

## LB&I Process Unit Knowledge Base – International

Library Level	Number	Title
Shelf		Business Outbound
Book	1	Income Shifting (Outbound)
Chapter	1.5	Sales or Leases of Tangible Property/Goods
Section		
Subsection		

<b>Unit Name</b>	Advance Pricing Agreement for Tangible Goods Transactions – Outbound	
<b>Primary UIL Code</b>	9411.05	Sales or leases of tangible property/goods

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# Process Overview

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

- Both U.S. and foreign multinational enterprises (“MNEs”) may have operations in high tax jurisdictions and low tax jurisdictions and engage in transactions across such jurisdictions. Under the tax rules of the United States, and consistent with the tax rules of many other jurisdictions worldwide, the compensation paid in such transactions must be consistent with the compensation that would result in comparable uncontrolled transactions (“arm’s length price”). Examples of cross-border transactions that taxpayers may engage in include, but are not limited to, the sale of tangible goods, provision of services, loans, guarantees, leases and license/transfer of intangibles. “Transfer Pricing” is one of the major strategic issue areas under “Income Shifting” on the Business Outbound face of the International Matrix. Since the determination of arm’s length pricing is based on the facts and circumstances of each case, the transfer pricing audit is fact intensive. While most major industrialized countries, as members of the Organisation for Economic Co-operation and Development (“OECD”), have agreed to apply a common arm’s length principle in their transfer pricing analyses, each country may have varying interpretations of the arm’s length principle. Often a transfer pricing audit results in disagreements with respect to the methodologies applied by the taxpayer and the IRS. Addressing such disputes can be time consuming and a resource challenge to both tax administrators and taxpayers. Therefore, some taxpayers seek to reach agreement on transfer pricing methodologies on a prospective basis.
- In February 2012, the IRS established the Advance Pricing and Mutual Agreement Program (“APMA”) to oversee its Advance Pricing Agreement (“APA”) program and to act as the representative office of the U.S. competent authority responsible for handling competent authority cases arising under the business profits and associated enterprises articles of U.S. tax treaties. APMA enables the IRS and the taxpayer to resolve transfer pricing issues under IRC 482 and the regulations thereunder, as well as under relevant U.S. income tax treaties. An APA is a voluntary process conducted in a cooperative manner on a prospective basis, and in certain cases, may incorporate prior tax years as well. The APA process increases the efficiency of compliance and audit by encouraging taxpayers to come forward voluntarily and present all the facts necessary for the proper evaluation of the proposed issues to be covered in an APA request (“Covered Issues”), and working cooperatively with the IRS to secure mutual agreement regarding the pricing of the Covered Issues. This gives taxpayers greater certainty, reducing the burden of compliance on the taxpayer. The APA process is also one of the effective Alternative Issue Resolution tools that allow the IRS and the taxpayer to resolve transfer pricing issues.

# Process Overview (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

Below are examples of circumstances under which this process unit may apply. This is not an exclusive list.

APAs are intended to supplement traditional administrative, judicial, and treaty mechanisms for resolving transfer pricing issues.

- The exam team may suggest to a taxpayer that it consider initiating an APA Request. Taxpayers formally initiate the process for APAs. Thereafter, APAs require discussions between the taxpayer and one or more tax administrations, including the IRS.
- Ordinarily, an APA is reached only on the Covered Issue(s). In some cases, however, APMA may also need to consider additional, interrelated issues, additional taxable years, and/or additional treaty countries in order to reach an effective resolution.
- In some cases, the IRS and the taxpayer may agree to apply the Covered Method of the APA to specific back years (“Rollback Years”). Such rollback years may be formally covered within an APA.
- An APA can be used to address the following issues:
  - Transfer pricing adjustments (increases/decreases to prices of tangible goods; increases/decreases to royalty or other payments for intangible property; increases/decreases to fees, interest payments, loan guarantees, or other remuneration for controlled transactions).
  - Cost sharing arrangements.
  - Attribution of profits to a permanent establishment (“PE”) under an income tax treaty.
  - Sourcing income within and outside of the United States.
  - Determining the amount of effectively connected income (“ECI”) from the conduct of a trade or business within the United States.
  - Related subsidiary issues such as:
    - Characterization of income (e.g., whether a payment is for a royalty or for a service; whether a royalty payment is for the use of a patent or some other type of intangible property).
    - Timing of income (differences in the taxable year in which certain items of income are recognized).

# Process Overview (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

- Traditional auditing techniques analyze whether the compensation for a particular controlled transaction was arm's length after-the-fact. An APA permits taxpayers and tax administrators to establish an arm's length benchmark for controlled transactions on a before-the-fact basis. An APA is an agreement between the taxpayer and the IRS in which the IRS agrees not to challenge the pricing of the Covered Issue(s) as long as the conditions of the APA are satisfied.
- An APA can be unilateral, bilateral or multilateral. The parties to a unilateral APA are the taxpayer and the IRS. The parties to a bilateral APA are the taxpayer, one foreign affiliate, the IRS, and the tax authority in the foreign affiliate's jurisdiction. The parties to a multilateral APA are the taxpayer, the taxpayer's foreign affiliates relevant to the Covered Issue(s), the IRS, and the tax authorities in the relevant foreign affiliates' respective jurisdictions. Generally, if the U.S. has a tax treaty with a Mutual Agreement Process ("MAP") with the foreign tax authority(ies) relevant to the Covered Issue(s), the IRS will encourage the taxpayer to pursue a bilateral or multilateral APA. Further, if the taxpayer requests a unilateral APA to cover any issue that could be covered under a bilateral or multilateral APA, the taxpayer must explain in a pre-filing memorandum why it believes that a unilateral APA is appropriate. When there is no treaty or MAP with a relevant foreign jurisdiction, the APA can only be unilateral.
- The APA process begins with the filing of an APA Request by the taxpayer. It is necessary to compile a very thorough and careful description of the facts (functions performed, risks incurred, resources employed), and obtain any relevant comparables and analysis to support the best method for establishing an arm's length result. This requires the investment of significant human and financial resources. Therefore, the taxpayer may choose to limit the requested Covered Issue(s) based on its assessment of costs, risks, and benefits. An APA need not cover all of the transactions and entities of the taxpayer. The APA identifies the legal entities of the taxpayer covered by the APA and the Covered Issue(s). The APA will specify the agreed Covered Method(s) and the expected range of arm's length results (or single point) for each of the Covered Issues.

# Process Overview (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

- This Unit will focus on:
  1. understanding the APA process;
  2. identifying Coverable Issues under the APA;
  3. understanding the risk allocation between related parties;
  4. prefiling procedures;
  5. rollback of the Covered Methods;
  6. renewal of an APA;
  7. compliance with APA terms and critical assumptions;
  8. the examiner's involvement in the APA process;
  9. controlling the statute of limitations while an APA is under consideration; and
  10. the use of an APA in the audit process.
- For this purpose, we will focus on the pricing of tangible goods between related parties. Although this Unit focuses on the APA analysis for an outbound distributor, a similar analysis can be applied in a situation where a U.S. affiliate is the manufacturer and the foreign affiliate is the distributor.
- This Unit does not cover the selection of the “best method” to establish an arm’s length result.

# Process Overview (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Legal Guidance

- Rev. Proc. 2015-41 (2015-35 IRB 263) provides guidance on the process of requesting and obtaining APAs, as well as guidance on the administration of executed APAs. The revenue procedure was published on August 31, 2015, and updates and supersedes Rev. Proc. 2006-9 as modified by Rev. Proc. 2008-31, which is also superseded. A proposed version of Rev. Proc. 2015-41 was released for public comment in Notice 2013-79. This revenue procedure substantially restructured the proposed guidance in Notice 2013-79 to improve clarity, readability, and organization. The effective date of Rev. Proc. 2015-41 is generally August 31, 2015. However, under the transition rule in section 11 of Rev. Proc. 2015-41, an APA request filed by December 29, 2015, that is substantially complete may instead still be filed under Rev. Proc. 2006-9. All APA requests must be filed in accordance with Rev. Proc. 2015-41 after December 29, 2015.
- Rev. Proc. 2015-41 was issued concurrently with Rev. Proc. 2015-40 (2015-35 IRB 236), the successor to Rev. Proc. 2006-54, which provides procedures and guidance on the process for requesting assistance from the U.S. Competent Authority (CA) under the provisions of U.S. tax treaties. Both Rev. Proc. 2015-40 and Rev. Proc. 2015-41 are consistent on many substantive points with respect to coordination and collaboration with Exam on prominent procedural decisions. The two revenue procedures are intended to integrate the APA and CA processes and serve as complementary programs of tax and treaty administration.

# Process Overview (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

General Outline of Rev. Proc. 2015-41

Section 1: Purpose, background, definitions

Section 2: Scope and general principles

Section 3: Procedures for filing APA requests

Section 4: Actions on APA requests

Section 5: Coordination with Rev. Proc. 2015-40 and rollbacks

Section 6: Legal effect of an APA

Section 7: Administering an APA

Section 8: Renewing an APA

Section 9: Disclosure

Section 10: Effect on other documents

Section 11: Effective date

Sections 12, 13: Paperwork Reduction Act; drafting information

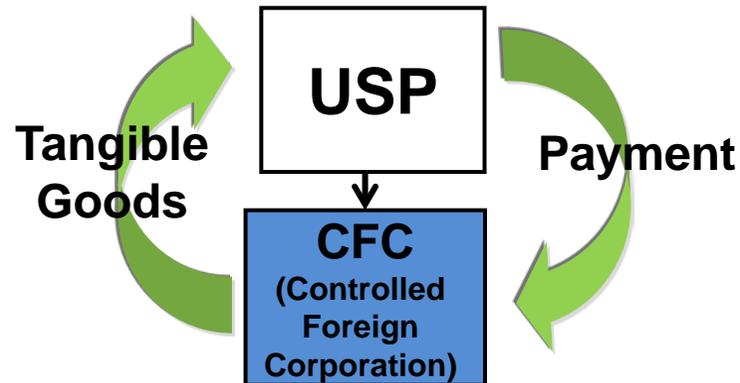
Appendix: APA request requirements and filing instructions

# Process Overview (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

The following example focuses on (i) the process involved in obtaining an APA by a U.S. Parent (“USP”) distributing tangible personal property purchased from its CFC in Japan (“CFC”); (ii) how to use an APA in the exam process, and (iii) the role of the various parties in the APA process. The principal facts are as follows:

- USP owns 100% of CFC. CFC is located in Japan.
- CFC manufactures tangible goods and sells them to USP, which in turn sells the goods to third-party customers in North America.
- USP is seeking a bilateral APA with the IRS and Japan’s National Tax Agency (“NTA”), and it is being represented by an outside consultant.
- The transfer pricing methodology (“TPM”) to be evaluated in this process unit is the comparable profits method (“CPM”)/transactional net margin method (“TNMM”). The CPM is a method specified under IRC 482. The CPM is not presented under other countries’ transfer pricing rules. The TNMM is a similar method presented under the OECD Transfer Pricing Guidelines for Multinational Enterprises (“OECD Guidelines”), which the NTA generally follows. The same process may apply to any tangible goods pricing methodology.



# Detailed Explanation of the Process

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Analysis

The APA process is a voluntary process that the exam team may suggest the taxpayer consider. The taxpayer must initiate the process, and the aim of the process is to work cooperatively with the IRS and other relevant tax authorities (in a bilateral or multilateral APA) to achieve a timely and fair resolution of transfer pricing issues. A related objective of the APA process is to avoid potential double tax issues through an alternative to traditional issue resolution procedures such as IRS Appeals and litigation. The parties may agree to apply the terms of a unilateral, bilateral or multilateral APA prospectively. Under certain circumstances, the parties may agree to apply the Covered Methods retroactively, if the foreign tax authority's local rules regarding APAs permit such rollbacks.

Entering into an APA eliminates the risk associated with future audits with respect to the Covered Issues, as an APA provides certainty to the taxpayer with respect to the Covered Issues. The APA process limits burdensome reporting requirements for information regarding foreign operations. An APA can also resolve other issues related to transfer pricing such as sourcing or determining ECI. In a bilateral or multilateral APA, such issues can be resolved with both the IRS and its foreign treaty partners through a single, efficient process.

Some of the hurdles that taxpayers face when entering into an APA are:

- The amount of time involved in completing the pre-filing requirements.
- The scope of the Covered Issues may be expanded to include other interrelated matters.
- The development and analysis of an APA submission requires input from individuals throughout the taxpayer's organization (i.e., is not limited to the input of the taxpayer's tax department). The taxpayers must be prepared to interact with IRS personnel in a cooperative manner.
- If the IRS considers the APA request or its continued development to be contrary to the principles of sound tax administration, the IRS may deny the APA request or terminate consideration of the APA.

# Detailed Explanation of the Process (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Analysis

- Generally an APA request should cover at least five prospective years. An APA can also be rolled back to cover one or more earlier taxable years. When rollback years are included, the APA term will then comprise both rollback years and prospective years.
- Filing an APA request doesn't suspend an examination or any other enforcement proceedings. Generally, the APMA Program will coordinate its activities with other IRS proceedings to avoid duplicative information requests and reduce the taxpayer's compliance burden.

### Steps Involved in APA Process

The following is a list of some of the steps involved in the APA process. Revenue Procedure 2015-41 elaborates the process involved in each of these steps:

- Pre-filing Requirements: For certain types of APA requests there is a mandatory pre-filing memorandum requirement, for example in the case of unilateral APA requests where a bilateral or multilateral APA is possible, as well as APA requests in which the taxpayer proposes covering issues pertaining to "intangible development arrangements," global dealing operations, and business restructurings (Rev. Proc. 2015-41, Sec. 3.02(4)). In other types of APA requests the pre-filing memorandum is optional. (Rev. Proc. 2015-41, Sec.3.02(5)). APMA, upon review of the pre-filing memorandum, will determine if a pre-filing conference is needed. (Rev. Proc. 2015-41, Section 3.02(8)).

# Detailed Explanation of the Process (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Analysis

#### Steps Involved in APA Process (cont'd)

- Content of the APA request: Once a taxpayer decides to go ahead with the APA, the APMA Program will require a complete APA request before it can proceed with the case. A complete APA request must contain the information specified in the appendix of Rev. Proc. 2015-41. The level of required detail depends upon the facts and circumstances of each case.
- Taxpayer Disclosure Obligations: While an APA request is pending, the taxpayer must be prepared to update on a timely basis all material facts and information submitted in connection with its APA request, including financial data for the selected comparables as new or revised data becomes available. Taxpayers may be concerned about making voluntary disclosures during the APA process since there is no assurance that an agreement will be reached, thereby exposing the taxpayer to adjustments for open years. The IRS and the taxpayer may not introduce the APA or any non-factual representations made in conjunction with the APA request as evidence in any judicial or administrative proceedings (Rev. Proc. 2015-41, Sec. 6.04).
- Processing of the APA request: The length of the APA process varies based on several factors, including complexity of transactions, foreign treaty partners involved, and other factors. Upon receipt of a complete APA request, an IRS team is formed, which generally includes an APMA Team Leader and the examiner, and also may include an Economist, and/or other IRS personnel as appropriate to the case. If there is a rollback of the APA involving taxable years in IRS Appeals, the Appeals officer will be invited to participate. The IRS team will evaluate the taxpayer's APA request by discussing it with the taxpayer, verifying the data supplied, and requesting additional supporting data if necessary. The IRS team will discuss a target completion timeline and additional documents necessary with the taxpayer and/or representative throughout the APA process. Once all of the issues are resolved and, in the case of a bilateral or multilateral APA, negotiations with foreign treaty partners are complete, the APA is executed through the signature of the APMA Director and the taxpayer. At any time before the execution of the APA, the taxpayer can withdraw its request.

# Detailed Explanation of the Process (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Analysis

#### Steps Involved in APA Process (cont'd)

- **Legal effect of an APA:** An APA is a binding agreement between the taxpayer and the IRS. The IRS will not contest the application of the Covered Methods to the Covered Issues of the APA, as long as the taxpayer complies with the terms and conditions specified in the APA. Revisions of the APA may be made by agreement of the parties, consistent with the interests of sound tax administration. Except as otherwise provided in this section, an APA will have no legal effect except with respect to the taxpayer, taxable years, and issues to which the APA specifically relates. (Rev. Proc. 2015-41, Sec. 6.03).
- **Administering the APA:** Taxpayer must file an annual report within the due date for each of the taxable years covered by the APA. The report must demonstrate the taxpayer's compliance with the APA terms and conditions, including the amount of any APA primary adjustment for a given APA year. The report must also include all other items required by the APA and should disclose any pending requests to renew, modify, or cancel the APA (Rev. Proc. 2015-41, Sec. 7.02(1)). The annual report must be signed under penalty of perjury. Failure to comply with the APA's annual report requirements may result in cancellation or revocation of the APA. If the taxpayer's reporting of income, deductions, credits, allowances, basis or any other item or element affecting taxable income does not clearly reflect the application of the Covered Methods to the Covered Issues, the taxpayer must report such items in an amount consistent with the Covered Methods either on an original return or an amended return. (Rev. Proc. 2015-41, Sec.7).
- **APA renewal:** A request for renewal of an APA follows the same procedure as an initial APA request. An abbreviated APA request might be appropriate if the taxpayer can establish to APMA's satisfaction that the applicable law, facts and circumstances, economic conditions, proposed Covered Issue(s) and Method(s), and other relevant factors surrounding the current APA are reasonably expected to be substantially the same as those in the proposed renewal APA years (Rev. Proc. 2015-41, Sec 8.01).

# Process Applicability

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

Taxpayers engaging in cross-border controlled transactions are required to conduct such transactions at arm's length price. In order to resolve disputes or have certainty, taxpayers may seek to enter into an APA with IRS.

Criteria	Resources
<ul style="list-style-type: none"> <li>▪ The examiner has identified significant controlled transactions                             <ul style="list-style-type: none"> <li>– Review Form 1120 - Schedule M-3, and Uncertain Tax Positions (UTP) Disclosures. Tie the financials to the tax return and note any differences. Review prior exam cycle files.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Form 1120, Schedule M-3 - <i>Net Income (Loss) Reconciliation for Corporations With Total Assets of \$10 Million or More</i></li> <li>▪ Form 1120, Schedule UTP - <i>Uncertain Tax Position Statement</i></li> <li>▪ Form 5471, Schedule M - <i>Transactions Between Controlled Foreign Corporation and Shareholders or Other Related Persons</i></li> </ul>
<ul style="list-style-type: none"> <li>▪ The examiner has identified economically significant activities performed in connection with the controlled transactions. The examiner may recommend to the taxpayer that it consider requesting an APA.                             <ul style="list-style-type: none"> <li>– Review the MNE structure, the activities performed, transaction materiality, and general risks of the transaction.</li> <li>– Review the company websites for additional discussions about the taxpayer's activities.</li> </ul> </li> </ul>	

# Process Applicability (cont'd)

<b>Advance Pricing Agreement for Tangible Goods Transactions – Outbound</b>	
<b>Criteria</b>	<b>Resources</b>
<ul style="list-style-type: none"><li>▪ The taxpayer is seeking the IRS's help to have certainty in the Covered Method(s) applied and to have a timely and fair resolution of the transfer pricing issues under audit.</li><li>▪ Review the taxpayer's APA request and the related documents.</li></ul>	

# Summary of Process Steps

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Process Steps

An APA is an effective tool for resolving transfer pricing issues. There are several steps involved for USP to enter into a bilateral APA with the IRS and NTA.

<a href="#">Step 1</a>	Factors to Consider
<a href="#">Step 2</a>	Pre-filing Requirements
<a href="#">Step 3</a>	Types of APA Requests
<a href="#">Step 4</a>	Scope of APA Request

# Summary of Process Steps (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Process Steps

An APA is an effective tool for resolving transfer pricing issues. There are several steps involved for USP to enter into a bilateral APA with the IRS and NTA

<a href="#">Step 5</a>	Rollback Provision
<a href="#">Step 6</a>	Content of an APA Request
<a href="#">Step 7</a>	Critical Assumptions
<a href="#">Step 8</a>	Final APA, Annual Report, and Record Retention

# Summary of Process Steps (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Process Steps

An APA is an effective tool for resolving transfer pricing issues. There are several steps involved for USP to enter into a bilateral APA with the IRS and NTA.

<a href="#">Step 9</a>	Role of the Taxpayer and its Consultant
<a href="#">Step 10</a>	Role of APMA
<a href="#">Step 11</a>	Role of APMA Economist
<a href="#">Step 12</a>	Role of the Examiner in the APA Process

# Step 1: Factors to Consider

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Step 1

There are several factors USP should consider to determine if it should request an APA. The benefits of an APA generally exceed the associated risks.

Considerations	Resources
<ul style="list-style-type: none"> <li>▪ USP's purchase of goods from CFC is subject to the transfer pricing rules of the IRS and NTA. The transfer price must be consistent with arm's length pricing. Because the selection of a TPM is based on the facts and circumstances, USP's choice of TPM may be subject to audit by the IRS, the NTA, or both. Entering into a bilateral APA on a prospective basis can resolve transfer pricing issues with both the IRS and NTA. Some of the benefits of an APA include:               <ul style="list-style-type: none"> <li>– It provides an agreed Covered Method with an agreed range of arm's length results for the Covered Issue based upon facts disclosed to the IRS and NTA.</li> <li>– Because the Covered Method is agreed to on a prospective basis, there is certainty of results. It eliminates the risk of audit and penalties for the Covered Issue during the APA term.</li> </ul> </li> <li>▪ Considerations taxpayers may need to evaluate: sharing sensitive information with the IRS and NTA (although neither tax authority is permitted to use such information for purposes other than the APA process), and the costs incurred in gathering the required information and engaging outside consultants.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 2015-41 – APA request</li> <li>▪ IRC 6662 – Accuracy-related Penalties</li> </ul>

# Step 2: Pre-filing Requirements

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Step 2

To make the APA process effective and efficient, the revenue procedure includes a mandatory filing requirement for certain cases.

Considerations	Resources
<ul style="list-style-type: none"> <li>▪ USP may be required to file a pre-filing memorandum prior to filing the APA request. A pre-filing memorandum is mandatory if:               <ul style="list-style-type: none"> <li>– The taxpayer wishes to file a unilateral APA request to cover an issue that could be covered under a bilateral or multilateral APA</li> <li>– The taxpayer seeks permission to file an abbreviated APA request</li> <li>– The Covered Issue(s) involves certain intangibles arrangements, or global trading, or business restructuring, or unincorporated branches, pass-through entities, hybrid entities, or entities disregarded for U.S. tax purposes.</li> </ul> </li> <li>▪ A taxpayer may voluntarily submit a pre-filing memorandum in an APA request (either on a named or anonymous basis), if the issues involve novel or complex substantive procedural issues. In this situation, APMA generally recommends that optional pre-filing memoranda be provided on a named basis for better understanding of the issues.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 2015-41, Sec. 3.02 – <i>Pre-filing Requirements and Requests for Pre-filing Guidance</i></li> <li>▪ Rev. Proc. 2015-41, Sec. 3.02(4) – <i>Mandatory Pre-filing Memoranda</i></li>   <li>▪ Rev. Proc. 2015-41, Sec. 3.02(5) – <i>Optional Pre-filing Memoranda</i></li> </ul>

# Step 2: Pre-filing Requirements(cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### [Step 2](#)

Considerations	Resources
<ul style="list-style-type: none"> <li>▪ A mandatory pre-filing memorandum must have a length and content appropriate to the size and complexity of the Covered Issue(s) proposed by the taxpayer, and must be primarily in memorandum form but may be accompanied by diagrams, slides, spreadsheets, and similar supporting materials. An optional pre-filing memorandum must have a length and content appropriate to the substantive or procedural issues the taxpayer wishes to raise with APMA, and may be in a format chosen by the taxpayer.</li> <li>▪ Unless USP must submit a mandatory pre-filing memorandum, which requires identification of the taxpayer, USP may request a pre-filing conference (“PFC”) on an anonymous or named basis (Rev. Proc. 2015-41 sec. 3.02(8)(b)). If USP requests an anonymous PFC, participation is limited to the APMA team members, as the exam team is unknown in such a case. If USP wishes to hold a PFC with APMA, it must submit its request as part of a mandatory or optional pre-filing memorandum.</li> <li>▪ APMA will notify USP whether it will accept or decline USP’s request to hold a PFC. If APMA decides against holding a PFC, it will direct USP to proceed with its APA request.</li> <li>▪ Statements or representations made in APMA in a PFC are informal and are therefore not binding on the IRS.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 2015-41, Sec. 3.02(6) – <i>Contents of Pre-filing Memorandum</i></li> <li>▪ Rev. Proc. 2015-41, Sec. 3.02(3) – <i>Requesting Pre-filing Conferences</i></li> <li>▪ Rev. Proc. 2015-41, Sec. 3.02(8) – <i>Actions Taken with Respect to Pre-filing Conferences and Memoranda.</i></li> <li>▪ Rev. Proc. 2015-41, Sec. 3.02(9) – <i>Informal advice in Pre-filing Conference</i></li> </ul>

# Step 3: Types of APA Requests

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Step 3

USP can request either a unilateral APA with the IRS or a bilateral or multilateral agreement with the IRS and the relevant foreign tax authority(ies).

Considerations	Resources
<ul style="list-style-type: none"><li>▪ USP may enter into APAs with more than one tax authority on a bilateral or multilateral basis. This is done through the MAP provisions of the relevant income tax treaties.</li><li>▪ Generally, after receiving the taxpayer's bilateral or multilateral APA request, the IRS team conducts analysis and incorporates its recommendation in a written document, which is shared and discussed with the foreign treaty partner. The APA is based on the agreement that the IRS reaches with the foreign tax authority(ies) with respect to the Covered Issue(s).</li><li>▪ To minimize taxpayer and governmental uncertainty and administrative cost, bilateral and multilateral APAs are generally preferable to unilateral APAs. In the case of a unilateral APA request to cover an issue that could be covered under a bilateral or multilateral APA, the taxpayer must provide an explanation to support that a unilateral APA is appropriate to cover that issue. APMA may reject a taxpayer's unilateral APA request for various reasons, particularly when accepting it would contravene procedures and practices established with particular treaty partners.</li></ul>	<ul style="list-style-type: none"><li>▪ Rev. Proc. 2015-41, Sec. 4.04(4) – Competent Authority Consideration</li><li>▪ Rev. Proc. 2015-41, Sec 2.02(4)(d) – <i>Preference for Bilateral and Multilateral APAs</i></li></ul>

# Step 3: Types of APA Requests (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### [Step 3](#)

Considerations	Resources
<ul style="list-style-type: none"><li>▪ In the case of a unilateral APA, the agreed Covered Method is binding only for U.S. tax purposes. Such a unilateral APA does not prevent a foreign tax authority from auditing and proposing an adjustment with respect to a taxpayer's transfer pricing for the Covered Issue. If APMA and taxpayer sign a unilateral APA, APMA might subsequently decline to consider a CA request on an issue that could reasonably and practically have been covered if the taxpayer had instead pursued a bilateral or multilateral APA.</li></ul>	<ul style="list-style-type: none"><li>▪ Rev. Proc. 2015-41, Sec. 4.04(4) – Competent Authority Consideration</li><li>▪ Rev. Proc. 2015-41, Sec 2.02(4)(d) – <i>Preference for Bilateral and Multilateral APAs</i></li></ul>

# Step 4: Scope of APA Request

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Step 4

A taxpayer's APA request will include issues relating to one or more intercompany transactions applicable to certain proposed taxable years, and involving one or more foreign competent authorities in the case of bilateral or multilateral APA request.

Considerations	Resources
<ul style="list-style-type: none"> <li>▪ USP's APA request will cover one or more issues, applicable to certain proposed taxable years involving U.S. and NTA.</li> <li>▪ In evaluating the taxpayer's request, in some cases APMA may also need to consider additional, interrelated issues, additional taxable years (including potential rollback years) or additional treaty countries (collectively, interrelated matters) in order to reach a resolution that is in the interest of principled, effective, and efficient tax administration.</li> <li>▪ APMA may do so, for example, when the taxpayer's proposed Covered Issues are most reliably evaluated together with other issues.</li> <li>▪ APMA may condition its acceptance, continued consideration, or resolution of an APA request upon the agreement of the taxpayer (and, if applicable, of the foreign competent authority(ies)) to expand the scope of the APA.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 2015-41, Sec. 2.02(4)(a) – Scope of APAs</li> <li>▪ Rev. Proc. 2015-41, Sec. 2.02(4)(c) - <i>Rollbacks</i></li> <li>▪ Rev. Proc. 2015-41, Sec. 5.02 – <i>Rollbacks</i></li> <li>▪ Treas. Reg. 1.482-1(f)(2)(i) – Aggregation of transactions in determining the arm's length consideration</li> <li>▪ Treas. Reg. 1.482-7(g)(2)(iv) – Aggregation of transactions for multiple PCT payments</li> <li>▪ Rev. Proc. 2015-41, Sec.2.02(4)(b) – <i>Examples of Interrelated Matters</i></li> </ul>

# Step 5: Rollback Provision

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Step 5

Applying the Covered Method(s) in an APA to prior open years enhances voluntary compliance and may be an effective way to address unresolved transfer pricing issues in prior open years under audit. Bilateral or multilateral APA rollbacks depend, in part, on the other jurisdiction's local rules allowing it.

Considerations	Resources
<ul style="list-style-type: none"> <li>▪ An APA term will comprise prospective years and rollback years (if any). Prospective years are determined by reference to the date the APA request is considered complete in relation to the applicable return date for that taxable year. APMA will determine which proposed APA year will be the first prospective year according to the provisions of Rev. Proc. 2015-41, Sec. 3.03. Any APA year ending before the first prospective year will be a rollback year.</li> <li>▪ If there are open tax years prior to the first prospective year of the APA term, USP may request a rollback to apply the same Covered Method(s) applied to the APA years to the open years. Although the taxpayer typically requests a rollback, APMA may coordinate with other IRS offices to pursue a rollback to any and all of taxpayer's open back years. APMA will consider taking such action where there is sufficient similarity in relevant facts and circumstances across the prospective years and open back years. Modification may be required for the variation in facts, economic conditions, and changes in law.</li> <li>▪ Rollback requests submitted in connection with a bilateral or multilateral APA and involving a taxable year under the jurisdiction of Appeals will be subject to the provisions regarding coordination with IRS Appeals and the simultaneous appeals procedure review.</li> <li>▪ If the rollback involves unresolved transactions still under consideration by Appeals, the taxpayer must include with its APA request a waiver of its right to be present during communications between the Appeals Office and the IRS team members.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 2015-41, Sec. 3.03(2) – <i>Prospective Years, Rollback Years, and Filing Deadline of Complete APA Request</i></li> <li>▪ Rev. Proc. 2015-41 Sec. 5.02 – <i>Rollbacks</i></li> <li>▪ Rev. Proc. 2015-40, Sec 6.04(2) – <i>Simultaneous Appeals Process Review.</i></li> <li>▪ Rev. Proc. 2015-40, Sec. 6.04 – <i>Coordination with IRS Appeals</i></li> <li>▪ Rev. Proc. 2015-41, Appendix, Sec. 1 – <i>Required contents for APA requests</i></li> </ul>

# Step 6: Content of an APA Request

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Step 6

The IRS requires the taxpayer to submit a complete APA request to initiate the APA process.

Considerations	Resources
<ul style="list-style-type: none"><li>▪ The APA request is not considered complete unless the request contains the information specified in Rev. Proc. 2015-41.</li><li>▪ USP may specify all or part of its controlled transactions with CFC as Covered Issues in the APA request. The IRS or NTA can approve or reject the request for inclusion or exclusion of certain transactions in the APA Process.</li><li>▪ The IRS and NTA would expect USP to propose an APA for a term that, while generally 5 prospective years, may vary depending on the industry, products, and transactions involved. For example, if the product involved is evolving technology, a shorter term may be more appropriate.</li></ul>	<ul style="list-style-type: none"><li>▪ Rev. Proc. 2015-41, Appendix – <i>APA Request Requirements</i></li><li>▪ Rev. Proc. 2015-41, Appendix – Section 1, <i>Content of Complete APA Requests</i></li></ul>

# Step 6: Content of an APA Request (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### [Step 6](#)

Considerations	Resources
<ul style="list-style-type: none"> <li>▪ The Appendix to Rev. Proc. 2015-41 specifies the list of information required for an APA request. The following is a partial list of such items :               <ul style="list-style-type: none"> <li>– Request letter</li> <li>– If USP is requesting a unilateral APA, there should be an explanation of why a unilateral APA is appropriate</li> <li>– An executive summary of APA request</li> <li>– A detailed history of the taxpayer, the proposed covered group, and the ownership structure, including identification of any branches or disregarded entities for tax purposes involved in the Covered Issue(s)</li> <li>– The proposed Covered Issue(s)</li> <li>– The selection and application of the proposed Covered Method(s)</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 2015-41, sec. 3.04 – <i>Content and Form of Complete APA Requests.</i></li> <li>▪ <i>Rev. Proc. 2015-41, Appendix – APA Request Requirements</i></li> </ul>

# Step 6: Content of an APA Request (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### [Step 6](#)

Considerations	Resources
<ul style="list-style-type: none"><li>▪ For each proposed Covered Issue a description of:<ul style="list-style-type: none"><li>– functions performed;</li><li>– assets employed;</li><li>– economic costs incurred;</li><li>– risks assumed;</li><li>– transactional or commercial flows;</li><li>– principal intercompany contracts or other agreements;</li><li>– relevant economic conditions; and</li><li>– relevant non-recognition transactions.</li></ul></li></ul>	<ul style="list-style-type: none"><li>▪ Rev. Proc. 2015-41 – Appendix, Section 1, <i>Content of Complete APA Requests</i></li></ul>

# Step 7: Critical Assumptions

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Step 7

Critical assumptions are facts whose continued existence is identified in an APA as being material to the reliability of the APA's Covered Methods; such fact may be related to the taxpayer, a third party, an industry, or business and economic conditions.

Considerations	Resources
<ul style="list-style-type: none"> <li>▪ The APA is based on the future outlook of the tested operations. Therefore, there are certain assumptions made with respect to the functions performed, risks incurred, and assets employed by the tested party that are critical to the continued application of the proposed Covered Method(s). If there are material changes to the taxpayer's trade or business with respect to these critical assumptions during the APA years, the continued application of the Covered Method(s) in the APA may no longer be appropriate. These assumptions may relate to the taxpayer, third parties (e.g., a significant supplier), currency movements, business and economic conditions, and accounting conventions. If one or more of these critical assumptions is not met within any APA year, the IRS may initiate a revision or cancellation of the APA. Revision of the APA can only be accomplished through agreement of all parties to the APA.</li> <li>▪ If there is a breach of a critical assumption, the taxpayer must notify the IRS promptly upon discovering the breach. The taxpayer, the IRS, and the relevant foreign tax authorities will then discuss whether the breach is material, and if so, whether to revise or cancel the APA.</li> </ul>	<ul style="list-style-type: none"> <li>▪ <i>Rev. Proc. 2015-41 – Sec. 7.06, Revoking or Canceling the APA</i></li>   <li>▪ <i>Rev. Proc. 2015-41, Sec. 7.06(3) – Breach of Critical Assumption</i></li> </ul>

# Step 8: Final APA, Annual Report and Record Retention

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Step 8

An executed APA addresses the terms, conditions, Covered Methods, Critical Assumptions, and Annual Report requirements for the APA.

Considerations	Resources
<ul style="list-style-type: none"><li>▪ The final signed APA will generally contain the following:<ul style="list-style-type: none"><li>– Parties to the agreement</li><li>– Recitals of key facts upon which the parties relied</li><li>– Terms and conditions of the agreement</li><li>– A detailed description of the Covered Issue(s), APA term, Covered Method(s), any special adjustments required in applying the Covered Method(s)</li><li>– A list of Critical Assumptions</li><li>– Annual Report filing requirements</li><li>– A definition of terms used in the APA</li><li>– A summary checklist for use in filing the Annual Report</li></ul></li></ul>	<ul style="list-style-type: none"><li>▪ Rev. Proc. 2015-41, Appendix, Sec. 1 Part 5.1(03), Exhibit 15 – Model APA will be posted on the APMA website.</li></ul>

# Step 8: Final APA, Annual Report and Record Retention (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Step 8

Considerations	Resources
<ul style="list-style-type: none"> <li>▪ The taxpayer must file an APA annual report for each year of the APA term. The report must demonstrate the taxpayer's compliance with the APA terms and conditions, including the amount of any APA primary adjustment for a given APA year. The report must also include all other items required by the APA and should disclose any pending requests to renew, modify, or cancel the APA. In addition, the report must identify and correct any materially false, incorrect, or incomplete information submitted during the APA process that the taxpayer discovers during the APA year.</li> <li>▪ The taxpayer must maintain books and records sufficient to enable the IRS to determine whether the taxpayer has complied with the APA. The taxpayer's compliance with this provision fulfills the record keeping requirements of IRC 6038A and IRC 6038C, as applied to the Covered Issues(s).</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 2015-41, Sec. 7.02 – <i>Annual Reports</i></li> <li>▪ Rev. Proc. 2015-41, Sec. 7.04 – <i>Record Retention</i></li> <li>▪ IRC 6038A - Record Retention</li> <li>▪ IRC 6038C - Record Retention</li> </ul>

# Step 9: Role of the Taxpayer and its Consultant

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Step 9

An APA request is a voluntary process initiated by the taxpayer. Supplying relevant facts timely is central to the APA process working efficiently.

Considerations	Resources
<ul style="list-style-type: none"> <li>▪ Following the completion of the pre-filing requirements discussed earlier, the taxpayer will decide whether to prepare an APA request to provide to the IRS and the relevant foreign tax authorities, and prepare such a request if it decides to proceed.</li> <li>▪ Upon receipt of a complete APA request, the APMA Team Leader will assemble the IRS Team. The team will first review the APA request and identify areas for further information gathering. The team next contacts the taxpayer or taxpayer’s consultant to schedule an opening conference. Through responding to questions and participating in meetings with the IRS Team, the taxpayer will provide the information necessary for the IRS Team to analyze the APA request and prepare a position for discussions with the foreign tax authorities.</li> <li>▪ Once an APA has been executed, the taxpayer is required to file an APA annual report to (i) provide evidence of its compliance with the APA’s terms and conditions, (ii) include the amount of APA primary adjustment, if any, (iii) all other items required by the APA, (iv) correct any material information provided during the APA process that is subsequently discovered to be false, incorrect, or incomplete, and (v) disclose any pending requests to renew, modify or cancel the APA.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 2015-41, Sec. 3.02 – <i>Pre-filing Requirements and Requests for Pre-filing Guidance</i></li> <li>▪ Rev. Proc. 2015-41, Sec. 4.06 – <i>Execution of the Agreement</i></li> <li>▪ Rev. Proc. 2015-41, Sec. 4.03 – <i>Initial Stages of APA Process</i></li> <li>▪ Rev. Proc. 2015-41, Sec. 7.02 – <i>Annual Reports</i></li> </ul>

# Step 10: Role of APMA

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Step 10

APMA is responsible for evaluating, executing, and administering APAs on behalf of the IRS.

Considerations	Resources
<ul style="list-style-type: none"><li>▪ APMA will receive and analyze the initial APA request and contact the taxpayer if additional information is necessary to complete the request. The APMA Director or his designee will assign the case to an APMA Senior Country Manager, who will assign the case to an APMA Team Leader. The APMA Team Leader is responsible for assembling the IRS Team, which includes Exam and may include participation by an APMA Economist, the Transfer Pricing Practice (“TPP”), the Office of Chief Counsel, and/or additional IRS specialists as appropriate to the case, such as an Engineer or Industry Specialist.</li><li>▪ The APMA Team Leader will arrange meetings involving the IRS Team, the taxpayer and its representative, will take the lead in preparing questions for the taxpayer and its representative, and draft a position paper and other case correspondence.</li><li>▪ Overall, the role of the IRS Team is to develop, in consultation with the taxpayer and consistent with sound tax administration, an IRS position either for discussion with the relevant foreign tax authorities (in a bilateral or multilateral APA), or as a recommendation for approval by the APMA Director in a unilateral APA.</li></ul>	

# Step 10: Role of APMA (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### [Step 10](#)

Considerations	Resources
<ul style="list-style-type: none"><li>▪ An APA enables a taxpayer to voluntarily resolve transfer pricing issues in a cooperative manner on a prospective basis by presenting all the facts necessary for the proper, joint evaluation of the issues with IRS and, in a bilateral or multilateral APA, the relevant foreign tax authorities. The goal of an APA is to reduce taxpayers' compliance burdens, and to provide certainty regarding the Covered Issues. As previously discussed, in a bilateral or multilateral APA, a taxpayer gains certainty with respect to both the U.S. and foreign taxing jurisdiction's treatment of the Covered Issues. In a unilateral APA, a taxpayer gains certainty with respect to the Covered Issues only from the U.S. perspective.</li><li>▪ APMA generally expects APA requests involving foreign treaty partners that have APA Programs to be bilateral, as opposed to unilateral, in the interest of efficient and sound tax administration. Taxpayers presenting a unilateral APA request must explain in pre-filing memorandum why it believes a unilateral APA is appropriate to cover that issue.</li></ul>	<ul style="list-style-type: none"><li>▪ Rev. Proc. 2015-41, Sec. 2.02(4)(d) – <i>Preference for Bilateral and Multilateral APAs</i></li></ul>

# Step 10: Role of APMA (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### [Step 10](#)

Considerations	Resources
<ul style="list-style-type: none"><li>▪ APMA sets the timing and grants any extensions, if needed, for the filing of annual reports.</li><li>▪ APMA may cancel an APA due to the taxpayer's misrepresentation, mistake as to a material fact, or failure to state a material fact, failure to file a timely annual report, and lack of good faith compliance with the APA's terms and conditions.</li><li>▪ When a taxpayer asserts a breach of a critical assumption, APMA will determine whether there is a breach.</li><li>▪ In the event of a failure of a critical assumption or a material change in governing case law, statute, regulation, or a treaty, the APA will be cancelled unless the parties agree to revise the APA.</li><li>▪ APMA may revoke an APA in the event of fraud or malfeasance by the taxpayer.</li></ul>	<ul style="list-style-type: none"><li>▪ Rev. Proc. 2015-41, Sec.7.06 – <i>Revoking or Canceling the APA</i></li></ul>

# Step 11: Role of APMA Economist

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Step 11

The APMA Economist is responsible for factual development of the case.

Considerations	Resources
<ul style="list-style-type: none"><li>▪ In general, the APMA Economist is responsible for review of all APA materials from the perspective of the relevant tax treaty and IRC 482 provisions for bilateral and multilateral APAs and IRC 482 for unilateral APAs.</li><li>▪ The APMA Economist takes an active role in the factual development of the case, the preparation of questions, conducting interviews, and the preparation of documents, as appropriate to the facts of each case.</li><li>▪ The APMA Economist, working with the APMA Team Leader, reviews the taxpayer's proposed Covered Methods and, if they disagree with the proposed Covered Methods, works with the taxpayer's representative to modify the proposed Covered Methods, or in some cases, internally develops an economic analysis for each Covered Issue.</li><li>▪ The APMA Economist drafts a written document presenting the economic analysis, to be integrated into the position document that the APMA Team Leader (and in some cases, the APMA Economist) will present to the treaty partner for negotiations.</li></ul>	

# Step 11: Role of APMA Economist (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Step 11

Considerations		Resources
<p>The table on this slide, which continues on the next slide, summarizes a generic APA process, from the perspective of the APMA Economist.</p>		
APA Step	Economist Tasks	
Pre-filing Requirements	Review materials; work with APMA Team Leader as appropriate to prepare preliminary research and questions; participate in pre-filing conference	
Taxpayer APA Request	Review request, participate in development of questions	
Opening Conference	Participate in preparation and meeting	
Case Development	Work with APMA Team Leader to understand relevant facts, analyze the correctness/completeness of taxpayer's proposed Covered Method(s), participate in interviews, work with taxpayer representative to prepare alternative economic analyses or internally prepare economic analyses	

# Step 11: Role of APMA Economist (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Step 11

Considerations		Resources
APA Step (cont'd)	Economist Tasks (cont'd)	
Economic Analysis	Based on case development, prepare a written document that presents the economic analysis for the U.S. position, to be incorporated in the position document that the APMA Team Leader takes the lead in drafting. APMA Country Manager, APMA Economist Manager and APMA Team Leader will review and provide comments	
Negotiation of APA	APMA Economist may assist Team Leader and/or participate in negotiations with Treaty partner or taxpayer (if unilateral APA)	
Finalize APA	Assist APMA Team Leader as needed with final APA	

# Step 12: Role of the Examiner in the APA Process

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Step 12

The examiner plays a major role in the APA Process.

Considerations	Resources
<ul style="list-style-type: none"><li>▪ The exam team representatives are key team members in the APA Process. Exam brings crucial historical knowledge of the taxpayer to the process, and Exam's involvement is important in the effective execution of the APA. The extent of an examiner's involvement in the APA process varies depending on each case.</li><li>▪ It is helpful if the examiner that participates in the APA Process is the examiner assigned to the exam team. This facilitates efficient tax administration, proper flow and safeguarding of taxpayer information, and maintaining taxpayer relationships.</li><li>▪ The examiner's role includes but is not limited to contributing to understanding: 1) the facts presented in the APA submission; 2) the terms of the Covered Issue(s); 3) the organization structure; 4) the entities included in the APA; and 5) the proposed Covered Method(s) and related economic analysis. The examiner can help the IRS team understand the taxpayer's accounting standard and US GAAP (or other accounting standard) adjustments, the reconciliation of amounts reported on the financial statements and tax returns, and how those items impact the calculations under the APA.</li></ul>	

# Step 12: Role of the Examiner in the APA Process (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### [Step 12](#)

Considerations	Resources
<ul style="list-style-type: none"><li>▪ The examiner generally would research the taxpayer’s business operations to ensure that its description of the business in the APA request is consistent with the examiner’s historical experience with this taxpayer.</li><li>▪ The examiner should review the financial data included in the APA request to check that it supports the underlying assumptions. For example, if the Covered Method is based on the taxpayer being a low risk distributor, and the examiner notices that there are expenses related to product liability and currency risks, the examiner should coordinate with other team members and propose adjustments to the Covered Method to reflect these additional risks.</li><li>▪ Before commencing an audit, the examiner should determine if the taxpayer has an APA in place or in process. If so, the examiner should contact APMA to discuss the coordination of the APA process with the examination. This approach will foster efficient and sound tax administration, and will encourage taxpayers to consider initiating an APA request where beneficial.</li></ul>	

# Step 12: Role of the Examiner in the APA Process (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### [Step 12](#)

Considerations	Resources
<ul style="list-style-type: none"> <li>▪ Another extremely important task that the examiner performs in the APA Process is to monitor the statutes for all years, for all entities impacted by the Covered Issues. Taxpayer and the IRS will execute consent agreements as necessary to extend the period of limitations for each proposed APA year (both prospective and rollback). As of the date the APA request is filed, the remaining period of limitations for assessment for each proposed APA year must be at least two years, or the APA request must contain an executed general consent to extend the period of limitations of assessment of tax to at least two years for each of the proposed APA year(s). As the APA progresses, the taxpayer must submit executed consent agreements to extend the period of limitations no later than 12 months before the end of the remaining period for each proposed APA year.</li> <li>▪ In certain cases, the APMA Team Leader may request that the examiner review a taxpayer's APA Annual Report for compliance with the APA's terms and conditions and the amount of the primary adjustment that result from the application of the APA Covered Method(s) for the year. The examiner should also look for disclosure of any pending or contemplated request to renew, modify, or cancel the APA. Also, the examiner needs to identify if there is any breach(es) of critical assumptions and consistency in applying the Covered Method(s).</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 2015-41, Sec. 2.03 – <i>General Requirements for Initiating and Continuing the APA Process</i></li> <li>▪ Rev. Proc. 2015-41, Sec. 2.03(3) – <i>Consent Agreements</i></li>   <li>▪ Rev. Proc. 2015-41, Sec. 7.02 – <i>Annual Reports</i></li> </ul>

# Step 12: Role of the Examiner in the APA Process (cont'd)

**Advance Pricing Agreement for Tangible Goods Transactions – Outbound**

[Step 12](#)

Considerations	Resources
<ul style="list-style-type: none"> <li>▪ An APA primary adjustment may result in additional tax consequences, called conforming adjustments, such as deemed dividend, contribution to capital, or other adjustments pursuant to Treas. Reg. 1.482-1(g)(3). The taxpayer can elect APA revenue procedure treatment to avoid the possible adverse tax consequences of the conforming adjustment that would be made pursuant to Treas. Reg. 1.482-1(g)(3) by establishing an account receivable or account payable to the relevant foreign affiliates. In such a case, the taxpayer would instead bear the tax consequences associated with a loan and repayment of the loan. In a bilateral or multilateral APA, APMA will seek identical treatment (a “correlative adjustment”) for the relevant foreign affiliates.</li> <li>▪ Upon review of the annual report, the examiner communicates his findings with respect to the taxpayer’s compliance with the APA terms, to the APMA Director or his designee.</li> <li>▪ Upon review of the annual report, the examiner communicates his findings with respect to the taxpayer’s compliance with the APA terms, to the APMA Director or his designee.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Rev. Proc. 2015-41, Sec. 7.01 – <i>Reporting of Income, APA Primary Adjustments, Conforming Adjustments, and Repatriation of Funds</i></li> <li>▪ Treas. Reg. 1.482-1(g)(3) – <i>Additional Tax Consequences of Secondary Adjustments</i></li> <li>▪ Rev. Proc. 99-32, 1999-2 C.B. 296 – <i>Election to Treat the Adjustment as A/R or A/P</i></li> </ul>

# Definitions

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Description

- **Arm's Length Standard:** A controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled/unrelated taxpayers had engaged in the same transaction under the same circumstances ("arm's length result").
- **Controlled taxpayer:** Two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests. Controlled entities are often referred to as "related" parties.
- **Covered Issue(s):** The coverable issue(s) that is (are) covered by the APA.
- **Covered Group:** The U.S. and non-U.S. taxpayers within a controlled group, including the taxpayer filing the APA request, whose intercompany transactions or other business activities are within the scope of the Covered Issue(s).
- **Covered Method(s):** The transfer pricing method(s) or other method(s) set forth in the APA for resolving the Covered Issues.
- **Transfer Pricing Method ("TPM"):** OECD transfer pricing guidelines as well as the regulations under IRC Section 482 prescribe specific methods to evaluate the pricing of related party transactions. The methods prescribed are specific to each type of transactions.
- **Best Method:** The method that, under the facts and circumstances, provides the most reliable measure of an arm's length result.
- **Profit Level Indicators ("PLI"):** Ratios that measure the relationship between profits and costs incurred or resources employed.
- **Interquartile Range:** The range from the 25<sup>th</sup> to the 75<sup>th</sup> percentile of the results derived from the uncontrolled comparables used to test the Covered Issue(s).

# Definitions (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Description

- Operating Profit Ratio: This is a financial ratio that is sometimes used in a CPM/TNMM analysis. Generally, in the transfer pricing context, it is calculated as the ratio of operating profit (measured pre-tax, pre-interest, and pre-extraordinary items) to net sales.
- Return on Assets (“ROA”) Ratio: This is a financial ratio that is sometimes used in a CPM/TNMM analysis. Generally, in the transfer pricing context, it is calculated as the ratio of operating profit (measured as in the Operating Profit Ratio calculation immediately above) to assets actively employed in business operations.
- Berry Ratio: This is a financial ratio that is sometimes used in a CPM/TNMM analysis. It is calculated as the ratio of gross profit (which is defined as net sales less cost of goods sold) to operating expenses.

# Examples of the Process

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Description

#### APA Primary & Correlative Adjustment Example

- US parent manufactures tangible goods, and its Japanese subsidiary supplies raw materials. A bilateral APA is in place for the years under audit. The Covered Method under the negotiated APA is a CPM with U.S. taxpayer as the tested party applying a Return on Assets PLI with a range of 4% to 12%. The average assets employed was \$800M and the expected range of income will be \$32M to \$96M. In the year under audit, U.S. taxpayer reported an operating profit of \$28M. To meet the Covered Method as agreed in the bilateral APA, an APA primary adjustment of \$36M was made to decrease the cost of materials purchased from Japan subsidiary and a correlative adjustment was made to decrease the intercompany sales income of the foreign subsidiary in Japan. Please note: this example assumes that the APA stipulated an annual test of the tested party's (U.S. taxpayer) operating profit result on the Covered Issue. If a different testing method, such as rolling multi-year average or term test were used, then the taxpayer would present the appropriate calculations in the APA annual report.
- In this example, if the APA is a unilateral APA, double taxation may result.

# Examples of the Process (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Description

#### Examples of Coordinating Issues During an Audit with APA Terms

- During an examination the examiner learned that as a result of the challenging business and economic climate, management made the decision in year xxx6 to indefinitely stop production and suspend the launch of certain newly developed products. All prototype units, inventories, and other related assets that could not be used for any other product or purpose were disposed of before December 31, xxx6. Product termination expense totaling \$80M was charged to selling, general, and administrative expense during the year ended December 31, xxx6, resulting in an operating margin of 1%. Under the existing bilateral APA, USP was characterized as a distributor of the products in North America with some manufacturing activity in the U.S. The Covered Method as per APA was calculated based on this assumption, with a range of 5% to 8% of operating margin, with an annual test of the tested party's (U.S. taxpayer) operating profit result on the Covered Issues. The APA didn't exclude product termination expenses from the operating margin calculation. Therefore, to comply with the APA terms the taxpayer should report a minimum operating profit of 5%. This will be done by increasing the income (via reduction in Cost of Goods Sold) of U.S. taxpayer and correspondingly reducing the income of the foreign entity.

# Examples of the Process (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Description

#### Examples of Coordinating Issues During an Audit with APA Terms

- U.S. taxpayer has deducted a substantial amount of expenses relating to a defective product as product liability expenses. The APA Covered Method assumed that the U.S. taxpayer operates as a limited risk entity and all manufacturing technology was supplied by its CFC. The examiner should look into the deduction for the product liability expenses and bring it to the attention of APMA. Depending on the facts, the product liability expenses may be disallowed for U.S. tax purposes and reallocated to the CFC.
- U.S. parent (“SalesCo”) manufactures and sells tangible goods. SalesCo also has a domestic subsidiary (“FinanceCo”), that finances SalesCo’s sales to its customers. SalesCo has an APA with its foreign subsidiary (CFC), that does not include its transactions with FinanceCo. Because FinanceCo’s transactions with SalesCo are not Covered Issues under the APA, those transactions are subject to transfer pricing audit.
- A taxpayer entered into an APA (“Original”) for years 1 to 5 and is requesting an APA renewal (“Renewal”) for years 6 to 11. The examiner discovers that during years 6 and 7, the taxpayer deducted \$500 million in warranty expenses associated with products purchased from foreign manufacturing affiliates, as the taxpayer serviced these warranty claims during those years. The original APA didn’t include the deduction for warranty expenses on the taxpayer’s purchases of products from foreign manufacturing affiliates. The examiner should consult with the APMA Team Leader regarding this material change in facts.

# Examples of the Process (cont'd)

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

### Description

#### Example of Potential Breach of Critical Assumptions

- US Inc. and US Inc. #2 file a consolidated US tax return. US Inc. owns a CFC. There is a bilateral APA including US Inc., US Inc.#2 and CFC, that covers various transactions. The Covered Methods for the Covered Issues are as follows:
  1. US Inc.'s purchase of components and finished goods from CFC. The Covered Method is the CPM/TNMM, with US Inc. as the tested party. The Covered Method uses the operating profit margin as the profit level indicator, and the target arm's length range is 2% to 4%.
  2. US Inc. #2's provision of contract manufacturing services for CFC. The Covered Method is the CPM/TNMM with US Inc.#2 as the tested party. The Covered Method uses the ROA as the profit level indicator, and the target arm's length range is 4% to 8%.
  3. US Inc.'s license of CFC's intangible property and payment of a royalty for the use of these intangibles. The Covered Method is the Residual Profit Split Method ("RPSM"). The routine return for CFC is an 8% ROA, and the residual profit is split at 40% to US Inc. and 60% to CFC.
  4. CFC's provision of management services to US Inc. The Covered Method is the Cost Plus Method, and the mark-up applied over fully loaded costs is 8%.

The exam team reviewed the APA annual report filed by US Inc. and discovered that during that year, US Inc. #2 moved all of its manufacturing operations to South America. Upon review of facts, the APA team decided this impacts Covered Issue #2 and may not impact Covered Issues #1, #3, and #4. The examiner should contact the APA team and the team will determine if there is a breach with respect to Covered Issue #2.

# Other Considerations / Impact to Audit

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

Considerations	Resources
<ul style="list-style-type: none"><li>▪ Often the examiner involved in the case may be assigned to review the APA Annual Report. If the examiner comes across a significant change in the taxpayer's operation then he/she should discuss such change with the APA team before accepting the Annual Report prepared by the taxpayer.</li></ul>	
<ul style="list-style-type: none"><li>▪ There are circumstances where not every intercompany transaction is included in the APA as a covered transaction. Therefore, the examiner must conduct a transfer pricing analysis for transactions not covered by the APA to evaluate the arm's length pricing.</li></ul>	

# Index of Referenced Resources

## Advance Pricing Agreement for Tangible Goods Transactions – Outbound

IRC 482

IRC 6038A

IRC 6038C

IRC 6662

Treas. Reg. 1.482-1

Treas. Reg. 1.482-7

Rev. Proc. 99-32

Rev. Proc. 2006-9

Rev. Proc. 2015-40

Rev. Proc. 2015-41

Form 1120, Schedule M-3 - *Net Income (Loss) Reconciliation for Corporations With Total Assets of \$10 Million or More*

Form 1120, Schedule UTP - *Uncertain Tax Position Statement*

Form 5471, Schedule M - *Transactions Between Controlled Foreign Corporation and Shareholders or Other Related Persons*

# Training and Additional Resources

Advance Pricing Agreement for Tangible Goods Transactions – Outbound	
Type of Resource	Description(s)
Saba Meeting Sessions	<ul style="list-style-type: none"> <li>▪ <i>Performing Functional Analysis</i> – 2012 CENTRA</li> <li>▪ <i>Overview and Introduction to 482</i> – 2012 CENTRA</li> <li>▪ <i>Comparable Profits Method</i> – 2012 CENTRA</li> <li>▪ <i>PLIs in a CPM World</i> – 2012 CENTRA</li> </ul>
Issue Toolkits	<ul style="list-style-type: none"> <li>▪ Audit Tool – Transfer Pricing Audit Road Map</li> <li>▪ IRM Exhibit 4.61.3-4 – <i>Transfer Pricing Functional Analysis Questionnaire</i></li> <li>▪ IRM 4.61.3 – <i>Development of IRC Section 482 Issues</i></li> <li>▪ IRM 4.61.3.5.1 – <i>Functional Analysis</i></li> </ul>
Databases / Research Tools	<ul style="list-style-type: none"> <li>▪ OECD – APA Guidelines</li> </ul>
Reference Materials – Treaties	<ul style="list-style-type: none"> <li>▪ <i>BNA Tax Management Int'l Portfolio 890, WS 1 – Sample Questionnaire for Intercompany Transactions</i></li> </ul>

# Glossary of Terms and Acronyms

Term/Acronym	Definition
APA	Advance Pricing Agreement
APMA	Advance Pricing and Mutual Agreement Program
CA	Competent Authority
CFC	Controlled Foreign Corporation
CPM	Comparable Profits Method
ECI	Effectively Connected Income
IP	Intangible Property
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
ISI	Income Shifting Inbound
ISO	Income Shifting Outbound
MAP	Mutual Agreement Process
MNE	Multinational Enterprise
NTA	National Tax Agency
OECD	Organisation for Economic Co-operation and Development
PE	Permanent Establishment
PFC	Pre-filing conference

# Glossary of Terms and Acronyms (cont'd)

Term/Acronym	Definition
PLI	Profit Level Indicator
ROA	Return on Assets
RPSM	Residual Profit Split Method
TNMM	Transactional Net Margin Method
TPM	Transfer Pricing Methodology
TPP	Transfer Pricing Practice
UIL	Uniform Issue List
USP	United States Parent
UTP	Uncertain Tax Positions

# Index of Related Practice Units

Associated UIL(s)	Related Practice Unit	DCN
9411	<i>Overview of IRC Section 482</i>	ISO/T/01-01 (formerly ISO/9411.07_01(2013))
9411.03	<i>Outbound Services by US Companies to CFCs</i>	ISO/T/01_03-01 (formerly ISO/9411.07_02(2013))
9411.05	<i>Comparability Analysis for Tangible Goods Transactions -Outbound</i>	ISO/P/01_05-01 (formerly ISO/PUO/V_1-01(2014))
9411.05	<i>Sales of Tangible Goods from a CFC to a USP CUP Method</i>	ISO/T/01_05-02 (formerly ISO/9411.05_01(2013))
9411.05	<i>CPM Simple Distributor Outbound</i>	ISO/T/01_05-03 (formerly ISO/9411.05_01(2014))
9411.05	<i>Advance Pricing Agreement for Tangible Goods Transactions – Outbound</i>	ISO/P/01_05-04
9411.07	<i>Revenue Procedures 99-32 Outbound Guidance</i>	ISO/01_07_02-01 (formerly ISO/9411.07_03(2013))
9411.07	<i>Competent Authority Revenue Procedure 2015-40 Guidance: U.S.- Initiated Adjustment(s)</i>	ISO/P/01_07_03-01

## Index of Related Practice Units (cont'd)

Associated UIL(s)	Related Practice Unit	DCN
9422	<i>Arm's Length Standard</i>	ISI/T/06-03 (formerly ISI/9422.09_06(2013))
9422.07	<i>Comparability Analysis for Tangible Goods Transactions-Inbound</i>	ISI/P/06_07-01 (formerly ISI/PUO/V_6_01(2014))
9422.07	<i>Purchase of Tangible Goods from a Foreign Parent – CUP Method</i>	ISI/T/06_07-02 (formerly ISI/9422.07_05(2013))
9422.07	<i>Advance Pricing Agreement for Tangible Goods Transactions – Inbound</i>	ISI/P/06_07-07
9422.07	<i>CPM Simple Distributor Inbound</i>	ISI/T/06-07-04 (Formerly ISI/9422.07_07(2013))
9422.07	<i>Inbound Resale Price Method Routine Distributor</i>	ISI/T/06_07-05 (formerly ISI/9422.07_08(2013))
9422.09	<i>Revenue Procedures 99-32 Inbound Guidance</i>	ISI/P_09_02-01 (formerly ISI/9422.09-08 (2013))