

# IRS Issues Interim Guidance to Staff on Reviewing and Accepting Advance Pricing Agreement Submissions

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The Internal Revenue Service (IRS) recently released instructions for employees that may have the effect of deterring some companies from submitting advance pricing agreement (APA) requests. That, in turn, could introduce more uncertainty for taxpayers and lead to more retroactive resolutions of transfer pricing issues. The IRS's new approach could also expose large global businesses to greater tax risks.

The April 25, 2023, "[Interim Guidance of Review and Acceptance of Advance Pricing Agreement \(APA\) Submissions](#)" (Guidance), directed to the Treaty and Transfer Pricing Operations practice area in the Large Business and International Division, would alter existing review process for corporate transfer pricing policies in several significant ways, directly and indirectly:

- In a departure from prior procedure, under the Guidance, IRS Examination (Exam) employees will be involved in the initial assessment of APA submissions alongside Advance Pricing And Mutual Agreement Program (APMA) staff.
- While the Guidance states that it is not meant to reduce the number of APA requests it assesses, it notes that "APAs are one of several tools available to the IRS to address transfer pricing compliance and certainty," and highlights the Organisation for Economic Co-operation and Development's (OECD's) International Compliance Assurance Program (ICAP) as an alternative avenue that may be "better suited to address the taxpayer's transfer pricing issues compared to an APA."
- However, ICAP, unlike the APA process, does not allow taxpayers to seek prospective certainty for key issues across taxing jurisdictions. If taxpayers reduce their use of the APA process, which is voluntary and affords greater prospective tax certainty, it will increase the number of retrospective cases brought under the mutual agreement procedure (MAP) article of relevant tax treaties.
- The significant involvement of Exam staff, coupled with the increased emphasis on ICAP, will also open U.S. taxpayers and the multinational enterprise (MNE) groups to which they belong to increased scrutiny across multiple taxing jurisdictions and across a widened range of tax risks.

The net result of decreased prospective certainty coupled with increased scrutiny may be to dissuade MNEs from approaching APMA for assistance with more aggressive foreign audits and more complicated tax issues.

## The ICAP Alternative

The OECD's ICAP initiative is a voluntary risk assessment and assurance program that allows MNEs to present their tax position to several tax administrations simultaneously, to determine whether any of the participating tax administrations would anticipate dedicating any additional resources to further review the MNE's tax risks in question.<sup>1</sup>

While the specific periods to be covered in a particular MNE group's risk assessment will be agreed by the MNE group and participating tax administrations, it is generally anticipated that an ICAP risk assessment will focus on "a single or two consecutive covered periods, which will be the most recent for which necessary documentation, including the MNE group's [country-by-country] report, is available."<sup>2</sup>

<sup>1</sup> OECD (2021), "International Compliance Assurance Programme — Handbook for tax administrations and MNE groups," OECD, Paris (ICAP Handbook), p. 9.

<sup>2</sup> *Id.* at 17.

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ICAP is also forward-looking, and aims to provide tax assurance to an MNE group “with respect to the covered risks for the two tax filing periods immediately following the covered period[s] ... provided there are no material changes during these periods.”<sup>3</sup>

The outcome of the ICAP process is presented to the MNE in the form of a completion letter issued by the lead tax administration (typically the parent jurisdiction), marking the conclusion of the ICAP process. The MNE group will also receive an outcome letter from each participant tax administration, containing the results of the tax administration’s risk assessment and assurance of the covered risks for the covered periods.

The ICAP process is intended to inform an MNE group of its tax risk level across multiple tax jurisdictions. However, the ICAP Handbook acknowledges that “ICAP does not provide an MNE group with the type of legal certainty that may be obtained through other bilateral or multilateral routes, such as a bilateral or multilateral APA, simultaneous or joint tax audit or MAP/arbitration.”<sup>4</sup> In fact, if one or more tax administrations cannot conclude that one or more tax positions of an MNE group are low risk, the ICAP process may result in a suggestion to pursue a bilateral or multilateral APA.<sup>5</sup>

## Summary of APA Gatekeeping Procedures Under the Guidance

### 1. Review at the Prefiling Stage

The current revenue procedure governing APA requests sets out when a prefiling memorandum prior to an APA request is optional and when one is required.<sup>6</sup> Under the Guidance, the IRS recommends that a prefiling memorandum be submitted even if optional so the taxpayer can “benefit from” a prefiling review.<sup>7</sup>

This review is intended to provide the taxpayer with “information about the likely acceptance of an APA request, as well as other potentially applicable workstreams, to achieve transfer pricing certainty.”<sup>8</sup> The review will be conducted by both an APMA team leader or economist (referred to collectively in the Guidance as the APMA team leader) and a member of the IRS’s transfer pricing risk assessment team (TPRA), which is part of Exam. Members of the review team are collectively referred to as the prefiling memorandum review team.

<sup>3</sup> *Id.*

<sup>4</sup> *Id.* at 9

<sup>5</sup> *Id.* at 13.

<sup>6</sup> See Rev. Proc. 2015-41, Sections 3.02(4)-(5). Note, however, that the IRS has indicated since late 2022 that it intends to revise the guidance currently provided under Rev. Proc. 2015-41. A superseding revenue procedure has yet to be released.

<sup>7</sup> Attachment to Guidance, p. 1.

<sup>8</sup> *Id.*

When the team reviews the taxpayer’s prefiling memorandum, it will consider the facts and circumstances of the proposed APA case, and criteria including (but not limited to):<sup>9</sup>

- a. Whether the issues raised are sufficiently significant to justify the use of resources necessary to engage in and complete an APA.
- b. For bilateral or multilateral cases, whether engagement with treaty partners will significantly enhance transfer pricing compliance, and whether information exchange agreements among the relevant tax administration provide for the information exchange necessary.
- c. Whether the proposed transactions are suitable for resolution through taxpayer participation in ICAP, based on factors including but not limited to:
  - The scope, materiality and complexity of the MNE group’s covered transactions in the United States and the jurisdictions participating in ICAP.
  - The MNE group’s history of transparent and cooperative engagement with the IRS.
  - The MNE group’s examination history with respect to transfer pricing and permanent establishment issues with the IRS.
  - The anticipated availability of TPRA resources necessary to perform the ICAP risk assessment.
- d. Whether the proposed transactions potentially are suitable for resolution through a future potential transfer pricing practice examination or joint audit, based on factors including but not limited to:
  - Common or complementary tax issues relevant to the tax administrations.
  - Transactions that pose significant compliance risk to one or more tax administrations relative to the resources employed.

The prefiling memorandum review team will communicate the results of its review to an APMA frontline manager, who will “make and orally communicate a decision about recommended taxpayer action ... to the taxpayer.”<sup>10</sup> In other words, the results of the prefiling memorandum review will not be communicated in writing to the taxpayer. The front line manager may recommend that the taxpayer:

- a. Proceed with the submission of the APA request.
- b. Consider an alternative workstream for more effective tax certainty, in which case the recommendation will identify the workstream that the IRS considers a better option.
- c. Provide additional information to APMA about the proposed APA, which may include participation in a prefiling conference,

<sup>9</sup> See *id.* at 4.

<sup>10</sup> *Id.* at 1-2.

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after which the prefiling memorandum review team will reconsider the results of its review and its recommendation.

- The review process is intended to be completed within the later of (i) four weeks after the date that the prefiling memorandum is submitted, or (ii) four weeks after additional information requested has been submitted by the taxpayer.<sup>11</sup>

## 2. Review at the APA Request Stage

Once an APA request is submitted to APMA, a review will occur to determine whether APMA will accept the request, or decline it and, instead, recommend an alternative workstream for the taxpayer to consider. The submission review team will be led by an APMA frontline manager and include an APMA team leader, a treaty assistance and interpretation team analyst (for any non-transfer pricing issues raised by the request), the TPRA manager (or their designee), and a transfer pricing practice reviewer.<sup>12</sup>

The submission review team will consider the facts and circumstances of the APA, and criteria including (but not limited to):

- a. The prefiling memorandum review criteria listed above, if such review had not been undertaken prior to APA request submission.
- b. Whether there is an actual or potential transfer pricing dispute that would be most efficiently resolved through an APA, based on APMA's experience and the taxpayer's examination history both within the United States and in the applicable foreign jurisdictions.
- c. Whether the APA process will likely result in prospective APA years.
- d. Whether there is arbitration with the treaty partner in question, and other country-specific strategic considerations.
- e. "Whether, in the opinion of the TPRA Submission Review Team member, the proposed transactions are suitable for ICAP," based on the same factors listed in part (f) of the prefiling memorandum review criteria above.<sup>13</sup>

The Guidance also notes that, in the case of a request for a bilateral or multilateral APA, the submission review team may, at its discretion, also solicit the views of the treaty partner(s) in question.<sup>14</sup>

In contrast to the results of the prefiling memorandum review, if it is determined that APMA will not initiate the APA process, APMA will send the taxpayer a formal decision letter in accordance with Section 4 of Rev. Proc. 2015-41. If, instead, it determines that participation in the APA process is appropriate,

<sup>11</sup> *Id.* at 2.

<sup>12</sup> *Id.* at 4.

<sup>13</sup> *Id.* at 7-8.

<sup>14</sup> *Id.* at 8.

APMA will proceed as per the process delineated in Rev. Proc. 2015-41 (or any successor revenue procedure). The submission review process is intended to be completed within eight weeks of the filing date of the taxpayer's completed APA request.<sup>15</sup>

## Potential Consequences of the Guidance for Taxpayers

In the introduction to the Guidance, the IRS maintains that it "is not intended to limit or decrease the number of APA requests accepted by APMA." However, one of the most significant procedural changes wrought by this guidance is that the initial assessment of whether a taxpayer's issues should be resolved through the APA process is now shared between APMA and Exam. Historically, APMA generally had primary responsibility for determining whether a set of tax issues and risks is appropriate for negotiation and resolution to achieve prospective tax certainty through the APA process. Through TPRA's involvement in both the prefiling memorandum review and the submission review, Exam will now play a significant role in determining a taxpayer's eligibility for the APA process, and may in fact push a taxpayer toward ICAP or a joint audit.

Increasing the use of ICAP or joint audits, and moving away from the APA process, may limit a taxpayer's ability to seek prospective certainty for key issues in key taxing jurisdictions. This may, in turn, increase the number of retrospective cases brought under the MAP article of relevant tax treaties. After lengthy audits across multiple jurisdictions, taxpayers will exercise their right to seek relief from double taxation and from other instances of taxation not in accordance with relevant tax treaties. Put another way, taxpayers seeking MAP relief after lengthy audits will be seeking resolution for issues that could have been proactively managed by competent authorities on the front end, had such issues been resolved through the APA process.

More worryingly, increased reliance on ICAP may result in a chilling effect, because taxpayers may be dissuaded from approaching APMA for assistance with aggressive foreign audits in general. The significant involvement of multiple competing jurisdictions in an ICAP process opens up MNE groups to an increased risk of irresolvable double taxation as multiple tax authorities assert competing claims that may not be resolvable through MAP.

MNE groups will need to carefully consider whether the risk of opening a multilateral audit with tax authorities that have very different approaches to transfer pricing (and other ancillary issues) outweighs the benefits of an APA. Waiting for an issue to crystallize and pursuing MAP relief thereafter may be a much more effective way to avoid double taxation, even at the cost of losing prospective certainty.

<sup>15</sup> *Id.* at 6.