Hughes stated that APMA's preference is to have taxpayers supplement their submissions with updated COVID-19 information and to cover in detail the specific, quantified impact on their business operations. Although specific questions relating to COVID-19 may arise as part of APMA's normal due diligence questions (DDQ) process, it will be helpful for taxpayers to take a proactive approach with respect to the relevant facts and framing up the taxpayer's circumstances in advance with the same questions referenced above in mind.

Finally, Mr. Hughes flagged a specific technical issue for taxpayers' attention. He noted some taxpayers that have approached APMA about their 2020 results in relation to their existing APA agreement have indiscriminately categorized all COVID-19-related costs incurred during 2020 year as 'extraordinary,' below the line, expenses. Mr. Hughes stated APMA is skeptical that such a categorical position can be justified, underscoring that the answer will depend on a thorough examination of the specific facts and circumstances of each taxpayer. APMA and other competent authorities are aware of how accounting classifications, for both costs and revenues, can impact APA results, so Mr. Hughes stressed the need for taxpayers to be transparent regarding their facts and circumstances and any proposed COVID-19 adjustments. Taxpayers should not attempt to use incorrect accounting classifications to achieve indirectly a modification in the APA's terms.

On this and other points, Mr. Hughes directed taxpayers' attention to Chapter IV of the recently issued [OECD guidance regarding the impact of COVID-19](#), which APMA will be looking to and incorporating into its discussions with treaty partners and taxpayers in order to achieve more cohesive and comprehensive global approaches. He noted that APMA's own ongoing monitoring of economic conditions during 2020, including its preliminary review of certain quarterly data, suggests that impacts on income of taxpayers in the APMA program are likely to be varied, in magnitude and duration, across and within business sectors.

Arbitration

When asked about the use of arbitration as an option to assist in the resolution of MAP and APA cases, Mr. Hughes explained that although arbitration is a recognized tool for effectively and efficiently resolving competent authority cases, he wonders why taxpayers do not more consistently and vigorously press to have their case submitted for arbitration if it is not resolved within the required timeframe. Mr. Hughes noted that the USCA regards arbitration as a right available to taxpayers (under applicable treaties) and that taxpayers should freely avail themselves of that right under appropriate circumstances.

In this regard, taxpayers and their advisors should proactively communicate with the competent authorities to request confirmation early on in the process that their submissions are deemed "substantially complete" by both governments. In addition, once the applicable time period has been satisfied in a particular case and it is ripe for arbitration, Mr. Hughes noted that taxpayers and their advisors should not be reticent about requesting arbitration as a reasonable alternative to move the case to a final resolution.

Observation: Due to the potential deterrent effect of commencing the arbitration process, the value of arbitration is sometimes measured by how seldom it is used (because cases may be resolved before arbitration actually commences), rather than by how often it is actually invoked to get final resolution. Under the circumstances, arbitration can be a useful tool in resolving tax disputes, and taxpayers should proactively consider it as an important and viable option, particularly when certain cases reach an impasse.

The takeaway

Mr. Hughes spoke about a broad range of developments that are impacting the tax controversy and dispute resolution environment in the United States and elsewhere. Mr. Hughes underscored the USCA's efforts to reduce, expedite, prevent, or resolve disputes in a principled manner, which is further demonstrated by APMA's recent commitment to expand its team of experienced attorneys, economists, and other professionals. The combination of TAIT and APMA is intended to bring coordination and leverage to both TP and non-TP matters, providing taxpayers an opportunity for coordinated and aligned relief in multiple tax areas under the APMA roof.

Additionally, given the COVID-19 environment, the APMA team is cognizant of the challenges facing taxpayers and is working to ensure that facts and circumstances will be viewed through a wide-ranging, thorough, and pragmatic lens. Taxpayers should be proactive in providing quantitative support for their changing business outlook. Further, the forthcoming enhanced FCD workbook will continue as an important focus of attention for certain taxpayers, and its enhancements, when complete, are expected to improve its application and effectiveness.

Although there likely is more uncertainty ahead in 2021, companies should get ahead of tax audits and disputes and engage with APMA in a transparent and proactive manner.

Let's talk

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

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