

Transfer Pricing

Uncertainty Over Tax Reform Not Halting Drive for IRS Pacts

BNA Snapshot

- Tax reform could negate, or require renegotiation of, agreements that allow companies to avoid a transfer pricing audit
- With border adjustment faltering, many taxpayers still moving ahead with IRS negotiations



By Alex M. Parker

Uncertainty over U.S. tax law changes hasn't kept taxpayers from seeking agreements with the government on their transfer pricing issues, practitioners told Bloomberg BNA.

The turbulent environment in tax enforcement is still pushing companies to seek advance pricing agreements from the Internal Revenue Service—even if a congressional overhaul of the tax laws could render those agreements moot, or outdated, within years.

"If you think about uncertainty with APAs, think about uncertainty without an APA," said Barbara Mantegani, an attorney in Washington and former analyst for the IRS Advance Pricing and Mutual Agreement Program. "Everybody feels like they're between a rock and a hard place at this point."

Since the Republican Party secured control of the White House and Congress in November, the tax world has been bracing for sweeping reforms to the federal tax system. Many companies responded by putting off international tax planning while lawmakers considered drastic changes to how the U.S. would tax income from international operations, including a proposal to convert the U.S. income tax into a border-adjusted cash-flow tax on imports and domestic sales.

If enacted, the border-adjusted tax could call into question the hundreds of existing APAs by drastically changing the economic incentives behind their terms. Current IRS regulations mandate that any change in law would supersede the terms of an APA, although tax attorneys and practitioners disagree on whether the GOP's proposals would technically do that. Many said APAs would have to be determined on a case-by-case basis, likely through renegotiation by the taxpayer and the IRS and, in some cases, a foreign tax authority.

New Consideration: Rate Reduction

Now that the border-adjusted tax proposal has faltered and no alternative has taken its place, taxpayers are weighing how much to even consider a possible change in the laws as they move forward.

"I kind of take that out of the prognostication, which is not to say that some companies would not have that in the back of their mind," said John Warner, a member of Buchanan Ingersoll & Rooney PC in Washington. "Given the lack of political success the administration has had, not to mention the lack of any detailed plan they've set out, you've got to wonder what the odds are that you can come close to predicting what the U.S. corporate environment is going to look like, even if there is tax reform."

Much of the debate on tax reform in Washington has shifted to consider a radical reduction in the U.S. corporate tax rate, with President Trump proposing to replace the current 35 percent rate with a rate of 15 percent. But a rate reduction, while possibly affecting the incentives behind a company's desire to pursue an APA, doesn't necessarily change the underlying dynamics.

"A change in tax rates could change taxpayer incentive for APAs," said Steven Wrappe, the deputy leader for global transfer

pricing dispute resolution at KPMG LLP. "Clients do ask about this,"

But he added that taxpayers often look to APAs as a way to gain certainty about a tax structure or situation that already exists, especially if it involves determining the cross-border allocation of income between two jurisdictions. Wrappe noted that the APA program "is not a process that is generally used in tax planning."

Companies will ask about the tax rates, "but generally that's not the motivation for getting an APA," he said.

Another practitioner pointed out that no matter what the tax rate, companies want to avoid being taxed on the same income in two countries. "Even if you've got a very low rate of tax, you still don't want to pay twice," said Karl Kellar, a partner at Jones Day in Washington.

The lengthy APA process, often a matter of years, is another complication in the calculus facing taxpayers. Corporations and advisers must weigh the possibility that the playing field will change while the agreement is being negotiated, prompting a decision on whether to pull out of the application.

"It's an expensive process, and a lot of taxpayers are going to say, 'I'm not going to spend my resources if I think there's only a 60 percent chance I'm going to go through with it,'" Warner said.

Drop in Applications

A recent IRS report showed a slow-down in interest in the U.S. APA program, with applications dropping from 183 in 2015 to 98 in 2016. IRS officials attributed the drop-off to the expiration of a revenue procedure in 2015 that prompted more applications that year. The IRS hasn't yet released any data from 2017. Without a breakdown by month, there is no way to determine what effect, if any, the prospect of U.S. tax reform has had on APAs.

New recommendations from the Organization for Economic Cooperation and Development designed to combat aggressive tax planning, or base erosion and profit shifting (BEPS), have also contributed to global uncertainty as different countries' interpretations of the BEPS guidance are predicted to increase cross-border tax disputes. Wrappe said BEPS has heightened interest in APAs as taxpayers seek certainty.

"It has generally been positive, as an APA can help address the additional uncertainty created by BEPS and implementation statutes," he said in a statement to Bloomberg BNA. "This increasing interest is especially true for 'benchmark' APAs that address an issue in a bilateral APA which exists between other members of the related group as well—the benchmark APA provides an indication of potential outcomes on that same type of transaction in other countries."

Even if an APA has to be reconsidered down the road, to many taxpayers, that seems preferable to the alternative.

"Whatever tax environment you're going to be in, you're going to be in," Kellar said. "It's not going to affect the rollback"—the part of the agreement that applies to past years. "It might affect future years, but that would be the case whether you've got an APA or not."

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