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APA Placement: Time to Move On

by Craig A. Sharon, Esq.
Bingham McCutchen LLP
Washington, D.C.

This commentary discusses the recently announced transfer of the Advance Pricing Agreement (APA) Program from IRS Chief Counsel (Chief Counsel) to the new IRS Transfer Pricing Practice (TPP) as part of the ongoing restructuring of the IRS international function, first announced in early August 2010 when: (1) the Large and Mid-Size Business Division (LMSB) was renamed the Large Business and International Division (LB&I); (2) the IRS's international resources in the field were moved from the various IRS industry groups and consolidated within LB&I; and (3) LB&I announced the creation of the TPP to oversee and coordinate the IRS's expanding transfer-pricing enforcement efforts. Since the APA Program's inception as a "pilot" alternative dispute resolution program in 1991, its placement within the Office of Associate Chief Counsel (International) (ACCI) versus the IRS has been a repeated topic of discussion. On multiple occasions, the issue has been presented to senior management within Chief Counsel and the IRS, and on each occasion — most recently in 2003 and 2006 — it was ultimately decided that the APA Program would remain in ACCI, at least for the time being.

APA placement was considered again as part of the initial LB&I restructuring, but a decision was made late in the process to exclude the Program, subject to further discussion and review. After a year of delay, the IRS finally announced on July 27, 2011, that the APA Program will be moving to a new office within

the TPP as part of a second realignment of the IRS's transfer pricing resources. Ironically, after 20 years of fierce opposition to such a move from within Chief Counsel and by taxpayers and taxpayer representatives, the announcement has been received with relative calm in the transfer pricing community — indeed, praised by some as a necessary solution to the Program's well-publicized resource challenges.

While I was with the APA Program from early 2005 to early 2011, including the last three years as Director, I was involved in both the 2006 and 2010-2011 debates about APA placement. After opposing the move in 2006, I came around to favoring it in 2010 — the first time, to my knowledge, that an incumbent APA Director had done so. For me, the following three factors — not necessarily in order of importance — tip the scales in favor of a transfer.

First, the APA Program is in need of substantial additional staff and other resources. APA applications are at record highs, case inventories are growing, case processing times are increasing, and complaints about case delays are rising. Unfortunately, because of competing demands and budget constraints, Chief Counsel has been challenged to furnish the Program with the support that it needs. On the other hand, LB&I has current authority to hire 30–50 additional professional staff, most of which have been allocated to the TPP, and it will be in a better position over time, given the relative size of the IRS vs. Chief Counsel, to move resources around and fill holes as needed. In contrast, an increase of 30+ additional APA staff would consume an unacceptably high percentage of any potential increase in Chief Counsel staffing and effectively "crowd out" any increase in the similarly short-staffed ACCI technical branches.

Second, the current proposal corrects the most important flaws in the earlier proposals. Specifically, the earlier proposals would have submerged the Program within the much larger IRS field function, undermining the Program's role as an effective dispute resolution program, diluting the Program's most important qualities, and threatening the Program's effectiveness over the long run. In contrast, the TPP will consolidate the IRS's transfer pricing expertise within a single, national organization, with the APA Program as a standard-bearer, to improve the overall quality, consistency, and effectiveness of U.S. transfer pricing enforcement.

Third, APA placement within LB&I and the TPP is fully consistent with the IRS's recent shift from an enforcement paradigm that relies principally on confrontation to a philosophy that emphasizes cooperation, transparency, interaction, and early resolution. Indeed, the changing paradigm is based in large part on the APA process. If the paradigm is to be successful, the APA Program will need to grow, become more widely accessible, and be fully integrated into the IRS's broader transfer pricing enforcement efforts. In this changing landscape, it makes far more sense for the Program to be a core part of LB&I, rather than an appendage to Chief Counsel.

In combination, these three factors create the possibility, for the first time, that a transfer of the Program will benefit not only the IRS, but also the APA Program and the taxpayer community at large.

The balance of this commentary describes the new Advance Pricing and Mutual Agreement (APMA) program and revisits the earlier arguments against a move of the APA Program in light of the current facts and circumstances. Subject to a few qualifications discussed below, the arguments in favor of a move — at least in the near term — clearly outweigh the arguments previously made for keeping the Program within Chief Counsel.

APMA Proposal

The idea of a national, specialized transfer pricing practice within LMSB International had been under consideration for more than a year and a half. At the time that IRS Commissioner Doug Shulman announced the creation of such a practice at the IRS-GWU international tax conference in December 2009, the concept was still in its formative stage, but senior IRS management was leaning toward a practice housed within LMSB International that was built on the existing industry-based IRS field structure.

The hiring of Mike Danilack in January 2010 as the new LMSB Deputy Commissioner (International) led to a fresh look at the IRS's international operations and a second look at the proposed TPP. This review produced a new conceptual model for the TPP as a

stand-alone operation and as one of three core elements of a revitalized international organization within LMSB, subsequently renamed LB&I. The new model converted the international organization of LB&I into a robust national office function that will have primary responsibility for: (1) the overall IRS international program; (2) administering the U.S. tax treaty network; and (3) supporting, training, and developing international examiners (IEs) and other international specialists in the field, which have lacked a natural organizational home since the restructuring of the IRS field in 2000.

Under the new model, the TPP will consist of two separate, but interrelated, functions: the APMA Program and a field-support function. The key details are as follows:¹

- The TPP will be managed by an SES-level Director (Director, TPP Operations) who will have executive oversight responsibilities for both the APMA Program and a field-support organization comprising field economists, transfer pricing technical analysts and IEs, and other transfer pricing specialists. Sam Maruca, a long-time, respected private practitioner, was named the Director, TPP Operations, in May 2011. Mr. Maruca will report directly to Mike Danilack.
- The APA Program and the IRS Mutual Agreement Program (which has historically been responsible, as part of the U.S. Tax Treaty Office, for resolving inter-country transfer pricing disputes (“double-tax allocation cases”) and negotiating bilateral APAs with our foreign tax treaty partners) will shift to a new office within the TPP.² The resulting APMA Program will be led by a new SES-level Director (as well as a deputy), who will report to the Director, TPP Operations. The effective date of the realignment is subject to working out a number of internal issues (e.g., obtaining union approvals) that could take three months or more to resolve.³ In the meantime, the APA and Mutual Agreement Programs will con-

¹ For additional information about the realignment of the APA and Mutual Agreement Programs, see the “Frequently Asked Questions” posted July 27, 2011, on the IRS website at <http://www.irs.gov/businesses/article/0,,id=242980,00.html>.

² The other work traditionally performed by the U.S. Tax Treaty Office, such as overseeing the exchange of information program and the Joint International Tax Shelter Information Centre (JITSIC), managing the activities of the IRS tax attachés stationed abroad, supporting the Department of the Treasury in its negotiation of tax treaties, and pursuing Competent Authority agreements with treaty partners in non-transfer-pricing cases, will continue under the direction of a new Assistant Deputy Commissioner (International), who will report directly to Mike Danilack.

³ At a Washington, D.C. tax bar meeting on Sept. 13, 2011,

tinue to work closely together on an informal basis, particularly on APAs (e.g., pooling resources, managing a single inventory, and eliminating the hand-off in bilateral APAs).

- In general, APAs and double-tax allocation cases already assigned to APA or Mutual Agreement staff will remain assigned to that staff and be worked under existing procedures. New cases should be submitted under the terms of the applicable revenue procedure (i.e., new APAs should be filed with the APA Program pursuant to Rev. Proc. 2006-9, while double-tax allocation cases should be filed with the Tax Treaty Office pursuant to Rev. Proc. 2006-54). If a case has been filed but not yet assigned to staff, a taxpayer should contact the appropriate program manager (e.g., the APA Director in the case of an unassigned APA).
- As part of the TPP, the APMA Program will operate, as the APA Program currently does within ACCI and as the Mutual Agreement Program does within LB&I, both independently of the field and as part of a national office function. This posture is critical to preserve the APA process as an advance issue resolution program and to exploit the Program's value as a laboratory for identifying emerging transfer pricing issues, developing and resolving issues on a consistent, principled basis, and shaping future IRS transfer pricing guidance.
- At the same time, placing the APA Program and the Mutual Agreement Program in the same office and under the same roof as the TPP field-support function will create a more seamless enforcement environment and enhance the existing working relationships between and among the Program, ACCI, the Tax Treaty Office, and the field. Cases can be steered onto the most appropriate track, issues can be developed on a coordinated basis, and policies can be applied more consistently across the different enforcement processes. The IRS and compliance-minded taxpayers will benefit from the integration, which should make the overall administrative process more efficient, better coordinated, more predictable in outcomes, and newly focused on early-case resolution.
- ACCI will continue to provide legal advice and support to LB&I, especially to the TPP. In APAs, the APMA team will recommend early in the process whether an APA should be treated as a “non-

strategic” APA or a “strategic” APA. A non-strategic APA is an APA that requires only a determination of facts or the application of well-established legal principles to known facts (i.e., is not novel or complex). In APAs determined to be strategic: (1) an ACCI attorney will be assigned to the APMA team (which is not currently done in the APA Program); and (2) the concurrence of ACCI will be required for the negotiated APA in a unilateral case and the recommended negotiating position in a bilateral case.

- The combined current staffing of the APA and Mutual Agreement offices is about 60 professionals. LB&I is in the process of hiring additional personnel for the new APMA Program, with a goal of having approximately 100 professionals, working in 12 teams, within the next few months. The expectation is that a significant percentage of the new hires will be external and comprise lawyers and professionally trained economists. The 12 teams will be based in Washington, D.C., San Francisco, and Southern California, with a likelihood that one or more new offices will be opened, presumably alongside the more dispersed TPP field function (e.g., Chicago, Dallas, and/or New York).⁴

Analysis of Factors Relevant to APA Program Placement

As noted earlier, APA placement was most recently considered in 2003 and 2006. The analysis in both instances looked at various factors that remain applicable today.⁵ Whereas the earlier analyses concluded that the APA Program should remain within Chief Counsel, the facts and circumstances have changed enough, in my view, to tip the scales in favor of a transfer. That is not to suggest that the APA Program would not survive if kept in Chief Counsel or that a transfer of the APA Program to LB&I is without risk. In the end, I am persuaded that the APMA Program, compared to earlier APA placement proposals and in light of the recent shift in IRS enforcement philosophy, represents a different kind of opportunity for the APA Program and would benefit both the IRS and the taxpayer community. That upside, combined with the

⁴ The APA Program currently has offices in Washington, D.C., San Francisco, and Laguna Niguel, CA. The Tax Treaty Office has offices in Washington, D.C., Los Angeles, and San Francisco, which opened on Aug. 1. The TPP field function will have more offices (e.g., 10 or more), with the exact number and locations still to be determined.

⁵ The two most recent occurrences are more important than earlier debates not only because they occurred more recently, but also because both occurred after the APA Program reached a certain level of size and maturity and because the analysis in each case focused on similar factors that remain relevant today.

Sam Maruca announced that the IRS has “targeted” January 1, 2012, as the date on which the APMA Program will be “fully integrated.” 178 *BNA Daily Tax Rpt.* G-6 (9/14/11).

APA Program's staffing shortages, explains why I supported the Program's move from Chief Counsel as APA Director and strongly support the move to the TPP as finally structured.

- *No Compelling Need for Transfer*

The earlier analyses adopted the old adage "if it isn't broken, don't fix it" in arguing to retain the APA Program within ACCI. It is not my position that the APA Program is broken. In fact, if anything, it has become a victim of its own success. At this point, however, there are two choices: (1) keep the APA Program within Chief Counsel and scale back its operations to match its resources;⁶ or (2) move the APA Program to LB&I, where it can be supported and leveraged to improve the efficiency and effectiveness of IRS transfer pricing enforcement generally. For the first time since the APA Program was founded, the downside in doing nothing appears to be greater than the risk of doing something.

- *Impact on Quality*

There is no dispute that quality staff is essential to the success of the APA Program. Because of the prestige of Chief Counsel and the fact that it operates under a less restrictive collective bargaining agreement (CBA), the APA Program is able to hire top-flight attorneys and economists to take the lead role on its cases. No doubt, the APA Program's ability to attract persons of this caliber is essential to the Program's success.

For that reason, LB&I envisions a continuation of APA Program hiring, compensation, and other personnel practices after the Program moves to the TPP. Those practices include hiring a substantial number of attorneys as team leaders and recruiting external candidates as team leaders and economists. This approach is decidedly different from the IRS's traditional hiring, compensation, and promotion practices, which reflect the much larger number of employees, are less flexible, and are designed primarily to provide internal advancement opportunities for career employees. The APA Program (and Chief Counsel, especially ACCI) has always had a more balanced mix of external hires and career employees, which keeps the Program fresh, aware of the latest trends, and less skeptical about taxpayer motives.

Given the importance of personnel and personnel management in the operation of the APA Program, it is essential that the APMA Program be able to retain

the APA Program's long-standing hiring and compensation practices. Any limit on outside hiring would be especially problematic. The IRS employs a very limited pool of attorneys, so most internal candidates will be non-attorneys. Chief Counsel has the opposite problem with economists. Hence, APA has always looked outside to hire economists. Going forward, the APMA Program will need to look outside for attorneys.

As for compensation, all APA professional staff are GS-14 or higher, and all APA managers are GS-15. By contrast, only a small percentage of IRS professionals are GS-14, and not all IRS managers are GS-15. Higher pay levels will be required for the APMA Program to compete for professionals with the experience, skills, and technical abilities needed to match up with the typical taxpayer and/or taxpayer representative in the Program.

The good news is that the Tax Treaty Office, with the support of past and present senior LB&I management, has changed its hiring practices over the past few years, bringing in a significant number of experienced external lawyers, economists, and other professionals. This observation is not meant to suggest that lawyers are always better than non-lawyers to be team leaders or that external hires are always better than internal hires. The point here is that the APMA Program (and the TPP, for that matter) needs to be able to attract the best and the brightest — whether lawyer or non-lawyer and whether external or internal — if it is to have any realistic hope of resolving the most difficult transfer pricing matters in an efficient and effective manner. Fortunately, in recent years, LB&I has demonstrated a willingness, and an ability to do that, a change that bodes well for the combined APMA Program.

- *Impact on Recruiting and Morale*

It has been argued in the past that the APA Program would have a difficult time recruiting and retaining attorneys (and economists) if it moved outside Chief Counsel because of Chief Counsel's prestige and high profile as an attorney-driven function. Under this view, an APA Program in the IRS would be viewed less favorably by both external applicants and current APA personnel, who would view the transfer as a step down in status, influence, and independence. Regardless of the merits of this view, the issue should be largely mitigated when the APA Program moves to the APMA Program, where the Program will have the ability to grow to better accommodate demand, expand its bilateral activities, consult on non-routine audits, retain its high public profile, and operate as a core component of a national office function in the form of a revitalized LB&I. As long as the APMA Program maintains the APA Program's independence, quality, and culture, it will attract and retain high-

⁶ The APA Program has historically accepted all submissions. However, after the Program was left out of the initial LB&I restructuring, APA management proposed limiting the Program's intake as part of a larger package of recommendations intended to mitigate the Program's resource challenges. Chief Counsel rejected that proposal, at least while the Program's status was under review.

quality professionals (provided the IRS personnel rules do not otherwise limit its ability to do so).

- *APA Program's Relationship with ACCI*

The APA Program has served as a “laboratory” to test how transfer pricing regulations and policies work in the actual administration of the rules. Because of that experience, APA staff was directly involved in the development of the new §482 regulations dealing with services and cost-sharing arrangements. In the past, there has been concern that this productive working relationship would be impaired if the Program were no longer part of Chief Counsel.

I do not see much merit in this concern. LB&I and ACCI have a close working relationship, as does the APA Program and ACCI Branch 6, the technical branch responsible for transfer pricing within ACCI. The organizations are in daily contact and by necessity will remain that way. Indeed, the TPP and the APMA Program are likely to improve the synergies between and among the various offices. Regardless, as described earlier, ACCI will continue to have a significant role in the most important cases (i.e., participation on APMA teams and joint review of strategic cases).

- *Public Reaction*

The earlier analyses assumed that the public reaction to the transfer of the APA Program to the TPP would be negative. Apart from the longstanding concern that a transfer of the APA Program to the IRS would jeopardize the Program's objectivity and independence, two aspects of the new APMA Program may raise concerns. The first issue is the expansion of team leader responsibilities to include bilateral APA negotiations. Some taxpayers prefer the current two-step process because it allows multiple negotiating opportunities — first with the APA Program and then with the Tax Treaty Office. The second issue relates to the APA Program's involvement with the TPP field-support function. Some taxpayers may regard this close association as the first step in an ultimate field takeover of the Program.

I understand the public's objections to earlier proposals to move the APA Program to the IRS. In my view, those proposals undervalued the APA Program's role in transfer pricing enforcement and overlooked the attributes of the Program that have made it so successful — its independence, objectivity, and emphasis on quality. None of the earlier proposals provided any upside to the APA Program and thus no benefits to taxpayers.

That is not the case for the APMA Program, which has been designed to exploit APA Program strengths — not submerge them into a larger, sometimes hostile

organization — by guaranteeing the Program's independence within a high-profile, national office function, protecting its culture by continuing its personnel policies, and broadening its influence by expanding its responsibilities. By solving the APA Program's biggest challenge, i.e., its staffing shortage, LB&I will help to resolve taxpayers' biggest problem with the APA process — the length of time it takes to complete an APA.

Conclusion

Notwithstanding the foregoing, I have a few concerns about the move, particularly in the long run after current LB&I management departs and the IRS's institutional memory begins to fade. For this reason, it's critically important that the independence, quality, and culture of the APA Program be incorporated into the TPP in as many institutional and formal ways as possible. Surely, this is not the last “great” IRS reorganization, which seems to occur every 10 years.

I am also concerned about funding issues, given the current budget environment. One hundred employees within the APMA Program may sound like a lot compared to historic APA staffing levels, but it's important to keep in mind that the APA Program is already badly understaffed at current application levels and that the new office will be expanding the Program's responsibilities to include double-tax allocation cases and consultation on the most difficult transfer pricing audits. At the same time, I am concerned about the APMA Program's ability to add 30–50 new staff in only a few months. I recruited aggressively as APA Director, but we still had to re-advertise a few job announcements to fill just one or two vacancies because of the dearth of quality candidates. The resulting delay in hiring was manageable, but the dilemma for LB&I is that the TPP could lose its existing hiring authority, as the APA Program did on one occasion, if it waits too long to fill the positions.

Regardless, the IRS had many choices in deciding what to do with the APA Program. Some ideas were better, some worse. In fact, however, the final structure incorporates a number of improvements to the model since I left the Program about seven months ago (e.g., having the TPP Director report directly to the LB&I Deputy Commissioner (International) and placing APAs and double-tax allocation cases in the same office). At this point, I am highly optimistic that the Program, now in its 20th year, will survive, albeit in modified form, to celebrate its 30th anniversary, still serving its central purpose to improve the IRS's ability to resolve the most difficult transfer pricing issues.