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## **Driving Efficiencies in the APA Program: The Top Ten Best APA Practices for Taxpayers**

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The Advance Pricing Agreement (APA) Program's resource challenges are well-known. APA applications have hit record highs in each of the past three years, without a corresponding increase in APA staffing. Indeed, APA staffing has fluctuated downward in recent years, resulting in caseloads per APA team leader and economist, respectively, that are nearly double the desirable numbers.

The disconnect between the demand for APAs and the supply of APA resources has led to significant delays in APA case processing. These delays are causing taxpayers to look increasingly outside the APA Program (e.g., to IRS Appeals) for answers to their transfer pricing problems. That's true notwithstanding the record APA applications in recent years. Based on conversations with taxpayers and outside representatives, it's clear that the number of applications would have been even higher if the Program had the resources to manage its inventory.

The shortage of APA staff is not the only source of APA case delays. Other sources include:

- overly cautious APA staff and lax case supervision by APA managers;
- recalcitrant and overworked IRS Field teams;
- uncooperative, aggressive, and dilatory taxpayers and representatives;
- the intermittent scheduling and the slow pace of Competent Authority proceedings;
- results-oriented foreign tax authorities;
- increasingly novel and complex technical issues.

Each of these sources of delay is worthy of special attention, but this article focuses on what taxpayers can do, on their own, to help speed up the process.<sup>1</sup> Specifically, they can adopt the "Top Ten Best APA Practices" described below. It's impossible to offer precise estimates of how effective these top 10 practices will be in any particular case, but taxpayers who adopt them will reduce case processing times in a typical case by many months. And that will reduce costs significantly.

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<sup>1</sup> The APA Program, with the support of LB&I, is taking steps to improve APA case processing in the absence of additional resources from within Chief Counsel. Recent initiatives include the adoption of new internal efficiency measures (e.g., assessing the risk level of new cases), the greater use of IRS Field Economists, the proposed pooling of APA and U.S. Competent Authority resources, and the elimination of the hand-off between the APA Program and the U.S. Competent Authority in bilateral cases.

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The overriding principle is not to let a case go off track. Although the Program is currently experiencing 6+-month delays in case starts (because of a shortage of economists), it can process most cases (i.e., complete a unilateral APA or prepare a recommended negotiating position in a bilateral APA) in about 15 months after due diligence begins. Once a case goes off track, however, it

can be stalled for months, even terminated, especially if the cause of the problem raises questions about the taxpayer's credibility. Most of the Top Ten Best APA Practices below are aimed at keeping a case on track from beginning to end.

### **Embrace the APA Concept**

First and foremost, taxpayers must embrace the APA concept. The Program is a voluntary alternative dispute resolution process. As such, it requires a different attitude from the traditional adversarial process. Taxpayers are expected to disclose more information, cooperate more fully, and advocate less zealously than in a typical audit.<sup>2</sup> The process almost always requires compromise. In the end, taxpayers are expected to agree to fair, reasonable, and principled outcomes.

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<sup>2</sup> See Rev. Proc. 2006-9, 2006-1 C.B. 278, §2.

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A taxpayer without the proper attitude should think twice about seeking an APA. That applies especially to taxpayers who enter the Program to avoid a difficult audit, as a last resort before litigation, or to achieve a narrow, specific outcome. Too often, these motives limit a taxpayer's flexibility, lead to results-oriented analyses, produce disagreement, and end up causing major delays, if not complete stalemate. If a taxpayer's objectives are broader than obtaining certainty and eliminating the potential for double taxation — the principal advantages of an APA — it should disclose those goals upfront, as early as a pre-filing conference (PFC).

### **Schedule PFCs and Listen to IRS Recommendations**

A taxpayer can request a PFC, on a named or anonymous basis, soliciting the informal views of the Program before filing a submission.<sup>3</sup> The views of the APA team assigned to the PFC are not binding, but a taxpayer that disregards such views in its formal APA request will be asked to either submit a supplemental submission to explain the inconsistencies or withdraw and resubmit its request and go to the back of the line. Either reaction will delay the start of the case. It will also cause mistrust from the outset and lead to more careful scrutiny during due diligence that will inevitably slow the process.

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<sup>3</sup> *Id.*, §3.

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### **File Complete APA Submissions**

APA submissions will be rejected if not substantially complete.<sup>4</sup> That determination has become particularly important in bilateral requests subject to potential arbitration under certain new U.S. income tax treaties (e.g., United Kingdom, Germany, and Canada) because the "Commencement Date" for APA arbitration effectively starts upon the submission of a substantially complete APA submission.<sup>5</sup> In the rare case that the APA Program doesn't formally reject an incomplete submission, the case will still be substantially delayed by the supplemental submissions and the additional information requests needed to complete the submission. The best APA submissions anticipate the information that the APA team will want, and they do not omit or obscure difficult issues.

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<sup>4</sup> *Id.*, §4.

<sup>5</sup> See, e.g., the "Memorandum of Understanding Between the Competent Authority of Canada and the United States," released Nov. 25, 2010, available at <http://www.irs.gov/businesses/small/international/article/0,,id=137376,00.html>.

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### **Take Reasonable Positions**

"Reasonableness" is obviously in the eye of the beholder, but a taxpayer that takes aggressive, unconventional, or unsubstantiated positions will arouse immediate suspicion and be subject to extra scrutiny. This applies to both factual representations (e.g., about historic risk allocations) and methodology issues (e.g., choice of most reliable method, proposed comparables, special data adjustments, etc.). The Competent Authority process is particularly ill-suited to resolve characterization issues that depend on additional factual development (e.g., whether or not a tested party was ever at risk), so it's important in bilateral cases that the taxpayer and the APA team fully develop the facts that drive the economic analysis. In any event, more aggressive proposals will typically require more time to resolve.

### **Maintain Relationship with Audit Team**

Many taxpayers seek an APA to avoid difficult audits, while other taxpayers enter the Program with the support of their audit teams. Both of these are appropriate. Whatever the case, a taxpayer should

be sure to maintain (or quick to develop) a healthy relationship with its audit team because the audit team will have representation on the APA team and will retain jurisdiction over any rollback years. Of course, it's not necessary to agree with the Field team on every issue, but it is highly advisable to disagree in an agreeable way.

### **Adopt and Follow Case Plans**

APA teams and taxpayers have been required since 2005 to agree early in the process on a step-by-step plan for each case. Too often, these case plans are ignored by both taxpayers and APA teams. APA management wants to see stricter enforcement of the plans, so taxpayers should use this tool to their advantage. Be sure to follow the plan and don't be reluctant to report persistent failures by an APA team to do the same.

### **Cooperate During the Due Diligence Process**

APA teams often conduct more due diligence than is needed, and taxpayers have a right to question the breadth of a team's analysis, but stonewalling and foot-dragging by a taxpayer only raise APA team suspicions that the taxpayer is trying to hide something. Rather than employing passive-aggressive resistance, a taxpayer should tackle the problem head-on by communicating its concerns directly with the APA team — even elevate the issue if necessary — but then cooperate fully once a final decision has been made.

### **Avoid Late-Stage Changes to APA Proposal**

Two particular examples come to mind. The first example involves a late-stage change in facts, data, or pricing methods. The more significant the change, the greater the resulting delay in case processing. Some late-stage changes are significant enough to effectively restart the process. If the change goes to the heart of the economic analysis, the Program is increasingly likely to terminate the request and require the taxpayer to resubmit based on the changed circumstances (and go to the back of the line). Factual changes are, of course, sometimes beyond the control of the taxpayer (or at least the tax department), but a taxpayer should not let its process be derailed by facts coming to light late in the process that should have been known (and disclosed) at the outset.

The second example involves a late-stage taxpayer request to change a unilateral APA into a bilateral APA. If the request comes after the APA team has begun substantive negotiations with the taxpayer, the taxpayer's request may be denied on the ground that the Program won't entertain a second round of concessions — a first round with the taxpayer to reach a unilateral agreement and then a second round with the foreign Competent Authority to reach the bilateral agreement. This is particularly likely where the APA team has conceded issues in exchange for taxpayer concessions on other issues. In these cases, even if the request is accepted, the APA team may well decide to reverse its positions on the previously agreed matters.

### **Stay in Touch During the Bilateral Stage, but Understand Taxpayer's Limited Role**

When a bilateral request moves from the APA Program to the U.S. Competent Authority for negotiation with the foreign tax authority, the interaction between the IRS and the taxpayer (and the IRS Field Team) usually falls off. That's primarily because the Competent Authority negotiations are government-to-government and don't contemplate a formal role for taxpayers. Still, taxpayers can help the process along by knowing the Competent Authority meeting schedule,<sup>6</sup> staying current on the issues in dispute, providing requested information on a timely basis, and, most importantly, not overtly favoring one tax authority over the other.

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<sup>6</sup> The U.S. Competent Authority schedule varies from country to country. The general rule is twice a year, but it can be more or less frequent (e.g., every other month or once a year) depending on the country. In many cases, not completing a case early enough to get it on the agenda for the next scheduled meeting can lead to a long wait for the next meeting.

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### **Push for Quick Execution of Closing Documents**

The pressure to close a case formally falls off once an agreement is in place. In a bilateral case, it can take months for the Competent Authorities to execute the mutual agreement and months more for the APA team leader to draft the APA. It's also not unusual for taxpayers to take weeks, if not months, to sign and return the final APA. Of the 10 best practices, this last practice is the simplest for taxpayers to adopt and the easiest way to cut case processing times. A gentle reminder from a taxpayer about the need to complete the formal closing documents can sometimes save three to six months in case processing times.

The time that it takes to complete an APA is the number one problem facing the Program. No doubt,

the Program needs significant additional resources, but even if that doesn't happen, taxpayers can take steps on their own to accelerate the process. With the foregoing Top Ten Best APA Practices, taxpayers no longer have an excuse not to do so!

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