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IRS APA Hearings
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Opening Statement

As I was finalizing my remarks for today's presentation, I learned of the sudden and unexpected death of Craig Gilbert's wife yesterday afternoon. As everyone knows, Craig serves as Matt Frank's very capable Special Counsel to the APA program. My words cannot adequately convey the deepest of sympathies and condolences for Craig and his children for their tragic loss. I know that I join all others here in a special prayer for Merrie, her family and her friends.

Background

The atmosphere that led to the creation of the APA program back in 1989 included what many believed was an exceptionally contentious relationship between IRS auditors and corporate taxpayers.

There was a perception within the Service and amongst some members of Congress that a number of U.S. multinational corporations were either improperly shifting income offshore or, in the case of some foreign-owned U.S. subsidiaries, not reporting an appropriate amount of income on their U.S. returns.

However, there were a large number of taxpayers, both U.S. and foreign-based, that welcomed the APA alternative, since they felt that they were already trying to comply with what was then an evolving concept of the arm's length standard. While the "idea" of an APA was greeted with broad enthusiasm, there were many skeptics. These included not only taxpayers who preferred that others precede them in this new procedure, but also IRS personnel and tax officials from other countries. Quite frankly, the biggest challenge for the Service at that time was in convincing taxpayers that they would be treated fairly, which, ironically, remains somewhat of an issue today. More on that point later.

Sitting here sixteen years later, it is difficult to fully appreciate the dramatic changes in attitude that have taken place toward the APA process and its progeny (e.g., Pre-Filing Agreements). Now, practically every major tax administration in the world has an APA program. Nearly every one of these programs differs in how it is administered, but all of them share, or should share, the same goal – common agreement on an approach or methodology that produces arm's-length results. These methodologies should be relatively easy to administer and even easier to audit, thus eliminating the risk of penalties for taxpayers and audit frustrations for tax administrations.

All of this said, there is no doubt that this process could continue to be improved and I welcome the opportunity to share my views with you. Some of these ideas may have been

mentioned by the speakers before me, and I will try to not dwell on points that have been repeatedly addressed already.

Finally, I should acknowledge that these are my views and they should not necessarily be attributed to Mayer, Brown, Rowe & Maw LLP or its clients.

Special Areas of Comment

A. Consistency

It is difficult to imagine anyone not supporting consistent treatment for similarly-situated taxpayers. And this proposition is hardly limited to transfer pricing, or even to the broad area of tax law. As everyone knows, the concept of equal and fair treatment by the government is a pillar of our Constitution.

As everyone also knows, the question of consistency in the APA program currently is the so-called "elephant in the room" -- the current Tax Court case involving Glaxo.

I am sure that there are several sides -- perhaps more -- to the Glaxo claim that it was improperly discriminated against, and I personally do not know any of the relevant facts underlying the company's equal protection arguments. Nevertheless, I am troubled by the accusations of such severe inconsistency of treatment. I have also heard complaints from practitioners and taxpayers alike that the "aggressiveness" toward an APA participant increases depending upon whether the trade flow is inbound or outbound. Thus, an "inbound" royalty may not be challenged with the same zeal that one sees toward an "outbound" royalty. Note, however, that this criticism is not limited to the United States.

It is unnecessary to raise specific accusations regarding this point, but I assure you that it is a concern shared by quite a number of practitioners and taxpayers. Every government needs to be aware of the implications if such an attitude is not tempered. APAs would no longer become an attractive alternative to full-fledged audits, where frequently, crafty IDRs are parried by well-considered responses. And remember, it is not only taxpayers that benefit from APAs, but tax administrations save significant resources having APAs as well.

What would be my solution? A large part is related to reaction and attitude by the relevant government. For example, the goal of an APA case should not simply be to see how many ways a taxpayer's proposal can be reconstructed in order to maximize revenues to the government that is reviewing the application. Rather, except in extraordinary cases, the place to start is with the taxpayer's proposal, determine if the assumed facts are materially correct, and then test whether the financial and economic analyses are reasonable. This requires some degree of due diligence. It should not convert an APA into a full-fledged audit. Taxpayers should understand, however, that they will need to provide a higher degree of cooperation to achieve such a result. If at end of the APA process, there remain lingering doubts as to what the "perfect" answer is, then perhaps that should be reflected in a shorter term for the APA rather than "mutual disagreement."

To those critics that are concerned about getting every APA case perfectly resolved, I would simply point out the wide swath of agreements that are forged in audits and appeals around the country virtually every day. I am certain there is far greater inconsistency in the non-APA cases than in those one would examine within the APA program.

B. Resources

I imagine that when the statistics for the 2004 APA program are published, they will reflect the fact that a large number of APA resources were redeployed from "active" APA cases to responding to the Congressional investigation of the APA program.

Most practitioners' experiences have reflected a slower turnaround time for the APA office review of their cases. Does that necessarily mean that the APA program is understaffed? I question whether all of these delays can be blamed solely on the APA investigation since, if my understanding is correct, the last time a Team Leader was brought into the APA Office from private practice was over three years ago.

Originally, one of the strong justifications for placing the APA program within Counsel's office was the unique ability of Counsel to inject "fresh blood" periodically into the program. If that principle has eroded, then I believe that the IRS should at least explore alternatives to supplement any understaffing problems.

My specific recommendations to address any resource constraints would include the following:

1) Consider, on a pilot basis at least, experimenting with the Fast Track teams within IRS Appeals to analyze some of the taxpayers' submissions. This would require internal IRS coordination that could prove daunting and it should require taxpayer consent. But, I believe that some of the most valuable resources within the Service are in Appeals, and I suspect that they are somewhat underutilized given the fact that so many cases are "resolved" at the Exam level these days.

Also, if this approach was considered, I would urge that the same 90 day window for Fast Track be applied to this internal review process.

2) Another resource constraint is the lack of travel money for the APA office. When the Canadians started their APA program and began to charge taxpayers directly for their travel expenses, I looked at such a possibility. I was told that it would be virtually impossible to achieve because it would represent an "unauthorized appropriation." I also heard, however, that other government agencies had special legislation to overcome this problem. I would encourage you to revisit this issue because the "voluntary" nature of this APA program, and its mature status versus where it was a dozen years ago, perhaps makes the arguments for special funding a bit different today.

If this was achieved, I would also subtract any travel expense covered by the taxpayer from the filing fee.

C. Procedural Changes

1) When the APA program started, I believed it was important that Chief Counsel's office retain control -- and origination -- of the APA agreement itself.

I no longer believe this to be true, and I would urge shifting the initial responsibility for drafting the agreement to the taxpayer because this has created unnecessary delays. Of course, the taxpayer would need to work from whatever the current model agreement was, and the agreement would still be subject to final approval by the IRS.

2) I would similarly place responsibility for any necessary disclosure statements on the taxpayers. At the same time, I would re-examine whether the current disclosures contained in the March 31 Annual APA Report from the IRS provide sufficient transparency to ensure that consistency of treatment is achieved and maintained.

D. Coordination

Currently there are issues in the PFA program (notably, the Permanent Establishment issue) that should seamlessly be integrated into one process and one agreement when a taxpayer seeks guidance on both its transfer pricing and PE issues.

I urge you to find a way to make this jurisdictional conflict a non-issue and taxpayer-friendly.

Conclusion

Thank you for your patience. I wish you well in your endeavors to improve the APA process.