

LB&I International Practice Service Process Unit – Audit

Shelf		Business Outbound		
Volume	1	Income Shifting – IBC Outbound	UIL Code	9411
Part	1.7	Other Transfer Pricing Issues	Level 2 UIL	9411.07
Chapter	1.7.1	Agreed Transfer Pricing Adjustments	Level 3 UIL	N/A
Sub-Chapter	N/A	Revenue Procedure 99-32 Considerations		

Unit Name	Revenue Procedure 99-32 Outbound Guidance
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Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Table of Contents

(View this PowerPoint in “Presentation View” to click on the links below)

[Process Overview](#)

[Determination of Process Applicability](#)

[Summary of Process Steps](#)

[Process Steps](#)

[Other Considerations and Impacts to Audit](#)

[Training and Additional Resources](#)

[Glossary of Terms and Acronyms](#)

[Index of Related Issues](#)

Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Process Overview

Revenue Procedure 99-32 Outbound Guidance

Process Description

When a section 482 allocation is made, a “conforming” adjustment must be made to conform a taxpayer’s account to reflect the allocated amount. Generally, the conforming adjustment treats the allocated amount, depending on the allocation, as either a dividend or a capital contribution. In appropriate cases, the allocated amount may, instead, be repaid in accordance with the applicable revenue procedures without the otherwise required conforming adjustment (or the tax consequences of the conforming adjustment). Revenue Procedure (Rev. Proc.) 99-32 sets forth the requirements and procedures for treating and repaying the allocated amount as an interest bearing account receivable or account payable.

Treatment under Rev. Proc. 99-32 is available for eligible taxpayer-initiated, as well as Service-initiated, adjustments. This unit focuses on Service-initiated adjustments.

Note that the treatment of conforming adjustments under Rev. Proc. 99-32 is separate from, but closely related to, the treatment of conforming adjustments under Rev. Proc. 2006-54 (and its successor (see Notice 2013-78)), which sets forth the procedures for requesting assistance of the U.S. competent authority to obtain relief from double taxation. In pursuing relief from double taxation for a taxpayer that has requested assistance, the U.S. competent authority “may provide relief consistent with the principles of Rev. Proc. 99-32.” (Rev. Proc. 2006-54, Section 10 (Application of Rev. Proc. 99-32)). See Revenue Procedure 2006-54 Considerations: ISI/PBB/P_6.09_02(2014) for further information on requesting competent authority assistance.

Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

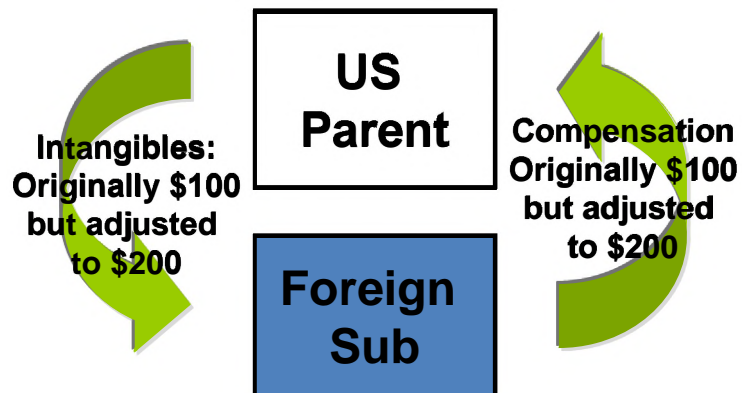
Process Overview (cont'd)

Revenue Procedure 99-32 Outbound Guidance

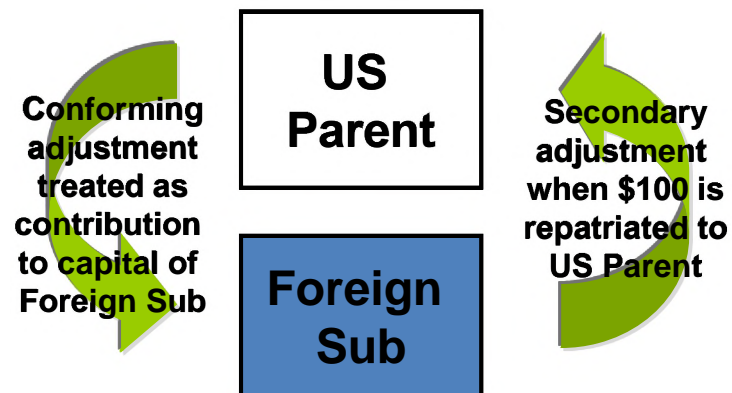
Example 1: (US Parent; without Rev. Proc. 99-32 treatment)

- In TY1, US Parent transfers intangibles to its wholly owned foreign subsidiary (Foreign Sub) for \$100X. The Service determines that the arm's-length compensation should have been \$200X.
- The Service makes the following adjustments:
 - Primary adjustment: US Parent's taxable income (and earnings and profits, or E&P) is increased by \$100X.
 - Correlative adjustment: Foreign Sub's taxable income (and E&P) is decreased by \$100X.
 - Conforming adjustment: Foreign Sub has excess cash of \$100X (the allocated amount) that is treated as US Parent's contribution to Foreign Sub's capital.
 - Secondary adjustment (or tax consequence) without Rev. Proc. 99-32 treatment: When the \$100X is repatriated, it is taxable as a dividend (to the extent of E&P).

Primary and Correlative Adjustment



Conforming and Secondary Adjustment



Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Process Overview (cont'd)

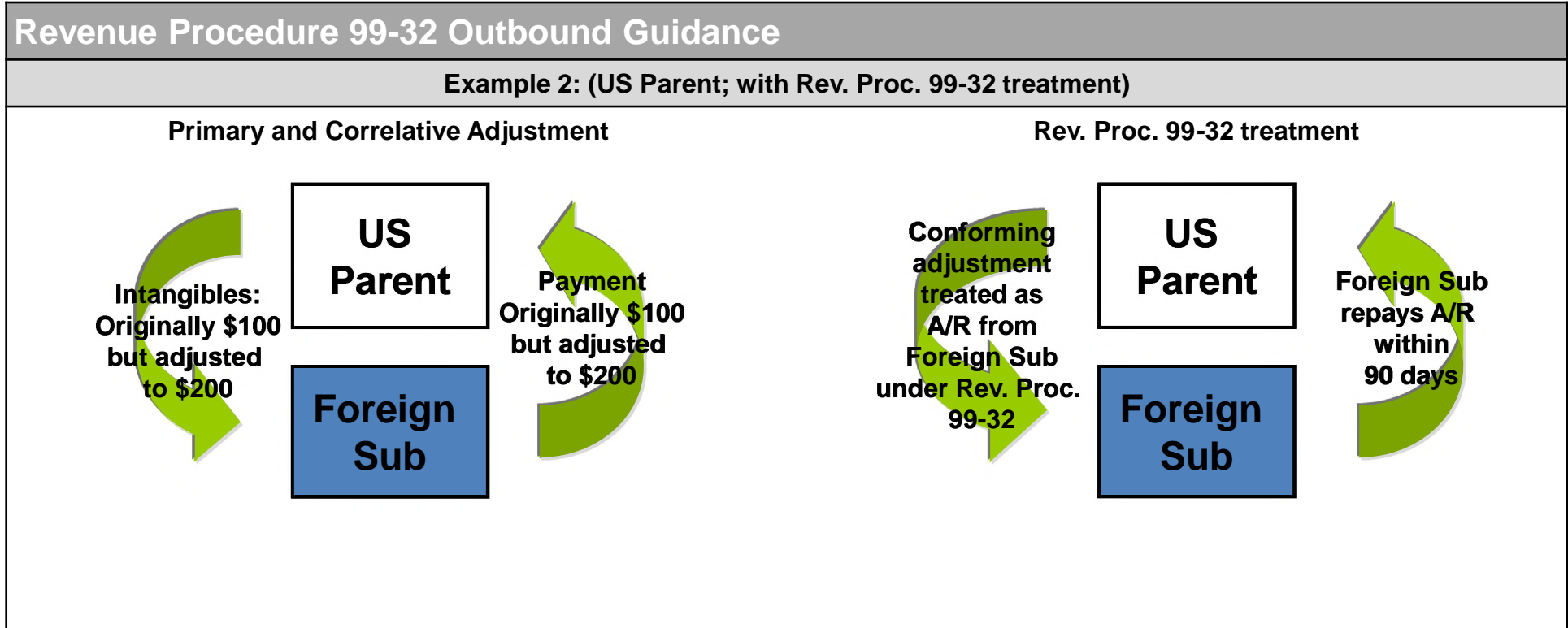
Revenue Procedure 99-32 Outbound Guidance

Example 2: (US Parent; with Rev. Proc. 99-32 treatment)

- In TY1, US Parent transfers intangibles to its wholly owned foreign subsidiary (Foreign Sub) for \$100X. The Service determines that the arm's-length compensation should have been \$200X.
- The Service makes the following adjustments:
 - Primary adjustment: US Parent's taxable income (and earnings and profits, or E&P) is increased by \$100X.
 - Correlative adjustment: Foreign Sub's taxable income (and E&P) is decreased by \$100X.
- Instead of the conforming adjustment in Example 1, under Rev. Proc. 99-32, the \$100X (allocated amount) is treated and repaid as an account receivable (A/R) to the US Parent from the Foreign Sub, which has an account payable (A/P) of \$100X:
 - An account receivable (A/R) of \$100X is deemed created as of the last day of TY1;
 - From the first day of TY2, the A/R bears arm's-length interest (or, most often, the applicable Federal rate);
 - US Parent includes in income interest that accrues on the A/R (and Foreign Sub as expense) until the A/R is paid;
 - The A/R must be paid by the 90th day of the execution of the (required) closing agreement on behalf of the Commissioner (for Service-initiated adjustments).

Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Process Overview (cont'd)



Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Determination of Process Applicability

Revenue Procedure 99-32 Outbound Guidance

Once a taxpayer requests Rev. Proc. 99-32 treatment, you must first determine if the adjustment falls within the scope of Rev. Proc. 99-32 and then determine if the applicable conditions were satisfied and the required procedures followed.

Criteria	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ The adjustment must be within the scope of Rev. Proc. 99-32. 	<ul style="list-style-type: none"> ▪ Rev. Proc. 99-32, sec. 2 ▪ Treas. Reg. 1.482-1(g)(1) 	
<ul style="list-style-type: none"> ▪ The applicable conditions must be satisfied. 	<ul style="list-style-type: none"> ▪ Rev. Proc. 99-32, sec. 3.01 and 3.03 ▪ Treas. Reg. 1.482-1(g)(2)(i) 	
<ul style="list-style-type: none"> ▪ The required procedures must be followed. 	<ul style="list-style-type: none"> ▪ Rev. Proc. 99-32, sec. 5.01 ▪ Treas. Reg. 1.482-1(g)(3)(i) 	

Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Summary of Process Steps

Revenue Procedure 99-32 Outbound Guidance	
<u>Step 1</u>	Determine if the adjustment falls within the scope of Rev. Proc. 99-32.
<u>Step 2</u>	Determine if the applicable conditions have been satisfied.
<u>Step 3</u>	Determine if the required procedures have been followed.
<u>Step 4</u>	Establish the terms of the Rev. Proc. 99-32 account and interest.
<u>Step 5</u>	Consult field counsel in drafting the closing agreement.

Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Step 1

Revenue Procedure 99-32 Outbound Guidance

Step 1: Determine if the adjustment falls within the scope of Rev. Proc. 99-32.

Rev. Proc. 99-32 treatment is available to only certain adjustments involving certain taxpayers.

Considerations	Resources	6103 Protected Resources
<p>Eligible adjustments:</p> <ul style="list-style-type: none"> Adjustments under IRC 482; and Service-initiated adjustments under IRC 61 or IRC 162 if such adjustments could have been made under IRC 482. 	<ul style="list-style-type: none"> Rev. Proc. 99-32, sec. 2 	
<p>Eligible taxpayer, a “United States taxpayer,” which under Rev. Proc. 99-32 is only:</p> <ul style="list-style-type: none"> A domestic corporation; and A foreign corporation that is, or is treated as, engaged in trade or business within the United States. 	<ul style="list-style-type: none"> Rev. Proc. 99-32, sec. 2 	
<p>Controlled transactions between a controlled foreign corporation (CFC) and a foreign related corporation are also eligible, but transactions with noncorporate persons, such as a transaction between a partnership and its controlling corporate partner, are not covered by Rev. Proc. 99-32.</p>	<ul style="list-style-type: none"> Rev. Proc. 99-32, sec. 2 and <i>Explanation of Provisions</i>, sec. E 	

Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Step 2

Revenue Procedure 99-32 Outbound Guidance

Step 2: Determine if the applicable conditions have been satisfied.

For Service-initiated adjustments, these conditions must be satisfied.

Considerations	Resources	6103 Protected Resources
No penalty under IRC 6662(e)(1)(B) or (h) on account of the primary adjustment is asserted, and if challenged, finally sustained.	<ul style="list-style-type: none"> Rev. Proc. 99-32, sec. 3.01 	
No part of any underpayment of tax in the taxable year of the primary adjustment is due to fraud.	<ul style="list-style-type: none"> Rev. Proc. 99-32, sec. 3.03 	

Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Step 3

Revenue Procedure 99-32 Outbound Guidance

Step 3: Determine if the required procedures have been followed.

For Service-initiated adjustments, these procedures must be followed by the taxpayer.

Considerations	Resources	6103 Protected Resources
<p>The taxpayer must file a written request with the Service that is both:</p> <ul style="list-style-type: none"> ▪ Filed before “closing action” is taken on the primary adjustment; “Closing action” means: <ul style="list-style-type: none"> – Execution of either a Form 870-AD or a closing agreement; – Stipulation to the IRC 482 allocation in the U.S. Tax Court; – Expiration of the statute of limitations on assessment for the taxable year of the primary adjustment; or – Final determination of tax liability of the taxable year of the primary adjustment by offer-in-compromise, closing agreement, or court action. ▪ Signed by a person authorized to sign the taxpayer’s federal income tax return. 	<ul style="list-style-type: none"> ▪ Rev. Proc. 99-32, sec. 5.01(1) and (2) 	

Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Step 3 (cont'd)

Revenue Procedure 99-32 Outbound Guidance

Step 3: Determine if the required procedures have been followed.

For Service-initiated adjustments, these procedures must be followed by the taxpayer.

Considerations	Resources	6103 Protected Resources
<p>The taxpayer's written request must contain the following:</p> <ul style="list-style-type: none"> ▪ A statement that the taxpayer desires the treatment provided in section 4 of Rev. Proc. 99-32 and the years for which such treatment is requested; ▪ A description of the transactions that give rise to the primary adjustment; and ▪ An offer to enter into a closing agreement. 	<ul style="list-style-type: none"> ▪ Rev. Proc. 99-32, sec. 5.01(2) 	
<p>The Service determines if the taxpayer qualifies for the requested treatment and informs the taxpayer of its decision.</p>	<ul style="list-style-type: none"> ▪ Rev. Proc. 99-32, secs. 5.01(3) & (4) 	

Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Step 4

Revenue Procedure 99-32 Outbound Guidance

Step 4: Establish the terms of the Rev. Proc. 99-32 account and interest.

If the Service determines that the taxpayer qualifies for the requested Rev. Proc. 99-32 treatment and the amount of the primary adjustment has been agreed upon, then the parties must execute a closing agreement containing certain required terms. Before consulting counsel in drafting the closing agreement, the agent should establish that the terms are met, as described below.

Considerations	Resources	6103 Protected Resources
The agreed amount of the primary adjustment.	<ul style="list-style-type: none"> Rev. Proc. 99-32, sec. 5.01(4)(a) 	
The amount and currency of and parties to the account to be established.	<ul style="list-style-type: none"> Rev. Proc. 99-32, secs. 5.01(4)(b) & sec. 4.01 	
Interest (and interest income/expense): <ul style="list-style-type: none"> The arm's-length rate of interest (most often, the applicable Federal rate); Amounts accrued or to be accrued. 	<ul style="list-style-type: none"> Rev. Proc. 99-32, sec. 5.01(4)(c) & sec. 4.01(2); Reg. sec. 1.482-2(a)(2)(iii) http://apps.irs.gov/app/picklist/list/federalRates.html 	
The amount of any foreign tax credit the taxpayer will claim with respect to the payment of the account established under section 4.01.	<ul style="list-style-type: none"> Rev. Proc. 99-32, sec. 5.01(4)(d) 	

Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Step 4 (cont'd)

Revenue Procedure 99-32 Outbound Guidance

Step 4: Establish the terms of the Rev. Proc. 99-32 account and interest.

If the Service determines that the taxpayer qualifies for the requested Rev. Proc. 99-32 treatment and the amount of the primary adjustment has been agreed upon, then the parties must execute a closing agreement containing certain required terms. Before consulting counsel in drafting the closing agreement, the agent should establish that the terms are met, as described below.

Considerations	Resources	6103 Protected Resources
The manner of payment of the account to be established. The manner of payment may be in the form of (a) money; (b) a written debt obligation payable at a fixed date and at arm's-length interest; or (c) offset by an existing debt. [Note: Refer to slide 15 for additional guidance on offset.]	<ul style="list-style-type: none"> Rev. Proc. 99-32, secs. 5.01(4)(e) & 4.01(4) 	
The amount and date of any prepayment.	<ul style="list-style-type: none"> Rev. Proc. 99-32, secs. 5.01(4)(e) & 4.02 	


Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Step 5

Revenue Procedure 99-32 Outbound Guidance

Step 5: Consult field counsel in drafting the closing agreement.

For a Service-initiated adjustment, a closing agreement is required.

Considerations	Resources	6103 Protected Resources
 CONSULTATION: After establishing the required terms in Step 4, contact field counsel for assistance with drafting the closing agreement.	<ul style="list-style-type: none"> IRM Exhibit 8.13.1-22 (11-09-2007) has draft closing agreements 	

Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Establishment and Satisfaction of Accounts Payable / Receivable

Revenue Procedure 99-32 Outbound Guidance		
After Rev. Proc. 99-32 treatment	References / Resources	6103 Protected Resources
<ul style="list-style-type: none"> When Rev. Proc. 99-32 treatment is effective, the taxpayer must establish an interest-bearing account that Rev. Proc. 99-32 refers to as an account receivable if payment is received from, or account payable if payment is to be made to, the related party (the account). A separate account is established for each year in which there is a primary adjustment with the amount of the account initially being equal to the amount of the primary adjustment for each year in which an allocation is made. Each account is deemed created as of the last day of the taxpayer's taxable year for which the primary adjustment is made. The account must bear interest at an arm's length rate from the day after the date the account is deemed to have been created to the date of payment. Further, the account must be satisfied within 90 days after execution of the closing agreement. Satisfaction of the account may be made by cash, written debt obligation, or an offsetting accounting entry against a pre-existing debt owed by the obligee of the account to the obligor. 	<ul style="list-style-type: none"> Rev. Proc. 99-32, secs. 4.01 & 5.01(4)(e) 	
<ul style="list-style-type: none"> <u>Satisfaction by Offset.</u> The taxpayer may treat all or part of the interest and principal of an account as prepaid before the beginning of the 90-day period to the extent of an accounting entry offsetting the account against a pre-existing debt between the parties. An account can be offset by a distribution or capital contribution <u>made in the taxable year that the closing agreement is executed.</u> 	<ul style="list-style-type: none"> Rev. Proc. 99-32, sec. 4.02 	

Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Other Considerations / Impact to Audit

Revenue Procedure 99-32 Outbound Guidance		
Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ For a taxpayer who elected to claim an IRC 965 deduction (in its most recent taxable year beginning before October 22, 2004 or its first taxable year that began on or after October 22, 2004), there may be IRC 965 considerations. 	<ul style="list-style-type: none"> ▪ IRC 965 Dividend Repatriation Audit Guidelines (LMSB-0808-043, August 27, 2008) http://www.irs.gov/Businesses/IRC-965-Dividend-Repatriation-Audit-Guidelines ▪ AM 2008-010 http://www.irs.gov/pub/irs-utl/am2008010.pdf ▪ <i>BMC Software Inc. v. Commissioner</i>, 141 T.C. No. 5 (2013) (holding that the taxpayer’s accounts receivable created under Rev. Proc. 99-32 constituted indebtedness for purposes of section 965(b)(3)) and that the IRS was not precluded from retroactively reducing the taxpayer’s dividends received deduction because of the increase in related-party indebtedness between the taxpayer and its CFC. Note that the <i>BMC</i> case was appealed by the taxpayer to the United States Court of Appeals for the Fifth Circuit on September 26, 2013. 	

Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Other Considerations / Impact to Audit (cont'd)

Revenue Procedure 99-32 Outbound Guidance		
Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ The next audit cycle would verify that the payment was made in the 90-day payment period. 		
<ul style="list-style-type: none"> ▪ <u>Mutual Agreement Procedure Context</u>. If a taxpayer intends to seek Rev. Proc. 99-32 treatment in connection with competent authority assistance relating to IRC 482 allocation, it must request Rev. Proc. 99-32 treatment in conjunction with its request for competent authority assistance. ▪ Rev. Proc. 99-32 treatment is the result of IRS published guidance. Foreign countries generally do not make a similar procedure available to taxpayers. However, pursuant to the MAP provisions of most treaties the U.S. has with other countries, the mutual agreements reached by the U.S. and foreign competent authorities often reflect the principles of Rev. Proc. 99-32 treatment. 	<ul style="list-style-type: none"> ▪ Rev. Proc. 2006-54, sec. 10. In November 2013, Notice 2013-78 proposed a revenue procedure to update and supersede Rev. Proc. 2006-54. See section 11 of Notice 2013-78. 	

Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Training and Additional Resources

Chapter 1.7.1 Agreed Transfer Pricing Adjustments

Type of Resource	Description(s) and/or Instructions for Accessing	References
CENTRA sessions	<ul style="list-style-type: none"> Rev. Proc. 99-32 Overview 	<ul style="list-style-type: none"> http://lmsb.irs.gov/hq/pftg/transferpricing/downloads/Training/99-32.pdf
White Papers / Guidance	<ul style="list-style-type: none"> Revenue Procedure 99-32, 1999-2 CB 296 	<ul style="list-style-type: none"> Revenue Procedure 99-32
Reference Material - Treatises	<ul style="list-style-type: none"> 2011/2012 Edition, ¶79.12.2 Payment of Reallocated Amounts, Page 79-173 Robert T. Cole, <u>Practical Guide to U.S. Transfer Pricing</u> (3rd ed., 2006) 	<ul style="list-style-type: none"> Bittker & Lokken Fund. of Int'l Tax, Para 79.12.2 Robert T. Cole, <u>Practical Guide to U.S. Transfer Pricing</u> (3rd ed., 2006)

Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Glossary of Terms and Acronyms

Acronym	Definition
A/R	Account Receivable
A/P	Account Payable
CFC	Controlled Foreign Corporation
E&P	Earnings & Profits
Foreign Sub	Foreign Subsidiary
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
ISO	Income Shifting Outbound
Reg.	Regulation
Rev. Proc.	Revenue Procedure
Sec.	Section
TY	Taxable Year
US Parent	United States Parent

Volume	Part	Chapter	Sub-Chapter
Income Shifting – IBC Outbound	Other Transfer Pricing Issues	Agreed Transfer Pricing Adjustments	Revenue Procedure 99-32 Considerations

Index of Related Issues

Issue	Associated UIL(s)	References
Competent Authority Procedures		<ul style="list-style-type: none"> ▪ Revenue Procedure 2006-54 Considerations: ISI/PBB/P_6.09_02(2014)
MAP Procedural Issues	9450.12	IPS Unit Coming Soon
Penalties-Substantial	9560.11	IPS Unit Coming Soon
Penalties-Gross	9560.12	IPS Unit Coming Soon