



A Peek Behind the Curtain: An Overview of LB&I International Practice Units

As part of an overall strategy to rethink and reorganize interactions with taxpayers, the IRS developed “Practice Units,” which are intended to describe for agents leading practices for specific international and transfer pricing issues. This article provides an overview of the recently released material and explains how Practice Units may be informative for taxpayers preparing for examinations or structuring transactions.

“If you know the enemy and know yourself, you need not fear the result of a hundred battles.” Sun Tzu, *The Art of War*

Or, if you prefer,

“To be prepared is half the victory.” Miguel de Cervantes

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The IRS’s Large Business and International (“LB&I”) Division released 46 International Practice Units (the “Practice Units”) in December 2014.¹ These documents, which appear to be detailed, current, and well organized, represent the first round of a promised continuing effort by the IRS to improve dialogue and engagement between IRS agents and taxpayers under exam, with additional units expected to be published in the near future.

Taxpayers currently in exam or with an exam pending—particularly if a challenge to transfer pricing is expected—might find it helpful to review the pertinent Practice Units. They identify areas of strategic importance to the IRS, provide insight into how examiners will approach various transactions, and can provide an understanding of the context in which an examiner is approaching a particular issue or transaction.

¹ <http://www.irs.gov/Businesses/Corporations/International-Practice-Units>.

Background

The Practice Units are part of LB&I's International knowledge management initiative, supporting the IRS's effort to implement an effective risk-based approach to examinations. Presumably, these units formalize the technical knowledge of "International Practice Networks" that replaced the tiered issue process as a better mechanism for the IRS to consistently and efficiently consider and resolve issues.²

Douglas O'Donnell, LB&I Deputy Commissioner (International), and Samuel Maruca, former LB&I Director of Transfer Pricing, both stated the Practice Units are intended to describe for agents leading practices for specific international and transfer pricing issues.³

Resource constraints limit the agency's ability to audit every taxpayer and every issue; as a result, the IRS must identify cases that present the most risk or exposure—issues that are "corrosive" enough to merit an expenditure of those limited resources. The amount of tax at issue is not the sole consideration.⁴ As a result, a greater emphasis is placed on planning at a strategic level and preexamination, and improving actual engagement with taxpayers. "When the agent has a full strategic picture of the transaction, they ask the right questions, which is good for the agent and the taxpayer," according to former LB&I Deputy Commissioner (International) Michael Danilack.⁵ This centralized knowledge base, of which the Practice Units are a significant part, appears to be the foundation of a more collaborative risk-based approach to examinations.

These 46 Practice Units are the tip of the iceberg. The IRS has indicated another 100-plus units are in the pipeline being vetted and redacted for approval and publication.⁶

² LB&I retired the tiered-issue process in LB&I-4-0812-010 (June 2014).

³ Tax Analysts, *U.S. Tax Review*, James P. Fuller, 2015 WTD 2-5 (Jan. 05, 2015); Delores W. Gregory, *Transfer Pricing Audit 'Roadmap' Will Go Live Within Days, Maruca Says*, 2014 DTR G-4 (Feb. 12, 2014).

⁴ Delores W. Gregory, *LB&I to Retrain Domestic Auditors to Expand International Exam Capacity*, 2014 DTR G-2 (Dec. 16, 2014).

⁵ Amy S. Elliott, *Tax Analysts Exclusive: Danilack Reflects on Time at LB&I*, 2015 TNT 8-1 (Jan. 13, 2015).

⁶ 2014 DTR G-2, *supra* note 4.

Purpose

Practice Units serve multiple functions. Developed to improve the skills of IRS agents throughout LB&I, not just those working transfer pricing issues, they provide readily available training materials on international issues.⁷ The Practice Units are job aids available to agents for use when preparing for an examination, and for reference when reviewing a particular transaction during the exam. They are also a mechanism for LB&I international employees to identify substantive areas of importance that they should both understand and carefully consider during an active examination.

The Practice Units are expected to evolve over time as experience is gained and input is received from the public—LB&I has invited the public to review the Practice Units and provide feedback.⁸ Practitioner and taxpayer feedback will be taken into consideration in revising the Practice Units.

The Practice Units are not mandates, however. The IRS is trying to up its agents' game by guiding them and making them more sensitive to risk tolerances. The IRS recognizes that there are always considerations that need to be taken into account because of each taxpayer's particular facts and circumstances.⁹ Importantly, the Practice Units are not official pronouncements of law and cannot be relied upon as such, as the IRS website makes clear.

Categories

The IRS has organized the Practice Units into three broad classifications or categories: Concept Units, Process Units, and Transaction Units. This initial batch of Practice Units presents 6 Concept Units, 15 Process Units, and 25 Transaction Units. A handful of the Practice Units, however, may more accurately be described as hybrid units and easily fall within more than one of these categories, and this is particularly true of the Transaction Units. The Practice Units cover a wide range of international tax concepts and issues, and at least 20 focus on transfer pricing. The Practice Units necessarily vary in their detail and complexity, and are not intended to be one-size-fits-all solutions, but instead are tools to be used by examiners.

⁷ 29 DTR G-4, *supra* note 3.

⁸ Comments should be submitted to lbi.practice.unit.public.feedback@irs.gov.

⁹ 2015 TNT 8-1, *supra* note 5.

Concept Units

Concept Units intend to provide a high-level overview and explanation of a particular issue or area of the Code, as well as a discussion of the underlying principles and legal authorities. Topics covered in the published Concept Units include:

Topic	Document control number ¹⁰
Subpart F Overview	DPL/CU/V_2_01(2013)
Overview—Interest Expense Allocation/Appportionment in Calculation of the FTC Limitation	FTC/9413.03-02_06(2014)
IRC Section 911 Election and Revocation	JTO/CU/C_09.6.5_08(2014)
Tax Home for Purposes of IRC Section 911	JTO/CU/P_9.6_05(2013)
Branch Profits Tax Concepts	RPW/CBB/P_08.2_01(2014)
Overview of FDAP	WIT/CU/P_15.1_01(2014)

Process Units

Process Units instruct agents on how to walk through the required steps in performing a common computation or a particular task. Topics covered by the published Process Units include:

[See table on next page]

Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the applicable regulations promulgated pursuant to the Code (the "regulations").

¹⁰ Document control numbers provided for comment submission purposes.

Topic	Document control number
Computing Foreign Base Company Income	DPL/9412.05-05(2013)
Asset Valuation Using the FMV Method for Interest Expense Allocation to Calculate FTC Limitation	FTC/9413.03-02_05(2014)
Exhaustion of Remedies	FTM/9413.01-02_01(2013)
How to Allocate and Apportion Research and Expense (R&E) Expenses	FTM/9413.03_04(2014)
Interest Expense Limitation Computation Under Section 163(j)	IBF/9423.05_04(2013)
Issuing a Formal Document Request When a U.S. Taxpayer is Unresponsive to an IDR	IGA/9460.02_02(2013)
Comparability Analysis for Tangible Goods Transactions – Inbound	ISI/PUOV_6_01(2014)
Review of Transfer Pricing Documentation by Inbound Taxpayers	ISI/PUOV_6_10(2014)
Revenue Procedure 99-31 Outbound Guidance	ISO/9411.07_03(2013)
Comparability Analysis for Tangible Goods Transactions – Outbound	ISO/PUOV_1_01(2014)
Determining Tax Residency Status of Lawful Permanent Residents	JTO/9431.01_02(2013)
Substantial Presence Test	JTO/9431.01_03(2013)
Election Under IRC Section 6013(g)	JTO/9431.02_09(2014)
Election Under IRC Section 6013(h)	JTO/9431.02_10(2014)
First-Year Election Under IRC Section 7701(b)(4)	JTO/9431.02_11(2014)

Transaction Units

Transaction Units describe particular transactions, both those commonly encountered and those that the IRS has determined to be strategically important. The Transaction Units contain a substantial amount of detail generally including a description of the transaction and relevant authorities, a diagram of the structure, a discussion of the relevant facts and underlying theories, an application of the relevant authorities, and the location within a taxpayer's return or records where an agent might find information relevant to a taxpayer's transaction. In addition, a number of the Transaction Units could double as a Concept or Process Unit in light of the expansive discussion or analysis provided. The title often provides a clue. Thus, the first batch of Practice Units emphasizes transfer pricing transactions (16 of the 25 Transaction Units involve transfer pricing issues), but transfer pricing is not their sole focus, as the following list reflects.

Topic	Document control number
Interest Income Derived by CFC or QBU Engaged in Banking, Financing, or Similar Business	DPL/9412.03_02(2013)
Disposition of a Portion of an Integrated Hedge	FCU/9470.02_03(2013)
French Foreign Tax Credits	FTC/9432.01_01(2013)
Exhaustion of Remedies and Transfer Pricing	FTM/9413.01-02_01(2013)
Exhaustion of Remedies in Non-Transfer Pricing Situations	FTM/9413.01-02_03(2013)
Section 861—Home Office and Stewardship Expenses	ISI/9422.01_05(2013)
License of Foreign Owned Intangible Property to U.S. Entity	ISI/9422.04_01(2014)
Management Fees	ISI/9422.05_01(2013)

Topic	Document control number
Purchase of Tangible Goods From a Foreign Parent—CUP Method	ISI/9422.07_05(2013)
CPM Simple Distributor Inbound	ISI/9422.07_07(2013)
Foreign Shareholder Activities and Duplicative Services	not provided
Best Method Determination for an Inbound Distributor	ISI/9422.09_04(2013)
Services Cost Method (Inbound Services)	ISI/9422.09_05(2013)
Arm's Length Standard	ISI/9422.09_06(2013)
Outbound Liquidation of U.S. Corp to Foreign Parent—IRC Section 367(e)(2) Overview	ISI/9422.10_01(2013)
Pricing of Platform Contribution Transaction (PCT) In Cost Sharing Arrangements (CSA)—Initial Transaction	ISO/9411.01_01(2013)
Cost Sharing Arrangements (CSA) vs. Licensing Arrangements	ISO/9411.01_03(2013)
License of Intangible Property From U.S. Parent to a Foreign Subsidiary	ISO/9411.02_01(2013)
Distinguishing Between Sale, License, and Other Transfers of Intangibles to CFCs by U.S. Transferors	ISO/9411.02_02(2013)
Sale of Tangible Goods from a CFC to a USP—CUP Method	ISO/9411.05_01(2013)
CPM Simple Distributor Outbound	ISO/9411.05_01(2014)

Topic	Document control number
Outbound Transfers of Property to Foreign Corporation—IRC 367 Overview	ISO/9411.08_01(2013)
Dual Consolidated Losses—Overview	ISO/9411.09_01(2013)
Qualification for Treaty Benefits Under the Publicly Traded Test	TRE/9450.01_01(2014)
Creation of a Permanent Establishment (PE) Through the Activities of Seconded Employees in the United States	TRE/9450.06_02(2014)

Conclusion

For various reasons, stretched and dwindling resources included, the IRS is rethinking and reorganizing the many ways its personnel interface with taxpayers in order to operate in a more efficient and effective, and less costly, manner. This review includes the audit function and all functions supporting exam teams. The development and production of the International Practice Units are but one step in that effort. Practice Units provide insight by identifying areas of strategic importance to the IRS, providing awareness of how examiners approach various transactions, and providing an understanding of the context in which an examiner may approach a particular issue or transaction.

In addition to helping taxpayers to better prepare for examinations, the information in the units may also prove useful in other ways. The Practice Units often discuss the theories and legal authorities for examiners to rely upon when challenging a particular transaction, and they often identify documents an examiner should request and review. They also explain the relevance of what is being reviewed in order to fully understand a particular transaction and the position taken by a taxpayer. As a result, the Practice Units may guide taxpayers in structuring transactions.

Last, but certainly not least, the units identify other Practice Units examiners should review, including not yet published units and those in development. Thus, they give us a glimpse into the future regarding the possible subject matter of future publications, and give us all something to look forward to in 2015.



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