

HIGHLIGHTS OF THIS ISSUE

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENT

Announcement 2012–13, page 805.

This announcement is issued pursuant to section 521(b) of Pub. L. 106-170, the Ticket to Work and Work Incentives Improvement Act of 1999, which requires the Secretary of the Treasury to report annually to the public concerning Advance Pricing Agreements (APAs) and the APA Program. The first report covered calendar years 1991 through 1999. Subsequent reports covered separately each calendar year 2000 through 2010. This Thirteenth report describes the experience, structure, and activities of the APA Program during calendar year 2011. It does not provide guidance regarding the application of the arm's length standard.

INCOME TAX

T.D. 9579, page 796.

Final regulations under section 863 of the Code prescribe the source of income received on a qualified fails charge.

T.D. 9580, page 801.

Final regulations under section 7623(a) of the Code relate to the payment of rewards and awards under section 7623(b).

REG–135491–10, page 803.

Proposed regulations under section 6109 of the Code provide rules requiring any person assigned an employer identification number (EIN) to provide updated information to the IRS in the manner and frequency prescribed by forms, instructions, or other appropriate guidance.

EXEMPT ORGANIZATIONS

T.D. 9581, page 798.

Final regulations under section 6104 of the Code pertain to the public inspection of material relating to tax-exempt organizations and final regulations pertaining to the public inspection of written determinations and background file documents.

Announcement 2012–18, page 845.

The IRS has revoked its determination that The Center for Creative Resources, Inc., of San Francisco, CA; Chadwell Townsend Private Foundation of Bellbrook, OH; Consumer Advocacy Group of Beverly Hills, CA; CreditGuard of America, Inc., of Boca Raton, FL; Friends of the Border Patrol, of Chino, CA; and Pro Israel, Inc., of Riverdale, NY, qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Code.

ESTATE TAX

T.D. 9580, page 801.

Final regulations under section 7623(a) of the Code relate to the payment of rewards and awards under section 7623(b).

GIFT TAX

T.D. 9580, page 801.

Final regulations under section 7623(a) of the Code relate to the payment of rewards and awards under section 7623(b).

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EMPLOYMENT TAX

T.D. 9580, page 801.

Final regulations under section 7623(a) of the Code relate to the payment of rewards and awards under section 7623(b).

EXCISE TAX

T.D. 9580, page 801.

Final regulations under section 7623(a) of the Code relate to the payment of rewards and awards under section 7623(b).

ADMINISTRATIVE

T.D. 9581, page 798.

Final regulations under section 6104 of the Code pertain to the public inspection of material relating to tax-exempt organizations and final regulations pertaining to the public inspection of written determinations and background file documents.

The IRS Mission

Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and en-

force the law with integrity and fairness to all.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are compiled semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations,

court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts. Also included in this part are Bank Secrecy Act Administrative Rulings. Bank Secrecy Act Administrative Rulings are issued by the Department of the Treasury's Office of the Assistant Secretary (Enforcement).

Part IV.—Items of General Interest.

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last Bulletin for each month includes a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a semiannual basis, and are published in the last Bulletin of each semiannual period.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

For sale by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

Section 863.—Special Rules for Determining Source

26 CFR 1.863–10: Source of income from a qualified fails charge.

T.D. 9579

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Source of Income From Qualified Fails Charges

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations that prescribe the source of income received on a qualified fails charge under section 863 of the Internal Revenue Code (Code). The regulations finalize proposed regulations and withdraw temporary regulations published on December 8, 2010, and affect persons that pay or are entitled to receive qualified fails charges, including withholding agents.

DATES: *Effective Date:* These regulations are effective on February 21, 2012.

Applicability Date: For the date of applicability, see §1.863–10(g).

FOR FURTHER INFORMATION CONTACT: Karen Walny, Office of Associate Chief Counsel (International) (202) 622–3870 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

In response to persistent delivery failures in delivery-versus-payment transactions involving U.S. Treasury securities (Treasuries), the Treasury Market Practices Group (TMPG) and the Securities

Industry and Financial Markets Association published a trading practice governing failed deliveries of Treasuries in 2008. In July, 2009, the Treasury Department and the Internal Revenue Service (IRS) issued Notice 2009–61, 2009–32 I.R.B. 181, which provided that the IRS will not challenge the position taken by a taxpayer or a withholding agent that a fails charge paid with respect to a Treasury on or before December 31, 2010 is not subject to U.S. gross basis taxation. On December 8, 2010, the Treasury Department and the IRS issued temporary and proposed regulations that establish source rules for a fails charge paid with respect to a Treasury, with a correction to the temporary regulations on December 28, 2010. 75 FR 76262, 75 FR 76321, and 75 FR 81457, respectively.

The temporary and proposed regulations provide that the source of income from a qualified fails charge is generally determined by reference to the residence of the taxpayer that is the recipient of the qualified fails charge income, with two exceptions. Qualified fails charge income earned by a qualified business unit (QBU) of a taxpayer is sourced to the country in which the QBU is engaged in a trade or business, and qualified fails charge income that arises from a transaction the income from which is effectively connected to a United States trade or business is sourced in the United States and treated as effectively connected to the conduct of a United States trade or business.

No comments were received on the proposed regulations, and no hearing was requested or held. This Treasury decision adopts the proposed regulations with the changes discussed in this preamble.

Explanation of Provisions

These final regulations adopt, with one substantive change, the proposed regulations on the source of a qualified fails charge. The final regulations also make a number of clarifying changes to the language of the regulations.

The preamble to the temporary regulations noted that no trading practice existed at that time for fails charges on

securities other than Treasuries, but that if a fails charge trading practice pertaining to other securities was endorsed by the TMPG or an agency of the United States government, the Treasury Department and the IRS would consider whether the source rule in the regulations should be extended to those fails charges. The TMPG has subsequently endorsed a trading practice for debentures issued by the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Federal Home Loan Banks and agency pass-through mortgage-backed securities issued or guaranteed by the Government National Mortgage Association (Ginnie Mae), Fannie Mae, and Freddie Mac (Agency Debt and Agency MBS, respectively) beginning in February, 2012.

The Treasury Department and the IRS have determined that the same source rule should apply to fails charges incurred with respect to Agency Debt and Agency MBS as to fails charges on Treasuries. Accordingly, these final regulations expand the scope of a qualified fails charge to fails charges paid with respect to Agency Debt. The sourcing rule in the final regulations also applies to a fails charge on Agency MBS guaranteed by Fannie Mae, Freddie Mac, and Ginnie Mae (for tax purposes, Fannie Mae, Freddie Mac, and Ginnie Mae do not issue Agency MBS). The final regulations do not address the source of any other payment, including a fails charge that is not a qualified fails charge.

The Treasury Department and the IRS are considering whether separate guidance is needed on the source of income attributable to certain payments, other than qualified fails charges, that arise in securities lending transactions or repurchase transactions and request comments regarding this issue.

Effective Date

These regulations are effective on February 21, 2012.

Applicability Date

These regulations apply to a qualified fails charge paid or accrued on or after December 8, 2010.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Karen Walny, Office of the Associate Chief Counsel (International). However, other persons from the Office of Associate Chief Counsel (International) and the Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 863(a) and 7805
* * *

Par. 2. Section 1.863–10 is added to read as follows:

§1.863–10 Source of income from a qualified fails charge.

(a) *In general.* Except as provided in paragraphs (b) and (c) of this section, the source of income from a qualified fails charge shall be determined by reference to the residence of the taxpayer as determined under section 988(a)(3)(B)(i).

(b) *Qualified business unit exception.* The source of income from a qualified fails charge shall be determined by reference to the residence of a qualified business unit (as defined in section 989) of a taxpayer if—

(1) The taxpayer's residence, determined under section 988(a)(3)(B)(i), is the United States;

(2) The qualified business unit's residence, determined under section 988(a)(3)(B)(ii), is outside the United States;

(3) The qualified business unit is engaged in the conduct of a trade or business in the country where it is a resident; and

(4) The transaction to which the qualified fails charge relates is attributable to the qualified business unit. A transaction will be treated as attributable to a qualified business unit if it satisfies the principles of §1.864–4(c)(5)(iii) (substituting "qualified business unit" for "U.S. office").

(c) *Effectively connected income exception.* Qualified fails charge income that arises from a transaction any income from which is (or would be if the transaction produced income) effectively connected with a United States trade or business pursuant to §1.864–4(c) is treated as from sources within the United States, and the income from the qualified fails charge is treated as effectively connected to the conduct of a United States trade or business.

(d) *Qualified fails charge.* For purposes of this section, a qualified fails charge is a payment that—

(1) Compensates a party to a transaction that provides for delivery of a designated security (as defined in paragraph (e) of this section) in exchange for the payment of cash (delivery-versus-payment settlement) for another party's failure to deliver the

specified designated security on the settlement date specified in the relevant agreement; and

(2) Is made pursuant to—

(i) A trading practice or similar guidance approved or adopted by either an agency of the United States government or the Treasury Market Practices Group, or

(ii) Any trading practice, program, policy or procedure approved by the Commissioner in guidance published in the Internal Revenue Bulletin.

(e) *Designated security.* For purposes of this section, a *designated security* means any—

(i) Debt instrument (as defined in §1.1275–1(d)) issued by the United States Treasury Department, the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, or any Federal Home Loan Bank; or

(ii) Pass-through mortgage-backed security guaranteed by the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation, or the Government National Mortgage Association.

(g) *Effective/applicability date.* This section is effective on February 21, 2012. This section applies to a qualified fails charge paid or accrued on or after December 8, 2010.

§1.863–10T [Removed]

Par. 3. Section 1.863–10T is removed.

Steven T. Miller,
*Deputy Commissioner for
Services and Enforcement.*

Approved February 14, 2012.

Emily S. McMahon,
*Acting Assistant Secretary
of the Treasury (Tax Policy).*

(Filed by the Office of the Federal Register on February 17, 2012, 8:45 a.m., and published in the issue of the Federal Register for February 21, 2012, 77 F.R. 9846)

Section 6104.—Publicity of Information Required From Certain Exempt Organizations and Certain Trusts

26 CFR 301.6104(a)-1: Public inspection of material relating to tax-exempt organizations.

T.D. 9581

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

Public Inspection of Material Relating to Tax-Exempt Organizations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations pertaining to the public inspection of material relating to tax-exempt organizations and final regulations pertaining to the public inspection of written determinations and background file documents. These regulations are necessary to clarify rules relating to information and materials made available by the IRS for public inspection under the Internal Revenue Code (Code). The final regulations affect certain organizations exempt from Federal income tax, organizations that were exempt but are no longer exempt from Federal income tax, and organizations that were denied tax-exempt status.

DATE: *Effective Date:* These regulations are effective on February 29, 2012.

FOR FURTHER INFORMATION CONTACT: Mary Ellen Keys, (202) 622-4570 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Procedure and Administration Regulations (26 CFR part 301). Section 6104(a) of the Code relates to information pertaining to tax-exempt organizations made

available by the IRS for public inspection. Section 6110 of the Code relates to information pertaining to written determinations made publicly available by the IRS.

These final regulations amend §§301.6104(a)-1(i) and 301.6110-1(a) to eliminate the portions of the previous regulations that the United States Court of Appeals for the District of Columbia Circuit, in *Tax Analysts v. IRS*, 350 F.3d 100 (D.C. Cir. 2003), held violated section 6110 of the Code. Prior to the *Tax Analysts* decision, the IRS relied on those regulations to withhold letter rulings denying or revoking tax exempt status from public inspection under section 6110. In accordance with the *Tax Analysts* decision, the IRS now makes those letter rulings available for public inspection pursuant to section 6110. These final regulations also update §301.6104(a)-1 to conform to other current laws and administrative practices.

The final regulations affect organizations exempt from Federal income tax under section 501(a) or section 527, organizations that were exempt but are no longer exempt from Federal income tax, and organizations that were denied tax-exempt status.

A notice of proposed rulemaking (REG-116215-07, 2007-2 C.B. 659) was published in the **Federal Register** (72 FR 45394-01) on August 14, 2007. One comment was received from the public in response to the notice of proposed rulemaking. This comment was considered and is available for public inspection at www.regulations.gov or upon request. No public hearing was requested or held. In this Treasury decision, the proposed regulations are adopted as revised in this preamble.

Summary of Comment and Explanation of Changes Made to the Proposed Regulation

The comment suggested that the proposed revisions did not accomplish the objective stated in the summary to the notice of proposed rulemaking, because §301.6110-1(a) was not changed. The comment urged that §301.6110-1(a) be revised to delete everything after the sentence that concludes “section 6104,” which immediately precedes the portion of the regulation that the court held violated

the statute in *Tax Analysts*. The comment further suggested that, because no changes were made to the section 6110 regulations, paragraph (f) of §301.6104(a)-1 should be revised to reflect the decision in *Tax Analysts*. In response to the comment, paragraph (f) of §301.6104(a)-1 is revised to explain that negative determinations issued to organizations that applied for an exemption from Federal income tax are included among the written determinations that are made available under section 6110. No changes were made to §301.6110-1(a) in response to the comment because the language in the notice of proposed rulemaking and these final regulations already is consistent with the substance of the comment.

These final regulations also include minor, nonsubstantive revisions that vary from the text of the proposed regulations. Paragraph (a) of §301.6104(a)-1 of these final regulations is revised to make clear that, in the past, some applications were destroyed and therefore are not available for inspection. Paragraph (c)(4) of §301.6104(a)-1 of these final regulations is revised to include among the information pertaining to an organization’s status that is open to public inspection under section 6104(a) any letter or document issued by the IRS relating to exempt operating foundation status under section 4940(d)(2). Also, because the IRS no longer issues advance and final rulings, the reference to “final determination letter” in §301.6104(a)-1(c)(4) is revised to read “determination letter.”

Special Analyses

It has been determined that these final regulations are not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not include a collection of information, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a regulatory flexibility analysis is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these final regulations was submitted to the Chief

Counsel for Advocacy of the Small Business Administration for comments on its impact on small businesses.

Drafting Information

The principal author of these final regulations is Mary Ellen Keys, Office of the Associate Chief Counsel (Procedure & Administration).

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read as follows:

Authority: 26 U.S.C. 7805***

Par. 2. §301.6104(a)–1 is revised to read as follows:

§301.6104(a)–1 Public inspection of material relating to tax-exempt organizations.

(a) *Applications for exemption from Federal income tax, applications for a group exemption letter, and supporting documents.* If the Internal Revenue Service determines that an organization described in section 501(c) or section 501(d) is exempt from Federal income tax for any taxable year, the application upon which the determination is based, together with any supporting documents, shall be open to public inspection. Such applications and supporting documents shall be open to public inspection even after any revocation of the Internal Revenue Service's determination that the organization is exempt from Federal income tax. In the past, some applications were destroyed and therefore are not available for inspection. For purposes of determining the availability for public inspection, a claim for exemption from Federal income tax filed to re-establish exempt status after denial thereof under the provisions of section 503 or 504 (as in effect on December 31, 1969), or under the corresponding provisions of any prior revenue law, is considered an application for exemption from Federal income tax.

(b) *Notices of status filed by political organizations.* If, in accordance with section 527(i), an organization notifies the Internal Revenue Service that it is a political organization as described in section 527, exempt from Federal income tax for any taxable year, the notice of status filed by the political organization shall be open to public inspection.

(c) *Letters or documents issued by the Internal Revenue Service with respect to an application for exemption from Federal income tax.* If an application for exemption from Federal income tax is filed with the Internal Revenue Service after October 31, 1976, and is open to public inspection under paragraph (a) of this section, then any letter or document issued to the applicant by the Internal Revenue Service that relates to the application is also open to public inspection. For rules relating to when a letter or document is issued, see §301.6110–2(h). Letters or documents to which this paragraph (c) applies include, but are not limited to—

(1) Favorable rulings and determination letters, including group exemption letters, issued in response to applications for exemption from Federal income tax;

(2) Technical advice memoranda issued with respect to the approval, or subsequent approval, of an application for exemption from Federal income tax;

(3) Letters issued in response to an application for exemption from Federal income tax (including applications for a group exemption letter) that propose a finding that the applicant is not entitled to be exempt from Federal income tax, if the applicant is subsequently determined, on the basis of that application, to be exempt from Federal income tax; and

(4) Any letter or document issued by the Internal Revenue Service relating to an organization's status as an organization described in section 509(a), 4940(d)(2), 4942(j)(3), or 4943(f), including a determination letter that the organization is or is not a private foundation.

(d) *Requirement of exempt status.* An application for exemption from Federal income tax (including applications for a group exemption letter), supporting documents, and letters or documents issued by the Internal Revenue Service that relate to the application shall not be open to public inspection before the organization is determined, on the basis of that application,

to be exempt from Federal income tax for any taxable year. If an organization is determined to be exempt from Federal income tax for any taxable year, these materials shall not be withheld from public inspection on the basis that the organization is subsequently determined not to be exempt for any other taxable year.

(e) *Documents included in the term "application for exemption from Federal income tax."* For purposes of this section—

(1) *Prescribed application form.* If a form is prescribed for an organization's application for exemption from Federal income tax, the application includes the form and all documents and statements that the Internal Revenue Service requires to be filed with the form, any amendments or revisions to the original application, or any resubmitted applications where the original application was submitted in draft form or was withdrawn. An application includes an application for reinstatement of tax-exempt status after an organization's tax exempt status has been revoked pursuant to section 6033(j). An application submitted in draft form or an application submitted and later withdrawn is not considered an application.

(2) *No prescribed application form.* If no form is prescribed for an organization's application for exemption from Federal income tax, the application includes the submission by letter requesting recognition of tax exemption and any statements or documents as prescribed by Revenue Procedure 2011–9, 2011–2 I.R.B. 283 (January 10, 2011) or any successor guidance describing procedures for application for exempt status pursuant to section 501 and section 521 of the Internal Revenue Code. See §601.601(d)(2)(ii)(b).

(3) *Application for a Group Exemption Letter.* The application for a group exemption letter includes the letter submitted by or on behalf of subordinate organizations that seek exempt status pursuant to a group exemption letter and any statements or documents as prescribed by Revenue Procedure 80–27, 1980–1 C.B. 677, (June 20, 1980), and any successor guidance. See §601.601(d)(2)(ii)(b).

(4) *Notice of status filed under section 527(i).* For purposes of this section, documents included in the term "notice of status filed under section 527(i)" include—

(i) Form 8871, “Political Organization Notice of Section 527 Status”;

(ii) Form 8453-X, “Political Organization Declaration of Electronic Filing of Notice of Section 527 Status”; and

(iii) Any other additional forms or documents that the Internal Revenue Service may prescribe.

(f) *Material open to public inspection under section 6110.* Under section 6110, certain written determinations, including negative determinations issued to organizations that applied for an exemption from Federal income tax, issued by the Internal Revenue Service are made available for public inspection. Section 6110 does not apply, however, to material that is open to public inspection under section 6104. See sections 6104(a)(1) and 6110(l)(1).

(g) *Supporting documents defined.* For purposes of this section, “supporting documents,” with respect to an application for exemption from Federal income tax, means any statement or document not described in paragraph (e) of this section that is submitted by the organization or group in support of its application prior to a determination described in paragraph (a) of this section. Items submitted in connection with an application in draft form, or with an application submitted and later withdrawn, are not supporting documents. There are no supporting documents with respect to Notices of Status filed by political organizations.

(h) *Statement of exempt status.* For efficient tax administration, the Internal Revenue Service may publish, in paper or electronic format, the names of organizations currently recognized as exempt from Federal income tax, including organizations recognized as exempt from Federal income tax under particular paragraphs of section 501(c) or section 501(d). In addition to having the opportunity to inspect material relating to an organization exempt from Federal income tax, a person may request a statement, or the Internal Revenue Service may disclose, in response to or in anticipation of a request, the following information—

(1) The subsection and paragraph of section 501 (or the corresponding provision of any prior revenue law) under which the organization or group has been determined, on the basis of an application open

to public inspection, to qualify for exemption from Federal income tax; and

(2) Whether an organization or group is currently recognized as exempt from Federal income tax.

(i) *Publication of non-exempt status.* (1) For publication of the notice of the revocation of a determination that an organization is described in section 501(c)(3), see section 7428(c).

(2) For publication of a list including any organization the tax exemption of which is revoked for failure to file required returns or notices for three consecutive years, see section 6033(j).

(3) For publication of notice of suspension of tax exemption of terrorist organizations, see section 501(p).

(j) *Withholding of certain information from public inspection.* For rules relating to certain information contained in an application for exemption from Federal income tax and supporting documents that will be withheld from public inspection, see §301.6104(a)–5(a).

(k) *Procedures for inspection.* For rules relating to procedures for public inspection of applications for exemption from Federal income tax and supporting documents, see §301.6104(a)–6.

(l) *Effective/applicability date.* The rules of this section apply February 29, 2012.

Par. 3. §301.6110–1 is amended by revising paragraph (a) and adding paragraph (d) to read as follows:

§301.6110–1 Public inspection of written determinations and background file documents.

(a) *General rule.* Except as provided in §301.6110–3, relating to deletion of certain information, §301.6110–5(b), relating to actions to restrain disclosure, paragraph (b)(2) of this section, relating to technical advice memoranda involving civil fraud and criminal investigations, and jeopardy and termination assessments, and paragraph (b)(3) of this section, relating to general written determinations relating to accounting or funding periods and methods, the text of any written determination (as defined in §301.6110–2(a)) issued pursuant to a request postmarked or hand delivered after October 31, 1976, shall

be open to public inspection in the places provided in paragraph (c)(1) of this section. The text of any written determination issued pursuant to a request postmarked or hand delivered before November 1, 1976, shall be open to public inspection pursuant to section 6110(h) and §301.6110–6, when funds are appropriated by Congress for such purpose. The procedures and rules set forth in §§301.6110–1 through 301.6110–5 and §301.6110–7 do not apply to written determinations issued pursuant to requests postmarked or hand delivered before November 1, 1976, unless §301.6110–6 states otherwise. There shall also be open to public inspection in each place of public inspection an index to the written determinations subject to inspection at such place. Each such index shall be arranged by section of the Internal Revenue Code, related statute or tax treaty and by subject matter description within such section in such manner as the Commissioner may from time to time provide. The Commissioner shall not be required to make any written determination or background file document open to public inspection pursuant to section 6110 or refrain from disclosure of any such documents or any information therein, except as provided by section 6110 or with respect to a discovery order made in connection with a judicial proceeding. The provisions of section 6110 shall not apply to material that is open to public inspection under section 6104. See section 6110(l)(1).

* * * *

(d) *Effective/applicability date.* The rules of paragraph (a) apply February 29, 2012.

Steven T. Miller,
Deputy Commissioner for
Services and Enforcement.

Approved February 15, 2012.

Emily S. McMahon,
Acting Assistant Secretary
of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on February 28, 2012, 8:45 a.m., and published in the issue of the Federal Register for February 29, 2012, 77 F.R. 12202)

Section 7623.—Expenses of Detection of Underpayments and Fraud, Etc.

26 CFR 301.7623–1: Rewards and awards for information relating to violations of internal revenue laws.

T.D. 9580

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 301

Rewards and Awards for Information Relating to Violations of Internal Revenue Laws

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the payment of rewards under section 7623(a) of the Internal Revenue Code for detecting underpayments or violations of the internal revenue laws and whistleblower awards under section 7623(b). The guidance is necessary to clarify the definition of proceeds of amounts collected and collected proceeds under section 7623. This regulation provides needed guidance to the general public as well as officers and employees of the IRS who review claims under section 7623.

DATES: *Effective Date:* This final regulation is effective on February 22, 2012.

Applicability Date: For dates of applicability, see §301.7623–1(g).

FOR FURTHER INFORMATION CONTACT: Kirsten N. Witter, at (202) 927–0900 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 7623(a) provides the Secretary with the authority to pay such sums as he deems necessary from proceeds of amounts collected based on information provided to the Secretary when the information relates to the detection of underpayments of tax or the detection and

bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same. Section 7623(b) provides the Secretary with the authority to pay awards to individuals if the Secretary proceeds with an administrative or judicial action described in section 7623(a) that results in collected proceeds based on information provided by the individuals. Section 301.7623–1(a) of the regulations on Procedure and Administration currently provides that proceeds of amounts (other than interest) collected by reason of the information provided include both amounts collected because of the information provided and amounts collected prior to receipt of the information if the information leads to the denial of a claim for refund that otherwise would have been paid. 63 Fed. Reg. 44777.

Section 301.7623–1(a) was promulgated prior to amendments of section 7623 as part of the Tax Relief and Health Care Act of 2006, division A, section 406, Public Law 109–432, 120 Stat. 2958. The amendments designated existing section 7623 as section 7623(a). Before the 2006 amendments, section 7623 provided that rewards shall be paid “from the proceeds of amounts (other than interest) collected by reason of the information provided” The 2006 Act struck the “other than interest” language. The Act also added section 7623(b), which provides that in certain cases individuals shall receive an award of at least 15% but not more than 30% of the collected proceeds resulting from the action with which the Secretary proceeded based on information brought to the attention of the Secretary by the individual. The Act also created the IRS Whistleblower Office, which is responsible for administering a whistleblower program within the IRS.

On January 18, 2011, a notice of proposed rulemaking (REG–131151–10, 2011–8 I.R.B. 519) was published in the **Federal Register** (76 FR 2852) clarifying the definitions of proceeds of amounts collected and collected proceeds for purposes of section 7623, and providing that the provisions of Treas. Reg. §301.7623–1(a) concerning refund prevention claims are applicable to claims under section 7623(a) and (b). The proposed regulations further provide that the reduction of an overpayment credit balance is also considered

proceeds of amounts collected and collected proceeds under section 7623.

Seventeen written comments responding to the notice of proposed rulemaking were received. A public hearing was held on May 11, 2011. After consideration of the comments and hearing testimony, the regulation is adopted as proposed.

Other issues concerning the whistleblower statute, including terminology, additional definitions, and implementation of the statute, all of which were beyond the scope of these regulations, have been deferred and will be considered and addressed, if appropriate, in future guidance.

Summary of Comments

Several commenters recommended removal of “overpayment” as a modifier of credit balance. The commenters suggested that the term only applied to individual taxpayers, and would discourage claimants from coming forward with information about corporate taxpayers. Further, the commenters stated that “overpayment” unnecessarily limits the definition of collected proceeds as credit balances may arise in circumstances other than an overpayment.

The use of the term “overpayment credit balance” was intended to include amounts that have been credited to a taxpayer’s account and that would have been refunded to the taxpayer under section 6402 but for the information provided by the whistleblower. These amounts represent monies credited to the taxpayer’s account that are available to pay any tax liability or certain other liabilities, or to be refunded to the taxpayer. Overpayment credit balances are distinguishable from other types of balances shown on a taxpayer’s account, such as a cash deposit under section 6603. Both individual and corporate taxpayers may have overpayment credit balances. Accordingly, the final regulations retain the term “overpayment credit balance” as consistent with the payment and refund provisions of the Code.

A number of commenters recommended that the definition of collected proceeds specifically include net operating losses (NOLs). In contrast to overpayment credit balances, NOLs and similar tax attributes do not represent amounts credited to the taxpayer’s account that are directly

available to satisfy current or future tax liabilities or that can be refunded. Rather, tax attributes such as NOLs are component elements of a taxpayer's tax liability. If an NOL claimed by a taxpayer is disallowed as a result of information provided by a whistleblower, the IRS will factor that disallowance into the computation of the taxpayer's liability, which may, in turn, result in collected proceeds. For example: a taxpayer reports an NOL of \$10 million for 2009 and a whistleblower's information results in a reduction of the NOL to \$5 million. If the NOL is unused as of the date the IRS computes the amount of collected proceeds, there are no collected proceeds. If, however, the 2009 NOL was partially carried back to 2008, initially generating a \$3 million refund, and the whistleblower's information reduced the carryback amount, resulting in a \$1.5 million reduction in the refund for 2008, then the amount of the erroneous refund recovered and collected would be collected proceeds. The final regulation's definition of collected proceeds, therefore, does not refer explicitly to NOLs, tax credits, or any other tax attributes that may factor into the computation of a particular taxpayer's liability.

Several commenters suggested that collected proceeds should include criminal fines. Under the Victims of Crimes Act of 1984, criminal fines that are imposed on a defendant by a district court are deposited into the Crime Victims Fund (CVF). 42 U.S.C. §10601(b)(1). Criminal fines imposed for Title 26 offenses are not exempt from this requirement. The fines imposed in criminal tax cases that are deposited into the CVF are not available to the Secretary to pay awards under section 7623. As criminal fines deposited in the CVF are not available to pay awards, the final regulations do not include criminal fines in the definition of collected proceeds. However, restitution ordered by a court to the IRS is collected as a tax by the IRS and, therefore, is encompassed in the definition of collected proceeds.

Several commenters suggested that whistleblowers should be rewarded for the prevention of future tax avoidance

based on the whistleblower's information. Whether the IRS has the authority to make such an award under section 7623 and, if so, how the amount of the award would be determined and paid, is beyond the scope of this regulation. The final regulations do not address awards relating to the prevention of future tax avoidance.

Special Analysis

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Drafting Information

The principal author of this regulation is Kirsten N. Witter, Office of the Associate Chief Counsel (General Legal Services).

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding an entry in numerical order to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 301.7623-1 also issued under 26 U.S.C. 7623. * * *

Par. 2. Section 301.7623-1 is amended by revising the section heading, and paragraphs (a) and (g) to read as follows:

§301.7623-1 Rewards and awards for information relating to violations of internal revenue laws.

(a) *In general*—(1) *Rewards and awards*. When information that has been provided to the Internal Revenue Service results in the detection of underpayments of tax or the detection and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same, the IRS may approve a reward under section 7623(a) in a suitable amount from the proceeds of amounts collected in cases when rewards are not otherwise provided by law, or shall determine an award under section 7623(b) from collected proceeds.

(2) *Proceeds of amounts collected and collected proceeds*. For purposes of section 7623 and this section, both proceeds of amounts collected and collected proceeds include: tax, penalties, interest, additions to tax, and additional amounts collected by reason of the information provided; amounts collected prior to receipt of the information if the information provided results in the denial of a claim for refund that otherwise would have been paid; and a reduction of an overpayment credit balance used to satisfy a tax liability incurred because of the information provided.

* * * * *

(g) *Effective/applicability date*. Paragraph (a) is effective on February 22, 2012. This section is applicable with respect to rewards paid after January 29, 1997, except the rules of paragraph (a) of this section apply with respect to rewards and awards paid after February 22, 2012.

Steven T. Miller,
*Deputy Commissioner for
Services and Enforcement.*

Approved February 14, 2012.

Emily S. McMahon,
*(Acting) Assistant Secretary
of the Treasury (Tax Policy).*

(Filed by the Office of the Federal Register on February 21, 2012, 8:45 a.m., and published in the issue of the Federal Register for February 22, 2012, 77 F.R. 10370)

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Updating of Employer Identification Numbers

REG-135491-10

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide rules requiring any person assigned an employer identification number (EIN) to provide updated information to the IRS in the manner and frequency prescribed by forms, instructions, or other appropriate guidance. These proposed regulations affect persons with EINs and will enhance the IRS's ability to maintain accurate information as to persons assigned EINs.

DATES: Written or electronic comments and request for a public hearing must be received by June 12, 2012.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-135491-10), room 5205, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-135491-10), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224 or sent electronically via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-135491-10).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Gregory T. Armstrong, (202) 622-4940; concerning submissions of comments and requests for a public hearing, Oluwafunmilayo (Funmi) Taylor of the Publications and Regulation Branch at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:M:S, Washington, DC 20224. Comments on the collection of information should be received by May 14, 2012. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information in this proposed regulation is in proposed §301.6109-1(d)(2)(ii)(A). This information is necessary to allow the IRS to gather correct ownership information with respect to persons that have an EIN. The respondents are persons that have an EIN.

Estimated total annual reporting burden: 403,177 hours.

Estimated average annual burden per respondent: varies from 10 to 20 minutes with an estimated average of 15 minutes.

Estimated number of respondents: 1,612,708.

Estimated frequency of responses: on occasion.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless it displays a valid control number assigned by the Office of Management and Budget. Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by section 6103 of the Internal Revenue Code.

Background and Explanation of Provisions

This document contains proposed amendments to the Procedure and Administration Regulations (26 CFR Part 301) under section 6109 relating to identifying numbers. In general, section 6109(a)(1) provides that persons shall include taxpayer identifying numbers on returns, statements, or other documents filed with the IRS. Additionally, section 6109(c) authorizes the Secretary to require such information as may be necessary to assign an identifying number to any person.

One of the principal types of taxpayer identifying numbers used to identify taxpayers is an employer identification number (EIN), which takes the form 00-0000000. See Treas. Reg. §301.6109-1(a)(1); Treas. Reg. §301.7701-12. In general, the IRS assigns an EIN for use by employers, sole proprietors, corporations, partnerships, non-profit associations, trusts, estates, government agencies, certain individuals, and other business entities for tax filing and reporting purposes.

Section 301.6109-1(d)(2)(i) provides that any person required to furnish an EIN must apply for one with the IRS on a Form SS-4, *Application for Employer Identification Number*. The IRS accepts applications for EINs electronically and by telephone, facsimile, or mail.

With increasing frequency, EIN applicants authorize certain individuals (sometimes referred to as "nominees") to act on the EIN applicants' behalf. These

nominees are listed on the EIN application as principal officers, general partners, grantors, owners, and trustors. The authority of these nominees to act on behalf of the EIN applicant is often temporary and expires after the application is processed. The listing of a nominee prevents the IRS from gathering correct ownership information with respect to the EIN applicant once the nominee is no longer authorized to act on behalf of the EIN applicant. In response to concern with this practice and the need for accurate records, effective January 2010, the IRS revised line 7a on the Form SS-4 requiring disclosure of the name of the EIN applicant's "responsible party" and the responsible party's Social Security Number, Individual Taxpayer Identification Number, or EIN.

The Instructions for Form SS-4 provide a definition for "responsible party." For entities with shares or interests traded on a public exchange, or which are registered with the Securities and Exchange Commission, the instructions currently provide that a "responsible party" is (a) a principal officer, if the business is a corporation, (b) a general partner, if a partnership, (c) the owner of an entity that is disregarded as separate from its owner (disregarded entities owned by a corporation enter the corporation's name and EIN), or (d) a grantor, owner, or trustor, if a trust.

For all other entities, the "responsible party" is the person who has a level of control over, or entitlement to, the funds or assets in the entity that, as a practical matter, enables the individual, directly or indirectly, to control, manage, or direct the entity and the disposition of its funds and assets. The ability to fund the entity or the entitlement to the property of the entity alone, however, without any corresponding authority to control, manage, or direct the entity (such as in the case of a minor child beneficiary), does not cause the individual to be a responsible party.

These proposed regulations require any person issued an EIN to provide updated information to the IRS in the manner and frequency required by forms, instructions, or other appropriate guidance, which the IRS will issue in the near future. This requirement includes updated application information regarding the name and taxpayer identifying number of the responsible party. This requirement covers those persons who previously applied for an EIN

by listing a person other than the applicant's responsible party. This updated information will allow the IRS to ascertain correct ownership details for persons who have an EIN. In turn, the IRS can use that knowledge to contact the correct persons when resolving a tax matter related to a business with an EIN and to help combat schemes that abuse the tax system through the use of nominees.

Proposed Effective/Applicability Date

These regulations are proposed to apply to all persons possessing an EIN after the date the Treasury decision adopting these rules as final regulations is published in the **Federal Register**.

Special Analyses

It has been determined that these proposed regulations are not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

When an agency issues a rulemaking proposal, the Regulatory Flexibility Act (RFA) (5 U.S.C. chapter 6), requires the agency to "prepare and make available for public comment an initial regulatory flexibility analysis" that will "describe the impact of the proposed rule on small entities." (5 U.S.C. 603(a)). Section 605 of the RFA provides an exception to this requirement if the agency certifies that the proposed rulemaking will not have a significant economic impact on a substantial number of small entities.

The proposed rules affect entities that have an EIN and the IRS has determined that these proposed rules will have an impact on a substantial number of small entities. The IRS has determined, however, that the impact on entities affected by the proposed rule will not be significant. The current Form SS-4 already requires entities to disclose the name of the EIN applicant's "responsible party" and the responsible party's Social Security Number, Individual Taxpayer Identification Number, or EIN. The amount of time necessary to submit the updated information required in these proposed regulations, therefore, should be minimal for these entities.

Based on these facts, the IRS hereby certifies that the collection of information contained in this notice of proposed rulemaking will not have a significant economic impact on a substantial number of small entities. Accordingly, a Regulatory Flexibility Analysis is not required.

Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. Treasury and the IRS request comments on all aspects of the proposed rules. All comments submitted by the public will be made available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these regulations are Tammie A. Geier and Gregory T. Armstrong of the Office of the Associate Chief Counsel (Procedure and Administration).

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 301.6109-1 is amended by adding paragraphs (d)(2)(ii)(A) and (d)(2)(ii)(B) to read as follows:

§301.6109-1. *Identifying numbers.*

* * * * *

(d) * * *
(2) * * *
(ii) * * *

(A) *Requirement to update.* Persons issued employer identification numbers in accordance with the application process set forth in paragraph (d)(2)(i) of this section shall provide to the Internal Revenue Service any updated application information in the manner and frequency required by forms, instructions, or other appropriate guidance.

(B) *Effective/applicability date.* Paragraph (d)(2)(ii)(A) of this section applies to all persons possessing an employer identification number after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register**.

* * * * *

Steven T. Miller,
*Deputy Commissioner for
Services and Enforcement.*

(Filed by the Office of the Federal Register on March 13, 2012, 8:45 a.m., and published in the issue of the Federal Register for March 14, 2012, 77 F.R. 15004)

ANNOUNCEMENT AND REPORT CONCERNING ADVANCE PRICING AGREEMENTS ANNOUNCEMENT 2012–13

April 2, 2012

This Announcement is issued pursuant to § 521(b) of Pub. L. 106–170, the Ticket to Work and Work Incentives Improvement Act of 1999, which requires the Secretary of the Treasury to report annually to the public concerning Advance Pricing Agreements (APAs) and the APA Program. The first report covered calendar years 1991 through 1999. Subsequent reports covered separately each calendar year 2000 through 2010. This thirteenth report describes the experience, structure, and activities of the APA Program during calendar year 2011. It does not provide guidance regarding the application of the arm’s length standard.

As described in greater detail below, in the first quarter of calendar year 2012, the APA Program merged with that portion of the Office of the U.S. Competent Authority (USCA) that resolves transfer pricing cases under the mutual agreement procedures of the United States’ bilateral income tax conventions. As the successor to the APA Program, the new Advance Pricing and Mutual Agreement (APMA) office has prepared and finalized this report.

Throughout the period covered by this report, and most particularly following the announcement of the new combined APMA Office, the APA Program and the USCA engaged in extensive efforts to ensure a smooth transition and successful realignment. In addition to addressing personnel transfer, systems management, and other logistical issues, during the fall of 2011, the USCA hired additional managers and staff for the APMA Office, representing a 50-percent increase in total headcount. These new employees are receiving extensive training and mentoring from existing staff and management.

In part because of these transitional issues, during 2011, case closures fell short of normal expectations and average cycle times increased. APA, with some assistance from USCA, completed 43 APAs (including one amended APA) and 47 recommended negotiating positions (RNPs), down from totals of 69 APAs and 58 RNPs in 2010. The average time to complete an APA increased from 37.2 months in 2010 to 40.7 months in 2011.

Additional contributing factors to these results were the decrease in APA personnel for most of 2011 and the record number of new APA applications filed during the past four years. It is anticipated that when the transition to the APMA Office is complete, the number of completed APAs will increase and the average cycle time will decrease. Despite a decrease in 2011, over the last several years the APA program experienced increasing productivity, as measured by the number of completed APA items (*e.g.*, APAs, APA amendments, and recommended US negotiating positions) divided by total APA staff hours.

In view of the existing backlog of APA submissions, the hiring of new personnel, an expected growth in requests in coming years, and the expanding role of APMA in examinations and other matters involving treaty jurisdictions, it is difficult to predict APMA’s future resource needs with confidence. With the recently augmented staff, however, management anticipates steady growth in the productivity of the new APMA Office in the years to come.

Samuel M. Maruca
Director, Office of Transfer Pricing Operations

Background

Internal Revenue Code (IRC) § 482 provides that the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among two or more commonly controlled businesses if necessary to reflect clearly the income of such businesses. Under the § 482 regulations, the standard to be applied in determining the true taxable income of a controlled business is that of a business dealing at arm's length with an unrelated business. The arm's length standard has also been adopted by the international community and is incorporated into the transfer pricing guidelines issued by the Organization for Economic Cooperation and Development (OECD). OECD, TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISES AND TAX ADMINISTRATIONS (2010). Transfer pricing issues by their nature are highly factual and have traditionally been one of the largest issues identified by the IRS in its audits of multinational corporations. The APA Program is designed to resolve actual or potential transfer pricing disputes in a principled, cooperative manner, as an alternative to the traditional examination process. An APA is a binding agreement between the IRS and a taxpayer by which the IRS agrees not to seek a transfer pricing adjustment under IRC § 482 for a covered transaction if the taxpayer files its tax return for a covered year consistent with the agreed transfer pricing method (TPM) and otherwise complies with the APA.

Since 1991, with the issuance of Rev. Proc. 91-22, 1991-1 C.B. 526, the IRS has offered taxpayers, through the APA Program, the opportunity to reach an agreement in advance of filing a tax return on the appropriate TPM to be applied to related party transactions. In 1996, the IRS issued internal procedures for processing APA requests. Chief Counsel Directives Manual (CCDM), ¶¶ 42.10.10 – 42.10.16 (November 15, 1996).¹ Also in 1996, the IRS updated Rev. Proc. 91-22 with the release of Rev. Proc. 96-53, 1996-2 C.B. 375.² In 1998, the IRS published Notice 98-65, 1998-2 C.B. 803,³ which set forth streamlined APA procedures for small business taxpayers. Then on July 1, 2004, the IRS updated and superseded both Rev. Proc. 96-53 and Notice 98-65 by issuing Rev. Proc. 2004-40, 2004-2 C.B. 50,⁴ effective for all APA requests filed on or after August 19, 2004.

On December 19, 2005, the IRS again updated the procedural rules for processing and administering APAs with the release of Rev. Proc. 2006-09, 2006-1 C.B. 278.⁵ Rev. Proc. 2006-09 supersedes Rev. Proc. 2004-40 and is effective for all APA requests filed on or after February 1, 2006. On May 21, 2008, the IRS released Rev. Proc. 2008-31, 2008-1 C.B. 1133, which revised Rev. Proc. 2006-09 to describe further the types of issues that may be resolved in the APA process.⁶ Specifically, Rev. Proc. 2008-31 added a new sentence to Section 2.01 of Rev. Proc. 2006-09, to advise that the APA process may be used to resolve any issue for which transfer pricing principles may be relevant, such as attribution of profit to a permanent establishment under certain U.S. income tax treaties, the amount of income effectively connected with the conduct of a U.S. trade or business, and the amount of income derived from sources partly within and partly without the United States.

With the formation of the APMA Office, the IRS anticipates that it will amend Rev. Proc. 2006-9 and 2008-31, as well as 2006-54 (the revenue procedure governing Competent Authority processes) in 2012.

Advance Pricing Agreements

An APA generally combines an agreement between a taxpayer and the IRS with an agreement between the United States and one or more foreign tax authorities (under the authority of the mutual agreement process of our income tax treaties) on an appropriate TPM for the transactions at issue (Covered Transactions). With such “bilateral” APAs, the taxpayer ordinarily is assured that the income associated with the Covered Transactions will not be subject to double taxation by the combination of the United States and the foreign jurisdictions. The policy of the United States, as reflected in §§ 2.08 and 7 of Rev. Proc. 2006-09, is to encourage taxpayers that enter the APA Program to seek bilateral or multilateral APAs when competent authority procedures are available with respect to the foreign country or countries involved. However, the IRS may execute an APA with a taxpayer without reaching a competent authority agreement (a unilateral APA).

A unilateral APA is an agreement between a taxpayer and the IRS establishing an approved TPM for U.S. tax purposes. A unilateral APA binds the taxpayer and the IRS, but does not prevent a foreign tax administration from taking a different position on the appropriate TPM for a transaction. As stated in § 7.07 of Rev. Proc. 2006-09, should a transaction covered by a unilateral APA be subject to double taxation as the result of an adjustment by a foreign tax administration, the taxpayer may seek relief by requesting that the U.S. Competent Authority (USCA) consider initiating a mutual agreement proceeding pursuant to an applicable income tax treaty (if any).

¹ Current CCDM provisions regarding APA procedures are available at <http://www.irs.gov/irm/part32/ch04s01.html>.

² Available at <http://www.irs.gov/pub/irs-irbs/irb96-49.pdf>.

³ Available at <http://www.irs.gov/pub/irs-irbs/irb98-52.pdf>.

⁴ Available at <http://www.irs.gov/pub/irs-irbs/irb04-29.pdf>.

⁵ Available at http://www.irs.gov/irb/2006-02_IRB/ar12.html.

⁶ Available at <http://www.irs.gov/pub/irs-irbs/irb08-31.pdf>.

The policy generally preferring bilateral (or multilateral) over unilateral APAs is grounded in the goal of achieving certainty and avoiding double taxation through an early dispute resolution process that is most efficient from both taxpayer and government perspectives. Consistent with that policy, the IRS reviews both initial and renewal submissions for factors weighing in favor of bilateral or multilateral APAs (*e.g.*, potentially large amounts of income; complex issues; a high risk of adjustment in a foreign country; or other indications in the interests of efficient tax administration) or unilateral APAs (*e.g.*, the lack of a tax treaty with the country or countries involved with the major transaction flows; the lack of an APA program in a treaty partner country involved with the major transaction flows; small amounts at stake relative to the additional transaction costs of a bilateral or multilateral APA; a multiplicity of smaller foreign situs operations covered by unilateral APAs while bilateral or multilateral APAs cover major intercompany transaction flows; or other indications in the interests of efficient tax administration).

When a unilateral APA involves taxpayers operating in a country that is a U.S. treaty partner, information relevant to the APA (including a copy of the APA and APA annual reports) may be provided to the treaty partner under normal rules and principles governing the exchange of information under income tax treaties.

The APA Program

The following discussion explains the APA Program as it was organized through the end of December, 2011. As described above, prior to the publication of this report, the APA Program merged with that portion of the Office of the U.S. Competent Authority (USCA) that resolves transfer pricing cases under the mutual agreement procedures of the United States' bilateral income tax conventions. It is currently anticipated that the APA process described below will remain substantially the same in the new APMA Office, although it is also anticipated that an updated Revenue Procedure will be issued that will include modifications to the specific procedures described below.

The team leader is responsible for organizing the IRS APA team. The IRS APA team leader arranges meetings with the taxpayer, secures necessary information from the taxpayer to analyze the taxpayer's Covered Transactions and the available facts under the arm's length standard of IRC § 482 and the regulations thereunder, and leads the discussions with the taxpayer.

Before the formation of APMA, the APA team generally included, in addition to the team leader an economist, an IRS Large Business and International Division (LB&I) international examiner, LB&I field counsel, and, in a bilateral case or multilateral APA case, a USCA analyst. The economist could be from the APA Program or the IRS field organization. In the last statutory report, as of December 31, 2010, the APA Program had seven economists on staff, plus one economist manager. As of December 31, 2011, the APA Program had ten economists on staff, plus one economist manager. The APA team sometimes included an LB&I International Technical Advisor, other LB&I exam personnel, field counsel and an Appeals Officer.

The APA Process

The APA process is voluntary. Taxpayers submit an application for an APA, together with a user fee as set forth in Rev. Proc. 2006–09, § 4.12. The APA process can be broken into five phases: (1) application; (2) due diligence; (3) analysis; (4) discussion and agreement; and (5) drafting, review, and execution. The APA process as described below remained essentially the same throughout 2011; any changes resulting from the efforts of the APA Program and the USCA to pool resources before the decision to create the APMA Office are noted where relevant below.

(1) Application

In many APA cases, the taxpayer's application is preceded by a pre-file conference (PFC) with the IRS staff in which the taxpayer can solicit the informal views of the APMA Office. Pre-file conferences can occur on an anonymous basis, although a taxpayer must disclose its identity when it applies for an APA. The APA Program required taxpayers interested in an APA under Rev. Proc. 2008–31 to schedule a PFC before submitting a formal APA application.

Even outside the expanded jurisdiction conferred by Rev. Proc. 2008–31, PFCs are useful tools for the early exchange of ideas and expectations on complex, novel, and potentially contentious issues that will be present in an APA submission. The APMA Office believes that having the taxpayer discuss the case with the IRS before making a submission has the potential of shortening the period of time required to complete an APA by identifying issues that will require specific development and providing preliminary views on acceptable methodologies. In 2010–2011 the APA Program revised its internal practices concerning PFCs to improve efficiency, including better tracking of PFCs and, most notably, assigning some PFCs presenting complex or novel issues to the most experienced staff.

As part of a taxpayer's APA application, the taxpayer must file the appropriate user fee on or before the due date, including extensions, of the tax return for the first taxable year that the taxpayer proposes to be covered by the APA. (If the taxpayer receives an extension to file its tax return, it must file its user fee no later than the actual filing date of the return.) Many taxpayers file a user fee first and then follow up with a full application later — a “dollar file” in APA parlance. The procedures for PFCs, user fees, and applications can be found in §§ 3 and 4 of Rev. Proc. 2006–09.

For most taxpayers, the APA application is a substantial document filling several binders. APA applications must be accompanied by a declaration, signed by an authorized corporate officer, attesting to the accuracy and completeness of the information presented.⁷

The application is assigned to a team leader, who is responsible for the case. The APA team leader's first responsibility is to organize the APA team. This involves contacting the appropriate LB&I International Territory Manager for assignment of an international examiner to the APA case and the LB&I Counsel's office for assignment of a field counsel lawyer. Before the formation of the APMA Office, in a bilateral or multilateral case the USCA would assign a USCA analyst to the team. In a large APA case, the international examiner may invite his or her manager and other LB&I personnel familiar with the taxpayer to join the team. If the APA may affect taxable years in Appeals, the appropriate appellate conferee will be invited to join the team. In cases involving cost-sharing arrangements, other complex intangibles and services transactions, or novel issues, the APA team leader contacts the Manager, LB&I International Technical Advisors, to determine whether or not to include a technical advisor on the team. The multi-functional nature of APA teams combines the transfer pricing expertise of APA personnel with the expertise of other IRS personnel that possess complementary or supplementary knowledge about the taxpayer, the taxpayer's industry, related or ancillary tax issues, the foreign competent authority, and other relevant issues. By bringing all relevant parties to the table in a single proceeding, the APA process can resolve transfer pricing issues early in a principled, efficient, consistent, and comprehensive manner.

The APA team leader distributes copies of the APA application to all team members, makes initial contact with the taxpayer to confirm the APA Program's receipt of the taxpayer's application, and sets up an opening conference with the taxpayer. Under past APA case management procedures, the APA Program strived to: (i) make initial contact with the taxpayer within 21 days of its receipt of the APA application; and (ii) hold the opening conference within 45 days from the date that the APA team expects to begin actively working the case — the "Start Date" under the revised case management procedures. However, limited Program resources led to significant delays, so, for example, opening conferences have been held six months or more after a completed application was received. During the period since the prior statutory report the pooling of resources noted above has reduced the number of cases for which opening conferences were delayed. A priority for the APMA Office is to meet the case processing goals listed in the Rev. Proc. and case management guidelines.

At the time of the opening conference, the APA team leader would propose a case plan appropriate for the case. Case plans were generally targeted to complete a unilateral APA or, in the case of a bilateral APA, the U.S. recommended negotiating position (RNP), within 12 months from the date of the opening conference. The targeted completion date in a particular case, however, could and often did vary from the 12-month benchmark, depending on the complexity of the case, team workloads, taxpayer response times, and other factors. Case plans are signed by both an office manager and an authorized official of the taxpayer and are intended to control the process except in unforeseen or exceptional circumstances. Implementation and adherence to case plans has been uneven. Rapidly increasing workloads have resulted in the actual median and average times for completion to increase significantly. These APA inventory and case completion times are described in greater detail below in Tables 2 through 11. During the period since the last statutory report the APA Program took steps to increase its tracking of and adherence to case plans and, as discussed above, expects to further improve timeliness as the new APMA Office becomes fully operational.

(2) Due Diligence

The APA team must satisfy itself that the relevant facts submitted by the taxpayer are complete and accurate. This due diligence aspect of the APA is vital to the process. It is because of this due diligence that the IRS can reach advance agreements with taxpayers in the highly factual setting of transfer pricing. Due diligence can proceed in a number of ways. Typically, the APA team leader submitted a list of questions to the taxpayer before the opening conference for discussion at the conference. The opening conference often resulted in additional questions and an agreement to meet one or more times in the future. These questions and meetings focus on the transfer pricing issues associated with the transactions in the taxpayer's application, or other transactions that the taxpayer and the IRS may agree to add. The APA due diligence process thus differs from standard audit procedures.

(3) Analysis

Much of the economic analysis associated with an APA is typically conducted by an economist assigned to the case. The analysis may result in the need for additional information. Once the APA team has completed its due diligence and analysis, it begins discussions with the taxpayer over the various aspects of the APA including the covered transactions, the TPM, the selection of comparable transactions, asset intensity and other adjustments, the appropriate critical assumptions, the APA term, and other key issues. The APA team leader will discuss particularly difficult issues with his or her managers, but generally the team leader is empowered to negotiate the APA.

⁷ Section 9 of Rev. Proc. 2006-09 describes the special APA procedures for small business taxpayers.

(4) Discussion and Agreement

The discussion and agreement phase differs for bilateral and unilateral cases. In a bilateral case, the discussions have typically (and for a majority of the cases in 2011) proceeded in two parts and involved two IRS offices — the APA Program and the USCA. In the first part, the APA team attempted to reach a consensus with the taxpayer regarding the RNP that the USCA should present in negotiations with its treaty partner. This U.S. RNP was a paper drafted by the APA team leader, reviewed by APA management, and signed by the Associate Chief Counsel (International) (ACC(I)) and the APA Director. The RNP provided the APA Program’s view of the best TPM for the Covered Transactions, taking into account IRC § 482 and the regulations thereunder, the relevant tax treaty, and the USCA’s experience with the treaty partner. It is anticipated that the new APMA Office will streamline these procedures once it is fully functional.

The experience of the APA Program and the USCA has been that APA negotiations are likely to proceed more rapidly with a foreign competent authority if the taxpayer fully supports the U.S. negotiating position. Consequently, the IRS has worked with the taxpayer in developing the U.S. RNP. Often, however, the taxpayer has disagreed with part or all of the RNP. In these cases, the APA Program will send an RNP to the USCA that identifies and explains the elements of the RNP with which the taxpayer disagrees. The APA team leader also solicited the views of the other members of the APA team, and, in the vast majority of APA cases, the other members of the APA team concur in the position prepared by the APA team leader. If there were any disagreement that could not be resolved, it was noted in the RNP.

After the APA Program completed the recommended U.S. negotiating position, the APA process shifted from the APA Program to the USCA — in a so-called “hand-off.” The USCA analyst assigned to the APA took the U.S. RNP and prepared the final U.S. negotiating position, which was then transmitted to the foreign competent authority. The negotiations with the foreign competent authority were conducted by the USCA analyst, most often in face-to-face negotiating sessions conducted periodically throughout the year. At the request of the USCA, APA Program staff members have occasionally assisted in the negotiations.

Both in response to the inherent inefficiencies of a “hand-off” of an APA from one team to another, and because of resource constraints, during 2011 the APA Program and USCA commenced efforts towards a pooling of resources and better managing their shared bilateral caseload as a single inventory. This pooling effort ultimately led to the merger, as noted above. Following the merger, the goal is to eliminate hand-offs, so only a single team leader and economist will be involved in all phases of the APA process — application, due diligence, analysis, discussion, agreement and negotiation with the foreign competent authority.

In unilateral APA cases, the discussions proceed solely between the APA team and the taxpayer. In a unilateral case, the taxpayer and the APA team must reach agreement to conclude an APA. As in bilateral cases, the APMA team leader almost always will achieve a consensus with the IRS field personnel assigned to the APA team regarding the final APA. Under APA procedures, the APA team formally solicits IRS field personnel assigned to a case for their concurrence in the final APA. This concurrence, or any item in disagreement, is noted in a memorandum prepared by the APMA team leader that accompanies the final APA sent forward for review and execution.

(5) Drafting, Review, and Execution

Once the IRS, competent authorities, and the taxpayer reach agreement, the APA team drafts the final APA. The IRS has developed standard language that is incorporated into every APA. The current version of this language appears in Attachment A. The relevant APA Branch Chief and the APA Director review final APAs. In addition, for the period covered by this statutory report, the team leader prepared a summary memorandum for approval by the ACC(I). On March 1, 2001, the ACC(I) delegated to the APA Director the authority to execute APAs on behalf of the IRS. *See* Chief Counsel Notice CC-2001-016. An authorized corporate officer executes the APA on behalf of the taxpayer. In light of the formation of the APMA Office, it is anticipated that there will be modifications to the process of executing APAs with taxpayers.

Model APA at Attachment A [§ 521(b)(2)(B)]

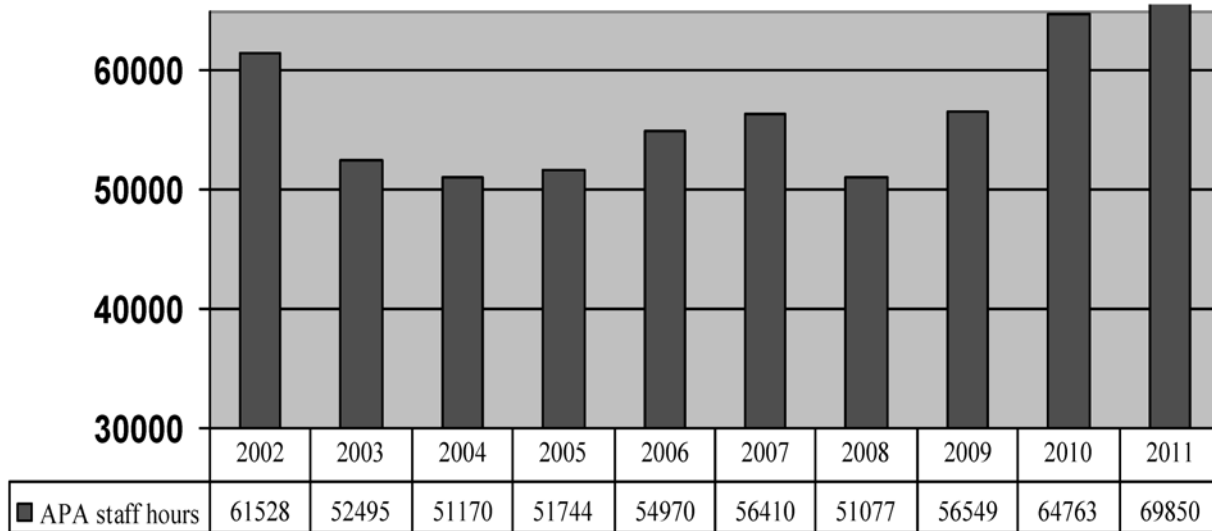
Attachment A contains the current version of the model APA language.

The APA Office Structure, Composition, and Operation

In 2011, the APA Program consisted of four branches, with Branches 1 and 3 staffed with APA team leaders and Branch 2 staffed with economists based in Washington, D.C. Branch 4, the APA West Coast branch, was headquartered in San Francisco, California, with an additional office in Laguna Niguel, California staffed with both team leaders and economists.

APA full-time staffing fluctuated during 2011, starting at 35 at the end of 2010, decreasing early in the year and returning to 35 by the end of the year. Total hours spent by APA professional staff increased slightly in 2011 over the previous year. The change in APA hours spent over the last nine years is reflected in the table below:

Hours of APA attorneys, economists, and paralegal staff by year (excluding holiday and leave):



As of January 25, 2012, for the resolution of allocation cases the U.S. Competent Authority employed seven managers, fifty-seven analysts, five economists, and five support staff, which were combined with the APA Program to form the APMA Office.

APA Issue/Industry Coordination Teams

In May 2005, the IRS Chief Counsel announced a series of initiatives to improve APA Program performance. One initiative was to increase specialization within the office by creating teams of select individuals to handle all cases of a particular type. The purpose was to increase efficiency, quality, and consistency.

The APA Program selected five categories of cases for specialization — cases involving cost sharing arrangements, financial products, the semiconductor industry, the automotive industry, and the pharmaceutical industry. These categories were selected because they each had a sufficient number of cases and commonality of issues to warrant their assignment to teams. Cases falling within these five categories have historically accounted for about 40 percent of the APA Program’s case load and about half of its total case time. At the end of 2011, cases within these five categories accounted for 86 of the 243 cases pending in the office that were either unilateral APAs or bilateral APAs that had not yet been forwarded to the USCA.

The new APMA Office is mindful that the purpose of the coordination effort is not to impose the same transfer pricing method on all taxpayers in an industry. The appropriate transfer pricing method remains a case-by-case determination, influenced by numerous factors that are not common to all companies operating in a particular industry. While the coordination effort may result in the IRS promoting a common approach on some issues where appropriate, the APMA Office expects that greater industry familiarity developed through the coordination effort will also allow it to develop a more sophisticated understanding of issues that will permit more tailored approaches, thereby promoting more (appropriately) varied results than might otherwise be the case. The IRS is considering whether to continue formal industry groups in APMA, and if so, in what form.

APA Training

In 2011 the APA Program continued its training activities. Training sessions addressed APA-related current developments, regulatory developments, new APA Program practices and procedures, OECD guidelines on business restructuring, review of novel or unique APAs or RNPs, and international tax law issues. In addition, a joint training session with the USCA office covered negotiation skills and techniques. The training materials used for new hires are available to the public through the APA internet site at <http://www.irs.gov/businesses/corporations/article/0,,id=96221,00.html>. The APA’s new-hire materials, which were originally prepared in 2003 and have not been updated, do not constitute guidance on the application of the arm’s length standard and are not to be relied upon or cited as precedent. Also available to the public is a spreadsheet model that performs calculations in a Comparable Profits Method (CPM) analysis, which APA economists developed in 2007 and which is now routinely used by the APMA Office when performing APA analyses. An electronic version of the model may be obtained by contacting the APMA Office in Washington, D.C. at (202) 435-5220 (not a toll-free number).

APA Program Statistical Data

[§ 521(b)(2)(C) and (E)]

The statistical information required under § 521(b)(2)(C) is contained in Tables 1 and 10 below; the information required under § 521(b)(2)(E) is contained in Tables 2 and 3 below. The 96 APA applications during 2011 represented a decrease from the all-time high of 144 in 2010 and previous record-breaking years in 2008 (123) and 2009 (127).⁸ From 2000–2007, the APA Program averaged 91 applications per year, and it had never received more than 110 applications in a single year. With the additional resources and added efficiencies from its recent restructuring, APMA expects APA applications to continue to be attractive to taxpayers and trend upwards in 2012, possibly reaching the same high levels as in 2008–2010.

TABLE 1: APA APPLICATIONS, EXECUTED APAS, AND PENDING APAS

	Unilateral	Bilateral	Multilateral	Year Total	Cumulative Total
APA applications filed during 2011	20	76		96	1619
All APAs executed ⁹					
Year 2011	8	34	0	42	1015
1991–2010	405	555	13	973	
APA renewals executed during 2011	2	13		15	308
APAs revised or amended during 2011	1	0		1	71
Pending requests for APAs	93	352		445	
Pending requests for new APAs	44	214		258	
Pending requests for renewal APAs	49	138		187	
APAs canceled or revoked	2	0		2	11
APAs withdrawn	4	5		9	174

⁸ Of the 127 new APA applications in 2009 — the first full year in which Rev. Proc. 2008–31 was in effect — approximately ten submissions invoked APA jurisdiction under Rev. Proc. 2008–31. In 2010, the APA Program completed three or fewer APAs falling within APA jurisdiction because of Rev. Proc. 2008–31. In 2011, there were no APAs completed that fell within APA jurisdiction because of Rev. Proc. 2008–31.

⁹ “All APAs executed” includes APA renewals, but not APAs revised or amended.

TABLE 2: MONTHS TO COMPLETE APAS

Months to Complete Advance Pricing Agreements in 2011					
All New		All Renewals		All Combined	
Average	40.9	Average	40.3	Average	40.7
Median	39.5	Median	38.9	Median	36.5
Unilateral New		Unilateral Renewals		Unilateral Combined	
Average	31.2	Average	14.2	Average	27.0
Median	28.6	Median	14.2	Median	26.8
Bilateral/Multilateral New		Bilateral/Multilateral Renewals		Bilateral/Multilateral Combined	
Average	43.9	Average	44.1	Average	44.0
Median	42.8	Median	42.4	Median	42.4

TABLE 3: APA COMPLETION TIME — MONTHS PER APA

Months	Number of APAs	Months	Number of APAs	Months	Number of APAs	Months	Number of APAs
1		21	1	41	1	61	1
2		22	1	42		62	
3		23	1	43	1	63	
4		24	1	44		64	
5		25	1	45		65	
6		26		46	1	66	
7		27	2	47	1	67	
8		28		48	2	68	2
9		29	2	49	1	69	
10		30	2	50	2	70	
11		31	1	51		71	1
12		32	1	52		72	
13	1	33	3	53	2	73	
14		34	1	54		74	
15	1	35	2	55		75	1
16		36		56			
17		37		57			
18		38	1	58			
19	1	39		59			
20		40	1	60	2		

TABLE 4: RECOMMENDED NEGOTIATING POSITIONS

Recommended Negotiating Positions Completed in 2011	47
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Table 5: MONTHS TO COMPLETE RECOMMENDED NEGOTIATING POSITIONS

New		Renewal		Combined	
Average	29.5	Average	23.7	Average	27.1
Median	32.9	Median	24.4	Median	29.0

TABLE 6: RECOMMENDED NEGOTIATING POSITIONS COMPLETION TIME — MONTHS PER APA

Months	Number	Months	Number	Months	Number	Months	Number
1		12		23		34	2
2	1	13		24		35	2
3		14	4	25	2	36	3
4	1	15		26	2	37	1
5		16	1	27	2	38	
6		17	2	28	1	39	1
7		18	1	29	1	40	
8		19	2	30	4	41	2
9		20		31		42	
10		21	2	32	1	43	2
11		22		33	5	44	
						45	1
						46	1

TABLES 7 AND 8 BELOW SHOW HOW LONG EACH APA REQUEST PENDING AT THE END OF 2011 HAS BEEN IN THE SYSTEM AS MEASURED FROM THE FILING DATE OF THE APA SUBMISSION. THE NUMBERS FOR PENDING UNILATERAL AND BILATERAL CASES DIFFER FROM THE NUMBERS IN TABLE 1 BECAUSE TABLES 7 AND 8 REFLECT ONLY CASES FOR WHICH SUBMISSIONS HAVE BEEN RECEIVED, WHILE TABLE 1 INCLUDES ANY CASE FOR WHICH A USER FEE HAS BEEN PAID.

TABLE 7: UNILATERAL APAS — TIME IN INVENTORY — MONTHS PER APA

Months	Number of APAs	Months	Number of APAs	Months	Number of APAs
1	1	17	2	33-35	
2	1	18	5	36	1
3	1	19	3	37	
4		20	4	38	1
5	2	21	3	39	1
6	2	22	1	40	
7	2	23	3	41	1
8		24	5	42	
9	1	25	5	43	2
10	1	26	1	44	1
11	2	27		45	1
12	4	28	3	46	1
13	3	29	2	47	
14	1	30	2	48	1
15	6	31		49	1
16	5	32	2	50	1

TABLE 8: BILATERAL APAS — TIME IN INVENTORY — MONTHS PER APA

Months	Number of APAs	Months	Number of APAs	Months	Number of APAs	Months	Number of APAs
1	9	26	3	51	2	81	1
2	7	27	2	52	0	82-83	0
3	1	28	6	53	2	84	1
4	8	29	7	54	1	85-86	0
5	8	30	12	55	1	87	1
6	4	31	5	56	1	88-91	0
7	7	32	11	57	1	92	1
8	6	33	0	58	0	93-106	0
9	7	34	6	59	3	107	1
10	14	35	6	60	0	108	0
11	4	36	11	61	3	109	1
12	17	37	6	62-63	0		
13	2	38	3	64	3		
14	7	39	3	65-67	0		
15	4	40	9	68	1		
16	2	41	4	69-70	0		
17	3	42	3	71	1		
18	9	43	5	72	2		
19	6	44	2	73	1		
20	4	45	4	74	0		
21	12	46	5	75	2		
22	7	47	8	76	0		
23	3	48	5	77	1		
24	10	49	8	78-79	0		
25	4	50	2	80	1		

Of the 350 cases in the APA Program’s inventory shown in Tables 7 and 8, 45 cases (all of which are reflected in Table 8) are bilateral cases that have been forwarded to the USCA office for discussion with a treaty partner. This leaves 305 cases in the APA Program’s active inventory at the end of 2011 that are either unilateral APAs (76 cases) or bilateral APAs for which the APA Program has not yet completed a recommended negotiating position (229 cases). Of the 305 active APA cases, 36 involve small business taxpayer (SBT) cases, as defined in Rev. Proc. 2006-9, § 4.12(5).

The table below shows the average age (in months) of the 305 active cases in inventory at the end of 2011, along with a comparison of the number of active cases and their average age at year-end for each year back to 2004. The table also shows the same information for cases that were at least 6-months old or 1-year old (the latter being a subset of the former) at the end of each year to allow comparison without potential distortions caused by year-to-year variations in the number of cases received in the latter half or during the course of the year.

TABLE 9: NUMBER AND AVERAGE AGE OF ACTIVE CASES IN INVENTORY AT YEAR-END

	2004	2005	2006	2007	2008	2009	2010	2011
Active cases	130	133	110	105	161	222	243	305
Average age (months)	15.2	13.2	10.6	9.1	10.2	12.9	15.4	17.4
Active cases 6+ months	106	87	81	66	110	176	196	248
Average age (months)	17.8	18.5	13.0	13.0	13.5	15.6	18.3	21.2
Active cases 1+ year	60	55	32	27	51	116	138	185
Average age (months)	24.2	23.3	19.4	18.5	18.7	19.5	22.1	24.9

TABLE 10: SMALL BUSINESS TAXPAYER APAs

Small Business Taxpayer APAs Completed in 2010	3
New	1
Renewals	2
Unilateral	1
Bilateral	2

TABLE 11: MONTHS TO COMPLETE SMALL BUSINESS TAXPAYER APAs

Months to Complete Small Business Taxpayer APAs in 2011					
New		Renewal		Combined	
Average	31.8	Average	17.2	Average	22.1
Median	31.8	Median	17.2	Median	19.2

Although the APA Program strives to complete SBT cases on an expedited basis, our experience is that such cases require nearly the same commitment of resources as non-SBT cases. This phenomenon may be explained by a number of factors, including the fact that the complexity or novelty of transfer pricing issues do not necessarily depend on the dollar volume of the related-party transactions, the lesser transfer pricing experience and/or resources of many SBTs, and the importance to both SBTs and non-SBTs of achieving outcomes that reflect each taxpayer's particular facts and circumstances (as opposed to an analysis based on streamlined factual development and general transfer pricing principles). The Program completed three SBT RNPs during 2011 with average and median lengths of 21.2 and 22.1 months, respectively.

TABLE 12: INDUSTRIES COVERED¹⁰

Industry Involved — NAICS Codes	Number
Computer and electronic manufacturing – 334	7–9
Wholesale trade, durable goods – 421	4–6
Miscellaneous manufacturing – 339	4–6
Professional scientific and technical services – 545	4–6
Motor Vehicle and parts dealers – 441	1–3
Wholesale Trade, non-durable goods – 422	1–3
Transportation equipment manufacturing – 336	1–3
Electronic equipment, appliance and component manufacturing – 335	1–3
Chemical manufacturing – 325	1–3
Machinery manufacturing – 333	1–3
Publishing industries – 511	1–3
Information service and data processing services – 514	1–3
Fabricated metal manufacturing – 332	1–3
Air transportation – 481	1–3
Plastics and rubber products manufacturing – 326	1–3
Securities, commodity contracts and other intermediary and related activities – 523	1–3
Sporting goods, hobby, book and music stores – 451	1–3
Broadcasting and telecommunications – 513	1–3
Broadcasting and telecommunications – 513	1–3
Heavy Construction – 234	1–3
Paper manufacturing – 322	1–3
Electronic and appliance stores – 443	1–3

¹⁰ The categories in this table are drawn from the North American Industry Classification System (NAICS), which has replaced the U.S. Standard Industrial Classification (SIC) system. NAICS was developed jointly by the United States, Canada, and Mexico to provide new comparability in statistics about business activity across North America.

Trades or Businesses

[§ 521(b)(2)(D)(i)]

The nature of the relationships between the related organizations, trades, or businesses covered by APAs executed in 2011 set forth in Table 13 below:

TABLE 13: NATURE OF RELATIONSHIPS BETWEEN RELATED ENTITIES

Relationship	Number of APAs
Foreign Parent — U.S. Subsidiary (-ies)	26
<i>Unilateral</i>	7
<i>Bilateral</i>	19
U.S. Parent — Foreign Subsidiary (-ies)	16
<i>Unilateral</i>	≤ 3
<i>Bilateral</i>	15
Foreign Company and U.S. branch(es)	0

Covered Transactions

[§ 521(b)(2)(D)(ii)]

The controlled transactions covered by APAs executed in 2011 are set forth in Tables 14 and 15 below:

TABLE 14: TYPES OF COVERED TRANSACTIONS

Transaction Type	Number
Sale of tangible property into the United States	22
Sale of tangible property from the United States	15
Performance of services by U.S. entity	15
Use of services by U.S. entity	9
Use of intangible property by non-U.S. entity	8
Use of intangible property by U.S. entity	5
Commodity trading on globally integrated basis	≤ 3
Financial Products- non US parent/US Sub	≤ 3
Financial Products-US branch of foreign company	≤ 3
Other	≤ 3

TABLE 15: TYPES OF SERVICES INCLUDED IN COVERED TRANSACTIONS

Intercompany Services Involved in the Covered Transactions	Number
Distribution	14
Technical support services	12
Marketing	9
Administrative	7
IT	7
Accounting and auditing	7
Legal	6
Management	6
Sales support	5
Tax	5
Statistical assistance	5
Payroll	4
Contract research & development	4
Headquarters costs	≤ 3
Warranty services	≤ 3
Product support	≤ 3
Logistical support	≤ 3
Treasury activities	≤ 3
Benefits	≤ 3
Purchasing	≤ 3
Corporate and public relations	≤ 3
Health, Safety, Environmental, and regulatory affairs	≤ 3
Staffing and recruiting	≤ 3
Accounts receivable	≤ 3
Budgeting	≤ 3
Accounts payable	≤ 3
Maquiladora Manufacturing	≤ 3
Insurance claims Management	≤ 3

Business Functions Performed and Risks Assumed

[§ 521(b)(2)(D)(ii)]

The general descriptions of the business functions performed and risks assumed by the organizations, trades, or businesses whose results are tested in the Covered Transactions in the APAs executed in 2011 are set forth in Tables 16 and 17 below:

TABLE 16: FUNCTIONS PERFORMED BY THE TESTED PARTY

Functions Performed	Number
Distribution	46
Product support services	26
Marketing functions	15
Manufacturing	15
Research and development	10
Product design and engineering	9
Licensing of intangibles	7
Product assembly or packaging	6
Transportation and warehousing	5
Product testing and quality control	5
Managerial, legal, accounting, finance, personnel, and other support services	5
Trading and risk management of financial products	5
Purchasing and materials management	≤ 3
Technical training and technical support	≤ 3
Telecom Services	≤ 3
Mining and extraction	≤ 3

TABLE 17: RISKS ASSUMED BY THE TESTED PARTY

Risks Assumed	Number
Market risks, including fluctuations in costs, demand, pricing, and inventory	60
Credit and collection risks	46
General business risks (<i>e.g.</i> , related to ownership of PP&E)	37
Financial risks, including interest rates and currency	24
Product liability risks	22
Research and development risks	8

Discussion

The majority of APAs involve Covered Transactions featuring numerous business functions and risks. For instance, with respect to functions, multinational groups that manufacture products typically conduct research and development (R&D), engage in product design and engineering, manufacture the product, market and distribute the product, and perform support functions such as legal, finance, and human resources services. These groups are subject to market risks, R&D risks, financial risks, credit and collection risks, product liability risks, and general business risks. In the APA evaluation process, the APA team devotes a significant amount of time and effort to understanding the allocation of functions and risks among the entities that are party to the Covered Transactions.

In its APA submission, the taxpayer must provide a functional analysis. The functional analysis identifies the economic activities performed, the assets employed, the economic costs incurred, and the risks assumed by each of the controlled parties. The importance of the functional analysis derives from economic theory, which posits that returns vary in proportion to risk, and that different economic functions contribute different value and have different opportunity costs associated with them. It is important that the functional analysis be specific - simply categorizing a tested party as, say, a distributor, is not sufficient. Not all distributors undertake similar functions and risks.

The functional analysis is critical in determining the appropriate TPM (including the selection of comparables, tested party, and profit level indicator (PLI)). In conjunction with evaluating the functional analysis, the APA Program considers contractual terms between the controlled parties, the allocation of risk between the parties, the relevant economic conditions, and the type of property or services at issue. In assessing contractual terms and risk allocations, the APA Program considers not only written agreements between the parties, but also the economic substance of the transactions as indicated by the conduct of the parties over time, the financial capacity of each party to fund losses arising from risks, and the managerial or operational control each party exercises over activities giving rise to risk. Relevant economic conditions reviewed often include the geographic market, the level of the market in which the functions are performed, and the business cycle or general economic condition of the industry.

During 2010 and 2011, the APA Program received numerous inquiries about the potential effect on existing and pending APAs of the economic downturn and the major earthquake and tsunami that struck Japan in 2011. With respect to existing APAs, the APA Program, in consultation with the USCA, has adopted a general policy not to re-open closed cases in the absence of a Critical Assumption on point.¹¹ The APA Program has dealt with pending APA applications (whether pending with the USCA or the APA Program) on a case-by-case basis. Whether or not a special “down-economy adjustment” might be appropriate depends on a variety of factors, including whether or not the tested party and the comparables have been similarly affected by the downturn, the tested party’s historic risk profile and performance, and a taxpayer’s willingness to accept a symmetrical adjustment (*e.g.*, in a renewal APA) when the economy improves. Approaches to the down economy that have been considered include changing the APA term, waiting for more current financial data, using a different set of comparables, and/or applying a longer testing period.

The APA Program’s evaluation of the functional analysis also considers the assets or other resources employed by each controlled party. In this evaluation, each party’s ownership or investment in intangible assets is often an important consideration.

¹¹ See Table 21 and accompanying text.

**Related Organizations, Trades, or Businesses Whose Prices or Results Are Tested to Determine
Compliance with APA Transfer Pricing Methods**
[§ 521(b)(2)(D)(iii)]

The related organizations, trades, or businesses whose prices or results are tested to determine compliance with TPMs prescribed in APAs executed in 2011 are set forth in Table 18 below:

**TABLE 18: RELATED ORGANIZATIONS, TRADES, OR BUSINESSES WHOSE
PRICES OR RESULTS ARE TESTED¹²**

Type of Organization	Number
U.S. distributor	25
U.S. manufacturer	20
U.S. provider of services	11
Non-U.S. provider of services	7
Non-U.S. distributor	6
U.S. licensor of intangible property	≤ 3
U.S. Licensee of intangible property	≤ 3
Non-U.S. manufacturer	≤ 3

¹² "Multiple tested parties" includes covered transactions that utilize profit splits, CUPs, and CUTs.

Transfer Pricing Methods and the Circumstances Leading to the Use of Those Methods
[§ 521(b)(2)(D)(iv)]

The TPMs used in APAs executed in 2011 are set forth in Tables 19 and 20 below:

TABLE 19: TRANSFER PRICING METHODS USED FOR TRANSFERS OF TANGIBLE AND INTANGIBLE PROPERTY¹³

TPM Used	Number
CPM: PLI is operating margin	30
Unspecified method	12
CPM: PLI is markup on total costs	7
CUT (intangibles only)	≤ 3
Residual profit split	≤ 3
Cost Plus Method (tangibles only)	≤ 3
CUP (tangibles only)- not based on market data	≤ 3
CPM: PLI is other PLI	≤ 3
CPM: PLI is Berry ratio	≤ 3
CPM: PLI is return on assets or capital employed	≤ 3
CPM:PLI is gross margin	≤ 3

TABLE 20: TRANSFER PRICING METHODS USED FOR SERVICES

TPM Used	Number
CPM: PLI is operating profit-to-total services cost ratio	8
Cost of Services plus method	≤ 3
Services Cost Method: Specified Covered Services	≤ 3
CPM: PLI is Berry ratio	≤ 3
Residual Profit Split Method	≤ 3

Discussion

The TPMs used in APAs completed during 2011 were based on the section 482 regulations. Under Treas. Reg. § 1.482-3, the arm's length amount for controlled transfers of tangible property may be determined using the Comparable Uncontrolled Price (CUP) Method, the Resale Price Method, the Cost Plus Method, the Comparable Profits Method (CPM), or the Profit Split Method. Under Treas. Reg. § 1.482-4, the arm's length amount for controlled transfers of intangible property may be determined using the Comparable Uncontrolled Transaction (CUT) Method, the CPM, or the Profit Split Method. An "Unspecified Method" may be used for transfers of either tangible or intangible property if it provides a more reliable result than the enumerated methods under the best method rule of Treas. Reg. § 1.482-1(c).

¹³ PLIs used with the Comparable Profit Method of Treas. Reg. § 1.482-5, and as used in these TPM tables, are as follows: (1) operating margin (ratio of operating profit to sales); (2) Berry ratio (ratio of gross profit to operating expenses); (3) gross margin (ratio of gross profit to sales); (4) markup on total costs (percentage markup on total costs); and (5) rate of return on assets or capital employed (ratio of operating profit to operating assets).

For transfers involving the provision of services, Treas. Reg. § 1.482-9(a) provides that the arm's length amount charged must be determined under one of six specified methods or an unspecified method. The six specified methods are the Services Cost Method, the Comparable Uncontrolled Services Price (CUSP) Method, the Gross Services Margin Method, the Cost of Services Plus Method, the CPM, and the Profit Split Method. Treasury Reg. § 1.482-2(a) provides rules concerning the proper treatment of loans or advances.

Treas. Reg. § 1.482-7 provides rules for cost sharing arrangements under which the parties agree to share the costs of developing intangibles in proportion to their shares of reasonably anticipated benefits. APAs involving cost sharing arrangements generally address both the method of allocating costs among the parties as well as determining the appropriate amount of the payment for "platform contribution transactions" (PCTs) (known as "buy ins" under the previous cost-sharing regulations). In 2011 the APA Program completed its recommendations on three or fewer bilateral cost sharing/PCT cases and sent those to the USCA. In addition, the APA Program is currently working on roughly 10 cases involving cost-sharing/PCTs, split almost evenly between bilateral and unilateral. The PCT cases include both initial and subsequent buy-in/buy-out transactions. The methods used in the completed and pending PCT cases include valuations based on the income method, including cases involving a split of the discounted present value of platform contributions made by two or more parties, and other types of analyses.

In reviewing the TPMs applicable to transfers of tangible and intangible property reflected in Table 19, the majority of the APAs followed the specified methods. However, several points should be noted. The section 482 regulations provide that for transfers of tangible property, the CUP Method will generally be the most direct and reliable measure of an arm's length price for the controlled transaction if there are no differences between an uncontrolled transaction and the controlled transaction that would affect the price, or if there are only minor differences that have a definite and reasonably ascertainable effect on price and for which appropriate adjustments may be made. Treas. Reg. § 1.482-3(b)(2)(ii)(A). As in earlier years, it was the experience of the APA Program in 2011 that qualifying CUP transactions were rare.

Similar to the CUP Method, for transfers of intangible property the CUT Method will generally provide the most direct and reliable measure of an arm's length result if an uncontrolled transaction involves the transfer of the same intangible under the same, or substantially the same, circumstances as the controlled transaction. Treas. Reg. § 1.482-4(c)(2)(ii). Under the regulation, circumstances between the controlled and uncontrolled transaction will be considered substantially the same if there are at most only minor differences that have a definite and reasonably ascertainable effect on the amount charged and for which appropriate adjustments may be made. *Id.* It has generally been difficult to identify external comparables, and APAs using the CUT Method tend to rely on internal uncontrolled transactions (*i.e.*, those between the taxpayer and uncontrolled parties). In 2011, three Covered Transactions utilized the CUT TPM.

The APA team did not apply the Resale Price Method in 2011. See Treas. Reg. § 1.482-3(c), (d).

Both taxpayers and the IRS frequently apply the CPM in APAs because reliable public data on comparable business activities of independent companies may be more readily available than potential CUP data, and comparability of resources employed, functions, risks, and other relevant considerations is more likely to exist than comparability of product. The CPM also tends to be less sensitive than other methods to differences in accounting practices between the tested party and comparable companies, *e.g.*, classification of expenses as cost of goods sold or operating expenses. Treas. Reg. § 1.482-3(c)(3)(iii)(B) and (d)(3)(iii)(B). In addition, the CPM generally requires a lesser degree of functional comparability to obtain a reliable result than that required under the Resale Price Method or the Cost Plus Method. This difference in degree of functional comparability reflects differences in functions performed, which often are reflected in operating expenses. Thus, taxpayers performing different functions may have very different gross profit margins but earn similar levels of operating profit. Treas. Reg. § 1.482-5(c)(2).

Table 19 reflects at least 45 uses of the CPM (with varying PLIs) in Covered Transactions involving tangible or intangible property. Some APAs used the CPM concurrently with other methods.

The CPM has proven to be versatile in part because of its various PLIs. The discussions in many cases involve identifying the appropriate PLI, which in turn depends heavily on the facts and circumstances of the particular case. Some APAs have applied different PLIs to different parts of the Covered Transactions or applied a secondary PLI as a check against the primary PLI.

The CPM was also used regularly with services as the Covered Transactions in APAs executed in 2011. At least twenty-four services Covered Transactions used the CPM Method, with various PLIs according to the specific facts of the taxpayers involved. Three or fewer services-related APAs completed in 2011 applied the new Services Cost Method under the § 1.482-9 regulations. Table 20 reflects the methods used to determine the arm's length results for APAs involving services transactions.

In 2011, three or fewer APAs involving tangible or intangible property used the Residual Profit Split Method. Treas. Reg. § 1.482-6(c)(3). In residual profit split cases, routine contributions by the controlled parties are allocated routine market returns, and the residual income is allocated among the controlled taxpayers based upon the relative value of their contributions of non-routine intangible property to the relevant business activity.

Profit splits have also been used in a number of financial product APAs in which the primary income-producing functions are performed in more than one jurisdiction.

Critical Assumptions

[§ 521(b)(2)(D)(v)]

Critical Assumptions used in APAs executed in 2011 are described in Table 21 below:

TABLE 21: CRITICAL ASSUMPTIONS

Critical Assumptions involving the following:	Number of APAs
Material changes to tax and/or financial accounting practices	42
Material changes to the business	42
Assets will remain substantially same	10
Other	7
Other financial ratios	≤ 3
Changes in affiliated companies	≤ 3
Catastrophic events	≤ 3
Currency fluctuations	≤ 3

Discussion

APAs include critical assumptions underlying the application of the TPM. A critical assumption is any fact (whether or not within the control of the taxpayer) related to the taxpayer, a third party, an industry, or business and economic conditions, the continued existence of which is material to the taxpayer’s proposed TPM. Critical assumptions might include, for example, a particular mode of conducting business operations, a particular corporate or business structure, or a range of expected business volume. Rev. Proc. 2006-09, § 4.05. Failure to meet a critical assumption may render an APA inappropriate or unworkable. Most APAs contain only the standard critical assumption language set forth in Appendix B of the Model APA (Attachment A to this Announcement and Report). Where appropriate, additional critical assumption language may be added, but the APA Program generally seeks to limit additional critical assumption language to objective, measurable benchmarks.

A critical assumption may change or fail to materialize due to changes in economic circumstances, such as a fundamental and dramatic change in the economic conditions of a particular industry. In addition, a critical assumption may change or fail to materialize due to a taxpayer’s actions that are initiated for good faith business reasons, such as a change in business strategy, mode of conducting operations, or the cessation or transfer of a business segment or entity covered by the APA.

If a critical assumption has not been met, the parties may agree to revise the APA. If such an agreement cannot be achieved, the APA is canceled. If a critical assumption has not been met, the taxpayer must notify and discuss the APA terms with the Service, and, in the case of a bilateral APA, competent authority consideration is initiated. Rev. Proc. 2006-09, §§ 11.05, 11.06.

Sources of Comparables, Selection Criteria, and the Nature of Adjustments to Comparables and Tested Parties
[§ 521(b)(2)(D)(v), (vi), and (vii)]

The sources of comparables, selection criteria, and rationale used in determining the selection criteria for APAs executed in 2011 are described in Tables 22 through 24 below. Various formulas for making adjustments to comparables are included as Attachment B.

TABLE 22: SOURCES OF COMPARABLES

Comparable Sources	Number of Times This Source Used
Compustat	54
Disclosure	21
Mergent	15
No comparables used	12
Moody's	5
Amadeus	4
Japan Accounts and Data on Enterprises (JADE)	4
Damodaran	4
Sources of comparables unidentified or unknown	≤ 3
Taxpayer's information on competition	≤ 3
Global Vantage	≤ 3
Osiris	≤ 3
SEC	≤ 3
Thompson financial	≤ 3
Japan Company Handbook	≤ 3
Other	≤ 3

TABLE 23: COMPARABLES SELECTION CRITERIA

Selection Criteria Considered	Number of Times This Criterion Used
Comparable functions	65
Comparable risks	51
Comparable industry	32
Comparable intangibles	20
Comparable products	23
Comparable terms	17

TABLE 24: ADJUSTMENTS TO COMPARABLES OR TESTED PARTIES

Adjustment	Number of Times Used
Balance sheet adjustments	
Payables	49
Receivables	47
Inventory	46
Property, plant, equipment	12
Other	≤ 3
Accounting adjustments	
LIFO to FIFO inventory accounting	40
Other	25
Accounting reclassifications (<i>e.g.</i> , from COGS to operating expenses)	≤ 3
Profit level indicator adjustments (used to “back into” one PLI from another PLI)	
Operating expense	≤ 3
Other	≤ 3
Miscellaneous adjustments	
Goodwill value or amortization	8
Stock-based compensation	7
Research and development	≤ 3
Other	4

Discussion

Comparables are at the core of most transfer pricing analysis. The APA Program works closely with taxpayers to find the best and most reliable comparables for each Covered Transaction. In some cases, the taxpayer and IRS can identify CUPs or CUTs. In other cases, the APA team uses profit data on comparable business activities of independent companies to apply the CPM or a Profit Split Method. Generally, in the APA Program’s experience since 1991, CUPs and CUTs have been most often derived from the internal transactions of the taxpayer.

For profit-based methods in which comparable business activities or functions of independent companies are sought, the APA Program typically selects them using a three-part process. First, the team identifies a pool of companies with potentially comparable business activities through broad searches. From this pool, the team eliminates companies performing business activities that are clearly not comparable to those of the tested party through the use of quantitative and qualitative analyses, *i.e.*, quantitative screens and review of business descriptions. Then, the team finalizes a set of comparable independent companies based on a review of available descriptive and financial data. The team then enhances the comparability of the final set by adjusting its financial data.

Sources of Comparables

Comparables used in APAs can be from the United States or foreign countries, depending on the relevant market, the type of transaction being evaluated, the availability of relevant data, and the results of the functional and risk analyses. In general, comparables have been located by searching a variety of databases that provide data on U.S. publicly traded companies and on a combination of public and private non-U.S. companies. Table 22 shows the various databases and other sources used in selecting comparables for the APAs executed in 2011.

Although comparables were most often identified from the databases cited in Table 22, in some cases, comparables were found from other sources, such as comparables derived internally from taxpayer transactions with third parties.

Selecting Comparables

Initial pools of potential comparables generally are derived from the databases using a combination of industry and keyword identifiers. Then, the pool is refined using a variety of selection criteria specific to the transaction or business activity being tested and the TPM being used.

The listed databases allow for searches by industrial classification, by keywords, or by both. These searches can yield a number of companies whose business activities may or may not be comparable to those of the tested party. Therefore, comparables based solely on industry classification or keyword searches are rarely used in APAs. Instead, the pool of comparables is examined closely, and companies are selected based on a combination of screens, business descriptions, and other information such as that found in the companies' Annual Reports to shareholders and filings with the U.S. Securities and Exchange Commission (SEC), company websites, and investment analyst reports.

Business activities of independent companies generally must meet certain basic comparability criteria to be considered comparable. The independent company's functions, risks, and economic conditions, and the property (product or intangible) and services associated with the company's business activities, must be comparable to those involved in the Covered Transaction. Determining comparability requires judgment - the goal has been to use comparability criteria restrictive enough to eliminate business activities that are not comparable, but yet not so restrictive as to leave no comparables remaining. The APA Program normally has begun with relatively strict comparability criteria and then has relaxed them slightly if necessary to derive a pool of reliable comparables. A determination on the appropriate size of the comparables set, as well as the business activities that comprise the set, is highly fact-specific and depends on the reliability of the results.

In addition, the APA Program, consistent with the section 482 regulations, generally has looked at the results of comparables over a multi-year period (the analysis window). Often this has been a three-year or a five-year period, but other periods are sometimes used depending on the circumstances of the controlled transaction. Using a shorter period might result in the inclusion of comparables in different stages of economic development or use of atypical years of a comparable due to cyclical fluctuations in business conditions.

The economic downturn and the major earthquake and tsunami that hit Japan in 2011 have focused particular attention on the appropriate analysis window for APAs with terms that include 2008 and 2009, and to a lesser extent 2010 and 2011, given the different economic conditions that may have confronted the comparables during the years comprising the analysis window, which typically lags behind the years covered by an APA (*e.g.*, the comparables results for 2005–09 may be used to test the taxpayer's results under the APA from 2008–2012). As noted in the discussion following Table 17, the APA Program has been dealing with the economic downturn in various ways, including waiting for more current comparables' financial data to develop a more contemporaneous analysis window.

Many Covered Transactions are tested with comparables that have been chosen using additional criteria and/or screens. These include sales level criteria and tests for financial distress and product comparability. These common selection criteria and screens are used to increase the overall comparability of a group of companies and as a basis for further research. The sales level screen, for example, has been used to remove companies that, due to their smaller size, might face fundamentally different economic conditions from those of the tested party. In addition, APA analyses have incorporated selection criteria designed to identify and remove companies experiencing "financial distress" because of concerns that such companies face unusual circumstances and operational constraints that limit comparability to the business activity being tested. These "financial distress" criteria may include an unfavorable auditor's opinion, bankruptcy, failure to comply with financial obligations (*e.g.*, debt covenants), and, in certain circumstances, operating losses in a given number of years.

An additional important class of selection criteria is the development and ownership of intangible property. In many cases the tested party does not employ unique intangible assets or engage in intangible development. In such cases the APA team has used several criteria to increase the chances that the comparables similarly do not own significant intangibles or conduct R&D. These selection criteria have included determining the importance of patents to a company or screening for R&D expenditures as a percentage of sales. Similar selection criteria may be applied to ensure, where appropriate, that the comparables do not own or develop unique marketing intangibles such as distinctive trademarks. The APA team uses quantitative screens related to identifying comparables with significant intangible property together with publicly available business information.

APA teams sometimes use selection criteria relating to asset and/or operating expense comparability. For example, a screen of property, plant, and equipment (PP&E) as a percentage of sales or assets, combined with a reading of a company's SEC filings, may help distinguish distributors (generally lower PP&E) from manufacturers (generally higher PP&E), regardless of their industry. Similarly, a test involving the ratio of operating expenses to sales has helped to determine whether a company undertakes a significant marketing and distribution function. Table 25 shows the number of times such screens were used in APAs executed in 2011:

TABLE 25: COMPARABILITY AND FINANCIAL DISTRESS SCREENS

Comparability/Financial Distress Screen	Times Used
Comparability screens used	
R&D/sales	37
Sales	24
Other	21
Foreign sales/total sales	19
PP&E/sales	7
PP&E total assets	6
Operating expense/sales	6
Non-startup or start-up	≤ 3
SG&A/sales	≤ 3
Sales to a specific customer type	≤ 3
Financial distress	
Bankruptcy	31
Unfavorable auditor's opinion	15
Losses in one or more years	10
Other	6

Adjusting Comparables

After the comparables have been selected, the regulations require that “[i]f there are material differences between the controlled and uncontrolled transactions, adjustments must be made if the effect of such differences on prices or profits can be ascertained with sufficient accuracy to improve the reliability of the results.” Treas. Reg. § 1.482–1(d)(2). In almost all cases involving income-statement-based PLIs used in the CPM or the Residual Profit Split Method, the analyst calculates certain “asset intensity” or “balance sheet” adjustments for factors that affect prices or profits. In addition, in specific cases, additional adjustments are performed to improve reliability.

The most common balance sheet adjustments used in APAs are adjustments for differences in accounts receivable, inventories, and accounts payable. The APA Program generally has required adjustments for receivables, inventory, and payables based on the principle that differences in these items may affect prices or profits. For these items, it is generally assumed that the most reliable measure of the difference is the interest rate on short-term debt.

To compare the profits of two business activities with different relative levels of receivables, inventory, or payables, the APA Program estimates the carrying costs of each item and adjusts profits accordingly. Although different formulas have been used in specific APA cases, Attachment B presents one set of formulas used in many APAs. Underlying these formulas are the notions that (1) balance sheet items normally should be expressed as mid-year averages, (2) formulas should try to avoid using data items that are being tested by the TPM (for example, if sales are controlled, then the denominator of the balance sheet ratio should not be sales), (3) a short term interest rate should be used, and (4) an interest factor should recognize the average holding period of the relevant asset. As it has since 2007, during the course of 2011, the APA Program used an interest rate equal to LIBOR (3 months) plus 200 basis points for purposes of calculating adjustments for accounts receivable and accounts payable for U.S. companies in many cases. In addition, the APA Program often used an interest rate equal to the Corporate Bonds (Moody's) Baa rate for purposes of calculating inventory adjustments for U.S. companies. However, the facts and circumstances surrounding a given case will ultimately determine the reliability of balance sheet adjustments and the selection of the most appropriate interest rate.

The APA Program also requires that financial data be compared on a consistent accounting basis. For example, although financial statements may be prepared on a first-in first-out (FIFO) basis, comparisons are less meaningful if one or more of the comparables use last-in first-out (LIFO) inventory accounting methods. This adjustment directly affects costs of goods sold and inventories, and therefore affects both profitability measures and inventory adjustments.

In some cases, the APA Program has made an adjustment to account for differences in relative levels of PP&E between a tested business activity and the comparables. Ideally, comparables and the business activity being tested will have fairly similar relative levels of PP&E, since major differences can be a sign of fundamentally different functions and risks. Typically, the PP&E adjustment is made using a medium-term interest rate. During the course of 2011, the APA Program often used the Corporate Bonds (Moody's) Baa rate as the interest rate for purposes of calculating adjustments for inventory and PP&E for U.S. companies. Again, however, the facts and circumstances surrounding a given case will ultimately determine the reliability of making balance sheet adjustments and the selection of the most reliable interest rate.

Additional adjustments used less frequently include those for differences in other balance sheet items, operating expenses, R&D, and currency risk. Accounting adjustments, such as reclassifying items from cost of goods sold to operating expenses, are also made when warranted to increase reliability. Often, data are not available for both the controlled and uncontrolled transactions in sufficient detail to allow for these types of adjustments.

The adjustments made to comparables or tested parties in APAs executed in 2011 are reflected in Table 24 above.

Ranges, Targets, and Adjustment Mechanisms

[§ 521(b)(2)(D)(viii)-(ix)]

The types of ranges, targets, and adjustment mechanisms used in APAs executed in 2011 are described in Tables 26 and 27 below.

TABLE 26: RANGES AND TARGETS¹⁴

Type of Range	Number
Interquartile range	30
Other	18
Specific point (cost-plus specific mark up)	7
Specific point within CPM range (not floor or ceiling)	5
Full range	5
Cost (no mark up-services)	5
Specific point (royalty)	≤ 3
Specific point (CUP)	≤ 3
Specific point (royalty)	≤ 3
Ceiling (<i>i.e.</i> , result must be no more than x)	≤ 3
Financial products statistical confidence interval to test against internal CUPs	≤ 3

¹⁴ The numbers do not include TPMs with cost or cost-plus methodologies.

TABLE 27: ADJUSTMENTS WHEN OUTSIDE THE RANGE

Adjustment mechanism	Number
Taxpayer makes an adjustment: to specified point or royalty rate	24
Taxpayer makes an adjustment: to closest edge of single year	23
Taxpayer makes an adjustment: to closest edge of multi-year average	22
Competent Authority negotiation	6
Taxpayer makes an adjustment: to median of current year	≤ 3
Cost plus mark up	≤ 3
Taxpayer makes an adjustment: to median of multi-year average	≤ 3
Taxpayer makes an adjustment: to a specific dollar amount	≤ 3
Covered Transaction no longer covered but APA not cancelled	≤ 3

Discussion

Treas. Reg. § 1.482-1(e)(1) states that sometimes a pricing method will yield “a single result that is the most reliable measure of an arm’s length result.” Sometimes, however, a method may yield “a range of reliable results,” referred to as the “arm’s length range.” A taxpayer whose results fall within the arm’s length range will not be subject to adjustment.

Under Treas. Reg. § 1.482-1(e)(2)(i), such a range is normally derived by considering a set of more than one comparable uncontrolled transaction of similar comparability and reliability. If these comparables are of very high quality, as defined in the section 482 regulations, then under Treas. Reg. § 1.482-1(e)(2)(iii)(A), the arm’s length range includes the results of all of the comparables (from the lowest to the highest). However, the APA Program has only rarely identified cases meeting the requirements for using the full range. If the comparables are of lesser quality, then under Treas. Reg. § 1.482-1(e)(2)(iii)(B), “the reliability of the analysis must be increased, when it is possible to do so, by adjusting the range through application of a valid statistical method to the results of all of the uncontrolled comparables.” One such method, the “interquartile range,” is ordinarily acceptable, although a different statistical method “may be applied if it provides a more reliable measure.” The interquartile range is defined as, roughly, the range from the 25th to the 75th percentile of the comparables’ results. See Treas. Reg. § 1.482-1(e)(2)(iii)(C). The interquartile range was used thirty times in 2011.

Twelve Covered Transactions reflected on Table 26 were tested against a single, specific result. Some APAs - deliberately infrequent - specify not a point or a range, but a “floor” or a “ceiling.” When a floor is used, the tested party’s result must be greater than or equal to some particular value. When a ceiling is used, the tested party’s result must be less than or equal to some particular value. Three or fewer APAs executed in 2011 used a ceiling; no APAs executed in 2011 used a floor.

Some APAs examine a tested party’s results over a period of years (multi-year averaging) to determine whether a taxpayer has complied with the APA. In 2011, rolling multi-year averaging was not used for any Covered Transactions.

Adjustments

Where a taxpayer’s actual transactions do not produce results that conform to the TPM, the taxpayer must nonetheless report its taxable income in an amount consistent with the TPM (an APA primary adjustment), as further discussed in § 11.02 of Rev. Proc. 2006-09. When the TPM specifies an arm’s length range, an APA primary adjustment is necessary only if the taxpayer’s actual transactional result falls outside the specified range.

Under Treas. Reg. § 1.482-1(e)(3), if a taxpayer’s results fall outside the arm’s length range, the IRS may adjust the result “to any point within the arm’s length range.” Accordingly, an APA may permit or require a taxpayer to make an adjustment after the year’s end to put the year’s results within the range, or at the point specified by the APA. Similarly, to enforce the terms of an APA, the IRS may make such an adjustment. When the APA specifies a range, the adjustment is sometimes to the closest edge of the range, and sometimes to another point such as the median of the interquartile range. Depending on the facts of each case, automatic adjustments are not always permitted. APAs may specify that in such a case there will be a negotiation between the competent authorities involved to determine whether and to what extent an adjustment should be made. APAs may permit automatic adjustments unless the result is far outside the range specified in the APA. Thus, APAs provide flexibility and efficiency, permitting adjustments when normal business fluctuations and uncertainties push the result somewhat outside the range.

APA Term and Rollback Lengths
[§ 521(b)(2)(D)(x)]

The various term lengths for APAs executed in 2011 are set forth in Table 28 below:

TABLE 28: TERMS OF APAS

APA Term in Years	Number of APAs
3	≤ 3
4	≤ 3
5	20
6	8
7	6
8	≤ 3
9	≤ 3

The number of rollback years to which an APA TPM was applied in 2011 is set forth in Table 29 below:

TABLE 29: NUMBER OF YEARS COVERED BY ROLLBACK OF APA TPM

Number of Rollback Years	Number of APAs
1	≤ 3
2	4
3	6
5 or more	≤ 3

Together, Tables 28 and 29 indicate that the 43 APAs (including one amended APA) completed in 2011 covered more than 270 taxable years, and potentially more than 300 taxable years. In terms of dollar value, 26 of the 43 completed APAs involved Covered Transactions exceeding \$100 million per year, with 21 APAs covering transactions exceeding \$250 million per year. Combining the total covered years and the total dollar-value of Covered Transactions represents one measure of the effectiveness of the APA Program.

Nature of Documentation Required

[§ 521(b)(2)(D)(xi)]

APAs executed in 2011 required that taxpayers provide various documents with their annual reports. These documents are described in Table 30 below:

TABLE 30: NATURE OF DOCUMENTATION REQUIRED

Documentation	Number
Statement identifying all material differences between Taxpayer's business operations during APA Year and description of Taxpayer's business operations contained in Taxpayer's request for APA, or if there have been no such material differences, a statement to that effect.	42
Statement of all material changes in the Taxpayer's accounting methods and classifications, and methods of estimation, from those described or used in Taxpayer's request for the APA. If there has been no material change in accountings methods and classifications or methods of estimation, a statement to that effect.	42
Description of any failure to meet Critical Assumptions or, if there have been none, a statement to that effect.	42
Copy of the APA	42
Financial analysis demonstrating Taxpayer's compliance with TPM.	42
Organizational chart	42
Any change to the taxpayer notice information in section 14 of the APA.	42
The amount, reason for, and financial analysis of any compensating adjustment under Paragraph 4 of Appendix A and Rev. Proc. 2006-9, § 11.02(3), for the APA year, including but not limited to: the amounts paid or received by each affected entity; the character (such as capital or ordinary expense) and country source of the funds transferred, and the specific line item(s) of any affected U.S. tax return; and any change to any entity classification for federal income tax purposes of any member of the Taxpayer's group that is relevant to the APA.	42
The amounts, description, reason for, and financial analysis of any book-tax difference relevant to the TPM for the APA Year, as reflected on Schedule M-1 or Schedule M-3 of the U.S. return for the APA Year.	42
Financial Statements and any necessary account detail to show compliance with the TPM, with a copy of the opinion from an independent CPA required by paragraph 5(f) of the APA.	42
Certified public accountant's opinion that financial statements present fairly the financial position of Taxpayer and the results of its operations, in accordance with a foreign GAAP.	≤ 3
Financial statements as prepared in accordance with a foreign GAAP	≤ 3
Various work papers	≤ 3
Certified public account's review of financial statements	≤ 3

Approaches for Sharing of Currency or Other Risks

[§ 521(b)(2)(D)(xii)]

During 2011, twenty-four tested parties faced financial risks, including interest rate and currency risks. In appropriate cases, APAs may provide specific approaches for dealing with currency risk, such as adjustment mechanisms and/or critical assumptions.

Efforts to Ensure Compliance with APAs

[§ 521(b)(2)(F)]

As described in Rev. Proc. 2006–09, § 11.01, APA taxpayers are required to file annual reports to demonstrate compliance with the terms and conditions of the APA. The filing and review of annual reports is a critical part of the APA process. Through annual report review, the APA Program monitors taxpayer compliance with the APA on a contemporaneous basis. Annual report review provides current information on the success or problems associated with the various TPMs adopted in the APA process.

All reports received by the APA Program are assigned to a designated APA team leader. Whenever possible, annual report reviews are assigned to the team leader who negotiated the case, who is already be familiar with the relevant facts and terms of the agreement. Other team leaders and economists may assist the assigned team leader as well. Once received by the APA Program, the annual report is also sent to the field personnel with exam jurisdiction over the taxpayer.

The statistics for the review of APA annual reports are reflected in Table 31 below. As of December 31, 2011, there were 251 pending annual reports. In 2011, 349 annual reports were closed.

TABLE 31: STATISTICS OF ANNUAL REPORTS

Number of APA annual reports pending as of December 31, 2011	251
Number of APA annual reports closed in 2011	349
Number of APA annual reports requiring adjustment in 2011	0
Number of taxpayers involved in adjustments	0
Number of APA annual report cases over one-year old	142

Attachment A
Model APA — Based on Revenue Procedure 2006–9

ADVANCE PRICING AGREEMENT
between
[Insert Taxpayer's Name]
and
THE INTERNAL REVENUE SERVICE

PARTIES

The Parties to this Advance Pricing Agreement (APA) are the Internal Revenue Service (IRS) and *[Insert Taxpayer's Name]*, EIN _____.

RECITALS

[Insert Taxpayer Name] is the common parent of an affiliated group filing consolidated U.S. tax returns (collectively referred to as “Taxpayer”), and is entering into this APA on behalf of itself and other members of its consolidated group.

Taxpayer’s principal place of business is *[City, State]*. *[Insert general description of taxpayer and other relevant parties]*.

This APA contains the Parties’ agreement on the best method for determining arm’s-length prices of the Covered Transactions under I.R.C. section 482, any applicable tax treaties, and the Treasury Regulations.

[If renewal, add] [Taxpayer and IRS previously entered into an APA covering taxable years ending _____ to _____, executed on _____.]

AGREEMENT

The Parties agree as follows:

1. *Covered Transactions.* This APA applies to the Covered Transactions, as defined in Appendix A.
2. *Transfer Pricing Method.* Appendix A sets forth the Transfer Pricing Method (TPM) for the Covered Transactions.
3. *Term.* This APA applies to Taxpayer’s taxable years ending _____ through _____ (APA Term).
4. *Operation*
 - a. Revenue Procedure 2006–9 governs the interpretation, legal effect, and administration of this APA.
 - b. Nonfactual oral and written representations, within the meaning of sections 10.04 and 10.05 of Revenue Procedure 2006–9 (including any proposals to use particular TPMs), made in conjunction with the APA Request constitute statements made in compromise negotiations within the meaning of Rule 408 of the Federal Rules of Evidence.
5. *Compliance.*
 - a. Taxpayer must report its taxable income in an amount that is consistent with Appendix A and all other requirements of this APA on its timely filed U.S. Return. However, if Taxpayer’s timely filed U.S. Return for an APA Year is filed prior to, or no later than 60 days after, the effective date of this APA, then Taxpayer must report its taxable income for that APA Year in an amount that is consistent with Appendix A and all other requirements of this APA either on the original U.S. Return or on an amended U.S. Return filed no later than 120 days after the effective date of this APA, or through such other means as may be specified herein.
 - b. *{Insert when U.S. Group or Foreign Group contains more than one member.}* [This APA addresses the arm’s-length nature of prices charged or received in the aggregate between Taxpayer and Foreign Participants with respect to the Covered Transactions. Except as explicitly provided, this APA does not address and does not bind the IRS with respect to prices charged or received, or the relative amounts of income or loss realized, by particular legal entities that are members of U.S. Group or that are members of Foreign Group.]
 - c. For each taxable year covered by this APA (APA Year), if Taxpayer complies with the terms and conditions of this APA, then the IRS will not make or propose any allocation or adjustment under I.R.C. section 482 to the amounts charged in the aggregate between Taxpayer and Foreign Participant[s] with respect to the Covered Transactions.

d. If Taxpayer does not comply with the terms and conditions of this APA, then the IRS may:

- i. enforce the terms and conditions of this APA and make or propose allocations or adjustments under I.R.C. section 482 consistent with this APA;
- ii. cancel or revoke this APA under section 11.06 of Revenue Procedure 2006–9; or
- iii. revise this APA, if the Parties agree.

e. Taxpayer must timely file an Annual Report (an original and four copies) for each APA Year in accordance with Appendix C and section 11.01 of Revenue Procedure 2006–9. Taxpayer must file the Annual Report for all APA Years through the APA Year ending [insert year] by [insert date]. Taxpayer must file the Annual Report for each subsequent APA Year by [insert month and day] immediately following the close of that APA Year. (If any date falls on a weekend or holiday, the Annual Report shall be due on the next date that is not a weekend or holiday.) The IRS may request additional information reasonably necessary to clarify or complete the Annual Report. Taxpayer will provide such requested information within 30 days. Additional time may be allowed for good cause.

f. The IRS will determine whether Taxpayer has complied with this APA based on Taxpayer’s U.S. Returns, Financial Statements, and other APA Records, for the APA Term and any other year necessary to verify compliance. For Taxpayer to comply with this APA, an independent certified public accountant must *{use the following or an alternative}* render an opinion that Taxpayer’s Financial Statements present fairly, in all material respects, Taxpayer’s financial position under U.S. GAAP.

g. In accordance with section 11.04 of Revenue Procedure 2006–9, Taxpayer will (1) maintain its APA Records, and (2) make them available to the IRS in connection with an examination under section 11.03. Compliance with this subparagraph constitutes compliance with the record-maintenance provisions of I.R.C. sections 6038A and 6038C for the Covered Transactions for any taxable year during the APA Term.

h. The True Taxable Income within the meaning of Treasury Regulations sections 1.482–1(a)(1) and (i)(9) of a member of an affiliated group filing a U.S. consolidated return will be determined under the I.R.C. section 1502 Treasury Regulations.

i. *{Optional for US Parent Signatories}* To the extent that Taxpayer’s compliance with this APA depends on certain acts of Foreign Group members, Taxpayer will ensure that each Foreign Group member will perform such acts.

6. *Critical Assumptions.* This APA’s critical assumptions, within the meaning of Revenue Procedure 2006–9, section 4.05, appear in Appendix B. If any critical assumption has not been met, then Revenue Procedure 2006–9, section 11.06, governs.

7. *Disclosure.* This APA, and any background information related to this APA or the APA Request, are: (1) considered “return information” under I.R.C. section 6103(b)(2)(C); and (2) not subject to public inspection as a “written determination” under I.R.C. section 6110(b)(1). Section 521(b) of Pub. L. 106–170 provides that the Secretary of the Treasury must prepare a report for public disclosure that includes certain specifically designated information concerning all APAs, including this APA, in a form that does not reveal taxpayers’ identities, trade secrets, and proprietary or confidential business or financial information.

8. *Disputes.* If a dispute arises concerning the interpretation of this APA, the Parties will seek a resolution by the IRS Associate Chief Counsel (International) to the extent reasonably practicable, before seeking alternative remedies.

9. *Materiality.* In this APA the terms “material” and “materially” will be interpreted consistently with the definition of “material facts” in Revenue Procedure 2006–9, section 11.06(4).

10. *Section Captions.* This APA’s section captions, which appear in *italics*, are for convenience and reference only. The captions do not affect in any way the interpretation or application of this APA.

11. *Terms and Definitions.* Unless otherwise specified, terms in the plural include the singular and vice versa. Appendix D contains definitions for capitalized terms not elsewhere defined in this APA.

12. *Entire Agreement and Severability.* This APA is the complete statement of the Parties’ agreement. The Parties will sever, delete, or reform any invalid or unenforceable provision in this APA to approximate the Parties’ intent as nearly as possible.

13. *Successor in Interest.* This APA binds, and inures to the benefit of, any successor in interest to Taxpayer.

14. *Notice.* Any notices required by this APA or Revenue Procedure 2006–9 must be in writing. Taxpayer will send notices to the IRS at the address and in the manner set forth in Revenue Procedure 2006–9, section 4.11. The IRS will send notices to:

Taxpayer Corporation
Attn: Jane Doe, Sr. Vice President (Taxes)
1000 Any Road
Any City, USA 10000
(phone: _____)

15. *Effective Date and Counterparts.* This APA is effective starting on the date, or later date of the dates, upon which all Parties execute this APA. The Parties may execute this APA in counterparts, with each counterpart constituting an original.

WITNESS,

The Parties have executed this APA on the dates below.

[Taxpayer Name in all caps]

By: _____
Jane Doe
Sr. Vice President (Taxes)

Date: _____, 20 _____

IRS

By: _____
John E. Hinding
Director, Advance Pricing Agreement Program

Date: _____, 20 _____

APPENDIX A

COVERED TRANSACTIONS AND TRANSFER PRICING METHOD (TPM)

1. Covered Transactions.

[Define the Covered Transactions.]

2. TPM.

{Note: If appropriate, adapt language from the following examples.}

[The Tested Party is _____.]

• CUP Method

The TPM is the comparable uncontrolled price (CUP) method. The Arm's Length Range of the price charged for _____ is between _____ and _____ per unit.

• CUT Method

The TPM is the CUT Method. The Arm's Length Range of the royalty charged for the license of _____ is between _____% and _____% of [Taxpayer's, Foreign Participants', or other specified party's] Net Sales Revenue. [Insert definition of net sales revenue or other royalty base.]

• Resale Price Method (RPM)

The TPM is the resale price method (RPM). The Tested Party's Gross Margin for any APA Year is defined as follows: the Tested Party's gross profit divided by its sales revenue (as those terms are defined in Treasury Regulations section 1.482–5(d)(1) and (2)) for that APA Year. The Arm's Length Range is between _____% and _____%, and the Median of the Arm's Length Range is _____%.

• **Cost Plus Method**

The TPM is the cost plus method. The Tested Party's Cost Plus Markup is defined as follows for any APA Year: the Tested Party's ratio of gross profit to production costs (as those terms are defined in Treasury Regulations section 1.482-3(d)(1) and (2)) for that APA Year. The Arm's Length Range is between ____% and ____%, and the Median of the Arm's Length Range is ____%.

• **CPM with Berry Ratio PLI**

The TPM is the comparable profits method (CPM). The profit level indicator is a Berry Ratio. The Tested Party's Berry Ratio is defined as follows for any APA Year: the Tested Party's gross profit divided by its operating expenses (as those terms are defined in Treasury Regulations section 1.482-5(d)(2) and (3)) for that APA Year. The Arm's Length Range is between _____ and _____, and the Median of the Arm's Length Range is _____.

• **CPM using an Operating Margin PLI**

The TPM is the comparable profits method (CPM). The profit level indicator is an operating margin. The Tested Party's Operating Margin is defined as follows for any APA Year: the Tested Party's operating profit divided by its sales revenue (as those terms are defined in Treasury Regulations section 1.482-5(d)(1) and (4)) for that APA Year. The Arm's Length Range is between ____% and ____%, and the Median of the Arm's Length Range is ____%.

• **CPM using a Three-year Rolling Average Operating Margin PLI**

The TPM is the comparable profits method (CPM). The profit level indicator is an operating margin. The Tested Party's Three-Year Rolling Average operating margin is defined as follows for any APA Year: the sum of the Tested Party's operating profit (within the meaning of Treasury Regulations section 1.482-5(d)(4) for that APA Year and the two preceding years, divided by the sum of its sales revenue (within the meaning of Treasury Regulations section 1.482-5(d)(1)) for that APA Year and the two preceding years. The Arm's Length Range is between ____% and ____%, and the Median of the Arm's Length Range is ____%.

• **Residual Profit Split Method**

The TPM is the residual profit split method. *[Insert description of routine profit level determinations and residual profit-split mechanism].*

[Insert additional provisions as needed.]

3. Application of TPM.

For any APA Year, if the results of Taxpayer's actual transactions produce a [price per unit, royalty rate for the Covered Transactions] [or] [Gross Margin, Cost Plus Markup, Berry Ratio, Operating Margin, Three-Year Rolling Average Operating Margin for the Tested Party] within the Arm's Length Range, then the amounts reported on Taxpayer's U.S. Return must clearly reflect such results.

For any APA year, if the results of Taxpayer's actual transactions produce a [price per unit, royalty rate] [or] [Gross Margin, Cost Plus Markup, Berry Ratio, Operating Margin, Three-Year Rolling Average Operating Margin for the Tested Party] outside the Arm's Length Range, then amounts reported on Taxpayer's U.S. Return must clearly reflect an adjustment that brings the [price per unit, royalty rate] [or] [Tested Party's Gross Margin, Cost Plus Markup, Berry Ratio, Operating Margin, Three-Year Rolling Average Operating Margin] to the Median.

For purposes of this Appendix A, the "results of Taxpayer's actual transactions" means the results reflected in Taxpayer's and Tested Party's books and records as computed under U.S. GAAP *[insert another relevant accounting standard if applicable]*, with the following adjustments:

- (a) [The fair value of stock-based compensation as disclosed in the Tested Party's audited financial statements shall be treated as an operating expense]; and
- (b) To the extent that the results in any prior APA Year are relevant (for example, to compute a multi-year average), such results shall be adjusted to reflect the amount of any adjustment made for that prior APA Year under this Appendix A.

4. APA Revenue Procedure Treatment

If Taxpayer makes a primary adjustment under the terms of this Appendix A, Taxpayer may elect APA Revenue Procedure Treatment in accordance with section 11.02(3) of Revenue Procedure 2006-9.

[Insert additional provisions as needed.]

APPENDIX B
CRITICAL ASSUMPTIONS

This APA's critical assumptions are:

1. The business activities, functions performed, risks assumed, assets employed, and financial and tax accounting methods and classifications [and methods of estimation] of Taxpayer in relation to the Covered Transactions will remain materially the same as described or used in Taxpayer's APA Request. A mere change in business results will not be a material change.

[Insert additional provisions as needed.]

APPENDIX C
APA RECORDS AND ANNUAL REPORT

APA RECORDS

The APA Records will consist of:

1. All documents listed below for inclusion in the Annual Report, as well as all documents, notes, work papers, records, or other writings that support the information provided in such documents.

ANNUAL REPORT

The Annual Report will include two copies of a properly completed APA Annual Report Summary in the form of Exhibit E to this APA, one copy of the form bound with, and one copy bound separately from, the rest of the Annual Report. In addition, the Annual Report will include a table of contents and the information and exhibits identified below, organized as follows.

1. Statements that fully identify, describe, analyze, and explain:

a. All material differences between any of the U.S. Entities' business operations (including functions, risks assumed, markets, contractual terms, economic conditions, property, services, and assets employed) during the APA Year and the description of the business operations contained in the APA Request. If there have been no material differences, the Annual Report will include a statement to that effect.

b. All material changes in the U.S. Entities' accounting methods and classifications, and methods of estimation, from those described or used in Taxpayer's request for this APA. If any such change was made to conform to changes in U.S. GAAP (or other relevant accounting standards), Taxpayer will specifically identify such change. If there has been no material change in accounting methods and classifications or methods of estimation, the Annual Report will include a statement to that effect.

c. Any change to the Taxpayer notice information in section 14 of this APA.

d. Any failure to meet any critical assumption. If there has been no failure, the Annual Report will include a statement to that effect.

e. Any change to any entity classification for federal income tax purposes (including any change that causes an entity to be disregarded for federal income tax purposes) of any Worldwide Group member that is a party to the Covered Transactions or is otherwise relevant to the TPM.

f. The amount, reason for, and financial analysis of any compensating adjustments under paragraph 4 of Appendix A and Revenue Procedure 2006-9, section 11.02(3), for the APA Year, including but not limited to:

i. the amounts paid or received by each affected entity;

ii. the character (such as capital, ordinary, income, expense) and country source of the funds transferred, and the specific affected line item(s) of any affected U.S. Return; and

iii. the date(s) and means by which the payments are or will be made.

g. The amounts, description, reason for, and financial analysis of any book-tax difference relevant to the TPM for the APA Year, as reflected on Schedule M-1 or Schedule M-3 of the U.S. Return for the APA Year.

2. The Financial Statements, and any necessary account detail to show compliance with the TPM, with a copy of the independent certified public accountant's opinion required by paragraph 5(f) of this APA.

3. A financial analysis that reflects Taxpayer’s TPM calculations for the APA Year. The calculations must reconcile with and reference the Financial Statements in sufficient account detail to allow the IRS to determine whether Taxpayer has complied with the TPM.
4. An organizational chart for the Worldwide Group, revised annually to reflect all ownership or structural changes of entities that are parties to the Covered Transactions or are otherwise relevant to the TPM.
5. A copy of the APA.

**APPENDIX D
DEFINITIONS**

The following definitions control for all purposes of this APA. The definitions appear alphabetically below:

Term	Definition
Annual Report	A report within the meaning of Revenue Procedure 2006–9, section 11.01.
APA	This Advance Pricing Agreement, which is an “advance pricing agreement” within the meaning of Revenue Procedure 2006–9, section 2.04.
APA Records	The records specified in Appendix C.
APA Request	Taxpayer’s request for this APA dated _____, including any amendments or supplemental or additional information thereto.
Covered Transaction(s)	This term is defined in Appendix A.
Financial Statements	Financial statements prepared in accordance with U.S. GAAP and stated in U.S. dollars.
Foreign Group	Worldwide Group members that are not U.S. persons.
Foreign Participants	[name the foreign entities involved in Covered Transactions].
I.R.C.	The Internal Revenue Code of 1986, 26 U.S.C., as amended.
Pub. L. 106–170	The Ticket to Work and Work Incentives Improvement Act of 1999.
Revenue Procedure 2006–9	Rev. Proc. 2006–9, 2006–1 C.B. 278.
Transfer Pricing Method (TPM)	A transfer pricing method within the meaning of Treasury Regulations section 1.482–1(b) and Revenue Procedure 2006–9, section 2.04.
U.S. GAAP	U.S. generally-accepted accounting principles.
U.S. Group	Worldwide Group members that are U.S. persons.
U.S. Return	For each taxable year, the “returns with respect to income taxes under subtitle A” that Taxpayer must “make” in accordance with I.R.C. section 6012. { <i>Or substitute for partnership:</i> For each taxable year, the “return” that Taxpayer must “make” in accordance with I.R.C. section 6031. }
Worldwide Group	Taxpayer and all organizations, trades, businesses, entities, or branches (whether or not incorporated, organized in the United States, or affiliated) owned or controlled directly or indirectly by the same interests.

APPENDIX E

APA ANNUAL REPORT SUMMARY FORM

The APA Annual Report Summary on the next page is a required APA Record. The APA Team Leader has supplied some of the information requested on the form. Taxpayer is to supply the remaining information requested by the form and submit the form as part of its Annual Report.

APA Annual Report SUMMARY	Department of the Treasury— Internal Revenue Service Office of Associate Chief Counsel (International) Advance Pricing Agreement Program	APA no. _____ Team Leader _____ Economist _____ Intl Examiner _____ CA Analyst _____
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APA Information	Taxpayer Name: _____ Taxpayer EIN: _____ NAICS: _____ APA Term: Taxable years ending _____ to _____ Original APA <input type="checkbox"/> Renewal APA <input type="checkbox"/> Annual Report due dates: _____, 200__ for all APA Years through APA Year ending in 200__; for each APA Year thereafter, on _____ [month and day] immediately following the close of the APA Year. Principal foreign country(ies) involved in covered transaction(s): _____ Type of APA: <input type="checkbox"/> unilateral <input type="checkbox"/> bilateral with _____ Tested party is <input type="checkbox"/> US <input type="checkbox"/> foreign <input type="checkbox"/> both Approximate dollar volume of covered transactions (on an annual basis) involving tangible goods and services: <input type="checkbox"/> N/A <input type="checkbox"/> <\$50 million <input type="checkbox"/> \$50–100 million <input type="checkbox"/> \$100–250 million <input type="checkbox"/> \$250–500 million <input type="checkbox"/> >\$500 million APA tests on (check all that apply): <input type="checkbox"/> annual basis <input type="checkbox"/> multi-year basis <input type="checkbox"/> term basis APA provides (check all that apply) a: <input type="checkbox"/> range <input type="checkbox"/> point <input type="checkbox"/> floor only <input type="checkbox"/> ceiling only <input type="checkbox"/> other _____ APA provides for adjustment (check all that apply) to: <input type="checkbox"/> nearest edge <input type="checkbox"/> median <input type="checkbox"/> other point
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<p>APA Annual Report Information (to be completed by the Taxpayer)</p>	<p>APA date executed: _____, 200__</p> <p>This APA Annual Report Summary is for APA Year(s) ending in 200__ and was filed on _____, 200__</p> <p>Check here <input type="checkbox"/> if Annual Report was filed after original due date but in accordance with extension.</p> <p>Has this APA been amended or changed? <input type="checkbox"/> yes <input type="checkbox"/> no Effective Date: _____</p> <p>Has Taxpayer complied with all APA terms and conditions? <input type="checkbox"/> yes <input type="checkbox"/> no</p> <p>Were all the critical assumptions met? <input type="checkbox"/> yes <input type="checkbox"/> no</p> <p>Has a Primary Compensating Adjustment been made in any APA Year covered by this Annual Report? <input type="checkbox"/> yes <input type="checkbox"/> no If yes, which year(s): 200__</p> <p>Have any necessary Secondary Compensating Adjustments been made? <input type="checkbox"/> yes <input type="checkbox"/> no</p> <p>Did Taxpayer elect APA Revenue Procedure treatment? <input type="checkbox"/> yes <input type="checkbox"/> no</p> <p>Any change to the entity classification of a party to the APA? <input type="checkbox"/> yes <input type="checkbox"/> no</p> <p>Taxpayer notice information contained in the APA remains unchanged? <input type="checkbox"/> yes <input type="checkbox"/> no</p> <p>Taxpayer's current US principal place of business: (City, State) _____</p>
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<p>APA Annual Report Checklist of Key Contents (to be completed by the Taxpayer)</p>	<p>Financial analysis reflecting TPM calculations <input type="checkbox"/> yes <input type="checkbox"/> no</p> <p>Financial statements showing compliance with TPM(s) <input type="checkbox"/> yes <input type="checkbox"/> no</p> <p>Schedule M-1 or M-3 book-tax differences <input type="checkbox"/> yes <input type="checkbox"/> no</p> <p>Current organizational chart of relevant portion of world-wide group <input type="checkbox"/> yes <input type="checkbox"/> no</p> <p>Attach copy of APA <input type="checkbox"/> yes <input type="checkbox"/> no</p> <p>Other APA records and documents included:</p> <p><i>[The information required in the following section should be tailored to the particular case]</i></p> <p>_____ <input type="checkbox"/> yes <input type="checkbox"/> no</p> <p>_____ <input type="checkbox"/> yes <input type="checkbox"/> no</p> <p>_____ <input type="checkbox"/> yes <input type="checkbox"/> no</p> <p>_____ <input type="checkbox"/> yes <input type="checkbox"/> no</p> <p>_____ <input type="checkbox"/> yes <input type="checkbox"/> no</p>
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<p>Contact Information</p>	<p>Authorized Representative</p>	<p>Phone Number</p>	<p>Affiliation and Address</p>

ATTACHMENT B

EXAMPLE FORMULAS FOR BALANCE SHEET ADJUSTMENTS

The formulas below provide examples of the balance sheet adjustment formulas used in the APA Program's CPM spreadsheet model.¹⁵ The formulas below are applicable to the operating margin profit level indicator. The APA Program's calculations measure balance sheet intensity by reference to the denominator of the profit level indicator (*e.g.*, for the Berry ratio, the denominator used is operating expenses). Therefore, the formulas vary for each profit level indicator.

Definitions of Variables:

AP	=	average accounts payable
AR	=	average trade accounts receivable, net of allowance for bad debt
cogs	=	cost of goods sold
INV	=	average inventory, stated on FIFO basis
opex	=	operating expenses (general, sales, administrative, and depreciation expenses)
PPE	=	property, plant, and equipment, net of accumulated depreciation
sales	=	net sales
h	=	average accounts payable or trade accounts receivable holding period, stated as a fraction of a year
i	=	interest rate
t	=	entity being tested
c	=	comparable

Equations:

Example Assuming Profit Level Indicator is Operating Margin:

Receivables Adjustment ("RA"):

$$RA = \{[(AR_t / \text{sales}_t) \times \text{sales}_c] - AR_c\} \times \{i/[1+(i \times h_c)]\}$$

Payables Adjustment ("PA"):

$$PA = \{[(AP_t / \text{sales}_t) \times \text{sales}_c] - AP_c\} \times \{i/[1+(i \times h_c)]\}$$

Inventory Adjustment ("IA"):

$$IA = \{[(INV_t / \text{sales}_t) \times \text{sales}_c] - INV_c\} \times i$$

PP&E Adjustment ("PPEA"):

$$PPEA = \{[(PPE_t / \text{sales}_t) \times \text{sales}_c] - PPE_c\} \times i$$

Then Adjust Comparables as Follows:

$$\text{adjusted sales}_c = \text{sales}_c + RA$$

$$\text{adjusted cogs}_c = \text{cogs}_c + PA - IA$$

$$\text{adjusted opex}_c = \text{opex}_c - PPEA$$

Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code

Announcement 2012-18

The Internal Revenue Service has revoked its determination that the organi-

zations listed below qualify as organizations described in sections 501(c)(3) and 170(c)(2) of the Internal Revenue Code of 1986.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an or-

ganization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, con-

¹⁵ Copies of the APA Program's CPM spreadsheet model are available from the APA Program by calling (202) 435-5220 (not a toll-free number) or by writing to the Office of Associate Chief Counsel (International), Advance Pricing Agreement Program, Attn: CC:INTL:APA, MA2-266, 1111 Constitution Ave. NW, Washington DC, 20224.

tributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin April 16, 2012, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is \$1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in

whole or in part, for the acts or omissions of the organization that were the basis for revocation.

The Center for Creative Resources, Inc.
San Francisco, CA

Chadwell Townsend Private Foundation
Bellbrook, OH

Consumer Advocacy Group, Inc.
Beverly Hills, CA

CreditGuard of America, Inc.
Boca Raton, FL

Friends of the Border Patrol
Chino, CA

Pro Israel, Inc.
Riverdale, NY

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as “rulings”) that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A

and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in laws or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in a new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance

of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.

ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign corporation.
G.C.M.—Chief Counsel’s Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.

PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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¹ A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2011–27 through 2011–52 is in Internal Revenue Bulletin 2011–52, dated December 27, 2011.

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