

Notice 98-10

PURPOSE

The Internal Revenue Service (“Service”) instituted the Advance Pricing Agreement (“APA”) Program to assist all taxpayers in their efforts to comply with I.R.C. §482. Under an APA, the Service and a taxpayer agree on a transfer pricing methodology (“TPM”) to be prospectively applied to an apportionment or allocation of income, deductions, credits, or allowances between or among two or more organizations, trades, or businesses owned or controlled, directly or indirectly, by the same interests. Provided the taxpayer complies with the terms and conditions of the APA, the Service will regard the results of applying the TPM as satisfying the arm’s length standard under §482. Rev. Proc. 96-53, 1996-2 C.B. 375, explains how a taxpayer may secure an APA from the Service.

To date, the Service has concluded over 100 APAs with U.S. taxpayers, the majority of which have been large business taxpayers with substantial income and/or assets. In an effort to reduce the §482 compliance burden of, and to make the APA Program more accessible to, small business taxpayers (“SBTs”), the Service is proposing special APA procedures for SBTs. For purposes of this Notice, a “small business taxpayer” is any U.S. taxpayer with total gross income (determined pursuant to §5.14(7) of Rev. Proc. 96-53 or its successor) of the amount set forth in §5.14(3) of Rev. Proc. 96-53 (or its successor), currently less than \$100 million.

The special procedures seek to address the SBT’s need to achieve the compliance certainty an APA provides at a cost that is reasonable relative to the size and complexity of the transactions involved. This Notice describes the circumstances under which an SBT may request special procedures in seeking an APA, the nature of the special procedures, and other provisions designed to assist SBTs in the APA process. (The Service will consider implementing similar procedures, on a case

by case basis, for the small transactions described in §5.14(4) of Rev. Proc. 96-53.)

The Service wishes to receive comments from interested members of the public prior to publishing the final procedures for SBT APAs. Comments (eight copies) should be sent to Associate Chief Counsel (International) CC:INTL:FO, Internal Revenue Service, 1111 Constitution Avenue, NW, Room 3501, Washington, DC 20224, making reference in the comments to Control Number INTL-OGI-117383-97. To ensure comments are given full consideration, they should be submitted by April 10, 1998.

BACKGROUND

The Service has indicated a desire to alleviate the §482 compliance burden for SBTs. For example, under the 1993 temporary regulations, §1.482-1T set forth a safe harbor for small taxpayers. That provision, however, was not retained in the final regulations due to deficiencies with the safe harbor. See “Explanation of Revisions and Summary of Comments” of the §482 final regulations, T.D. 8552, 1994-2 C.B. 93, 104. At that time, the Service solicited suggestions from the public for alternative approaches to assist small taxpayers with their §482 compliance burden. *Id.* No comments were received as a result of this solicitation.

The Service also attempted to assist all taxpayers, including SBTs, with their §482 compliance efforts by implementing the APA Program under Rev. Proc. 91-22, 1991-1 C.B. 526. The Program’s experience, however, indicates that SBTs are not participating in the Program to the same extent as larger taxpayers, due at least in part to cost concerns (in terms of internal staff time, external legal, accounting, and consulting fees, and Service user fees).

As a consequence, the Service established additional incentives for SBTs to seek APAs. Section 3.09 of Rev. Proc. 96-53 provides that the Service and a small business taxpayer may agree to special procedures for obtaining an APA, including simplified procedures that depart from standard procedures, to meet the needs of the particular SBT. In addition, §5.14 of Rev. Proc. 96-53 establishes a reduced user fee for an SBT seeking an

APA. The APA Program has successfully applied the approach referenced in §3.09 in several cases to assist SBTs in receiving APAs.

The Service believes that maintaining the ability to adapt procedures to the facts and circumstances of a particular SBT is better than establishing formal procedures that may not be applicable to all SBTs. However, it is important for the Service to furnish guidance regarding the types of procedures it deems appropriate for SBT APAs. Accordingly, the provisions in this Notice expand upon §3.09 of Rev. Proc. 96-53 by providing examples of simplified procedures the Service believes may be appropriate. It is hoped that the flexibility underlying this approach will encourage more small business taxpayers to participate in the APA Program.

PRINCIPLES FOR SMALL BUSINESS TAXPAYER APA REQUESTS

The Service intends to maintain flexibility in the APA process to address the particular needs of SBTs. Accordingly, the special procedures set forth below are the types of procedures the Service will entertain for SBT APA requests; they are not exclusive, and the Service will consider other procedures that harmonize with the objectives of the APA Program and the SBT. In addition, different procedures may apply to different SBTs, depending upon the facts and circumstances of each APA case.

To address the concern that the perceived costs to secure an APA are high in proportion to the size of the transactions involved, the special procedures focus on simplifying the APA process for the SBT transactions. This simplification is intended to reduce costs in terms of the amount of time required to evaluate the request, while permitting the Service to satisfy its due diligence requirements.

This objective can be accomplished when the SBT proposes to cover less complicated transactions with which the APA Program has had experience (such as those involving the manufacture or distribution of tangible property under §1.482-3 and the performance of administrative and technical services under §1.482-2(b)) and proposes a “best method” that is spec-

ified under the regulations. Transactions involving non-routine intangibles, including research and development cost sharing arrangements under §1.482-7, would not ordinarily be amenable to such special procedures due to the complexity of valuing such intangibles.

In addition, to the extent practical, the Service will coordinate the special procedures with the SBT's other tax compliance efforts so as to minimize the costs to the SBT. For example, the documentation that SBTs are required to maintain under I.R.C. §6662(e) may be accepted as the APA submission materials, and such documentation could form the primary foundation for the Service's evaluation of the SBT's APA request.

SPECIAL PROVISIONS FOR SBT APAs

At the request of an SBT, the Service will apply any or all of the following provisions under the principles of this Notice, if deemed appropriate by the APA Director:

1. Under ordinary conditions, a taxpayer contemplating an APA may (but is not required to) request a prefiling conference with the Service. If a prefiling conference is requested, the Service provides informal advice to the taxpayer regarding the taxpayer's proposal, but ordinarily does not begin its due diligence evaluation in earnest until the taxpayer formally files an APA request along with the appropriate user fee. Once the formal APA request is received, the APA Program targets finalizing the negotiating position for bilateral APAs in nine months and concluding unilateral APAs in 12 months. In contrast, for SBT transactions the Service intends, if requested, to commence its due diligence analysis at the front-end of the process to accelerate the conclusion of the APA negotiations.

(a) The Service and SBT may hold a prefiling conference (before a user fee is paid) to determine as early as possible the best method for the SBT's proposed covered transactions. To accomplish this, the Service will need a detailed description of the underlying facts of, and the proposed TPM for, the SBT's requested covered transactions at least 60 days prior to the scheduled conference. For purposes of this Notice, the SBT may provide the information it is required to maintain under I.R.C. §6662(e) to satisfy this requirement. Prior to its prefiling submission, the SBT must consult with APA Program personnel to determine the information the Service deems necessary to evaluate the SBT's particular covered transactions.

(b) An APA Team will evaluate the SBT APA prefiling submittal to determine items of concern and the additional documentation, if any, needed to evaluate the request. The SBT will be advised of the APA Team's initial conclusions before the prefiling conference so that it can address these items before or at the conference.

(c) At the prefiling conference, the SBT and Service will negotiate the case management plan with the objective of concluding a unilateral APA, or finalizing the recommended negotiating position for a bilateral APA, within six months of the date the SBT files its APA request. The Service's efforts to perform more of its analysis earlier in the process should result in a reduced number of post-filing meetings and supplemental information requests.

2. The Service and SBT may negotiate the reduction or elimination of specific elements otherwise required under §5 of Rev. Proc. 96-53. Examples of the types of information the Service may determine the SBT could exclude from its APA request include those described in the following subsections of Rev. Proc. 96-53:

(a) §5.04(3); (b) §5.04(5); (c) §5.04(6); (d) §5.08; and (e) §5.09.

3. The Service will hold all meetings with the SBT at a location convenient to the SBT. To minimize the number of meetings, teleconferences will be employed whenever feasible.

4. The Service will reasonably assist the SBT in the selection and evaluation of comparables or the computation of adjustments to comparables under §1.482-1(e), as well as, if appropriate, assist the SBT in determining other adjustments.

5. The initial term of an SBT APA will be three years, with the potential to renew the APA for a longer term.

6. For unilateral APA requests, an SBT may submit a proposed draft APA in a form substantially identical to the current APA model agreement attached to this Notice (the APA model is subject to change; SBTs should check with the APA Program for updated versions). To expedite review of the proposed draft APA, the SBT should also include a "redline" version showing the differences between the APA model and the SBT's proposed draft. In addition, SBTs should also submit the draft on a computer disk in a word processing format acceptable to the Service.

7. The Service will consider other procedures suggested by the SBT to reduce the SBT's administrative and financial burden, consistent with the objectives of the APA Program and the requirements of §482.

DRAFTING INFORMATION

The principal author of this Notice is David J. Canale of the Advance Pricing Agreement Program, Office of Associate Chief Counsel (International). For further information regarding this Notice, contact Mr. Canale or Mr. Karl Kellar at (202) 874-4360 (not a toll-free call).