

IRS Implements Final Changes to Advance Pricing Agreement Process

Skadden

09/02/15

If you have any questions regarding the matters discussed in this memorandum, please contact the following attorneys or call your regular Skadden contact.

Robert H. Green

Washington, D.C.
202.371.7840
robert.green@skadden.com

Matthew S. Kramer

Palo Alto
650.470.4597
matthew.kramer@skadden.com

John M. Breen

Washington, D.C.
202.371.7385
john.breen@skadden.com

This memorandum is provided by Skadden, Arps, Slate, Meagher & Flom LLP and its affiliates for educational and informational purposes only and is not intended and should not be construed as legal advice. This memorandum is considered advertising under applicable state laws.

Four Times Square
New York, NY 10036
212.735.3000

skadden.com

On August 12, 2015, the IRS issued Rev. Proc. 2015-41, which sets out the procedures for pursuing advance pricing agreements (APAs). The new revenue procedure replaces Rev. Proc. 2006-9 and finalizes revenue procedures proposed in IRS Notice 2013-79, issued in November 2013. See Skadden Alert dated Jan. 10, 2014.

Before 2012, the APA Program was under the associate chief counsel (International (ACCI) in the Office of IRS Chief Counsel. In 2012, the functions of U.S. Competent Authority and APA were unified under the deputy commissioner of the Large Business and International (LB&I) division. The office now consists of the Treaty Assistance and Interpretation Team (TAIT) and the Advance Pricing and Mutual Agreement (APMA) Program, the latter office under the director of the Transfer Pricing Operations (TPO) division. Revenue Procedure 2015-41 and a separate document that applies to competent authority procedures (Rev. Proc. 2015-40) provide final guidance concerning taxpayer interaction with these offices. The transition of the APA Program from chief counsel to LB&I means that jurisdiction over certain substantive and procedural matters relevant to the APA Program, such as resolution of disagreements between APA personnel and taxpayers, APA approvals, revisions, revocations and cancellations, no longer resides with the ACCI, but instead with the APA director and the TPO.

Under the new revenue procedure, taxpayers may apply either Rev. Proc. 2006-9 or Rev. Proc. 2015-41 to substantially complete APAs filed on or before Dec. 29, 2015. Importantly, under Section 4.07(2) of Rev. Proc. 2006-9, taxpayers had 120 days after paying the APA user fee to file a substantially complete APA request. The 120-day period does not apply under Rev. Proc. 2015-41. Taxpayers thus cannot pay the user fee on, say, November 1, 2015, file the APA request 120 days later on March 1, 2016, and have the provisions of Rev. Proc. 2006-9 apply to that APA Request. Regardless of when the APA user fee is submitted, the APA request must be filed on or before December 29, 2015, for Rev. Proc. 2006-9 to apply.

Rev. Proc. 2015-41 introduces several requirements not found in Rev. Proc. 2006-9. The new requirements appear intended to increase transparency, facilitate the efficient processing and execution of APAs, and maximize the use of APMA's resources. In many instances, the increased efficiency comes at the cost of taxpayer control. In addition, taxpayers may find certain new documentation requirements burdensome. Those that do may want to redouble their efforts to ensure they file before the December 29, 2015, deadline for Rev. Proc. 2006-9 applicability.

Most Significant Changes From Rev. Proc. 2006-9

APMA Discretion as to When an APA Request Will Be Considered Complete

The revenue procedure sets out three criteria for a complete APA request: (i) payment of the correct user fee; (ii) inclusion of all required information, as set out in an appendix to the revenue procedure; and (iii) proposed covered methods that provide a reasonable basis on which to consider resolution of the proposed covered issues (Section 3.04(1)). After receiving the request, APMA will review it and determine whether it meets all three criteria or whether certain minor deficiencies need to be cured. APMA may allow a subsequent remedy of substantial deficiencies but only under exceptional circumstances. APMA's decision as to whether and when an APA request is filed or considered filed is not subject to administrative review. The revenue procedure adds that APMA will not accept an APA request for hypothetical transactions (*e.g.*, potential business restructurings or cost-sharing arrangements that are in only the planning stages).

IRS Implements Final Changes to Advance Pricing Agreement Process

The requirement of a complete APA request is nothing new; every APA revenue procedure set out the required contents of an APA request. What is new is the emphasis on APMA's upfront review and potential rejection, with no administrative review, of an APA request if the request does not meet the three criteria. APMA personnel often remind taxpayers in prefiling meetings that the better the APA request, the more efficient the process. The emphasis on an upfront review of the APA request seems intended to help the APMA team start and complete the APA process in an efficient manner.

At the same time, this upfront review process could present distinct administrative problems. The first two criteria (user fee and provision of required information in the appendix of the revenue procedure) are objective and should be relatively easy to fulfill. The third criterion (whether the proposed methods provide a reasonable basis on which to consider resolution of the proposed covered issues) may be intended to give APMA the ability to determine whether resolution is likely before expending significant resources on the case. However, the criterion could require APMA to pass judgment on a taxpayer's proposed methods at far too early a stage in the process. Any taxpayer that in recent years has tried to price high value or hard-to-value intangibles likely knows the potential difficulties and arguments about whether a proposed method might be considered reasonable.

Expanded Scope of APA Coverage

The revenue procedure allows APMA to consider including additional years, issues or treaty countries in an APA request (collectively, "interrelated matters") to reach a resolution "that is in the interest of principled, effective and efficient tax administration" (Section 2.02(4)(a)). The same general extension of APMA's reach compared to Rev. Proc. 2006-9 was contained in Notice 2013-79. APMA will provide taxpayers and foreign competent authorities with the opportunity to present their views on whether such interrelated matters should be covered. If APMA disagrees with those views and the taxpayer or foreign competent authority declines to cover the interrelated matters, APMA may reject the APA request. The revenue procedure does not state what recourse a taxpayer might have if the taxpayer agrees to cover the interrelated matters that APMA identifies, but the foreign competent authority does not.

The revenue procedure also allows APMA to address ancillary issues such as interest and penalties, but only to the extent to which APMA has authority under the Code or a treaty (Section 2.02(2)).

Expanded Required Contents of APA Requests

An appendix sets out the required contents of APA requests. New requirements include executed consents to extend the period of limitations for assessment of tax; documents or written submissions provided to foreign tax authorities; covered issue diagrams

showing the controlled group's legal structure, tax structure, business units, value chain, and organization and management charts; a narrative with reference to nonproposed covered issues in the covered issue diagrams; a draft APA, together with a redline version comparing the taxpayer's draft APA with the model APA on APMA's website; and documents prepared under Section 6662(e) of the Code.

Most of these new required contents are relatively straightforward, though many taxpayers may find three requirements in particular very burdensome: the covered issue diagrams; the narrative regarding noncovered issues in those diagrams; and the model APA. The covered issue diagrams must include diagrams, charts or similar representations depicting information "as it relates to the proposed covered issues and any interrelated matters that APMA might reasonably consider in analyzing the proposed covered issues." The narrative associated with nonproposed covered issues must discuss why in the interest of principled, effective and efficient tax administration such issues need not be covered, and the extent to which such issue should be considered in the APA process. These requirements are a departure from the prior revenue procedure and APA practice, under which taxpayers could select the specific transaction they wanted to cover, and any diagrams or discussion of transactions focused only on that transaction. In many cases a draft APA at the initial stages of an APA request will be a waste of time and resources. The due diligence and negotiation process frequently transform the agreement envisaged at the beginning of the process into a completely different product months or years later.

Rollbacks

Rev. Proc. 2015-41 contains three key changes to the rollback provisions of Rev. Proc. 2006-9. First, rollbacks may now be formally covered in the APA agreement itself (Section 1.01(2)). Previously, APAs covered only the prospective APA years and were silent about any rollbacks. Under Rev. Proc. 2015-41, the APA term would thus include any prospective APA years plus the rollback years.

Second, for rollback requests in bilateral or multilateral requests, APMA would agree to a rollback for an open filed year only if it would agree to accept a competent authority or accelerated competent authority request for that year, and would agree to a rollback for a closed filed year only if it would agree to accept a competent authority or ACAP request for that year and the applicable treaty would allow implementation of the competent authority resolution in that year (Section 5.02(4)). Those criteria are consistent with general competent authority jurisdiction over filed years but were not explicitly stated in Rev. Proc. 2006-9.

Third, the revenue procedure states that APMA will encourage and in some cases require a taxpayer to expand the scope of its

IRS Implements Final Changes to Advance Pricing Agreement Process

APA request to include a rollback if doing so would further the interests of principled, effective and efficient tax administration (Section 2.02(4)(c)). Under prior APA practice, rollbacks were generally at the discretion of taxpayers.

Abbreviated APA Requests

A very helpful definitions section defines an abbreviated APA request as an APA request in which information, documents or content required for a complete APA request has been truncated or omitted, per explicit authorization from APMA. Section 3.04(2) states that an abbreviated APA request might be appropriate for: expansion of a competent authority request under Rev. Proc. 2014-40 into APA years; certain APA renewals, provided the taxpayer can establish to APMA's satisfaction that the applicable law, facts and circumstances, economic conditions, proposed covered issue(s) and method(s), and other relevant factors surrounding the current APA are reasonably expected to be substantially the same as those in the proposed renewal APA years, per Section 8.01; certain small business taxpayer requests; and "other, exceptional circumstances." This section of the revenue procedure makes clear that efficiency is a key consideration in determining whether an abbreviated APA request is acceptable.

Decisions Made at the Discretion of APMA Director Not Subject to Administrative Review

The revenue procedure states that the APMA director, either directly or by delegation, may take any action (not contrary to statute, regulation or treaty) necessary to carry out the intent of the revenue procedure. Such actions include, but are not limited to, declining to initiate or suspending or terminating the APA process, and modifying the application of provisions contained in the revenue procedure in particular cases. Such actions are not subject to administrative review.

The APMA Director's ability to take such action is not new. Rev. Proc. 2006-9 contained much the same language regarding the director's ability to carry out the intent of the revenue procedure, provided that action was not contrary to statute, regulation or treaty. What is new is the lack of administrative review of any such action. Rev. Proc. 2006-9 (Section 6.10) allowed taxpayers one conference of right with the APA director if an APA request was rejected. Taxpayers may fairly ask what recourse they have under Rev. Proc. 2015-15 if they regard the director's action as unfair.

Impact of APA Revocation or Cancellation

The grounds for and consequences of a revoked or cancelled APA in Rev. Proc. 2015-41 are generally the same as those in Rev. Proc. 2006-9 and Notice 2013-79. However, Rev. Proc. 2015-41, like Notice 2013-79, adds that the IRS will deny a request for relief submitted under Rev. Proc. 2105-40 for APAs that are revoked.

Fulfillment of Documentation Requirements

The revenue procedure states that the submission of a complete APA request will be a factor taken into account in determining whether the taxpayer has met the documentation requirements of Treas. Reg. §1.6662-6(d)(2)(iii) for the proposed APA years. Rev. Proc. 2006-9 did not mention whether an APA request would satisfy the contemporaneous documentation requirements of that regulation. With the high threshold for filing a complete APA request set out in the revenue procedure, it would seem that taxpayers would have a strong argument that a complete APA request would satisfy those documentation requirements and thus provide protection from the transfer pricing penalties associated with not having fulfilled those requirements.

User Fees

Rev. Proc. 2015-41 increases user fees for most APA requests from \$50,000 to \$60,000. The user fee for renewal requests that do not involve an expansion in the scope of APA coverage remain at \$35,000. The user fee for small cases as defined in the revenue procedure increases from \$22,500 to \$30,000 (presumably also for small case renewals, although the revenue procedure does not explicitly say so), and the user fee for an APA amendment increases from \$10,000 to \$12,000.

Provisions That Memorialize Longstanding Practices

Preference for Bilateral APAs

Consistent with Notice 2013-79, Rev. Proc. 2015-41 states a clear preference for bilateral APAs over unilateral APAs whenever possible (Section 2.02(4)(d)). The revenue procedure provides that taxpayers may express their views on why they wish to pursue a unilateral APA when a bilateral is feasible and provides as an example a transaction involving so many treaty countries that bilateral APAs or a multilateral APA would be impractical. The revenue procedure makes clear that the decision whether to allow a unilateral APA where a bilateral is possible lies with APMA. The revenue procedure also adds a constraint on taxpayers that may want to pursue a bilateral or multilateral APA after executing a unilateral APA on the same transaction: Even if APMA and a taxpayer execute a unilateral APA, APMA may not subsequently allow the taxpayer to pursue a bilateral or multilateral APA, particularly if doing so would reduce U.S. taxable income compared to the terms of the unilateral APA.

Consent Agreements

Rev. Proc. 2006-9 was silent about the IRS's and taxpayer's rights and obligations with respect to consent agreements in an APA context, and taxpayers were often surprised, and Exam teams sometimes remiss, with respect to statute extensions. Section

IRS Implements Final Changes to Advance Pricing Agreement Process

2.03(3)(a) of Rev. Proc. 2015-41 makes explicit that taxpayers must agree to execute consent agreements as necessary to extend the statutes of limitations for each proposed prospective and roll-back year. General consents are required if the remaining period of limitations for a proposed APA year is less than two years from the date on which the APA request is filed. General consents are also required for a proposed APA year for which an issue other than the proposed covered issues is under ongoing or potential examination by the IRS. If there are no issues other than the proposed covered issues under examination by the IRS for a proposed APA year, the taxpayer may request a restricted consent.

Ability to Forgo an Opening Conference/Use of Case Plans

The revenue procedure makes clear (Section 4.03(1)) that in most cases, an opening conference will occur between the taxpayer and the APMA team. However, the revenue procedure adds that the APMA team may determine that an opening conference is not necessary, depending on the team's experience, familiarity and lack of disagreement with the proposed covered issues and methods. The revenue procedure adds that case plans will ordinarily be adopted to facilitate efficient processing of the APA request (Section 4.03(2)).

Joint Presentations to APMA and Foreign Competent Authorities

Section 3.04 states that the APMA team will consider requests from, and may invite or require, the taxpayer to make presentations jointly to the APA team and the foreign competent authorities to facilitate efficient case processing.

Information Sharing With Treaty Partner

The revenue procedure states that taxpayers should be prepared to provide the competent authorities with any written responses, analyses or other documents that they provide to a competent authority, whether such materials are provided in response to a request from a competent authority or are submitted voluntarily by the taxpayer in support of its APA request. (Section 3.09(2)).

Overall Impact of Rev. Proc. 2015-41

Many of the new provisions and requirements set out in Rev. Proc. 2015-41 are clearly intended to increase efficiency, transparency and cooperation between the APMA Program and taxpayers. For taxpayers that want to cover as many transactions and years as possible, with as many treaty partners as possible, those provisions and requirements could be welcome. Taxpayers concerned about the IRS possibly expanding the scope of coverage beyond what taxpayers might desire, or examining certain types of international structures or transactions, will want to consider carefully whether an APMA is the appropriate forum for resolution of their transfer pricing issues.