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U.S. APA Transfer Pricing and LB&I ReStructure / Audit Process Update

William Byrnes (Texas A&M University Law) · Monday, April 11th, 2016

Treasury recently released its 2015 Transfer Pricing Advance Pricing Agreements Report to Congress, the seventeenth report since the initial 1999 report. Each year, the Treasury APA Report describes the annual experience, structure, and activities of the APMA Program. Treasury also formally released the much discussed new audit/examination protocols that will become effective 1 May 2016. For this brief article, I review the APA report in contrast to last years, the new LB&I Examination publication, and share my additional comments.

IRS' Large Business & International (LB&I) Restructure of 2015

As of 31 December, 2015, the APMA program was comprised of 62 team leaders, 21 economists, and 10 senior managers organized into 10 groups (7 team leader groups and 3 economist groups). Each team leader group has responsibility for cases involving certain countries with one of the economist groups also taking responsibility of a country. Because of the large volume of cases with certain treaty partners, some countries are the responsibility of more than one group.

In June of 2015, in light of its budget constraints and decreasing personnel, LB&I revealed that it would reorganize its examination process and protocols. As reported to the ABA Tax Section mid-year meeting (14 March 2016), LB&I's staffing, due to retirements and jumping ship for private industry, has been further reduced to 5,200 from 5,500 as of June 2015, which is overall down from a high of 7,500 in 2010. Of the 5,200 LB&I positions, between 500 and 600, it is reported, are international trained examiners in addition to 2,800 domestically trained. Although the IRS reports that 80 percent of the issues, by revenue, are international in nature, only 20 percent of the resources are allocated to these issues.

In December 2015, Congress approved through September 2016 a \$290 million increase in the IRS's budget. The IRS budget has not been increased for the past five years, partly stemming from Congress' anger over the IRS' targeting of conservative groups (see daily coverage of the scandal on [Tax Prof Blog](#)).

New Audit – Examination Process Begins Next Month

The IRS has for the past year been shifting tact from its Coordinated Industry Case (CIC) model with continuous auditing to a risk assessment based modeling focused on data analytics. LB&I Deputy Commissioner Douglas O'Donnell stated in spring 2015 that these coordinated audit

groups are leveraging the risk based approach by weighing the size of the compliance risk, how often the risk is occurring, where it is occurring and if the risk is a result of a promoted scheme.

LB&I will follow the lead of the Transfer Pricing Practice as a practice area group and develop other ones, as well as reconstitute exam teams along specialized practice areas. The measurement of performance may shift from the number of case closures to number of case openings and time expended on each case.

Treasury thoughts have crystallized in the form of Publication 5125 “the LB&I Examination Process” which will become effective 1 May 2016. The publication outlines the new examination process which provides an issue-based approach for conducting professional examinations from the first contact with the taxpayer through the final stages of issue resolution. The enhanced process establishes roles and responsibilities for both LB&I examiners and taxpayers and sets specific expectations with respect to claims for refund. Publication 5125 highlights key factors in each phase of the examination including Planning, Execution and Resolution. Key examination points from the new protocols include:

- Sets clear expectations for LB&I examiners, taxpayers, and representatives.
- Examiners are expected to work transparently in a collaborative manner with taxpayers to understand their business and share the issues that have been identified for examination.
- Encourages taxpayers and/or representatives to work transparently with examiners to provide an overview of business activities, operational structure, accounting systems and a global tax organizational chart.
- Establishes expectations for working collaboratively to develop audit steps, timelines and providing appropriate personnel to actively assist in the development of the issue(s) identified

2015 New APA and MAP Revenue Procedure

On 31 August 2015, new revenue procedures governing MAP and APA applications were published in 2015-35 I.R.B. 236 and 263, respectively. Revenue Procedure (Rev. Proc.) 2015-41 provides guidance and instructions on filing APA requests as well as guidance and information on the administration of APAs. You can read the detailed analysis of the impact of the new Revenue Procedures in Prof. William Byrnes’ [Practical Guide to U.S. Transfer Pricing](#) as well as analysis of the LB&I reorganization, year-by-year data, and new examination process.

Survey of Submitted and Completed APA and APMA Data for 2015

In 2015, 183 taxpayers submitted transfer pricing APAs. Four of these APAs sought required multilateral involvement, 127 bi-lateral, and only 52 were proposed solely with the IRS. Separately, 14 taxpayers sought a double tax agreement mutual agreement procedure because of a transfer pricing adjustment. Contrast this growth for APAs with the 108 APAs submitted in 2014. Thus, it appears that more taxpayers are seeking the certainty of an APA. No APAs were revoked by Treasury in 2015, although taxpayers withdrew 10 from the process of negotiation.

Of the Bilateral APAs (BAPAs) completed in 2015, 46 percent were with the Japanese Revenue Authority – consistent with previous years and 23 percent with Canada. Thus, nearly 70 percent of BAPAs are with just two countries. Treasury announced a milestone in accomplishing its first BAPA with Italy.

However, while request for APAs increased, the number of executed APAs decreased to 110,

consisting of 30 unilateral APAs and 80 bilateral APAs. No multilateral APAs managed to crystallize in 2015. These numbers represent a decline from total APA/BAPS of 145 in 2013 and 140 in 2012. The average length of the APA years covered of the 110 agreements is seven years, including 24 agreements that included previous years (“roll back”) instead of the customary five prospective years alone. Treasury granted 11 APAs with coverage of 10 or more years.

Of these 110 agreements executed in 2015, 44 of the agreements (40 percent) were actually new APAs (*i.e.*, not a renewal of a prior APA). This was a decrease from the 53 (52 percent) new APAs executed in 2014, whereas Treasury renewed 18 unilateral APAs and 48 bilateral APAs, for a total of 66 extended APA/BAPAs.

75 percent of the 110 APAs executed covered manufacturing (40 percent, or 44 APAs) or wholesale/retail operations (35 percent, or 39 APAs), with service operations only covered by 11 percent (12 APAs). 85 percent of these APAs relied on the comparable profits method (CPM)/transactional net margin method (TNMM), and 11 percent on the services cost method.

Arm’s Length Data

Taxpayers and Treasury culled arm’s length financial and contractual data from public sources and numerous providers e.g. RoyaltyStat, OneSource, Orbis, Mergent, Bloomberg, Disclosure, Global Vintage, BvD, ktMINE, LoanConnector, Recap, RoyaltySource and Worldscope.

Median Completion Time

In 2014 the average cycle time rose to 38.3 months for only 101 executed APAs, and as of July 2015, the average cycle time increased yet again to 41.2 months. 376 APAs remained pending at that time with each senior manager responsible for 54 on average, seven per team leader. The good news is that the overall median time to complete is now only 31.9 month, primarily because BAPAs require more than three years (38.2 months). Unilateral APAs are running a median completion time of 17.3 months, less than 1.5 years – quite acceptable.

One can draw a conclusion that foreign partner Revenue authorities have not committed the resources necessary or do not have the expertise yet to reduce the median completion time for BAPAs. Unfortunately, given the advent of CbCR, BAPAs are more critical than ever before.

Competent Authority’s Advance Pricing and Mutual Agreement Program (APMA) and Treaty Assistance and Interpretation Team (TAIT)

In 2014, the USCA reported it received 286 requests compared to the 266 requests of 2013 and 181 requests of 2012. It only managed to resolve 133 of these cases, down from 159 in 2013 of these cases with 718 cases remaining in pending status, a substantially higher backlog from the 524 in 2013 and 2012’s 90 resolved and 403 pending. In 2015, the MAP backlog has grown to 762 open cases with an average cycle time of 24 months, leading to an average per senior manager of 109 MAP cases and 13 MAP cases per team leader, in addition to the APA open cases mentioned above.

By June of 2015 the IRS reported that the Revenue Authority of India had already lodged 61 new transfer pricing mutual agreement procedures with total proposed adjustments of \$1.25 billion. This is up from the 96 lodged a year earlier by India with \$1.2 billion of adjustments and 56 in 2013 of \$900 million of adjustments.

The Office of the United States Competent Authority (USCA) includes both the Advance Pricing and Mutual Agreement (APMA) Program and the Treaty Assistance and Interpretation Team (TAIT). (APMA) has primary responsibility for cases arising under the business profits and associated enterprises articles of U.S. income tax treaties whereas TAIT handles cases arising under all other articles of U.S. income tax treaties, and under U.S. estate and gift tax treaties. In 2014 the IRS launched the APMA website. Currently the site contains APMA program information, such as new procedures for APA user fees, published guidance, and tax treaty information.

Prof. William Byrnes (Texas A&M Law) [Practical Guide to U.S. Transfer Pricing](#) is a primary resource of over 2,000 subscribing multinationals, government departments, and firms who must cope with transfer pricing rules and procedures, taking into account the U.S. international norms established by the Organisation for Economic Co-operation and Development (OECD).

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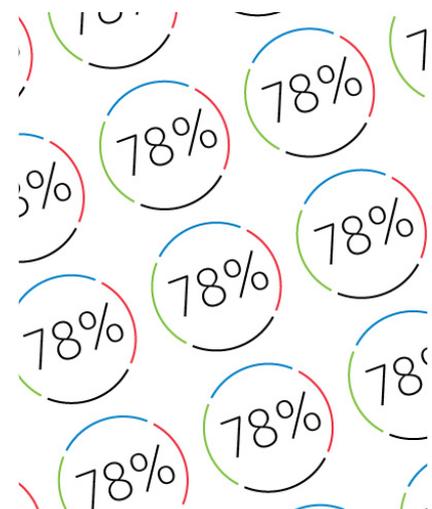
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