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Moving On: Why Placing the APA Function in LB&I Makes Sense

A former IRS APA program director makes the case for the current placement of the APA function in the Large Business & International division.

By CRAIG A. SHARON, BINGHAM McCUTCHEM LLP

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) rather than the enforcement side of the Internal Revenue Service—currently the Large Business and International division—has been a repeated topic of discussion. On multiple occasions, the issue has been presented to senior management within Chief Counsel and the Large and Mid-Size Business Division (the precursor to LB&I), and on each occasion—most recently in 2003 and 2006—it was ultimately decided that the APA program would remain in ACC(I), at least for the time being.

APA placement was considered again as part of the initial LB&I restructuring in October 2010, but a decision was made late in the process to exclude the program, subject to further discussion and review.¹ After a year of delay, the IRS finally announced July 27, 2011, that the APA program will be moving to an office within LB&I's new Transfer Pricing Practice as part of a second realignment of the IRS's transfer pricing resources.²

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.³

¹ See 19 *Transfer Pricing Report* 455, 459; 8/12/10.

² See 20 *Transfer Pricing Report* 283, 7/28/11.

³ 20 *Transfer Pricing Report* 319, 8/11/11.

Craig A. Sharon, a partner with Bingham McCutchen LLP in Washington, D.C., was director of the IRS's Advance Pricing Agreement program from April 2008 to February 2011.

The author, after initially resisting the idea of a move in the 2006 discussions, came to favor it by 2010. 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 between 30 and 50 additional professional staff, most of which have been allocated to the Transfer Pricing Practice, and it will be in a better position over time, given the relative size of LB&I compared with Chief Counsel, to move resources around and fill holes as needed. In contrast, an increase of 30 or more 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 ACC(I) 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 its most important qualities, and threatening the program's effectiveness over the long run. In contrast, the Transfer Pricing Practice 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 Transfer Pricing Practice 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.

APMA Proposal

The idea of a national, specialized transfer pricing practice within LMSB had been under consideration for more than a year and a half. At the time that IRS Commissioner Douglas Shulman announced the creation of such a practice at the IRS-George Washington University 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 that was built on the existing industry-based IRS field structure.

The hiring of Michael 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 Transfer Pricing Practice. This review produced a new conceptual model for the practice 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:

- the overall IRS international program;
- administering the U.S. tax treaty network; and
- supporting, training, and developing international examiners 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 Transfer Pricing Practice will consist of two separate, but interrelated, functions: the APMA program and a field-support function. The key details are as follows:⁴

- The Transfer Pricing Practice will be managed by a director at the Senior Executive Service level of the government 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.⁵

- 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 and negotiating bilateral APAs with foreign tax treaty partners) will shift to a new office within the Transfer Pricing Practice.⁶ The

resulting APMA program will be led by a new SES-level director (as well as a deputy), who will report to the director of transfer pricing operations. The effective date of the realignment is subject to working out a number of internal issues (for example, obtaining union approvals) that could take three months or more to resolve.⁷ In the meantime, the APA and mutual agreement programs will continue to work closely together on an informal basis, particularly on APAs (for example, 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 competent authority 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 (new APAs should be submitted under Rev. Proc. 2006-9, 2006-1 C.B. 278, while double tax cases should be filed with the Tax Treaty Office under Rev. Proc. 2006-54, 2006-49 I.R.B. 1035). If a case has been filed but not yet assigned to staff, a taxpayer should contact the appropriate program manager (in the case of an unassigned APA, the APA director).

- As part of the Transfer Pricing Practice, the APMA program will operate, as the APA program currently does within ACC(I) 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 Transfer Pricing Practice field-support function will create a more seamless enforcement environment and enhance the existing working relationships between and among the program, ACC(I), 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.

- ACC(I) will continue to provide legal advice and support to LB&I, especially to the Transfer Pricing Practice. 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 determina-

⁴ For additional information, see the list of questions and answers posted on the IRS website at <http://www.irs.gov/businesses/article/0,,id=242980,00.html>, also available at 20 *Transfer Pricing Report* 415, 9/22/11.

⁵ Samuel Maruca, formerly of Covington & Burling LLP in Washington, D.C., was named director of transfer pricing operations in May 2011. See 20 *Transfer Pricing Report* 4, 5/5/11.

⁶ 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 at-

tachés 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 the LB&I deputy commissioner (International), currently Danilack.

⁷ At a Washington, D.C. District of Columbia Bar tax section meeting Sept. 13, Maruca announced that the IRS has targeted Jan. 1, 2012, as the date on which the APMA program will be fully integrated. See 20 *Transfer Pricing Report* 407, 9/22/11.

tion of facts or the application of well-established legal principles to known facts (that is, it is not novel or complex). In APAs determined to be strategic: (1) an ACC(I) attorney will be assigned to the APMA team (which is not currently done in the APA program); and (2) the concurrence of ACC(I) 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 Transfer Pricing Practice field function (for example, Chicago, Dallas, and New York).⁸

Factors Relevant to APA Placement

As noted above, APA placement was most recently considered in 2003 and 2006. The analysis in both instances looked at various factors that remain applicable today.⁹ Whereas the earlier analyses concluded that the APA program should remain within Chief Counsel, the facts and circumstances have changed enough 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. Ultimately, however, 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.

Those advantages, combined with the APA program's staffing shortages, are reasons for supporting the program's move from Chief Counsel, and strongly supporting the move to the Transfer Pricing Practice as finally structured.

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 ACC(I). It is not that the APA program is broken; if anything, it has become a victim of its own success.

At this point, however, there are two choices: keep the APA program within Chief Counsel and scale back

⁸ The APA program currently has offices in Washington, D.C., San Francisco, and Laguna Niguel, Calif. The Tax Treaty Office has offices in Washington, D.C., Los Angeles, and San Francisco, which opened Aug. 1. The Transfer Pricing Practice field function will have more offices—likely at least 10—with the exact number and locations still to be determined.

⁹ 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 had reached a certain level of size and maturity, and because the analysis in each case focused on similar factors that remain relevant today.

its operations to match its resources,¹⁰ or 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 disadvantages of doing nothing appear 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 Chief Counsel operates under a less restrictive collective bargaining agreement, the APA program is able to hire highly skilled attorneys and economists to take the lead role on its cases. The APA program's ability to attract persons of this caliber is essential to its success.

For that reason, LB&I envisions a continuation of APA program hiring, compensation, and other personnel practices after the program moves to the Transfer Pricing Practice. 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 traditional hiring, compensation, and promotion practices at the rest of the IRS, 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 ACC(I)) 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. Because LB&I employs a limited pool of attorneys, most internal candidates would 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-15.¹¹ 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.

Fortunately, 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,

¹⁰ 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.

¹¹ According to data from the U.S. Office of Personnel Management, the starting annual salary for a GS-14 position in Washington, D.C., in 2010 was \$105,210 and for a GS-15 position was \$123,757.

bringing in a significant number of experienced external lawyers, economists, and other professionals. This observation is not meant to suggest that external hires are always better than internal hires—rather to highlight that LB&I has demonstrated a willingness, and an ability, to recruit those with the highest level of expertise—something that bodes well for the combined APMA program.

Relationship with ACC(I)

The APA program has served as something of a laboratory to test how transfer pricing regulations and policies work in the actual administration of the rules. Because of that experience, APA staff were directly involved in the development of the new Section 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.

There may not be much merit to this concern. LB&I and ACC(I) have a close working relationship, as does the APA program and ACC(I) Branch 6, the technical branch responsible for transfer pricing within ACC(I). The organizations are in daily contact and by necessity will remain that way. Indeed, the Transfer Pricing Practice and the APMA program are likely to improve the synergies between and among the various offices. ACC(I) will continue to have a significant role in the most important cases (that is, 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 Transfer Pricing Practice would be negative. Apart from the longstanding concern that a transfer of the APA program from Chief Counsel 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 Transfer Pricing Practice field-support function. Some taxpayers may regard this close association as the first step in an ultimate field takeover of the program.

The public's objections to earlier proposals to move the APA program to the IRS are understandable. 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 advantages 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—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, some concerns remain 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 is critically important that the independence, quality, and culture of the APA program be incorporated into the Transfer Pricing Practice in as many institutional and formal ways as possible.

Concerns also exist about funding issues, given the current budget environment. One hundred employees within the APMA program may seem like a lot compared to historic APA staffing levels, but it is 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, there is the question of the APMA program's ability to add between 30 and 50 new staff in only a few months. In the past, despite aggressive recruiting, some job announcements had to be re-advertised to fill just one or two vacancies due to a lack of qualified candidates. The resulting delay in hiring was manageable, but the dilemma for LB&I is that the Transfer Pricing Practice could lose its existing hiring authority—as the APA program did on one occasion—if it waits too long to fill the positions.

Ultimately, the IRS had many choices in deciding what to do with the APA program. Some ideas were better, and some worse. In fact, however, the final structure incorporates a number of improvements to the model (such as having the transfer pricing 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, there is reason to be 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.