

**IRS APA HEARINGS
FEBRUARY 1, 2005
OUTLINE OF TESTIMONY**

A. Welcome and Thank You for the Opportunity to Testify

1. The Existing APA program represents one of the most significant historical advances in tax policy and administration
2. The APA program exemplifies US leadership in global tax policy, with many countries following the US lead
3. When originally created, the APA program resulted from an innovative and open IRS state of mind, willing to take certain risks to achieve the quantum advance in tax policy administration
4. The ideas presented below could substantially enhance the value and impact of the APA program, but will require a similar innovative governmental perspective

B. Presentation of 4 Ideas to Improve Accessibility, Timeliness, Handling and Effectiveness of APA Program

1. Re-position APA Group in an independent manner parallel to IRS Appeals
 - ❖ The APA Group specializes in Transfer Pricing matters with a number of the IRS APA employees dedicating much of their life's work to fully understanding this area of tax law
 - ❖ IRS Exam employees oversee many issues such as Subpart F and foreign tax credits and do not have the specialized experience or training that the APA Group has
 - ❖ In practice, the APA Group like IRS Appeals is trained to fully analyze but also resolve transfer pricing issues, while IRS Exam and IRS Exam economists are generally trained to raise issues as advocates for the government
 - ❖ Today, the APA team in a number of instances has operated more as a mediator/referee between IRS Exam and the Taxpayer rather than as an independent decision-maker
 - ❖ This has discouraged a number of taxpayers from entering the program, based upon my discussions with other companies
 - ❖ Make the APA National Office Economists' views authoritative relative to the IRS Exam Economists, and consider specializing APA Economists by Industry Group

2. Petition Treasury for authorization to enter into “synthetic” bilateral APA’s where no tax treaty exists; ask Congress to facilitate use of synthetic bilateral APA’s by indicating that it would be good for American business to have such a policy
 - ❖ The US does not have treaties with a number of important trading partners such as Brazil, Argentina, and Singapore
 - ❖ US taxpayers can experience significant double taxation exposure due to use of formulary methods by foreign governments that are not based upon the arms-length standard
 - ❖ This problem can inherently increase transfer pricing disputes that cost both the government and taxpayers time and resources
 - ❖ It should not be necessary for 2 countries to reach agreement on and ratify all aspects of a regular treaty such as withholding, limitation of benefits and source of income, in order for such countries to eliminate the resource costs and inequities of transfer pricing issues
 - ❖ Allowance of “synthetic” APA’s where no treaty exists would enhance effectiveness and accessibility of APA program, enhance IRS knowledge of such foreign jurisdictions, and proactively avoid transfer pricing disputes before they start, thereby furthering the Commissioner’s goals

3. For routine rates of return, publish safe-harbor comparable profits transfer pricing ranges by SIC Code for both royalties and tangible property, based on the extensive IRS knowledge base. For non-routine rates of return, publish safe-harbor arms-length profit split ranges by SIC Code, by standardized level of functionality. Allow “Short-form” APA for taxpayers of all sizes at reduced fee that use such ranges.
 - ❖ This action would improve all 4 targets of enhancing accessibility, timeliness, handling and effectiveness of the APA program
 - ❖ Utilize same safe-harbor ranges, by SIC Code for both inbound and outbound transactions
 - a. Avoids whipsaw for government and taxpayers
 - b. Avoid “haircut” (simplified LIFO) that would discourage taxpayer use of Short-form program and antagonize other jurisdictions
 - ❖ Advances continuing US tax leadership in worldwide tax matters by increasing openness, stabilizing and standardizing comparable rates of return, and countering practice of secret comparables utilized by certain foreign jurisdictions
 - a. Use of same safe-harbor for both inbound and outbound transactions should relax a number of concerns of foreign trading partners
 - ❖ Parallels action already in place for interest rates involving USD-based loans

- ❖ Introduces concept of “Short-form APA” for both large, medium and small taxpayers
 - a. Commit to 6-month turn-around time due to stream-lined procedures that would result from published comparable safe-harbor ranges
 - b. IRS Exam would conduct an advance confirming review of the factual representations relative to the selected safe harbor range during the first 3 months of the Short-form APA process.
 - c. Large taxpayers would use both for transfer pricing matters that do not have significant intangibles, or for CFC's that have small to medium levels of sales, where long-form APA's would be cost prohibitive
 - d. Medium sized taxpayers might for the first time access the APA program due to the increased velocity and cost effectiveness
 - ❖ Taxpayers that either have significant intangibles or a CUP methodology would continue to use the Long-form APA
 - ❖ Could lead to an eventual worldwide pool of agreed comparable safe-harbor transfer pricing ranges, as other countries followed US leadership in this area
4. Compile and extend safe-harbor interest rate range tables to include major foreign currencies such as the Euro, due to the expansion of international commerce
- ❖ Adds velocity and certainty to the Exam process and eliminates needless controversy

C. Conclusion

John S. Mitchell
Vice President-Taxes
Eaton Corporation