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Global Tax Alert

News from Transfer Pricing

US IRS announces plans to limit the use of "telescoping" in APA and MAP cases

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The United States (US) Internal Revenue Service's (IRS) Advance Pricing and Mutual Agreement program (APMA) has announced that it is updating the parameters that it follows in mutual agreement procedure (MAP) and advance pricing agreement (APA) cases. The updates are expected to significantly restrict the use of "telescoping" of results in MAPs and APAs.

Telescoping

Telescoping refers to reflecting an income tax adjustment in a year different from the year to which the adjustment relates. Taxpayers sometimes request this departure from the notion of annual accounting in a MAP or APA to relieve the administrative burden of filing multiple amended federal and state income tax returns. APMA occasionally allowed taxpayers to do this, under the authority of an income tax treaty. The *Tax Cuts and Jobs Act* (TCJA) changed substantive provisions of the Internal Revenue Code. Thus, different tax rates and other rules may apply to similar related-party transactions, depending on which year they occur.

Under the new APMA parameters, taxpayers must generally amend the applicable year's (or years') federal income tax return rather than reflect the changes to taxable income in a most current tax year. For cases with pre- and post-TCJA years, the IRS states that changing the US taxpayer's taxable

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income under a competent authority resolution is likely to impact the substantive calculation of tax. APMA's updates to the telescoping parameters are intended to promote compliance with the changes brought to US tax law by the TCJA. Many of the TCJA's interlocking provisions require careful determination of a US taxpayer's taxable income and tax attributes.

The updated parameters have three main elements:

1. At the conclusion of its competent authority case, the US taxpayer will be instructed in terms of which tax year(s) impacted by the resolution is/are to be reflected in the taxpayer's US taxable income. The US taxpayer will generally be instructed to amend its US federal income tax returns for each of the individual years covered by its case.
2. When the competent authority case involves multiple years beginning before 1 January 2018, e.g., an audit cycle involving consecutive tax years, the US taxpayer may request aggregation of the change to taxable income for each year of the case, netted and reflected in the last of those tax years. Thus, for example, if a MAP case involved the US taxpayer's 2014, 2015 and 2016 tax years, the taxpayer may request that the changes to the respective years be netted and reflected in an amended US federal income tax return for 2016.
3. If the change to the US taxpayer's taxable income resulting from a competent authority resolution is US$10 million or less, the IRS may permit the US taxpayer to reflect the aggregate change in a tax year beyond the last year (or last of the years) covered by the case. The exact year in which the change will be permitted will depend upon various factors; in making its determination, the IRS will consider the amount of the change in taxable income and the administrative burden on the taxpayer in otherwise following the general approach.

The IRS will continue to review and update these parameters as needed to maintain balance between the interests of the US taxpayers (e.g., mitigate the administrative cost of implementing competent authority resolutions) and the needs of "sound tax administration."

Implications

Taxpayers should review their current MAP and APA cases to determine whether telescoping is allowed in their situation and whether it makes sense, given their facts. Moreover, taxpayers considering filing a MAP or APA request should be aware of the new APMA parameters, as the limitations on telescoping will change some practices to which taxpayers may have grown accustomed over the years.

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