A Shrouded Remedy: Increasing Transparency in the IRS Advance Pricing and Mutual Agreement Program by Releasing Redacted Advance Pricing Agreements and Increasing Administrative Disclosures

BLAKE L. CURREY*

TABLE OF CONTENTS

 J.D. Candidate, University of San Diego School of Law, 2014; B.S., Finance, San Diego State University, 2011. I am grateful to Professor Mark Hoose for his thoughtful guidance as my faculty adviser. I am also thankful to Robert Knox IV, my Comments Editor, for his insightful feedback and tireless editorial support.

I. INTRODUCTION

In a December 2011 filing with the United States Securities and Exchange Commission (SEC), the Western Union Company admitted that its previous tax returns had underreported the value of property it had received during a business restructuring by over $800 million.[1] This admission ended an extensive Internal Revenue Service (IRS or Service) transfer pricing investigation that concluded with a $220 million payment by Western Union to the IRS.[2] This settlement payment added to a $250 million deposit that the company had made prior to settlement negotiations.[3] By comparison, this transfer pricing adjustment resulted in a total charge approaching Goldman Sachs's $550 million penalty to the SEC for misleading investors, yet to a much smaller company.[4] This victory for

---

1. *See* Press Release, W. Union Co., W. Union Reaches Agreement with IRS (Dec. 15, 2011), *available at* http://ir.westernunion.com/News/Press-Releases/Press-Release-Details/2011/Western-Union-Reaches-Agreement-with-IRS/default.aspx; Associated Press, *Western Union To Pay $220M More in IRS Settlement*, BLOOMBERG BUSINESSWEEK (Dec. 15, 2011, 9:22 PM), http://www.businessweek.com/ap/financialnews/D9RLAMO00.htm.

2. Press Release, W. Union Co., *supra* note 1; Associated Press, *supra* note 1. Transfer prices are the dollar values that must be reported to the IRS for calculating taxes when transactions occur between closely related parties, such as an American parent corporation and its wholly owned subsidiary located in another country. Yariv Brauner, *Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes*, 28 VA. TAX REV. 79, 81 (2008).

3. Press Release, W. Union Co., *supra* note 1; Associated Press, *supra* note 1.

4. Press Release, SEC, Goldman Sachs To Pay Record $550 Million To Settle SEC Charges Related to Subprime Mortgage CDO (July 15, 2010), *available at* http://www.sec.gov/news/press/2010/2010-123.htm. At the end of the years in which they received their penalties, Goldman Sachs had total assets of $923 billion whereas Western Union had total assets of $9 billion. Goldman Sachs Grp., Inc., Annual Report (Form 10-K) 204 (Mar. 1, 2011); W. Union Co., Annual Report (Form 10-K) 44 (Feb. 24, 2012).

the IRS also came on the heels of an unprecedented $3.4 billion transfer pricing settlement with pharmaceutical company GlaxoSmithKline in 2006.[5]

At the heart of the Western Union investigation were the transfer prices assigned to intangible assets that First Data Corporation transferred to Western Union when Western Union was spun off as its own independent business.[6] The IRS and many of its foreign counterparts require that these transfer prices be determined based upon the "arm's length" principle.[7] In other words, the prices assigned to these transactions must be set at a level where the involved parties would be taxed the same amount on the transaction as if they were unrelated to each other and doing business in the open market.[8] Further, this standard is largely subject to interpretation and debate by both the companies involved and the IRS, which ultimately inspects and scrutinizes the selected transfer prices.[9]

The arm's length standard also leaves room for strategic manipulation, especially when these transactions occur between closely related parties located in countries with disparate corporate tax rates.[10] In these

---

5. *See* Audrey Nutt, *Glaxo, IRS Settle Transfer Pricing Dispute for $3.4 Billion*, TAX NOTES TODAY, Sept. 12, 2006, *available at* LEXIS, 2006 TNT 176-1. Although the final settlement amount was $3.4 billion, GlaxoSmithKline also admitted that its exposure for "potential transfer pricing adjustments was, as of December 31, 2005, $11.5 billion for its 1989 through 2005 tax years." *Id.*

6. Associated Press, *supra* note 1.

7. *See* I.R.C. § 482 (2006); Treas. Reg. § 1.482-1(b) (as amended in 2012).

8. Treas. Reg. § 1.482-1(b); Brauner, *supra* note 2, at 81–82.

9. *See* MICHELLE MARKHAM, THE TRANSFER PRICING OF INTANGIBLES 20, 23–24 (2005). The IRS is granted broad discretion and power to scrutinize and adjust transfer prices under Internal Revenue Code § 482 (2006), which provides that

> [i]n any case of two or more organizations . . . the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations . . . if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any such organizations.

Id. at 20 (quoting I.R.C. § 482 (1994) (internal quotation marks omitted)).

10. *See* Edward D. Kleinbard, *Stateless Income*, 11 FLA. TAX REV. 699, 734–37 (2011) (outlining several transfer pricing strategies used to shift profits from countries with high corporate tax rates to countries with low corporate tax rates); *see also* Tom Bergin, *Special Report: Amazon's Billion-Dollar Tax Shield*, REUTERS (Dec. 6, 2012, 11:08 AM), http://www.reuters.com/article/2012/12/06/us-tax-amazon-idUSBRE8B50AR20121206 (explaining Amazon.com's use of transfer pricing to channel profits through Luxemburg to reduce its tax rate); Jesse Drucker, *Google 2.4% Rate Shows How $60 Billion Lost to Tax Loopholes*, BLOOMBERG (Oct. 21, 2010, 3:00 AM), http://www.bloomberg.com/news/2010-10-21/google-2-4-rate-shows-how-60-billion-u-s-revenue-lost-t

circumstances, where one party is located in a country with a very high corporate tax rate and the other controlled company is in a country with a very low corporate tax rate, there is a financial incentive for businesses to escape being taxed at the higher corporate tax rate by recognizing as much revenue as possible in the lower tax country.[11]

For example, Google Inc. has used transfer pricing as part of a broader tax strategy to reduce its overseas tax rate to 2.4%, despite earning its foreign revenue in a majority of countries where the "average corporate rate is well over 20 percent."[12] Apple Inc. similarly paid 1.9% in taxes on foreign pretax profits of $36.8 billion.[13] In comparison, the top marginal domestic corporate tax rate for these two companies' revenue earned in the United States is 35%.[14] In Google's strategy, nicknamed the "Double Irish/Dutch Sandwich," the company first transferred the rights to its search and advertising technologies to a wholly owned subsidiary in Ireland.[15] Next, the subsidiary in Ireland became a resident of Bermuda for tax purposes and again licensed the rights it received from the parent Google to another controlled subsidiary in the Netherlands.[16] Finally, the Dutch subsidiary licensed these rights back to a second but separate wholly owned subsidiary in Ireland, which once again licensed these rights and collected billions of dollars in advertising revenues from their use while benefitting from Ireland's low corporate tax rate, a result achieved by taking advantage of loopholes in each of the involved countries' tax systems.[17] One tax program director went so far as to say, "The system is broken . . . . Companies are getting away with murder."[18]

---

o-tax-loopholes.html (describing Google's successful use of transfer pricing as part of a comprehensive strategy to lower its tax rate).

11. *See* Bergin, *supra* note 10; Drucker, *supra* note 10.

12. Drucker, *supra* note 10 (internal quotation marks omitted).

13. *Apple Paid Only 2% Corporation Tax Outside US*, BBC NEWS, http://www.bbc.co.uk/news/business-20197710 (last updated Nov. 4, 2012, 9:08 PM). Other large firms have obtained similar results in high-tax countries. *See Starbucks 'Paid Just £8.6m UK Tax in 14 Years,'* BBC NEWS, http://www.bbc.co.uk/news/business-19967397 (last updated Oct. 16, 2012, 1:28 PM) (noting that Starbucks Corporation paid less than one percent in corporation tax and identifying payments between subsidiaries as a "factor in reducing its taxable income in the UK"); Kenneth Thomas, *Boy Is This a Galling Tax Dodge from Facebook: It Paid 0.3% Taxes on $1.34 Billion Profits*, BUS. INSIDER (Dec. 28, 2012, 7:27 AM), http://www.businessinsider.com/surprise-facebook-avoids-its-european-taxes-2012-12#!CgSvb (describing how Facebook channels its profits through multiple foreign subsidiaries to reduce taxes).

14. *See* IRS, PUBLICATION 542: CORPORATIONS 16–17 (rev. 2012), *available at* http://www.irs.gov/pub/irs-pdf/p542.pdf (showing a tax rate of thirty-five percent for corporate income over $18,333,333).

15. Kleinbard, *supra* note 10, at 708–10.

16. *Id.* at 709.

17. *Id.* at 709–10. Of importance for this Comment's ensuing discussion, Google also secured an advance pricing agreement with the IRS in 2006. *Id.* at 708. This

Now, energized by its largest transfer pricing victory in recent years, the IRS is forming an elite team of professionals recruited from the Big Four audit firms and prominent law firms to "[c]rush [t]ransfer [p]ricing [a]buse."[19] This latest IRS recruitment effort also coincides with the hiring of several hundred additional international examiners, with a goal of hiring 120 auditors primarily responsible for transfer pricing reviews.[20] According to a former IRS division director, Craig Sharon, although the IRS lags behind its foreign counterparts in transfer pricing enforcement, the Service's recent changes will help close the gap.[21] The shift within the IRS over the last several years is part of a global trend by governmental tax authorities to protect and increase their countries' tax bases in a challenging economy by ramping up transfer pricing enforcement.[22] In

agreement locked in the transfer prices that Google assigned to its search technology rights and other intangible assets when it transferred these items to the first Irish subsidiary. *See id.*

18. Drucker, *supra* note 10 (quoting the remarks of Reuven S. Avi-Yonah, director of the international tax program at the University of Michigan Law School) (internal quotation marks omitted).

19. Kelly Phillips Erb, *IRS Brings 'A Team' To Crush Transfer Pricing Abuse*, FORBES (Mar. 27, 2012, 2:27 PM), http://www.forbes.com/sites/kellyphillipserb/2012/03/27/irs-brings-a-team-to-crush-transfer-pricing-abuse/. This "dream team" includes tax specialists from the firms KPMG, Ernst & Young, Mayer Brown, and Covington & Burling. *Id.*; *see also* Patrick Temple-West, *U.S. IRS Forms 'Swat Team' for Tax Dodger Crackdown*, REUTERS (Mar. 20, 2012, 5:57 PM), http://www.reuters.com/article/2012/03/20/usa-tax-irs-transfer-idUSL1E8EKHU220120320 (noting the same).

20. ERNST & YOUNG, 2010 GLOBAL TRANSFER PRICING SURVEY 5 (2010), *available at* http://www.ey.com/Publication/vwLUAssets/Global_transfer_pricing_survey_-_2010/$FILE/2010-Globaltransferpricingsurvey_17Jan.pdf.

21. Stephanie Berrong, *Google's 'Double Irish' and 'Dutch Sandwich' Schemes Raise Questions About Tax System*, TAX NOTES TODAY, Dec. 7, 2010, *available at* LEXIS, 2010 TNT 234-5.

22. ERNST & YOUNG, 2012 GLOBAL TRANSFER PRICING TAX AUTHORITY SURVEY 7–8 (2012), *available at* http://www.ey.com/Publication/vwLUAssets/2012-Global-TP-Tax-Authority-Survey/$FILE/2012-Global-TP-Tax-Authority-Survey.pdf. The international community has embraced this goal, with the Group of Twenty Finance Ministers and Central Bank Governors (G20) soliciting the Organisation for Economic Co-operation and Development (OECD) to develop a comprehensive action plan to combat tax base erosion and profit shifting strategies. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING 11 (2013), *available at* http://www.oecd.org/ctp/BEPSActionPlan.pdf. G20 is composed of nineteen countries and the European Union. *About G20*, G20.org, https://www.g20.org/about_G20 (last visited Mar. 30, 2014).

September 2012, the IRS emphasized that transfer pricing enforcement is the Service's biggest challenge looking forward.[23]

Companies involved in transfer pricing are not blind to or complacent about the regulatory risks that Western Union and GlaxoSmithKline failed to navigate. A survey conducted by Ernst & Young reported that 74% of parent company respondents and 76% of subsidiary respondents disclosed that transfer pricing is either an "absolutely critical" or "very important" tax issue that they are facing over the next few years.[24]

Faced with this high-stakes environment and increasing governmental scrutiny, one potentially effective way for multinational enterprises to manage the risks involved in setting their transfer prices is to negotiate an advance pricing agreement (APA) with the IRS and other taxing authorities.[25] These agreements provide several advantages, including significant savings in time and costs associated with investigations and litigation by likely preventing the business from becoming entangled in a transfer pricing dispute similar to the one Western Union faced.[26]

While confronting an increase in transfer pricing enforcement activity, at-risk businesses will likely find APAs offered by the IRS more attractive than ever.[27] Yet, the IRS program that negotiates and issues APAs, originally known as the Advance Pricing Agreement Program (APA Program) and recently reformed into the Advance Pricing and Mutual Agreement Program (APMA Program or Program), has consistently come under serious negative scrutiny.[28] Specifically, international tax practitioners have questioned

---

23. *Offshore Profit Shifting and the U.S. Tax Code—Part 1 (Microsoft and Hewlett–Packard): Hearing Before the Permanent Subcomm. on Investigations, S. Comm. on Homeland Sec. & Gov't Affairs*, 112th Cong. 147 (2012) (statement of William J. Wilkins, Chief Counsel, IRS).

24. ERNST & YOUNG, *supra* note 20, at 3.

25. ERNST & YOUNG, *supra* note 22, at 4, 11. An APA is an agreement between a taxpayer and the IRS as to the best transfer pricing method before the controlled transactions occur. Rev. Proc. 2006-9, 2006-2 I.R.B. 278, 279, § 2.04.

26. *See* OECD, OECD TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISES AND TAX ADMINISTRATIONS 173 (2010).

27. *See* ERNST & YOUNG, *supra* note 22, at 11 (describing the increased availability of APAs as a "welcome development[]" for businesses because transfer pricing penalties are becoming "more frequent and more onerous"). The fact that countries continue to create new APA programs also shows the demand for these types of agreements. *See* Antonis Desipris, *Greece Amends Transfer Pricing Framework and Introduces APA Program*, WORLDWIDE TAX DAILY, Mar. 4, 2013, at 1, 5, *available at* LEXIS, 2013 WTD 42-9; Cecilia Lee et al., *News Analysis: Hong Kong's First APA Case and How To Proceed from Here*, WORLDWIDE TAX DAILY, Feb. 28, 2013, at 1–2, *available at* LEXIS, 2013 WTD 40-7.

28. Lee A. Sheppard, *News Analysis: Draft Senate Finance APA Report Shows Incompetent IRS*, TAX NOTES TODAY, June 22, 2005, *available at* LEXIS, 2005 TNT 119-1; Richard C. Stark et al., *Consistency, Sunshine, Privacy, Secret Law, and the APA Program*, WORLDWIDE TAX DAILY, Mar. 28, 2011, *available at* LEXIS, 2011 WTD 59-

whether the Program can be effective in an environment in which the time necessary to finalize an agreement has increased significantly since the original APA Program's inception.[29] Also, the IRS's recent abrupt cancellation of two APAs that it had entered into with Eaton Corporation has further decreased the Program's corporate appeal.[30] These events correspond with a long running concern regarding a lack of information about the Program, a problem that culminated in a congressional investigation that produced a complete draft report.[31] Yet, this report subsequently "vanished into thin air,"[32] and calls for increased disclosure regarding the Program persist.[33]

This Comment examines the current state of the IRS's handling of pricing agreements within the APMA Program, arguing that the IRS should improve the Program by increasing its transparency to coincide with the additional resources being devoted to the Program, the IRS's elevating transfer pricing enforcement, and the modern valuation challenges in transfer pricing. Part II further introduces transfer pricing and the arm's length standard, and Part III examines the recent performance of the APMA Program. Part IV explores the Program's troubling lack of

---

10; David D. Stewart, *Practitioners Raise Concerns over Delays in IRS APA Program*, WORLDWIDE TAX DAILY, June 9, 2011, *available at* LEXIS, 2011 WTD 111-3; Shamik Trivedi & Jaime Arora, *Tech Company Tax Directors Question Appeal of APAs*, TAX NOTES TODAY, Nov. 14, 2012, *available at* LEXIS, 2012 TNT 220-6; Lynnley Browning, *The Tax Break that Corporate America Wants Kept Secret*, CNN MONEY (July 22, 2013, 5:00 AM), http://finance.fortune.cnn.com/2013/07/22/irs-corporate-tax-deal/; Jeremy Scott, *Shedding Light on Advance Pricing Agreements*, TAXANALYSTS (July 22, 2013, 4:21 PM), http://www.taxanalysts.com/taxcom/taxblog.nsf/Permalink/JSCT-99UL7R?OpenDocument. The IRS recently consolidated the original stand-alone APA Program and the Service's mutual agreement procedures into a single program within the Large Business and International Division titled the Advance Pricing and Mutual Agreement Program. I.R.S. News Release IR-2012-38 (Mar. 27, 2012). The procedures for obtaining an APA under the realigned program remain the same until the IRS issues updated guidance. *Id.* For this Comment, all references to the APMA Program are to the Service's processing and handling of APAs.

29. Stewart, *supra* note 28. For further discussion of this concern and the Program's improvements in 2012, see *infra* Part III.B.

30. Jeremiah Coder, *News Analysis: APA Cancellations Diminish IRS Program's Appeal*, TAX NOTES TODAY, July 16, 2012, *available at* LEXIS, 2012 TNT 136-2.

31. *See* Lisa M. Nadal, *News Analysis: Who Killed the Senate APA Report?*, WORLDWIDE TAX DAILY, Jan. 15, 2008, *available at* LEXIS, 2008 WTD 10-9.

32. *Id.*

33. *See* Lisa M. Nadal, *Should Advance Pricing Agreements Be Disclosed?*, WORLDWIDE TAX DAILY, Sept. 10, 2008, *available at* LEXIS, 2008 WTD 176-12; Stark et al., *supra* note 28; Browning, *supra* note 28; Scott, *supra* note 28.

transparency. Part V analyzes the legal and financial interests implicated by improving the Program's transparency, arguing that the Program should be improved by (1) amending Internal Revenue Code §§ 6103(b)(2) and 6110 to allow disclosure of time-delayed redacted APAs to guide practitioners and address public concerns; (2) providing additional categories of information within the APMA annual report, including examples of APAs from that year; and (3) adding a mandatory internal appeals process for the cancellation of APAs. Last, Part VI concludes that the Program can better achieve its mission by adopting one or more of these proposals.

II. THE MODERN CHALLENGES OF TRANSFER PRICING AND THE ARM'S LENGTH STANDARD

A. Basics of Transfer Pricing

Transfer pricing is defined as the "pricing of intercompany transactions that take place between affiliated businesses."[34] In other words, transfer prices are the amounts charged by one segment of a business when it transfers physical goods and intangible property or provides services to another associated business.[35] To survive a possible audit or other transfer pricing scrutiny by the IRS, the companies' price values must comport with the arm's length standard.[36]

The Organisation for Economic Co-operation and Development (OECD), an economic association of thirty-four member countries that produces international tax guidance and statistics,[37] specifies when a violation of the arm's length standard occurs and what results:

> [if] conditions are made or imposed between the two associated enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.[38]

---

34. MARKHAM, *supra* note 9, at 9 (quoting Robert Feinschreiber, *Practical Aspects of Transfer Pricing*, *in* TRANSFER PRICING HANDBOOK 2-1, 2-1 (Robert Feinschreiber ed., 3d ed. 2001)) (internal quotation marks omitted).

35. OECD, *supra* note 26, at 19. Under this definition, two businesses are associated if "one of the enterprises participates directly or indirectly in the management, control, or capital of the other" business. *Id.*

36. Treas. Reg. § 1.482-1(b)(1) (as amended in 2012).

37. *Members and Partners*, OECD, http://www.oecd.org/about/membersandpartners/ (last visited Mar. 30, 2014); *OECD Tax Database*, OECD, http://www.oecd.org/tax/tax-policy/tax-database.htm (last visited Mar. 30, 2014).

38. OECD, *supra* note 26, at 33 (quoting Model Tax Convention on Income and Capital art. 9(1) (Org. for Econ. Co-operation and Dev. 2003)).

In other words, this standard requires that a transaction between two related or affiliated enterprises be conducted as if the businesses were unrelated or independent companies dealing in the open market.[39] For example, say that American computer company Alpha sells smart phones assembled in Taiwan by its wholly owned subsidiary, Beta. As Alpha receives shipments of smart phones, it must set a price and "purchase" these goods from Beta, even though Alpha completely owns Beta. This transfer price allows the IRS and Taiwan's Ministry of Finance to tax these goods as they change hands and territories. The arm's length principle applied here means that the smart phone transfer price must be similar to what a wholesale retail distributor would pay a neutral third-party manufacturer for similar smart phones. Yet, this principle faces intense criticism because it assumes that a subsidiary can independently negotiate and set a price normally determined by independent actors.[40]

B. Methods of Determining Transfer Pricing

There is widespread agreement that the arm's length standard applied in such instances leaves significant room for uncertainty as to the proper transfer price for many transactions.[41] With a multitude of variables that could affect each transaction, proper prices are often difficult to determine for many goods and services, and they are even more challenging to pinpoint in cases where licenses and unique intangible property, such as patents and trademarks, are exchanged between related companies.[42]

The first and most basic transfer pricing method is the comparable uncontrolled price method.[43] Under this method, the transfer price is compared with an amount charged in a comparable uncontrolled transaction.[44] This transaction is also adjusted for differences between

39. *See* Treas. Reg. § 1.482-1(b)(1).

40. *See* Kleinbard, *supra* note 10, at 709 (criticizing the standard's assumption that a "wholly-owned subsidiary has a mind of its own with which to negotiate 'arm's-length' contractual terms with its parent" as one of several "fantastic notions" that countries remarkably readily accept).

41. Reuven S. Avi-Yonah et al., *Allocating Business Profits for Tax Purposes: A Proposal To Adopt a Formulary Profit Split*, 9 FLA. TAX REV. 497, 500 (2009).

42. *Id.*

43. *See* Treas. Reg. § 1.482-3(a) (as amended in 2012).

44. *Id.* § 1.482-3(b)(1) (as amended in 2012). For the majority of the APAs that the Program executed in 2012, the required comparable data was acquired from Standard and Poor's Compustat database, with various other sources being used in appropriate cases. I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, 922.

the quality and marketability of the compared products.[45] From here, pricing methods under the arm's length standard in the United States become increasingly complex; these methods include the comparable profits method and various profit split methods.[46] The variety of intricate pricing methods leaves room for reasonable disagreement between the taxpayers and taxing authorities involved.[47]

C. Intensifying Scrutiny

As mentioned above, the IRS has been recruiting a team of experts to eliminate transfer pricing abuse.[48] Also, by taking advantage of an economic downturn that has made talent much more affordable, the IRS has hired additional employees to target transfer pricing, including 2000 employees in 2009 and 2010 to deal with general international issues.[49] In a further effort to improve enforcement of transfer pricing, the IRS has centralized and aggregated resources that were scattered across multiple departments.[50]

The effects of this escalation are already visible, with tax authority review increasingly focusing on the transfer prices set for financial transactions

---

45. *See* Treas. Reg. § 1.482-3(b)(2)(ii)(B) (as amended in 2012).

46. *Id.* § 1.482-3(a)(1)–(5). The comparable profits method instead focuses on financial ratios or profit level indicators "derived from uncontrolled taxpayers that engage in similar business activities under similar circumstances." *Id.* § 1.482-5(a) (as amended in 2012). This method is applied by comparing the operating profit of one taxpayer with the profit of another party in a similar uncontrolled transaction to determine an arm's length price. MARKHAM, *supra* note 9, at 108. This method, along with a variation that focuses on net profit margins, was the transfer pricing method used in seventy-five percent of the Program's APAs involving tangible and intangible property in 2012. I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, 920. It was also used for fifty-five percent of the Program's APAs involving services in 2012. *Id.* at 921. For additional methods used in other tax jurisdictions and proposed new methods, see generally MARKHAM, *supra* note 9, at 94–132, for an in-depth discussion of the more traditional transactional, profit-based, and profit split methods; OECD, *supra* note 26, listing various methods that the OECD accepts; Avi-Yonah et al., *supra* note 41, at 500, 507, analyzing current methods based on profitability and proposing a new method; and Brauner, *supra* note 2, at 127.

47. *See* Andrew B. Whitford, *The Reduction of Regulatory Uncertainty: Evidence from Transfer Pricing Policy*, 55 ST. LOUIS U. L.J. 269, 276–77 (2010).

48. *See supra* note 19.

49. ERNST & YOUNG, *supra* note 20, at 5; Erb, *supra* note 19; Allen Smith, *IRS, Global Taxing Enforcement Agencies Intensify Enforcement on Transfer Pricing*, SOC'Y FOR HUM. RESOURCE MGMT. (Nov. 19, 2009), http://www.shrm.org/LegalIssues/FederalResources/Pages/TransferPricing.aspx.

50. Douglas H. Shulman, Comm'r of Internal Revenue Serv., Remarks at the IRS/George Washington University 24th Annual Institute on Current Issues in International Taxation (Dec. 15, 2011), *available at* http://www.irs.gov/uac/Commissioner-Douglas-H.-Shulman-Speaks-at-the-IRS-George-Washington-University-24th-Annual-Institute.

made between subdivisions of a company.[51] Tax authority review of these transactions increased dramatically from 7% in 2007 to 42% in 2010.[52] Further, reviews of transactions concerning services increased from 55% to 66% during the same time.[53] Litigation, a very costly byproduct of enforcement, is still uncommon and seen as a last resort after mediation and arbitration.[54] Litigation, however, is on the rise.[55] Additionally, tax authorities such as the IRS are armed with increasingly sophisticated investigatory methods, including the ability to extend the scope of a transfer pricing investigation beyond a single party to examine the transfer price's effect on the profit of the other party to the transaction and possibly the business's full distribution chain.[56]

III. ONE SOLUTION TO RISING ENFORCEMENT: ADVANCE PRICING AGREEMENTS

A. The APA Process in the IRS APMA Program

An APA offers one potential solution for taxpayers trying to navigate the plethora of potential pitfalls involved in transfer pricing.[57] The main advantage of this agreement is that it eliminates uncertainty by making tax treatment for controlled transfers more predictable.[58] This increased level of certainty improves the taxpayer's ability to make strategic planning

51. *See* ERNST & YOUNG, *supra* note 20, at 3.
52. *Id.*
53. *Id.*
54. *Id.*; Peter Nias, *Transfer Pricing and Dispute Resolution—The U.K. Experience*, INT'L TAX J., Sept.–Oct. 2010, at 25, 29.
55. ERNST & YOUNG, *supra* note 20, at 3. As evidence, the IRS is currently embroiled in transfer pricing litigation with several large U.S. companies. Patrick Temple-West, *Amazon Fights $234 Million Tax Liability in Tax Court*, REUTERS (Jan. 15, 2013, 5:06 PM), http://www.reuters.com/article/2013/01/15/net-us-usa-tax-amazon-idUSBRE90E0QY20130115; Patrick Temple-West, *Brazil Royalties Dispute Lands 3M, IRS in U.S. Tax Court,* REUTERS (Apr. 3, 2013, 4:41 PM), http://www.reuters.com/article/2013/04/03/us-usa-tax-3m-idUSBRE93214020130403; Patrick Temple-West, *Eaton, IRS Tangle over Cross-Border Pricing Pacts*, REUTERS (June 17, 2012, 1:15 PM), http://www.reuters.com/article/2012/06/17/us-usa-tax-court-eaton-idUSBRE85G0F420120617.
56. ERNST & YOUNG, *supra* note 20, at 6.
57. Rev. Proc. 2006-9, 2006-2 I.R.B. 278, 279, § 2.01.
58. OECD, *supra* note 26, at 173.

and financial decisions.[59] An APA can also prevent costly and time-consuming investigations and litigation, both for the taxpayer and the IRS.[60]

A completed APA specifies what transactions will be covered, what pricing methods will be used for those transactions, and what compliance and reporting requirements the company must abide by.[61] An APA can also be unilateral or bilateral.[62] A unilateral APA is an agreement between the IRS and the taxpayer, and it provides shelter from only U.S. transfer pricing laws.[63] Thus, a unilateral APA does not protect an entity from the danger of double taxation.[64] In contrast, a bilateral APA is negotiated between the taxpayer, the IRS, and the IRS equivalent in the other party's home country and will prevent double taxation.[65]

Additionally, these agreements are kept confidential and not released to the public.[66] Companies that have entered into an APA frequently do not admit that the agreement exists, and when companies do disclose an agreement's existence, shareholders are not provided with its details.[67]

Returning to the example of Alpha's smart phones, Alpha purchases assembled smart phones from its Taiwanese subsidiary, Beta, and Alpha first approaches the IRS to apply for a bilateral APA. The IRS then negotiates with the Ministry of Finance in Taiwan for both administrations to agree on the best transfer pricing method for the transactions. This agreement would protect Alpha from scrutiny on its transfer pricing methods as long as the company followed the Program's reporting and documentation guidelines.[68] This agreement could then be renewed, possibly applied to previous years for tax purposes, and even adjusted during the tenure of the agreement if circumstances changed.[69]

---

59. *See* MARKHAM, *supra* note 9, at 9–10.
60. OECD, *supra* note 26, at 173.
61. *See* Rev. Proc. 2006-9, 2006-2 I.R.B. 278, 279, § 2.04.
62. *See* I.R.S. Announcement 2012-13, 2012-16 I.R.B. 805, 806.
63. *See id.*
64. *See id.*
65. *See id.*
66. I.R.C. § 6103(a), (b)(2)(C) (2006) (providing that return information, which includes "any advance pricing agreement," shall be confidential).
67. Browning, *supra* note 28; Scott, *supra* note 28.
68. *See* Rev. Proc. 2006-9, 2006-2 I.R.B. 278, 289, § 10.02 (providing that if the taxpayer complies with the requirements and conditions of the APA, the Service "will not contest the application of" the agreed upon transfer pricing methodology).
69. *See id.* §§ 8.01, 11.02, 12.01.

B. Creation and Current State of the APMA Program

The IRS has offered these agreements since 1991 through its APA and now APMA Program.[70] The stated goal of the Program is to increase the efficiency of tax administration by encouraging taxpayers to "work towards a mutual agreement in a spirit of openness and cooperation."[71] The Program is completely voluntary, although the IRS can take the initiative and approach a company to suggest an APA.[72] Historically, the Program has been received positively by businesses, but it has also been consistently scrutinized by the public.[73]

For example, in 2011, practitioners questioned the APA Program's ability to complete agreements.[74] Two trends from the APA Program's annual reports validated these concerns. First, completion times for APAs steadily increased each year, rising from an average of 33.7 months in 2007 to 40.7 months in 2011.[75] This trend occurred in spite of staff hours spent on APAs increasing by 13,440 hours from 2007 to 2011.[76] Second, the APA Program received significantly fewer applications from businesses and completed fewer agreements in 2011 than in previous years.[77] These fluctuations underscored practitioners' concerns, and the APA Program's director acknowledged that as a result, some taxpayers "may have chosen to forgo the process" in its entirety.[78]

---

70. Rev. Proc. 91-22, 1991-1 C.B. 526 (establishing the original APA Program in 1991).

71. Rev. Proc. 2006-9, 2006-2 I.R.B. 278, 279, § 2.01.

72. *Id.* § 2.05.

73. *See* MARKHAM, *supra* note 9, at 237–38; *supra* note 28.

74. *See* Stewart, *supra* note 28.

75. I.R.S. Announcement 2008-27, 2008-15 I.R.B. 751, 757 tbl.2. From 2007 to 2011, the average time in months to complete a new agreement or renewal was 33.7 in 2007, 34.7 in 2008, 37.9 in 2009, 37.2 in 2010, and 40.7 in 2011. *See* I.R.S. Announcement 2012-13, 2012-16 I.R.B. 805, 812; I.R.S. Announcement 2011-22, 2011-16 I.R.B. 672, 679; I.R.S. Announcement 2010-21, 2010-15 I.R.B. 551, 558; I.R.S. Announcement 2009-28, 2009-15 I.R.B. 760, 766; I.R.S. Announcement 2008-27, 2008-15 I.R.B. 751, 757 tbl.2.

76. *See* I.R.S. Announcement 2012-13, 2012-16 I.R.B. 805, 810.

77. *Id.* at 811 & tbl.1 (reporting that the Program received 96 applications and completed 42 APAs in 2011); I.R.S. Announcement 2011-22, 2011-16 I.R.B. 672, 679 & tbl.1 (reporting that the Program received 144 applications and completed 69 APAs in 2010); I.R.S. Announcement 2010-21, 2010-15 I.R.B. 551, 558 & tbl.1 (reporting that the Program received 127 applications and completed 63 APAs in 2009).

78. Stewart, *supra* note 28.

Shortly thereafter, in early 2012, the IRS attempted to reduce inefficiencies in the APA Program by moving it from the Office of Chief Counsel to the Office of Transfer Pricing Operations, which is part of the IRS's Large Business and International Division.[79] In doing so, it merged the APA Program's staff with the Office of the U.S. Competent Authority's employees, thereby forming the current APMA Program.[80] From the middle of 2011 through the end of 2012, the IRS also increased the Program's resources by expanding its staff by 35%.[81]

In 2013, the IRS reported that these changes successfully improved the Program's ability to resolve APA cases.[82] The Program's subsequently issued annual report confirmed this outcome, showing it had executed a single-year high of 140 APAs in 2012.[83] However, the average time to complete an APA still remains high at 41.7 months.[84] The IRS also has 391 APAs and 182 APA renewals pending for completion.[85] Further, although the Program received 126 APA applications in 2012, this number still fell short of the 144 applications the Program received in 2010.[86] Overall, the data shows that the Program's ability to complete agreements is improving but that participants still face lengthy processing times.[87]

In addition to concerns over the Program's ability to complete agreements, the Program has been accused of unfair and discriminatory treatment of businesses.[88] Critics also assert that the IRS is applying

---

79. I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, 912.

80. *Id.*

81. *See id.*

82. Kristen A. Parillo, *New APMA Is a Success, Says IRS Official*, WORLDWIDE TAX DAILY, Feb. 1, 2013, *available at* LEXIS, 2013 WTD 22-2.

83. I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, 911.

84. *Id.* at 925 tbl.6. The introduction to the Program's 2012 annual report states that "[t]he average time to complete an APA decreased from 40.7 months in 2011 to 39.8 months in 2012." *Id.* at 911. Yet, according to the report's Table 6, the average time to complete an agreement is 41.7 months, whereas the median time to complete an agreement is 39.8 months. *Id.* at 925 tbl.6. Consequently, when the equivalent statistics are compared, it appears that both the median and average time to complete an agreement actually increased from 2011 to 2012. *Compare id.* (reporting a combined average time of 41.7 months and a median time of 39.8 months), *with* I.R.S. Announcement 2012-13, 2012-16 I.R.B. 805, 812 tbl.2 (reporting a combined average time of 40.7 months and a median time of 36.5 months).

85. I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, 915 tbl.2.

86. *Compare id.* at 914 tbl.1, *with* I.R.S. Announcement 2011-22, 2011-16 I.R.B. 672, 679 tbl.1.

87. *See supra* notes 83–85.

88. John B. Magee et al., *GlaxoSmithKline Holdings Petitions Tax Court on Transfer Pricing Issues*, TAX NOTES TODAY, Apr. 2, 2004, *available at* LEXIS, 2004 TNT 67-14 (discussing GlaxoSmithKline's claim that it is entitled to a refund of its overpayment of tax plus interest in the amount of approximately $1 billion due to the IRS's failure to treat Glaxo in as favorable a manner as its competitors under the transfer

transfer pricing law too favorably to the large businesses that use the Program.[89] These accusations are amplified by the lack of disclosure within the Program.[90] The concept of *secret deals* under the Program has been condemned as antithetical to the "democratic political values of the US."[91] Therefore, one possible solution to make the APMA Program more attractive to the public and interested taxpayers in this environment of heightened scrutiny and continued delays is to increase the Program's transparency.

IV. TRANSPARENCY IN THE TAX ADMINISTRATION OF APAS

Improving the degree of transparency within the APMA Program could both increase the attractiveness of the Program and reduce regulatory uncertainty in the enforcement of transfer prices. *Transparency* is defined as "[o]penness; clarity; lack of guile and attempts to hide damaging information" and is commonly used in the context of financial disclosures, organizational policies and practices, and lawmaking where organizations interact with the public.[92] Efforts to increase tax transparency are underway at both the global and national levels of taxation.[93] Indeed, the IRS has

pricing methodology); Martin A. Sullivan, *Economic Analysis: With Billions at Stake, Glaxo Puts APA Program on Trial*, TAX NOTES TODAY, Apr. 27, 2004, *available at* LEXIS, 2004 TNT 81-7 (reporting that GlaxoSmithKline alleged that the IRS discriminated against the company in its transfer pricing enforcement).

89. Sheppard, *supra* note 28; Browning, *supra* note 28; Scott, *supra* note 28.

90. *See* Browning, *supra* note 28 (reporting that because the details of APAs are not public, "[c]ritics argue that the process effectively creates a secret body of law, one that might not be applied evenly across companies").

91. MARKHAM, *supra* note 9, at 281.

92. BLACK'S LAW DICTIONARY 1638 (9th ed. 2009); *see also* Robert M. Bushman et al., *What Determines Corporate Transparency?* 42 J. ACCT. RES. 207, 210 (2004) (discussing the availability of financial disclosures and information about governance and accounting principles as a measure of transparency for publicly traded firms); Diane Dilanni, *The Legal Framework of Transparency and Accountability Within the Context of Privatization*, LEAGUE WOMEN VOTERS, http://www.lwv.org/content/legal-framework-transparency-and-accountability-within-context-privatization (discussing transparency in "government proceedings, deliberations, decision-making and records") (last visited Mar. 30, 2014).

93. *See* OECD, GLOBAL FORUM ON TRANSPARENCY AND EXCHANGE OF INFORMATION FOR TAX PURPOSES: TAX TRANSPARENCY 2012 REPORT ON PROGRESS 7–8, 16–19 (2012), *available at* http://www.oecd.org/tax/transparency/Tax%20Transparency%202012_JM%20MB%20corrections%20final.pdf (expressing the goals of 170 international delegate members for increasing the exchange of tax administration information); T. Keith Fogg, *Transparency in Private Collection of Federal Taxes*, 10 FLA. TAX REV. 763, 764 (2011) (arguing that

invoked this term when establishing new programs in the area of corporate taxation, and the Service is now calling for greater transparency in the context of international tax administration.[94]

When the IRS uses the term *transparency* in a tax administration context, it is referring to the requirement that taxpayers reveal additional detailed information about transactions on their tax returns that they anticipate the IRS may challenge.[95] IRS auditors are then able to use this detailed information to maximize the collection of revenue by more easily identifying issues in a tax return.[96] Yet, for taxpayers, transparency should carry an entirely different meaning.[97] Transparency involves the ability of taxpayers to perceive and understand the application of tax laws to their individual circumstances.[98] Also, increased levels of transparency throughout the IRS allow taxpayers to perceive whether the IRS is adhering to the core tax policies of equality and proportionality.[99]

Moreover, an abundance of secrecy and a lack of transparency contribute to taxpayers' inability to predict how the IRS will apply the law to them, creating regulatory uncertainty—a key decisionmaking factor that can make or break companies and their leaders.[100] The Program affords an optimal opportunity for the IRS to reciprocate its call for transparency when considering the Program's significant delays and continued concealment of valuable regulatory applications of complex transfer pricing law to specific taxpayer circumstances.[101] In noting the increasing heightened scrutiny that businesses are facing in transfer pricing situations, a former tax policy director for the OECD expressed that "[y]ou don't get good

---

the amount of taxes collected on behalf of the United States and paid over to the IRS should be disclosed); Cheryl A. Kettler, *Mirror, Mirror on the Wall, What's Transparency After All?*, 9 DEPAUL BUS. & COM. L.J. 321, 321 (2011) (discussing the IRS's recent transparency-oriented uncertain tax positions program for large corporate taxpayers).

94. *See* Kettler, *supra* note 93, at 321; Jaime Arora, *APMA Director Calls for Increased Transparency and Responsiveness*, TAX NOTES TODAY, Aug. 3, 2012, *available at* LEXIS, 2012 TNT 150-10.

95. *See* Kettler, *supra* note 93, at 321. *Tax administration* is defined as the "management, conduct, direction, and supervision of the execution and application of the internal revenue laws or related statutes." I.R.C. § 6103(b)(4) (2006).

96. Kettler, *supra* note 93, at 321.

97. *See id.*

98. *See* Leigh Osofsky, *The Case Against Strategic Tax Law Uncertainty*, 64 TAX L. REV. 489, 494–95 (2011) (stating that tax administrators can play a significant role in reducing tax uncertainty).

99. *See* Joseph T. Sneed, *The Criteria of Federal Income Tax Policy*, 17 STAN. L. REV. 567, 574 (1965) (defining the policy of proportionality as requiring that those who are equal in the relevant aspects bear equal tax burdens); *see also* United States v. Kaiser, 363 U.S. 299, 308 (1960) ("The Commissioner cannot tax one and not tax another without some rational basis for the difference.") (Frankfurter, J., concurring).

100. *See* Whitford, *supra* note 47, at 269–70.

101. *See supra* Part III.B.

compliance just by enforcement. You need to have better dialogue with taxpayers."[102] The APMA Program is not transparent despite the IRS's annual release of reports on the Program, and the continued secrecy can be viewed as inconsistent with the IRS's increasing emphasis on transparency in tax administration.[103]

A. Statutory Grounds for Transparency and Disclosure of APA Information Within the APMA Program

The IRS in its entirety is subject to minimum disclosure requirements mandated by federal statutes.[104] The Freedom of Information Act (FOIA) requires that the IRS publish to the public specific information, including regulations, opinions and orders, and specifically requested agency records.[105] Congress passed the FOIA to encourage an "informed" electorate and to provide private parties with the information needed to interact effectively with federal agencies such as the IRS.[106] In addition to desiring open administration, Congress was particularly concerned about parties who had to resort to litigating with "agencies on the basis of secret laws or incomplete information."[107] However, there are nine exemptions to disclosure provided in the statute, including "exempt[ion] from disclosure by statute."[108] The primary statutory exemption affecting the IRS's disclosure of information under the broad-ranging FOIA is Internal Revenue Code § 6103, "Confidentiality and Disclosure of Returns and Return Information."[109] This statute provides that individual returns, and return information for taxes, will be kept confidential.[110] At the onset of the

102. Shamik Trivedi, *Practitioners Call for More Business-Government Dialogue on Tax Reform*, TAX NOTES TODAY, Oct. 5, 2012, *available at* LEXIS, 2012 TNT 194-6 (internal quotation marks omitted).

103. *See infra* Part V.A.1.

104. *See generally* IRS, FREEDOM OF INFORMATION ACT (FOIA) GUIDELINES (2013), *available at* http://www.irs.gov/uac/Freedom-of-Information-Act-(FOIA)-Guidelines#appendixA (detailing how the FOIA applies to the Service and outlining the procedures for making information requests).

105. 5 U.S.C. § 552(a)(1)–(3) (2006).

106. S. REP. NO. 89-813, at 3, 7 (1965).

107. Renegotiation Bd. v. Bannercraft Clothing Co., 415 U.S. 1, 9 (1974) (quoting Bannercraft Clothing Co. v. Renegotiation Bd., 466 F.2d 345, 352 (D.C. Cir. 1972), *rev'd*, 415 U.S. 1) (internal quotation marks omitted).

108. 5 U.S.C. § 552b(c)(3) (2006).

109. I.R.C. § 6103(a) (2006).

110. *Id.* § 6103(a), (b)(1), (b)(2).

original APA Program, the statute did not encompass APAs; it seemed that the FOIA could provide a glimpse into the secrecy of the APA Program.[111]

B. Bureau of National Affairs *Lawsuit and Aftermath*

Under the guidance of these statutes, tax news publisher the *Bureau of National Affairs* (*BNA*) sued the IRS in federal court to compel disclosure of APAs.[112] The organization hoped to publish APAs to its subscribers for tax guidance.[113] Prior to this case, the IRS treated APAs as subject to the confidentiality requirements in § 6103, but in the course of the litigation, the IRS stipulated that APAs were in fact "rulings" on transfer pricing issues.[114] This admission made APAs written legal determinations for the purposes of § 6610 and subject to disclosure to the general public.[115]

Yet, Congress, under pressure from lobbying by corporate taxpayers concerned about privacy, quickly amended § 6103 to provide that APAs and related background information are excluded from the definition of *written determinations* under § 6110 and, instead, constitute confidential return information under § 6103.[116] As a concession to the parties desiring more disclosure, Congress required the Department of the Treasury to publish an annual report containing information regarding APAs and the APA Program.[117] Although these annual reports provide the completion time for agreements and the number of agreements completed, they do

111. *See infra* Part IV.B.

112. Bureau of Nat'l Affairs, Inc. v. IRS, 24 F. Supp. 2d 90, 91 (D.D.C. 1998). The *BNA* based this effort on the holding in a preceding case, where an appellate court held that the legal analysis in an IRS memorandum, apart from the taxpayer's personal information, did not qualify as "return information" under the statutory exemption from FOIA disclosure in § 6103. *See* Tax Analysts v. IRS, 117 F.3d 607, 608, 611, 616 (D.C. Cir. 1997). This holding implied that the legal analysis of APAs, apart from any personal information, would also not be protected from disclosure. *See Bureau of Nat'l Affairs, Inc.*, 24 F. Supp. 2d at 92–93.

113. *See Bureau of Nat'l Affairs, Inc.*, 24 F. Supp. 2d at 91–93.

114. MARKHAM, *supra* note 9, at 280–81.

115. *See id.* at 281.

116. Ticket to Work and Work Incentives Improvement Act of 1999, Pub. L. No. 106-170, § 521(a), § 6103, 113 Stat. 1860, 1925 (1999) ("[S]ection 6103(b) of the Internal Revenue Code of 1986 (defining return information) is amended by . . . inserting . . . 'any advance pricing agreement entered into by a taxpayer and the Secretary and any background information related to such agreement or any application for an advance pricing agreement,'.").

117. *Id.* § 521(b) ("Not later than 90 days after the end of each calendar year, the Secretary of the Treasury shall prepare and publish a report regarding advance pricing agreements.").

not provide any numbers-based guidance on how the IRS applies transfer pricing regulations within these agreements.[118]

Continued concerns over a lack of information, allegations of preferential treatment, and claims that the corporations within the APA Program were not paying their fair share of taxes led the Senate Finance Committee to launch an investigation into the APA Program in December 2003.[119] In a letter to the IRS Commissioner, Senator Grassley requested undisclosed information from the Program, including instances where the IRS waived certain program requirements and rejected APA applications.[120] In June 2005, a draft report was completed, but neither the report's findings nor any official details surrounding the investigation were released.[121] In retrospect, the annual reports failed to quell the complaints over secrecy within the Program.[122] Rather, the IRS's own push for tax administration transparency, the Service's increasing pressure on taxpayers to comply with complex transfer pricing rules, and the public's concerns with the APA process necessitate the consideration of proposals to increase the Program's transparency.[123]

V. ANALYZING PROPOSALS TO IMPROVE TRANSPARENCY IN THE APMA PROGRAM

The Program's minimal level of transparency could be improved through various changes to the Program's disclosure and reporting requirements. Possible changes include releasing redacted pricing agreements, expanding the administrative and substantive information disclosed within the Program's annual reports, and requiring the IRS's Office of Appeals to review and share detailed information with a taxpayer before making the rare decision to cancel or revoke a taxpayer's APA.[124] The first two

118. I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, 911 ("This fourteenth report describes the experience, structure, and activities of the APA Program during calendar year 2012. It does not provide guidance regarding the application of the arm's length standard.").

119. Nadal, *supra* note 31.

120. *See* Letter from Sen. Grassley, Chairman, Senate Fin. Comm., to Mark Everson, Comm'r, IRS (Dec. 22, 2003), *available at U.S. Lawmakers Ask IRS if Multinationals Pay 'Fair Share' of Taxes*, WORLDWIDE TAX DAILY, Dec. 23, 2003, *available at* LEXIS, 2003 WTD 246 246-12.

121. Nadal, *supra* note 31.

122. *Id.*

123. *Id.*; *supra* notes 19–20, 28.

124. *See infra* Part V.A–C.

proposals focus on increasing transparency primarily from the public's perspective, whereas the third proposal focuses on increasing transparency for the Program's participants.[125]

A. Amend §§ 6103(b)(2) and 6610 To Allow Disclosure of Redacted APAs

The most desirable way to improve transparency within the APMA Program is for the IRS to disclose the detailed pricing agreements that the Program creates with individual taxpayers.[126] Releasing these agreements could have several practical and abstract benefits, including revealing whether the IRS is being consistent with taxpayers not using the APMA Program and providing practical guidance for taxpayers seeking to reduce regulatory uncertainty.[127] But releasing these agreements also involves concerns regarding disclosing private information, possibly reducing the effectiveness of the Program, and imposing new disclosure requirements that could affect precious Program resources.[128]

1. Benefits of Disclosing Redacted APAs

First, releasing agreements would comport with an increasing emphasis on top-down transparency in the federal government's administrative agencies. Congress and taxpayers are striving to require executive agencies to release more information to the general public.[129] For example, in an effort to increase transparency further, Congress passed the Openness Promotes Effectiveness in Our National Government Act of 2007, amending

---

125. *See infra* Part V.A–C.

126. *See* Bureau of Nat'l Affairs, Inc. v. IRS, 24 F. Supp. 2d 90, 91 (D.D.C. 1998); Press Release, Bureau of Nat'l Affairs, Inc., BNA Sues IRS for Release of Advance Pricing Agreement Information (Feb. 28, 1996), *available at* LEXIS, 96 TNT 42-39 (asserting that not disclosing the information within APAs to the public "constitutes a private tax system" where a few law or accounting firms may gain "exclusive rights to [the] IRS' ruling position on dynamic areas of tax law"). This possibility was subsequently considered but rejected in Nadal, *supra* note 33, and more broadly advocated for in Stark et al., *supra* note 28.

127. *See infra* Part V.A.1.

128. *See infra* Part V.A.2.

129. *See* OPEN Government Act of 2007, Pub. L. No. 110-175, § 2, 121 Stat. 2524, 2524–25 (finding that Congress should "regularly review" the FOIA to "determine whether further changes and improvements are necessary to ensure that the Government remains open and accessible to the American people and is always based not upon the 'need to know' but upon the fundamental 'right to know'"); *see also* Federal Funding Accountability and Transparency Act of 2006, Pub. L. No. 109-282, § 2(b), 120 Stat. 1186, 1187 (mandating that a searchable website that is accessible to the public be created to disclose for each federal award the name of the entity receiving the award, the amount of the award, and other descriptive information).

the FOIA to provide for more disclosure of executive agency information.[130] This Act broadened the scope of information available to the public by altering the definition of *agency record* and requiring agencies such as the IRS to list the specific statutory exemption claimed for each deletion in disclosed documents.[131] Also, the executive branch stated that agencies generally must be more transparent to "promote[] accountability by providing the public with information" and improve "the quality of government information available to the public."[132] Because the APMA Program is a component of an executive agency,[133] these policies favor requiring broader disclosure within the Program as well. Additionally, given the very "large amounts negotiated in APAs, which often involve very large corporate taxpayers," the agreements' secrecy amplifies the

130. 121 Stat. 2524, 2524 ("An Act [t]o promote accessibility, accountability, and openness in Government by strengthening . . . the Freedom of Information Act . . . .").

131. *See id.* at 2530–31; *Congress Passes Amendments to the FOIA*, U.S. DEP'T JUST. OFF. INFO. & PRIVACY, http://www.justice.gov/oip/foiapost/2008foiapost9.htm (last visited Mar. 30, 2014). In another example, the American Recovery and Reinvestment Act of 2009 required a website to be created to "foster greater accountability and transparency in the use of covered funds." Pub. L. No. 111-5, § 1526(a), 123 Stat. 115, 293. The website allows users to track where the Act's funds are spent down to the zip code level and also provides the option for the public to report potential fraud, waste, and abuse of funds. *Where Is the Money Going?*, RECOVERY.GOV, http://www.recovery.gov/arra/Transparency/Pages/WhereIsTheMoneyGoing2.aspx (last visited Mar. 30, 2014).

132. Memorandum from Peter R. Orszag, Dir., Office of Mgmt. & Budget, to the Heads of Exec. Dep'ts & Agencies 1–3 (Dec. 8, 2009), *available at* http://www.whitehouse.gov/sites/default/files/omb/assets/memoranda_2010/m10-06.pdf. Despite these efforts, the federal government still faces continued criticism for a lack of transparency and consistently faces lawsuits that push the boundaries of the FOIA. *See* Josh Levs & Carol Cratty, *Court Considers Demand that U.S. Release Photos of Bin Laden's Body*, CNN, http://www.cnn.com/2013/01/10/world/bin-laden-photos/index.html (last updated Jan. 10, 2013, 1:59 PM) (describing a federal appeal by a conservative legal group to gain access using the FOIA to at least some of the fifty-two images taken of Osama bin Laden's body after his death). In another example, citizens have tried to use the FOIA to obtain any of their personal data being stored by the National Security Administration through its PRISM electronic surveillance program. Jeff Larson, *NSA: Responding to This FOIA Would Help "Our Adversaries*,*"* PROPUBLICA (June 25, 2013, 2:57 PM), http://www.propublica.org/article/nsa-responding-to-this-foia-would-help-our-adversaries. In fact, the number of FOIA filings has "surged" since President Obama took office, arguably because the administration is not living up to its goals. Dave Boyer, *Court Filings Surge in FOIA Cases During Obama Years*, WASH. TIMES (Dec. 24, 2012), http://www.washingtontimes.com/news/2012/dec/24/court-filings-surge-in-foia-cases-during-obama-yea/?page=all.

133. *See The Agency, Its Mission and Statutory Authority*, IRS, http://www.irs.gov/uac/The-Agency,-its-Mission-and-Statutory-Authority (last updated Feb. 12, 2014) ("The IRS is a bureau of the Department of the Treasury . . . .").

argument that the Program should be more transparent and subject to government scrutiny and oversight.[134]

Further, the IRS is calling for more transparency from corporations and taxpayers in the APMA Program but is largely unable to reciprocate this call under Congress's statutory exemption.[135] With this statutory bar, the IRS has said that there is no plan to increase the Program's transparency.[136] But because transparency is mutually beneficial only when it runs in both directions, the IRS should reciprocate by releasing agreements to further its own call for transparency.[137] Without doing so, the IRS's push for more transparency from corporations and taxpayers is subject to the same limiting criticism of being only a "two-way mirror," a criticism that has been leveled recently at other IRS corporate tax programs.[138] If this is the case, taxpayers will surrender more information to the IRS and therefore lighten the challenges in enforcing tax laws but will not receive any real benefit themselves.[139] Rather, when the IRS releases more information, taxpayers are able to perceive how the Program applies transfer pricing laws, which can decrease tax law uncertainty for them.[140] Reducing tax law uncertainty is valuable because taxpayers may view highly uncertain tax law as "fundamentally unfair" and as a result may make a greater effort to avoid paying their required taxes.[141]

On this basis, providing more information could address claims of unfairness, which undermine the very purpose of the APMA Program by leading to litigation.[142] This danger is illustrated by *GlaxoSmithKline Holdings (Americas) Inc. v. Commissioner*, in which British pharmaceutical company GlaxoSmithKline (Glaxo) contested a $2.6 billion transfer pricing deficiency that the IRS assessed against it for the years 1989 to 1996.[143] Glaxo was not using an APA, but the company obtained confidential APA information of a previous direct pharmaceutical

---

134. Nadal, *supra* note 31.

135. *See* Arora, *supra* note 94; *see supra* note 116.

136. Nadal, *supra* note 31.

137. *See* Kettler, *supra* note 93, at 321–22 (referencing the requirement for large corporate taxpayers to report uncertain tax positions).

138. *See id.*

139. *Id.* at 321 (arguing that the IRS's concept benefits the Service but "fails to enhance the taxpayer's understanding of a tax code that has become increasingly difficult to understand and apply").

140. *See* Osofsky, *supra* note 98, at 494–95. *Tax law uncertainty* is defined as "any type of tax law question that a taxpayer cannot definitely resolve based on the available tax law authority." *Id.* at 493.

141. *Id.* at 524.

142. *See* Petition, GlaxoSmithKline Holdings (Americas) Inc. v. Comm'r, No. 5750-04 (T.C. Apr. 4, 2004).

143. *Id.*

competitor that was in similar transfer pricing circumstances.[144] The company alleged that the IRS discriminated against it based on differences in how the IRS applied transfer pricing regulations to its transactions versus its direct competitors'.[145] Similar to the suit by the *BNA*, Glaxo attempted to use the court system to pressure the IRS and compel judicial discovery of advance pricing agreement information to support its claims.[146] Yet, the IRS successfully blocked this attempt as a result of the statutory amendment discussed above.[147] Glaxo and the IRS ultimately settled for $3.4 billion but only after the lawsuit and Glaxo's allegations renewed scrutiny of the APA Program's lack of transparency.[148] Yet, with Glaxo's settlement, there is no way of obtaining additional information regarding APAs to determine whether taxpayers are indeed being treated differently under transfer pricing laws.

Increased transparency is one potential answer to the claim Glaxo raised—a taxpayer is being treated differently under transfer pricing laws.[149] A taxpayer not participating in the APMA Program needs to know "how it was treated in the traditional administrative process and then compare the results" to businesses in similar circumstances that use the Program to establish transfer prices.[150] If a business using the APMA Program was able to take advantage of a methodology not available to the traditional taxpayer, then there is a "serious concern that the difference was inappropriate" because of a lack of equivalent treatment for businesses outside of the Program.[151] Improving transparency by releasing agreements

144. *See* Sullivan, *supra* note 88. Glaxo acquired this confidential APA information after it merged with SmithKline in 2001. *Id.* Both companies applied for APAs in the 1990s. *Id.* Thereafter, the IRS executed SmithKline's APA, but Glaxo alleged that the IRS refused to act on its application. *Id.*

145. *Id.*

146. *See* Mary Ann Cohen, *Glaxo Moves To Compel Discovery; IRS Moves To Compel Production*, TAX NOTES TODAY, Mar. 9, 2006, *available at* LEXIS, 2006 TNT 46-9.

147. *See* Theodore J. Kletnick et al., *IRS Asserts Sanctions Inappropriate; Can't Reveal Taxpayer Information*, TAX NOTES TODAY, Mar. 16, 2006, *available at* LEXIS, 2006 TNT 51-20; *supra* note 116.

148. Nutt, *supra* note 5.

149. Diane M. Ring, *On the Frontier of Procedural Innovation: Advance Pricing Agreements and the Struggle To Allocate Income for Cross Border Taxation*, 21 MICH. J. INT'L L. 143, 203–04 (2000).

150. *See id.* at 203.

151. *See id.* Specifically, if all businesses and taxpayers have access to redacted APAs, then they would be able to "monitor [them] on their own behalf and point out . . . what appears to be the 'new' approach" being used and accepted by the IRS. *Id.*

would help ensure that taxpayers are being treated fairly. Further, making the agreements public would remove the incentive for companies to resort to litigation in the hopes of gathering additional information to claim unfairness.[152]

Alternatively, these agreements may indeed show that companies in similar situations are being treated differently under the same transfer pricing regulations. If that is the case, then increased transparency through more disclosure will spur the Program not only to adhere to its original goal of openness but also to comport with policies against inequality in taxation.[153] Several reasons amplify the need for equality in this context. At the outset, unequal treatment in transfer pricing could potentially amount to a difference of millions, even billions, of dollars.[154] Additionally, the Program's fees and likely accompanying tax professional fees and expert opinion fees make the Program unavailable to many taxpayers.[155] Last, some of the largest and most influential multinational corporations' use of APAs in conjunction with elaborate tax strategies magnifies the potential for other corporations to be competitively disadvantaged by unequal tax treatment.[156]

Second, the information contained within APAs would provide practical guidance for practitioners and taxpayers. Parties in favor of disclosing APAs argue that they are the "working law" of the IRS on transfer pricing issues.[157] Again, a challenging part of setting a transfer price is meeting the IRS's requirement that taxpayers secure relevant pricing data from similar transactions or situations to justify their chosen transfer pricing method.[158] Since the Program's inception, the IRS has completed over one thousand agreements that would be potentially subject to release.[159] These agreements would provide a new source of data that would help companies meet this requirement. Disclosing this information would help

---

152. *See* Cohen, *supra* note 146.

153. *See supra* notes 71, 99 and accompanying text.

154. *See supra* notes 1–5 and accompanying text; *see also* OECD, *supra* note 26, at 19 ("Transfer prices are significant for both taxpayers and tax administrations because they determine in large part the income and expenses, and therefore taxable profits, of associated enterprises in different tax jurisdictions.").

155. *See* Rev. Proc. 2006-9, 2006-2 I.R.B. 278, 284–85, § 4.12 (listing the required fees for APA requests).

156. *See supra* notes 10–12 and accompanying text; *see also* Kleinbard, *supra* note 10, at 702, 707–13 (outlining Google's complex tax strategy, which uses an APA and also noting that the advantage it creates is "not available to wholly domestic firms").

157. Nadal, *supra* note 33; Letter from Thomas F. Field, President & Publisher, Tax Analysts, to Rep. Bill Archer, Chairman, House Ways & Means Comm. (June 2, 1999), *available at* LEXIS, 1999 TNT 106-11.

158. Rev. Proc. 2006-9, 2006-2 I.R.B. 278, 281, § 4.03.

159. I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, 915 tbl.2 (stating that the IRS has completed a total of 1155 agreements as of the end of 2012).

taxpayers learn about the IRS's favored methods and other nuances in terms of how the IRS evaluates transfer pricing issues as it encounters them.[160]

Moreover, as transfer pricing valuations increasingly shift to cover intangible property, where there is a very limited number of comparable transactions, the completed APAs could provide a trove of information on how the IRS is accommodating these types of exchanges.[161] Valuing the exchange of an intangible such as a patent or trade secret is particularly difficult because it may have no book value on the company's balance sheet and may also exhibit special characteristics that make finding comparable transactions or situations difficult.[162] From 2010 to 2012, approximately sixty-eight agreements covering high-value transactions were completed that dealt specifically with the exchange and use of intangible property.[163] These agreements could help other parties set their own transfer prices in line with the IRS's consideration of previous transfer pricing transactions, in turn lowering the regulatory uncertainty surrounding transfer pricing law. If taxpayers could comport with the IRS's transfer pricing methods at the outset, then that could also prevent costly investigations and litigation over transfer prices.

Last, releasing pricing agreement information would make the Program more accountable to the electorate and the public, which would restore confidence in the Program. The press reported that leaked information from the Senate Finance Committee investigation revealed that "[t]he

160. *See* Nadal, *supra* note 33.

161. *See* Brauner, *supra* note 2, at 81; *see also* Julie Martin, *Maruca Outlines IRS Approach to Transfer Pricing*, TAX NOTES TODAY, Feb. 19, 2013, *available at* LEXIS, 2013 TNT 33-7 (reporting that the IRS is concerned about intangible transactions where there are typically no comparables for the types of assets).

162. OECD, *supra* note 26, at 195–96.

163. *See* I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, 915 tbl.2, 919 (indicating that eighteen percent of the 140 executed APAs, or approximately twenty-five APAs, involved the use of intangible property); I.R.S. Announcement 2012-13, 2012-16 I.R.B. 805, 819 tbl.14 (indicating that thirteen agreements of this type were completed in 2011); I.R.S. Announcement 2011-22, 2011-16 I.R.B. 672, 685 tbl.14 (indicating that thirty agreements of this type were completed in 2010). The Service is committed to handling these types of challenging transactions within the Program, stating that

> [w]hile complex transactions involving intangibles may be more challenging in some cases than other types of transactions, and represent a smaller percentage of the APA inventory than the other types of transactions, the IRS will continue to seek opportunities to work with taxpayers and treaty partners to provide prospective certainty for such transactions wherever appropriate.

I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, 919.

problem, as the draft report points out using case studies (drawn from real cases), is that the program is badly managed, and the IRS is giving away the store" within the APA Program.[164] This leaked excerpt aligns with the core of the Senate's concern regarding whether the APA Program is "an effective tool in the efforts to enforce" transfer pricing regulations.[165] Although this draft report subsequently disappeared, questions regarding the Program's lack of transparency toward the taxpaying public and the tax press remain: "How aggressively does the IRS negotiate APAs with corporate taxpayers?" and "Do U.S. tax officials fear an outcry from corporate multinationals who have finally found a way around their transfer pricing headaches?"[166] Releasing agreements could resolve continued concerns that prompted the launch of the original investigation. Pricing agreements could be compared with transfer pricing assessments outside of the Program to see whether the IRS is indeed "giving away the store" from the perspective of the public and the general taxpayer.[167] This increased transparency would serve as a check against mismanagement of the Program, allowing tax policy advocates and members of the electorate to make more informed decisions about the direction of the APMA Program in an environment of increasingly complex transactions and elevated transfer pricing scrutiny.

2. Concerns over Releasing Agreements

Aside from increasing the Program's transparency, disclosing pricing agreements to the public generates several concerns. These potential disadvantages include chilling participation in the Program, consuming precious resources to implement the disclosure policy, and damaging the usefulness of APAs overall.

At the outset, any change in the IRS's disclosure policies faces an uphill battle against a presumption that the privacy interests of the taxpayer outweigh the benefits of disclosure.[168] Accordingly, the predominant concern cited for not disclosing APAs is the fear that potentially compromising privacy would chill taxpayer participation.[169] Participation would arguably be chilled because once APAs are released, the public will want to see more documents after realizing that not enough information is revealed through an APA alone.[170] These background documents, used

164. Sheppard, *supra* note 28.
165. *See* Letter from Sen. Grassley, *supra* note 120.
166. Nadal, *supra* note 31.
167. *See* Sheppard, *supra* note 28.
168. *See* Fogg, *supra* note 93, at 782–83.
169. MARKHAM, *supra* note 9, at 281.
170. Nadal, *supra* note 33.

to support the taxpayer's position in the APA, would include valuable proprietary information and other sensitive business information, further compromising taxpayer privacy.[171] When the IRS originally planned to release APAs during the *BNA* lawsuit, Program participants acted on this fear and filed amicus curiae briefs in the lawsuit opposing disclosure.[172] These participants expressed fear that sensitive material would now immediately be made public, jeopardizing the entire Program, and then engaged in the successful lobbying of Congress after it appeared that the IRS would release the APAs.[173] But in aiming to disclose APAs, the valid concern over the privacy of sensitive business information could be mitigated through several precautions, including the release of agreements subject to protective procedures and time delay.

First, agreements could be released under the procedures laid out in § 6110, in the same way that the IRS releases "private letter rulings" to the public.[174] This provision would provide cautionary protections for the personal information contained within APAs, which supply important applications of revenue laws.[175] These protections include exempting identifying details of the parties involved, trade secrets, commercial or financial information obtained from a person, privileged or confidential information, and information where disclosure "would constitute a clearly unwarranted invasion of personal privacy."[176] Under this disclosure scheme, the IRS would release only the APA document and would not release background documents that potentially contain proprietary and sensitive business information.[177] Further, § 6110 requires notice to be sent to the parties to the agreement and allows the parties to restrain disclosure if they disagree with any failure to remove identifying information that would compromise their right to privacy.[178] These provisions could be aptly applied to APAs because they similarly contain a mix of private information, numerical data, and discretionary applications

171. *Id.*
172. *Id.*; Letter from Thomas F. Field, *supra* note 157.
173. Nadal, *supra* note 33.
174. *See* I.R.C. § 6110 (2006) (outlining appropriate procedures for the public inspection of written determinations); *see also* Press Release, Bureau of Nat'l Affairs, Inc., *supra* note 126 (describing the effort in the 1970s to obtain disclosure of "private letter rulings"); Letter from Thomas F. Field, *supra* note 157.
175. I.R.C. § 6110(c); Letter from Thomas F. Field, *supra* note 157.
176. I.R.C. § 6110(c).
177. *See id.*
178. *Id.* § 6110(f)(3).

of transfer pricing law to that information.[179] The parties involved under these procedures would be given an opportunity to review the redacted APA before it is released to the public.[180] An additional safeguard would be allowing concerned businesses an opportunity to contest disclosure of their APAs under § 6110 if privileged information is not properly redacted from the agreement.[181] The public may still want access to background information; however, the documents containing background information would predominantly include confidential business or financial information.[182] Therefore, the advantage of providing guidance would likely be outweighed by concerns for taxpayer privacy. Additionally, the volume of documents used for an APA request would, by itself, make redaction of background documents arguably impractical.[183]

Second, another possibility would be to delay the release of agreements for a period to mitigate concerns that proprietary information could be misused.[184] The foundation for this type of delay can be seen in other IRS procedures including subsection (g) of § 6110.[185] This subsection applies a baseline delay requirement of seventy-five days after the notice of pending disclosure is mailed to the parties.[186] An additional 180-day delay is also available if supplemental requirements are met.[187]

The executive branch employs similar time delays to protect sensitive classified information possessed by the government under the rationale of protecting national security.[188] As an example of a delay requirement on the opposite end of the spectrum, Executive Order 13526 requires executive agencies to declassify all documents after twenty-five years

---

179. *See* Press Release, Bureau of Nat'l Affairs, Inc., *supra* note 126 (comparing APAs to "private letter rulings" because the agreements contain "written determinations that multinational corporations use to calculate their U.S. taxable income").

180. *See* I.R.C. § 6110(f); Tax Analysts v. IRS, 416 F. Supp. 2d 119, 123 (D.D.C. 2006) ("Section 6110 grants the Secretary discretion to redact portions of otherwise public advice in accordance with the exemptions provided under the FOIA.")

181. *See* I.R.C. § 6110(f).

182. *See* Rev. Proc. 2006-9, 2006-2 I.R.B. 278, 280–82, § 4.03(2), (5), (7), (9), (10) (including income tax returns, pricing and distribution agreements, and company business plans as background documents subject to data collection for forming an APA).

183. *See id.* § 4.03 (listing the additional documentary requirements for requesting an APA).

184. This proposal is adopted from a broader suggestion in Stark et al., *supra* note 28, and is further analyzed here.

185. I.R.C. § 6110(g) (2006).

186. *Id.* § 6110(g)(1)(A).

187. *Id.* § 6110(g)(4).

188. *See* Press Release, Office of the Press Sec'y, Executive Order 13526- Classified National Security Information (Dec. 29, 2009), *available at* http://www.whitehouse.gov/the-press-office/executive-order-classified-national-security-information.

unless they fall under one of the nine exemptions outlined in the order.[189] To protect privacy while releasing pricing agreements, the IRS could adopt similar safeguards. For instance, to safeguard most sensitive information within the agreements, the IRS could release a business's APA after a two- to three-year delay period following the agreement's expiration. A longer period of ten years has also been suggested, albeit for disclosure of the APA and all of its background documents.[190] The advantage to this type of delay is that the information in the agreements would be less sensitive or useful for competitors if they were able to identify the involved parties. For example, an APA and its appendices can include sensitive internal pricing and profitability information regarding a business's specific products.[191] By delaying the release of a redacted agreement, this information would potentially be out of date and less useful to a competitor that was able to identify the company party to the APA despite the redactions.[192] If a set time frame of several years is not long enough to have this effect, then the burden could be placed on the company to use the procedures under § 6110 to request a longer delay period.[193] Additionally, with the APMA Program having completed agreements since the early 1990s, many APAs that were completed in the early years of the original APA Program have not been renewed and are likely now free from many of the privacy concerns.[194]

Yet, the disadvantage of this ancillary safeguard is that the information released would be less useful to practitioners and interested businesses if the application of pricing laws or the regulations themselves have changed since the completion of the agreement. Despite this disadvantage, time-delayed agreements would still serve to allay the concerns over unfairness and mismanagement within the Program. Indeed, the tax treatment in the agreements could be compared with the treatment received by businesses not covered by an APA during the same time period.

---

189. *Id.*

190. Stark et al., *supra* note 28.

191. *See* I.R.S. Announcement 2012-13, 2012-1 I.R.B. 1 app. A at 68–70 (including an example APA that contains "Appendix A," which in an actual agreement, could include the internal operating margin and cost information of the business's products).

192. *See* Stark et al., *supra* note 28 (advocating for the eventual disclosure of unredacted agreements).

193. *See supra* note 178.

194. *See* I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, 923, 925 (reporting that eighty percent of the APAs executed in 2012 are designed to last between five and eight years); Stark et al., *supra* note 28.

Further, the Service faces practical challenges by releasing agreements because of an engrained tension between "balancing efficiency on one hand with participation, transparency and accountability on the other."[195] With the Program already experiencing significant delays in processing agreements,[196] the requirement that an employee redact these agreements would consume additional resources. Moreover, if the agreements are released with the detailed procedural protections adopted from § 6110,[197] then additional human capital would have to be allocated to handle requests for further redactions and challenges from businesses contesting the disclosure of their pricing agreements. A business could also file suit to block disclosure under the scheme of § 6110, potentially consuming even more of the Program's precious resources.[198]

However, it is an ideal time for the IRS to implement these requirements because the IRS has finished realigning the original APA Program into the current APMA Program.[199] In addition, the IRS already has personnel and policies for complying with disclosures under the FOIA and § 6110.[200]

The IRS could also pass some of the costs on to the users of the information, similar to how the IRS handles standard FOIA requests.[201] For these requests, the IRS employs a "FOIA Fee Schedule" to recoup copying, searching, and reviewing charges from the users requesting the information.[202] Furthermore, resources consumed on releasing agreements could be offset or outweighed by the prevention of costly transfer pricing litigation and investigations. This decrease in litigation and investigations would result from providing practical information to taxpayers not using the APMA Program. These taxpayers could use this information to better align their own transfer pricing positions with other taxpayers' positions that are approved by the IRS within the Program. Additionally, by delaying the releases by a few years, the IRS would have more time to make the redactions and address the concerns over a particular APA because the IRS would give a business ample notice that its APA is going to be released.

---

195. *See* Leslie Book, *A New Paradigm for IRS Guidance: Ensuring Input and Enhancing Participation*, 12 FLA. TAX REV. 517, 532 (2012).

196. *See* I.R.S. Announcement 2012-13, 2012-16 I.R.B. 805, 808.

197. *See* I.R.C. § 6110(c) (2006).

198. *Id.* § 6110(f)(3) (2006).

199. *See supra* text accompanying notes 79–80.

200. *See Today's IRS Organization*, IRS, http://www.irs.gov/uac/Today's-IRS-Organization (last updated Mar. 11, 2014) (including the "Office of Privacy, Governmental Liaison and Disclosure" as part of the Service's Operations Support Unit).

201. *See* IRS, *supra* note 104.

202. *Id.* (providing a table that divides the Service's FOIA costs into fees for copying, searching, and reviewing tax materials).

As an additional concern, a fear exists that a new disclosure policy for APAs would result in "homogenized" agreements that are less responsive to the complex needs of multinational businesses.[203] The argument is that taxpayers would mimic the published agreements and that APAs would then lose their value as a more specialized application to a single taxpayer's circumstances.[204] This concern could again be offset by the requirement that APAs be released on a delay. Releasing agreements on a delay would help prevent mimicking because an agreement's underlying circumstances, including the relevant economic conditions and risks of the covered transactions, could change after several years.[205] Also, although users could view how the IRS applied transfer pricing law to the redacted business's circumstances in the previous years, the Service would still craft a new agreement to the taxpayer's specific circumstances based on the extensive information that the taxpayer must provide to the Service during the application and negotiation process.[206]

B. Release Additional Information in the Program's Annual Report

A supplemental or alternative improvement would be to produce more detailed and specific reports on the APMA Program.[207] An advantage of this proposal is that it could be implemented without amending the

---

203. MARKHAM, *supra* note 9, at 282.

204. *See id.* at 282–83.

205. *See* Rev. Proc. 2006-9, 2006-2 I.R.B. 278, 281, § 4.03 (requiring a program applicant to provide for each party to the controlled transactions a current detailed analysis of the "(a) functions and economic activities performed; (b) the assets employed; (c) the economic costs incurred; (d) the risks assumed; (e) relevant contractual terms; (f) relevant economic conditions; and (g) relevant non-recognition transactions"). That these circumstances can change and require a shift in the IRS's position from one taxable year to the next is evident from the Service's ability to assess adjustments against a taxpayer when the actual transactions do not fit into the agreed upon transfer pricing method. *Id.* § 11.02.

206. *Id.* § 4. The IRS requires "[r]epresentative financial and tax data" from the parties to the agreement, which includes specific information from parties' income tax returns; financial statements; annual reports to shareholders, pricing and licensing agreements; marketing and financial studies; and company-wide projections, business plans, and profitability reports. *Id.* § 4.03(10).

207. *See* Nadal, *supra* note 33; *see also* Stark et al., *supra* note 28 (suggesting that the content of the reports should be reconsidered to adhere more closely to the original intention of the compromise underlying the report feature). This proposal is modified here based on the IRS's changes to the Program's reports and is supplemented with suggestions for new report content based in part on the inquiries from the failed Senate Finance Committee investigation launched by Senator Grassley. *See infra* pp. 32–35.

statute barring expansive disclosure of APAs.[208] Section 521 of the Ticket to Work and Work Incentives Improvement Act of 1999 states that the Program's annual report "shall include the following for the calendar year to which such report relates: (A) Information about the structure, composition, and operation of the advance pricing agreement program office."[209] The statute, however, does not specify that the listed categories of information are the only ones allowed to be published in the yearly report.[210] As plainly stated by the current annual reports, the reports do not actually "provide guidance regarding the application of the arm's length standard."[211] The Program's reports largely contain administrative information about the Program.[212] This proposal is also pertinent because in 2013, the IRS decreased the amount of descriptive information provided in the Program's annual reports, further limiting the Program's transparency.[213]

The most basic improvement to the reporting system would be to publish example APAs. The current report format includes a model agreement with empty fields but does not include any examples.[214] The report also includes in its appendices the supplemental forms defining the transactions covered and the critical assumptions that the transfer pricing agreement

208. *See* I.R.C. § 6103 (2006) (listing general rules regarding the confidentiality and disclosure of returns and return information).

209. Ticket to Work and Work Incentives Improvement Act of 1999, Pub. L. No. 106-170, § 521(b)(2), 113 Stat. 1860, 1925–27.

210. *See id.*

211. I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, 911; *accord* § 521(b)(3), 113 Stat. at 1927–28 (providing that "the reports shall not include information—(A) which would not be permitted to be disclosed under section 6110(c) of such Code if such report were a written determination as defined in section 6110 of such Code; or (B) which can be associated with, or otherwise identify, directly or indirectly, a particular taxpayer").

212. *See generally* I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911; I.R.S. Announcement 2012-13, 2012-16 I.R.B. 805.

213. *Compare* I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, 911–39 (omitting information about the types of services covered by transfer pricing transactions from the Program's 2012 annual report), *with* I.R.S. Announcement 2012-13, 2012-16 I.R.B. 805, 820 tbl.15 (categorizing the types of services covered in the transfer pricing transactions, which varied from warranty services to marketing, in the Program's 2011 annual report). Similarly, the 2011 report described the types of functions performed by the tested party under the APAs, but this information is also not included in the 2012 report. *Compare* I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, *with* I.R.S. Announcement 2012-13, 2012-16 I.R.B. 805, 821. Further, in many areas of the 2012 report, the Service opted for graphical representations that improve the report's readability, but the Service did not provide the underlying data tables found in previous reports. *Compare* I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, 916–25, *with* I.R.S. Announcement 2012-13, 2012-16 I.R.B. 805, 813–27.

214. *See* I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911 app. A at 928.

relies upon.[215] These appendices could be improved by providing additional examples of the underlying forms, including hypothetical transactions and the accompanying financial calculations. Although parties interested in obtaining an APA are often large businesses that seek specialized tax advice, example agreements would still be helpful to smaller taxpayers that continue to confront transfer pricing issues.[216]

Another suggested improvement is to release specific information for each of the industry categories that the Program formed specialized teams of employees to address.[217] Because these categories were created based on the "commonality of issues to warrant their assignment to teams," these areas might lend themselves to more standardized guidance information that could be produced in the reports by industry.[218] In the Program's 2012 annual report, however, the IRS no longer included information on its industry-specific teams, which had been relied upon to craft this proposal.[219] Yet, the report still divides the number of executed APAs into six broad industries, providing an exact number of completed APAs for each category.[220] Therefore, this proposal could be adapted to these categories, with the IRS releasing more detailed information for each one and potentially any major subcategories.[221] As an example, the 2012 report shows that in the manufacturing industry, the Program completed eighteen APAs covering computer and electronic products, eleven covering chemical products, and eight covering transportation

215. *Id.* apps. A–E at 931–38.

216. Nadal, *supra* note 31.

217. Nadal, *supra* note 33.

218. *Id.* (quoting I.R.S. Announcement 2007-31, 2007-12 I.R.B. 769, 773) (internal quotation marks omitted).

219. *See* I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, 911–39 (omitting reference to industry-specific teams); Nadal, *supra* note 33 (listing the categories of cases handled by specific teams in 2007). For example, the Program's 2011 annual report stated that the "APA Program selected five categories of cases for specialization —cases involving cost sharing agreements, financial products, the semiconductor industry, the automotive industry, and the pharmaceutical industry." I.R.S. Announcement 2012-13, 2012-16 I.R.B. 805, 810.

220. I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, 916 tbl.4 (listing the number of APAs finalized or renewed in the following industries: manufacturing; wholesale and retail trade; management; services; finance, insurance, and real estate; and natural resources and transportation). In previous years, the Service shared more specific information about the Program by detailing the industries' APAs covered by their North American Industry Classification System codes. *See* I.R.S. Announcement 2012-13, 2012-16 I.R.B. 805, 818 tbl.12 (listing in detail twenty-two categories of industries involved in APAs).

221. *See* I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, 916 tbl.4.

equipment.[222] There is likely a commonality of issues among these agreements from which to generate guidance information.

This information could include which of the suggested transfer pricing methods are predominantly used and accepted by the IRS for APAs issued in that industry.[223] This would help Program applicants select a transfer pricing method among the many options available and provide the required detailed explanation for why that is the best method for their business's circumstances.[224] Weighing against this change is that limited summary industry guidance might not reveal enough information to be of significant help to practitioners, especially when compared with the publication of redacted agreements.[225]

Yet another possibility for increasing transparency would be for the IRS to supplement the current administrative information provided in the reports with additional descriptive data.[226] Useful additional information would include information on the occurrences of the IRS rolling back an APA to adjust a taxpayer's previous transfer pricing transaction and the number of APA requests that the IRS denies each year.[227] From an accountability perspective, it would also be useful to know if and when the IRS has waived or excused requirements that the Program traditionally places on participating businesses.[228] Ideally, this information would gauge the Program's effectiveness and hold it accountable to the public, especially if supplemented by disclosed agreements.

Even though this information would be of some help, the complaints regarding secret laws and unfair treatment leveled at the APMA Program could not be addressed solely by publishing more detailed reports.

---

222. *Id.* at 917 tbl.4a.

223. *See* Treas. Reg. § 1.482(c)(2) (as amended in 2012). The IRS does partially provide this information, but it reports only the transfer pricing methods used based on two broad categories of transactions covered by the agreements: services and tangible and intangible property. *See* I.R.S. Announcement 2013-17, 2013-16 I.R.B. 911, 921.

224. Under current APMA procedures, a taxpayer must provide a detailed explanation and analysis of why the "proposed TPM [transfer pricing method] is the best method within the meaning of § 1.482-1(c)." Rev. Proc. 2006-9, 2006-2 I.R.B. 278, 282, § 4.03(20). An applicant must also apply this proposed transfer pricing method to its previous three taxable years or instead project it onto hypothetical data when applying it to a new business or product. *Id.* § 4.03(24).

225. Industry guidance would presumably not include the level of detail that could be found in hundreds of released redacted pricing agreements.

226. *See* Letter from Sen. Grassley, *supra* note 120.

227. *See id.* (asking the IRS to provide copies of all IRS materials for the letter's attached list of organizations); *see also* Sullivan, *supra* note 88 (reporting the allegation by GlaxoSmithKline that the IRS refused to act on its APA application).

228. *See* Letter from Sen. Grassley, *supra* note 120 (asking for IRS materials on particular organizations that finance terrorism and perpetuate violence to oversee their tax-exempt status and hold them accountable for their actions).

Moreover, the Program would not be significantly more accountable to the public merely because of more detailed annual reporting. Also, requiring greater disclosure through annual reports would consume some of the Program's resources. This proposal, however, would not involve the larger implementation issues related to redacting and releasing APAs.

C. Increase Program Transparency Through an Administrative Appeal Process for the Cancellation or Revocation of APAs

Even more useful for potential APMA Program users would be additional information about the situations in which the IRS cancels or revokes an APA.[229] When the IRS cancels an APA, the taxpayer loses any benefits that the APA provided from the beginning of the current tax year.[230] But if the IRS revokes an agreement, then "the APA is void *ab initio* and is treated as if it never existed," which would be devastating for any Program participant.[231] At the outset, government officials responsible for the Program characterized the agreements as "nearly ironclad."[232] This characterization is illustrated by the difficulties that a taxpayer encounters when seeking to amend an APA.[233] In this situation, former APA Program Director Sean Foley described the IRS's position as "'a deal is a deal,' because APAs are about certainty."[234] Yet, under section 11.06 of Revenue Procedure 2006-9, the IRS can cancel an APA based on the taxpayer's "misrepresentation, mistake as to a material fact, failure to state a material fact, failure to file a timely annual report, or lack of good faith compliance with the terms and conditions of the APA."[235] The IRS will also coordinate the cancellation action with the foreign competent authority for any bilateral or multilateral APA, removing the tax benefits of the agreement in the other taxing jurisdiction.[236]

The IRS recently exercised this power for "compliance violations" against Eaton Corporation, cancelling both of the company's APAs and

229. This proposal is extrapolated from the surrounding circumstances and the discussion of the cancellation of two of Eaton Corporation's APAs. *See infra* notes 237–41 and accompanying text.
230. Rev. Proc. 2006-9, 2006-2 I.R.B. 278, 291, § 11.06(7).
231. Coder, *supra* note 30.
232. *Id.*
233. *See id.*
234. *Id.*
235. Rev. Proc. 2006-9, 2006-2 I.R.B. 278, 291, § 11.06(2).
236. *Id.* § 11.06(8).

concurrently assessing against it $127 million in additional taxes and misstatement penalties.[237] In an approach similar to *Glaxo*, Eaton filed suit against the IRS and is determined to challenge the cancellation of its agreements through costly litigation, alleging that its two APAs were abruptly cancelled on a whim and without a substantive basis.[238] This dispute "has the potential to do real damage to the APA program," with litigation again being used to attempt to drag the Program through the mud.[239] When the Service pulls out of an APA, "it tarnishes the reputation of that agreement process."[240] Especially troubling is the fact that there was "no opportunity for discussion with Appeals" of the cancellations before the IRS abruptly informed the company of the cancellations and served a notice of tax deficiency.[241]

Accordingly, one solution to prevent repeated harm to the Program's reputation is to require an internal appeal process when the Service makes the decision to cancel an APA. This proposal would increase internal transparency for businesses using the Program. The IRS already employs similar appeal processes for many other determinations that the Service makes.[242] The IRS's Office of Appeals strives to resolve tax controversies without litigation on a fair and impartial basis to the government and the taxpayer "in a manner that will enhance voluntary compliance and public confidence in the integrity and efficiency of the Service."[243] Considering the situation surrounding Eaton and the subsequent fallout in the taxpaying community,[244] the cancellation of an APA is an apt opportunity for the appeals office to further its goals. With their magnitude, complexity, and asserted ironclad status, APAs should not be cancelled without a thorough vetting of the circumstances. An internal appeal process decreases the chances that a company such as Eaton will choose to use the Tax Court and external litigation to receive a second opinion, consuming more Program resources in the process.[245] This appears especially true in Eaton's case because it was not given a chance to appeal the decision to revoke its

---

237. *See* Coder, *supra* note 30.

238. Petition, Eaton Corp. v. Comm'r, 2013 T.C.M. (CCH) 59,575 (2013) (No. 5576-12); Coder, *supra* note 30. The U.S. Tax Court subsequently held that it had jurisdiction to review the cancellation of APAs, albeit only at an abuse of discretion standard. *Eaton Corp.*, 2013 T.C.M. (CCH) 59,575.

239. Coder, *supra* note 30 (internal quotation marks omitted).

240. *Id.* (internal quotation marks omitted).

241. *Id.* (internal quotation marks omitted).

242. *Appeals. . . Resolving Tax Disputes*, IRS, http://www.irs.gov/Individuals/Appeals...-Resolving-Tax-Disputes (last updated Jan. 23, 2014) (providing information on the appeals process, which "resolves over 100,000 cases per year").

243. *Id.*

244. *See* Coder, *supra* note 30.

245. *See* Petition, *supra* note 238.

APA to the Office of Appeals.[246] This outcome practically left the company no choice but to file a complaint and draw public ire to the Program in the process.[247] Whereas releasing redacted agreements arguably has the potential to chill taxpayer participation in the Program, requiring the IRS to be more transparent with taxpayers before terminating their pricing agreements would make the Program more attractive to potential business users.

Unlike the proposal to improve transparency by releasing redacted agreements, requiring an appeal process for terminating APAs has few drawbacks. APAs are rarely cancelled, and the limited resources spent on reviewing a decision before cancelling or revoking an agreement would be offset if even one lawsuit were prevented.[248] Further, the IRS already contains the internal structure needed to handle reviewing the agency's complex determinations, its Office of Appeals.

VI. CONCLUSION

With billions of dollars at stake, transfer pricing remains a potent battleground for both international businesses and the IRS.[249] While businesses are increasingly turning to complex tax strategies that involve transfer pricing, the IRS is responding by hiring specialists and allocating substantial resources to intensify transfer pricing enforcement.[250] Meanwhile, the APMA Program that the Service advertises as an open and cooperative solution to prevent transfer pricing disputes is mired in secrecy and has been scrutinized for its delay in processing applications.[251] With application numbers recovering but public criticism persisting, the IRS should look to other possibilities for improving the APMA Program besides its recent administrative restructuring.[252] One possibility is to enhance the Program's utility by increasing its transparency.[253]

First, to bolster transparency, the IRS should release redacted APAs to the public.[254] Despite the fact that in 1999 Congress bowed to pressure

246. *See* Coder, *supra* note 30.
247. *See id.*
248. *See* Petition, *supra* note 238; Coder, *supra* note 30.
249. *See supra* notes 1–4 and accompanying text.
250. *See supra* notes 19–23 and accompanying text.
251. *See supra* Part III.B.
252. *See supra* Part III.B.
253. *See supra* Part IV.
254. *See supra* Part V.A.

to prevent the IRS from doing so, releasing agreements would still be net beneficial for the Program.[255] The predominant concern surrounding the release of these agreements—the potential for jeopardizing taxpayer privacy—can be mitigated by using the protective procedures that the IRS utilizes for releasing similar documents that contain both taxpayer and "working law" information.[256] Moreover, this concern can be minimized further by delaying the release of the redacted pricing agreements.[257]

Second, even if APAs are not released, increasing the amount of information disclosed in the Program's annual reports can improve the Program's transparency.[258] The current annual reports lack any substantive transfer pricing guidance or examples of an actual complete pricing agreement.[259] Providing additional information about industries and the internal administration of the Program is not barred by the applicable statute, and these changes would assist businesses outside of the Program and improve its damaged reputation.[260] Further, this proposal would consume few resources and is not subject to the same privacy concerns raised by releasing redacted agreements.[261]

Third, adding a mandatory internal review procedure for the IRS's APA cancellation process can further increase transparency and bolster the Program's appeal.[262] The Program is again under scrutiny for terminating two agreements and is embroiled in resulting litigation.[263] This final proposal would consume few resources and potentially deter similar reputation-damaging litigation by adding credibility to the IRS's final decision to cancel an APA.[264]

Ultimately, the IRS's APMA Program is filled with potential but is harmed by its lack of transparency, a problem that fosters discontent within the public. With a broad trend toward increased governmental transparency and the IRS's call for more transparency from taxpayers, it is an ideal opportunity for the Service to reciprocate on its end.[265] By increasing transparency through the adoption of one or more of these

255. *See supra* Part V.A.
256. *See supra* Part V.A.2.
257. *See supra* Part V.A.2.
258. *See supra* Part V.B.
259. *See supra* Part V.B.
260. *See supra* Part V.B.
261. *See supra* Part V.B.
262. *See supra* Part V.C
263. *See supra* notes 237–41 and accompanying text.
264. *See supra* Part V.C.
265. *See supra* Part III.

proposals, the Program can better achieve its prime goal of solving transfer pricing issues for businesses in an open and cooperative manner.[266]

266. *See supra* note 72.