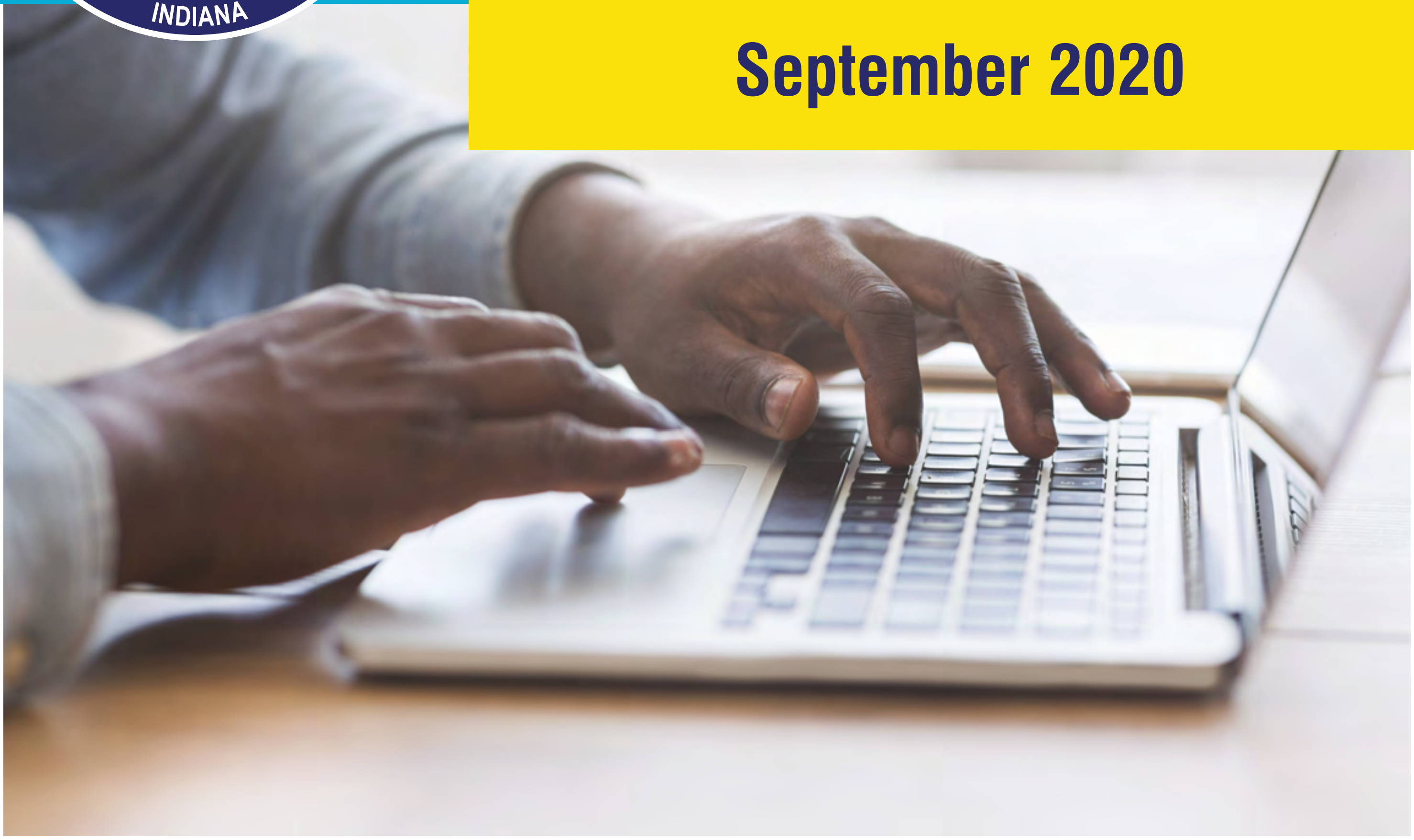
Advanced Pricing Agreement Program

September 2020



Indiana Department of Revenue

EXECUTIVE OVERVIEW

The Indiana Department of Revenue (DOR) has instituted an Advance Pricing Agreement (APA) program related to transfer pricing issues. The form of the Indiana APA is much like the IRS International APA model. It should be emphasized that all parts of the program and any agreement are open for discussion.

Often during an audit's final conference, a taxpayer's representative inquires whether a going forward position might be reached between the taxpayer and DOR. While DOR wants to offer the possibility of finalizing and executing an APA, such an outcome is much more likely if the desire to participate in the program is communicated at the beginning of the audit process. This notice will allow the appropriate people to participate from DOR's team.

It should be noted that all taxpayers are eligible to request an APA. This includes both taxpayers that are not currently under audit, as well as those who have begun the audit process. However, all open tax periods will be subject to the terms of the APA regardless whether an audit is in progress.

1. What are the advantages of an APA to Indiana taxpayers?

For Indiana taxpayers who are members of controlled groups with significant intercompany transactions, transfer pricing issues have become a significant audit focus. For taxpayers who enter an APA, there are several advantages:

A. <u>Certainty of outcome:</u> Once a taxpayer enters an APA with the Indiana DOR, both parties take a large source of uncertainty off the table for the next six years, as well as for open audit years.

B. <u>Efficient use of resources:</u> Instead of spending the majority of a Tax Department's resources on audits, the Tax Department can reallocate those resources to other, more value-added activities.

2. How long is an APA effective?

Typically, an APA is in effect for two future audit cycles, or six years, although the term of the APA is open for discussion. The APA also identifies other events that could cause early termination of the agreement (e.g. change in control). The terms of the APA will be rolled back to include all open audit years.

3. What records must a taxpayer make available to DOR to negotiate an APA?

The same tax records are required for an APA as are required for an audit of transfer pricing. These records typically include:

A. Complete federal tax returns for the last three years

B. A summary of all intercompany transactions by type, amount, and entity

C. Transfer pricing studies

D. Organizational charts

E. Financial statements on a GAAP basis for each party to a controlled transaction. If these are not available, the taxpayer and DOR will jointly determine operating income using the federal return (Form 1120) and its accompanying Schedule M-3 schedules.

F. Other records as needed

4. How does the process work?

If the taxpayer has a current Transfer Pricing Study (Study), DOR will review the Study (in combination with the other records provided) to determine if the Study's conclusions comply with IRC 482 and its associated regulations. DOR will then identify those areas in which DOR reaches a different conclusion than the Study. These differences may include, but not limited to:

A. The choice of the best method.

B. The choice of the tested party.

C. The profit level indicator chosen and the basis for the choice.

D. The search method for comparable companies.

E. The appropriateness of any adjustments.

5. Does DOR use the interquartile range as the basis of the APA?

DOR may use the interquartile range as the starting point of the APA discussions.

6. What are the typical issues that may be difficult to resolve?

A successful APA may need to resolve the following six recurring issues:

A. Timeliness of comparables information.

B. Inclusion of companies outside the taxpayer's geographic area.

C. Inclusion of loss companies.

D. Inappropriate adjustments.

E. Use of methods comparing uncontrolled transactions to the controlled transactions under review.

F. Choice of Profit Level Indicator.

All the above issues will be analyzed to determine compliance with IRC 482 and its associated regulations.

7. What happens if the taxpayer and DOR transfer pricing team cannot reach an agreement?

Despite the taxpayer and DOR's best efforts, the APA discussions may not result in an APA. It is DOR's intention for the result to be a win/win situation for both parties: the taxpayer and state of Indiana. That means both parties are better off with the agreement. This result is more likely if both parties go into the discussions willing to compromise. Where an agreement is reached, the APA will be signed by both parties and once fully executed DOR will provide the APA document to the taxpayer and, if applicable, the taxpayer's representative.

If discussions are not successful after extended efforts, the taxpayer and DOR may agree to abandon the process. If the APA process is abandoned, the audit will proceed as normal, and the taxpayer will retain all normal protest rights. Neither party will be held to positions taken or assumed during efforts to reach an agreement.

If you have an interest or questions, please contact Mandi Shawarira at mshawarira@dor.in.gov.