

## LB&I International Practice Service Process Unit – Audit

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Shelf	N/A	Income Shifting	–	–
Volume	6	Income Shifting – Business Inbound	<b>Level 1 UIL</b>	9422
Part	6.9	Other Transfer Pricing Issues	<b>Level 2 UIL</b>	9422.09
Chapter	6.9.1	Other Transfer Pricing Issues	<b>Level 3 UIL</b>	N/A
Sub-Chapter	N/A	N/A	–	–

<b>Unit Name</b>	Revenue Procedure 99-32 Inbound Guidance
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# Process Overview

## Revenue Procedure 99-32 Inbound Guidance

### Process Description

When an allocation is made under IRC 482, a “conforming” adjustment must be made to conform a taxpayer’s account to reflect the allocated amount. Generally, the conforming adjustment treats the allocated amount, depending on the allocation, as either a dividend or a capital contribution. In appropriate cases, the allocated amount may, instead, be repaid in accordance with the applicable revenue procedures without the otherwise required conforming adjustment (or the tax consequences of the conforming adjustment). Revenue Procedure (Rev. Proc.) 99-32 sets forth the requirements and procedures for treating and repaying the allocated amount as an interest bearing account receivable or account payable.

Treatment under Rev. Proc. 99-32 is available for eligible taxpayer-initiated, as well as Service-initiated, adjustments. This unit focuses on Service-initiated adjustments.

Note that the treatment of conforming adjustments under Rev. Proc. 99-32 is separate from, but closely related to, the treatment of conforming adjustments under Rev. Proc. 2015-40 (and its successor (see Notice 2013-78)), which sets forth the procedures for requesting assistance of the U.S. competent authority to obtain relief from double taxation.

Rev. Proc. 2015-41, Section 7, governs repatriation with respect to APA primary adjustments. For the repatriation of funds to conform the accounts following an APA primary adjustment, Rev. Proc. 99-32 or its successor guideline will govern unless the competent authority repatriation specified in Rev. Proc. 2015-41, section 7.01(2)(c) – Competent Authority Repatriation, applies. In pursuing relief from double taxation for a taxpayer that has requested assistance, the U.S. competent authority may provide relief consistent with the principles of Rev. Proc. 99-32. (Rev. Proc. 2015-40, Section 4.02(2) – Competent Authority Repatriation). See Practice Unit, “Competent Authority Revenue Procedure 2015-40 Guidance: U.S. initiated Adjustment(s),” ISO/PUO/P\_1.7\_03(2015) for further information on requesting competent authority assistance.

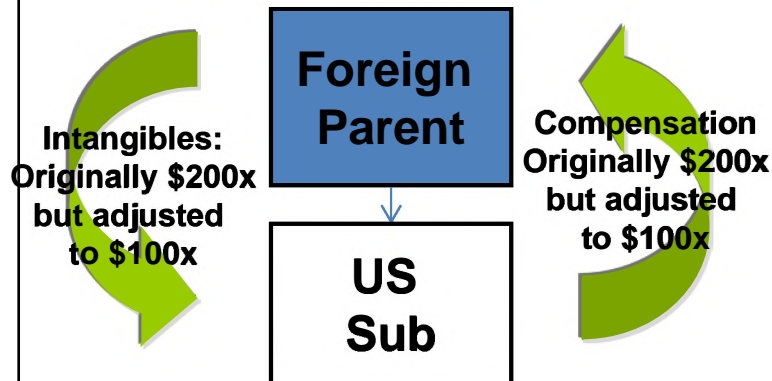
# Process Overview (cont'd)

## Revenue Procedure 99-32 Inbound Guidance

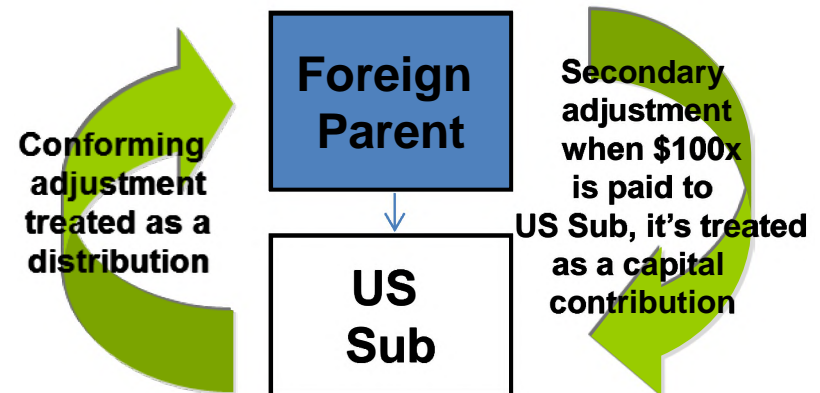
### Example Circumstances Under Which Process Applies

- In TY1, Foreign Parent (FP) licenses intangibles to its wholly owned US subsidiary (US Sub) for an annual royalty of \$200X. The IRS respects the form of the transaction as a license. The Service determines that the arm's-length royalty should have been \$100X. The Service makes the following adjustments:
  - Primary adjustment: US Sub's taxable income (and earnings and profits, or E&P) is increased by \$100X.
  - Correlative adjustment: FP's taxable income (and E&P) is decreased by \$100X.
  - Conforming adjustment: FP has excess cash of \$100X (the allocated amount) that is treated as a distribution from the US Sub.
  - Secondary adjustment (or tax consequence) without Rev. Proc. 99-32 treatment: When the \$100X is paid, it is treated as a capital contribution to the US Sub.

#### Primary and Correlative Adjustments



#### Conforming and Secondary Adjustments



# Process Overview (cont'd)

## Revenue Procedure 99-32 Inbound Guidance

### Example Circumstances Under Which Process Applies

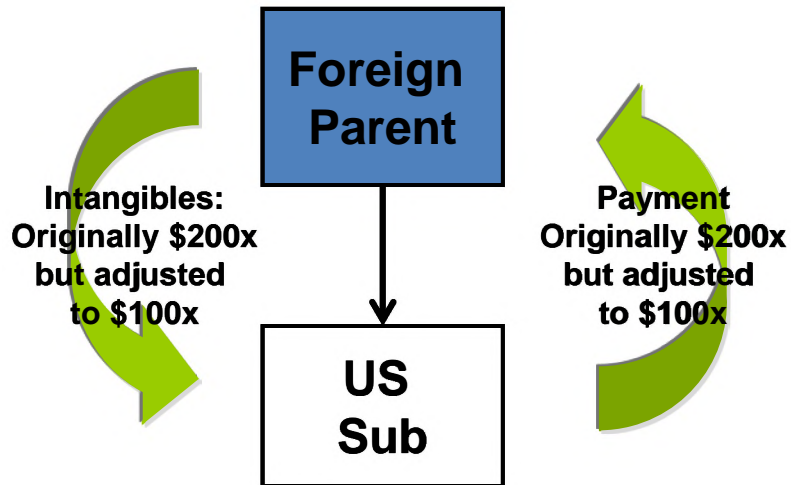
- In TY1, Foreign Parent (FP) licenses intangibles to its wholly owned US subsidiary (US Sub) for an annual royalty of \$ 200X. The IRS respects the form of the transaction as a license. The Service determines that the arm's-length royalty should have been \$100X.
- The Service makes the following adjustments:
  1. Primary adjustment: US Sub's taxable income (and earnings and profits, or E&P) is increased by \$100X.
  2. Correlative adjustment: FP's taxable income (and E&P) is decreased by \$100X.
- Instead of the conforming adjustment in Example 1, under Rev. Proc. 99-32, the \$100X (allocated amount) is treated and repaid as an account payable (A/P) from FP to the US Sub, which has an account receivable (A/R) of \$100X:
  1. An account receivable (A/R) of \$100X is deemed created as of the last day of TY1;
  2. From the first day of TY2, the A/R bears arm's-length interest (or, most often, the applicable Federal rate);
  3. US Sub includes in income interest that accrues on the A/R (and FP as expense) until the A/R is paid;
  4. The A/R must be paid by the 90th day of the execution of the (required) closing agreement on behalf of the Commissioner (for Service-initiated adjustments).

# Process Overview (cont'd)

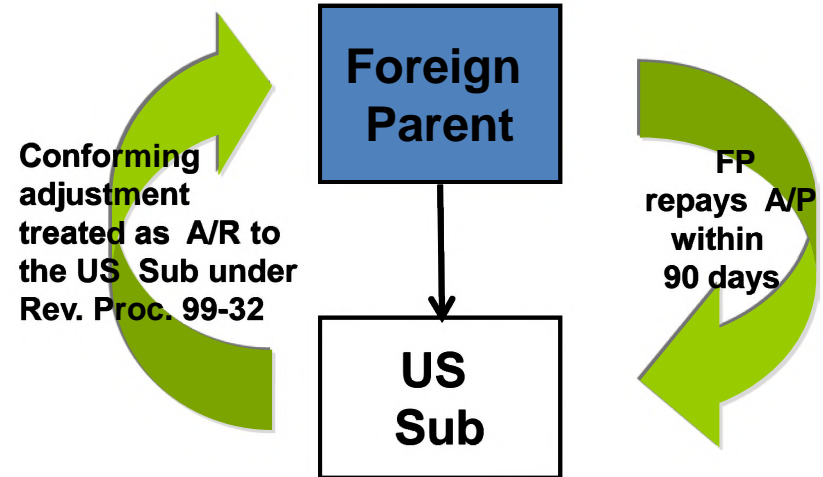
## Revenue Procedure 99-32 Inbound Guidance

### Example Circumstances Under Which Process Applies

#### Primary and Correlative Adjustments



#### Rev. Proc. 99-32 treatment



# Determination of Process Applicability

## Revenue Procedure 99-32 Inbound Guidance

Once a taxpayer requests Rev. Proc. 99-32 treatment, you must first determine if the adjustment falls within the scope of Rev. Proc. 99-32 and then determine if the applicable conditions were satisfied and the required procedures followed.

Criteria	Resources	6103 Protected Resources
<ul style="list-style-type: none"><li>▪ The adjustment must be within the scope of Rev. Proc. 99-32.</li></ul>	<ul style="list-style-type: none"><li>▪ Rev. Proc. 99-32, sec. 2</li><li>▪ Treas. Reg. 1.482-1(g)(1)</li></ul>	
<ul style="list-style-type: none"><li>▪ The applicable conditions must be satisfied.</li></ul>	<ul style="list-style-type: none"><li>▪ Rev. Proc. 99-32, sec. 3.01 and 3.03</li><li>▪ Treas. Reg. 1.482-1(g)(2)(i)</li></ul>	
<ul style="list-style-type: none"><li>▪ The required procedures must be followed.</li></ul>	<ul style="list-style-type: none"><li>▪ Rev. Proc. 99-32, sec. 5.01</li><li>▪ Treas. Reg. 1.482-1(g)(3)(i)</li></ul>	

# Summary of Process Steps

## Revenue Procedure 99-32 Inbound Guidance

### Step 1

Determine if the adjustment falls within the scope of Rev. Proc. 99-32.

### Step 2

Determine if the applicable conditions have been satisfied.

### Step 3

Determine if the required procedures have been followed.

### Step 4

Establish the terms of the Rev. Proc. 99-32 account and interest.



# Summary of Process Steps (cont'd)

## Revenue Procedure 99-32 Inbound Guidance

### [Step 5](#)

Consult field counsel in drafting the closing agreement.

### [Step 6](#)

Establishment and Satisfaction of Accounts Payable / Receivable

# Step 1

## Revenue Procedure 99-32 Inbound Guidance

### Step 1: Determine if the adjustment falls within the scope of Rev. Proc. 99-32.

Rev. Proc. 99-32 treatment is available to only certain adjustments involving certain taxpayers.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ Eligible adjustments:               <ul style="list-style-type: none"> <li>– Adjustments under IRC 482; and</li> <li>– Service-initiated adjustments under IRC 61 or 162 if such adjustments could have been made under IRC 482.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 99-32, sec. 2</li> </ul>	
<ul style="list-style-type: none"> <li>▪ Eligible taxpayer, a “United States taxpayer,” which under Rev. Proc. 99-32 is only:               <ul style="list-style-type: none"> <li>– A domestic corporation; and</li> <li>– A foreign corporation that is, or is treated as, engaged in trade or business within the United States.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 99-32, sec. 2</li> </ul>	
<ul style="list-style-type: none"> <li>▪ Controlled transactions between a controlled foreign corporation (CFC) and a foreign related corporation are also eligible, but transactions with noncorporate persons, such as a transaction between a partnership and its controlling corporate partner, are not covered by Rev. Proc. 99-32.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 99-32, sec. 2 and Explanation of Provisions, sec. E</li> </ul>	

# Step 2

## Revenue Procedure 99-32 Inbound Guidance

### Step 2: Determine if the applicable conditions have been satisfied.

For Service-initiated adjustments, these conditions must be satisfied.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"><li>No penalty under IRC 6662(e)(1)(B) or (h) on account of the primary adjustment is asserted, and if challenged, finally sustained.</li></ul>	<ul style="list-style-type: none"><li>Rev. Proc. 99-32, sec. 3.01</li></ul>	
<ul style="list-style-type: none"><li>No part of any underpayment of tax in the taxable year of the primary adjustment is due to fraud.</li></ul>	<ul style="list-style-type: none"><li>Rev. Proc. 99-32, sec. 3.03</li></ul>	

# Step 3

## Revenue Procedure 99-32 Inbound Guidance

### Step 3: Determine if the required procedures have been followed.

For Service-initiated adjustments, these procedures must be followed by the taxpayer.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ The taxpayer must file a written request with the Service that is both:               <ol style="list-style-type: none"> <li>1. Filed before “closing action” is taken on the primary adjustment; “Closing action” means:                   <ul style="list-style-type: none"> <li>▪ Execution of either a Form 870-AD or a closing agreement;</li> <li>▪ Stipulation to the IRC 482 allocation in the U.S. Tax Court;</li> <li>▪ Expiration of the statute of limitations on assessment for the taxable year of the primary adjustment; or</li> <li>▪ Final determination of tax liability of the taxable year of the primary adjustment by offer-in-compromise, closing agreement, or court action.</li> </ul> </li> <li>2. Signed by a person authorized to sign the taxpayer’s federal income tax return.</li> </ol> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 99-32, sec. 5.01(1) and (2)</li> </ul>	

# Step 3 (cont'd)

## Revenue Procedure 99-32 Inbound Guidance

### Step 3: Determine if the required procedures have been followed.

For Service-initiated adjustments, these procedures must be followed by the taxpayer.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ The taxpayer's written request must contain the following:               <ul style="list-style-type: none"> <li>– A statement that the taxpayer desires the treatment provided in section 4 of Rev. Proc. 99-32 and the years for which such treatment is requested;</li> <li>– A description of the transactions that give rise to the primary adjustment; and</li> <li>– An offer to enter into a closing agreement.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 99-32, sec. 5.01(2)</li> </ul>	
<ul style="list-style-type: none"> <li>▪ The Service determines if the taxpayer qualifies for the requested treatment and informs the taxpayer of its decision.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 99-32, secs. 5.01(3) &amp; (4)</li> </ul>	

# Step 4

## Revenue Procedure 99-32 Inbound Guidance

### Step 4: Establish the terms of the Rev. Proc. 99-32 account and interest.

If the Service determines that the taxpayer qualifies for the requested Rev. Proc. 99-32 treatment and the amount of the primary adjustment has been agreed upon, then the parties must execute a closing agreement containing certain required terms. Before consulting counsel in drafting the closing agreement, the agent should establish that the terms are met, as described below.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ The agreed amount of the primary adjustment.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 99-32, sec. 5.01(4)(a)</li> </ul>	
<ul style="list-style-type: none"> <li>▪ The amount and currency of and parties to the account to be established.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 99-32, secs. 5.01(4)(b) &amp; sec. 4.01</li> </ul>	
<ul style="list-style-type: none"> <li>▪ Interest (and interest income/expense):               <ul style="list-style-type: none"> <li>– The arm’s-length rate of interest (that the applicable Federal rate (AFR) only applies to US dollar denominated A/P and A/R);</li> <li>– Amounts accrued or to be accrued.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 99-32, sec. 5.01(4)(c) &amp; sec. 4.01(2); Reg. sec. 1.482-2(a)(2)(iii)</li> <li>▪ Index of Applicable Federal Rates (AFR) Rulings</li> </ul>	
<ul style="list-style-type: none"> <li>▪ The amount of any foreign tax credit the taxpayer will claim with respect to the payment of the account established under section 4.01.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 99-32, sec. 5.01(4)(d)</li> </ul>	

# Step 4 (cont'd)

## Revenue Procedure 99-32 Inbound Guidance

### Step 4: Establish the terms of the Rev. Proc. 99-32 account and interest.

If the Service determines that the taxpayer qualifies for the requested Rev. Proc. 99-32 treatment and the amount of the primary adjustment has been agreed upon, then the parties must execute a closing agreement containing certain required terms. Before consulting counsel in drafting the closing agreement, the agent should establish that the terms are met, as described below.


Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ The manner of payment of the account to be established. The manner of payment may be in the form of (a) money; (b) a written debt obligation payable at a fixed date and at arm's-length interest; or (c) offset by an existing debt. [Note: Refer to slide 15 for additional guidance on offset.]</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 99-32, secs. 5.01(4)(e) &amp; 4.01(4)</li> </ul>	
<ul style="list-style-type: none"> <li>▪ The amount and date of any prepayment.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 99-32, secs. 5.01(4)(e) &amp; 4.02</li> </ul>	

# Step 5

## Revenue Procedure 99-32 Inbound Guidance

### Step 5: Consult field counsel in drafting the closing agreement.

For a Service-initiated adjustment, a closing agreement is required.

Considerations	Resources	6103 Protected Resources
 <b>CONSULTATION:</b> After establishing the required terms in Step 4, contact field counsel for assistance with drafting the closing agreement.	<ul style="list-style-type: none"><li>Internal Revenue Manual (IRM) 8.13.1 - Exhibit 8.13.1-21 (11-09-2007) has draft closing agreements</li></ul>	



# Step 6

## Revenue Procedure 99-32 Inbound Guidance

### Step 6: Establishment and Satisfaction of Accounts Payable/Receivable

Establishment and Satisfaction of Accounts Payable / Receivable

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ When Rev. Proc. 99-32 treatment is effective, the taxpayer must establish an interest-bearing account that Rev. Proc. 99-32 refers to as an account receivable if payment is received from, or account payable if payment is to be made to, the related party (the account). A separate account is established for each year in which there is a primary adjustment with the amount of the account initially being equal to the amount of the primary adjustment for each year in which an allocation is made. Each account is deemed created as of the last day of the taxpayer's taxable year for which the primary adjustment is made.</li> <li>▪ The account must bear interest at an arm's length rate from the day after the date the account is deemed to have been created to the date of payment. Further, the account must be satisfied within 90 days after execution of the closing agreement.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 99-32, secs. 4.01 &amp; 5.01(4)(e)</li> </ul>	

# Step 6 (cont'd)

## Revenue Procedure 99-32 Inbound Guidance

### Step 6: Establishment and Satisfaction of Accounts Payable/Receivable

Establishment and Satisfaction of Accounts Payable / Receivable

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ Satisfaction of the account may be made by cash, written debt obligation, or an offsetting accounting entry against a pre-existing debt owed by the obligee of the account to the obligor.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 99-32, secs. 4.01 &amp; 5.01(4)(e)</li> </ul>	
<ul style="list-style-type: none"> <li>▪ Satisfaction by Offset. The taxpayer may treat all or part of the interest and principal of an account as prepaid before the beginning of the 90-day period to the extent of an accounting entry offsetting the account against a pre-existing debt between the parties. An account can be offset by a distribution or capital contribution made in the taxable year that the closing agreement is executed.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 99-32, sec. 4.02</li> </ul>	

# Other Considerations / Impact to Audit

## Revenue Procedure 99-32 Inbound Guidance

Considerations	Resources
<ul style="list-style-type: none"><li>▪ The next audit cycle would verify that the payment was made in the 90-day payment period.</li></ul>	
<ul style="list-style-type: none"><li>▪ Mutual Agreement Procedure Context. If a taxpayer intends to seek Rev. Proc. 99-32 treatment in connection with competent authority assistance relating to a section 482 allocation, it must request Rev. Proc. 99-32 treatment in conjunction with its request for competent authority assistance.</li><li>▪ Rev. Proc. 99-32 treatment is the result of IRS published guidance. Foreign countries generally do not make a similar procedure available to taxpayers. However, pursuant to the MAP provisions of most treaties the U.S. has with other countries, the mutual agreements reached by the U.S. and foreign competent authorities often reflect the principles of Rev. Proc. 99-32 treatment.</li></ul>	<ul style="list-style-type: none"><li>▪ Rev. Proc. 2015-40, sec.02(2) Competent Authority Repatriation</li></ul>

# Training and Additional Resources

## Chapter 6.9.1 Other Transfer Pricing Issues

Type of Resource	Description(s) and/or Instructions for Accessing	References
Reference Materials - Treaties	<ul style="list-style-type: none"><li>▪ Bittker and Lokken, <i>Fundamentals of International Taxation</i>; 2011/2012 Edition, Para. 79.12.2 Payment of Reallocated Amounts, Page 79-173</li></ul>	
Articles	<ul style="list-style-type: none"><li>▪ Robert T. Cole, <i>Practical Guide to U.S. Transfer Pricing</i>; (3rd ed., 2006)</li></ul>	
White Papers/Guidance	<ul style="list-style-type: none"><li>▪ Rev. Proc. 99-32</li></ul>	
Other Training Materials	<ul style="list-style-type: none"><li>▪ Rev. Proc. 99-32 Training</li></ul>	

# Glossary of Terms and Acronyms

Term/Acronym	Definition
A/P	Account Payable
A/R	Account Receivable
E&P	Earnings & Profits
FCC	Foreign Controlled Corporation
FP	Foreign Parent
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
ISI	Income Shifting Inbound
Reg.	Regulation
Rev. Proc.	Revenue Procedure
Sec.	Section
TY	Taxable Year
US Sub	United States Subsidiary

# Index of Related Issues

Issue	Associated UIL(s)	References
Competent Authority Procedures	<ul style="list-style-type: none"><li data-bbox="530 291 679 319">▪ 9422.09</li></ul>	<ul style="list-style-type: none"><li data-bbox="1268 291 1980 396">▪ Practice Unit, “Competent Authority Revenue Procedure 2015-40 Guidance: U.S. Initiated Adjustment(s),” DCN: ISO/PUO/P_1.7_03(2015)</li></ul>
Transfers of Intangibles	<ul style="list-style-type: none"><li data-bbox="530 429 679 458">▪ 9411.02</li></ul>	<ul style="list-style-type: none"><li data-bbox="1268 429 1929 575">▪ Practice Unit, “Distinguishing Between Sale, License and other Transfers of Intangibles to CFCs by U.S. Transferors,” DCN: ISO/9411.02_02(2013)</li></ul>