



cutting through complexity

Automotive Tax Share Forum

2012 Los Angeles Auto Show

November 28, 2012



ANY TAX ADVICE IN THIS COMMUNICATION IS NOT INTENDED OR WRITTEN BY KPMG TO BE USED, AND CANNOT BE USED, BY A CLIENT OR ANY OTHER PERSON OR ENTITY FOR THE PURPOSE OF (i) AVOIDING PENALTIES THAT MAY BE IMPOSED ON ANY TAXPAYER OR (ii) PROMOTING, MARKETING OR RECOMMENDING TO ANOTHER PARTY ANY MATTERS ADDRESSED HEREIN.

You (and your employees, representatives, or agents) may disclose to any and all persons, without limitation, the tax treatment or tax structure, or both, of any transaction described in the associated materials we provide to you, including, but not limited to, any tax opinions, memoranda, or other tax analyses contained in those materials.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

Agenda

- Introductions – Tom Garigliano, Partner, Federal Tax (Los Angeles)
- CBP's New Policy on Retroactive Transfer Price Adjustments: Potential Duty Refunds
 - Todd Smith, Principal, Trade & Customs (Los Angeles)
 - Burcin Nee, Managing Director, Economic & Valuation Services (Los Angeles)
 - Erin Collins, Managing Director, Tax Controversy Services (Los Angeles)
- Tax Operations – Jeff Bogan, Managing Director, Federal Tax (Phoenix)
- FATCA – Justin Weiss, Managing Director, Federal Tax (Orange County)
- R&D, Manufacturing Deduction and Repair Regulations – Adam Boyar, Principal, Federal Tax (Los Angeles)
- Q & A and Closing – Tom Garigliano, Partner, Federal Tax (Los Angeles)



cutting through complexity

CBP's New Policy on Retroactive Transfer Price Adjustments: Potential Duty Refunds

Todd Smith

Principal, Trade & Customs

trsmith@kpmg.com

2949-885-5617

Erin Collins

Managing Director, Tax Controversy Services

emcollins@kpmg.com

213-955-8568

Burcin Nee

Managing Director, Economic & Valuation Services

bnee@kpmg.com

213-593-6699



Speakers

Todd Smith, *Principal*
Trade & Customs Advisory, KPMG LLP



Todd has a broad knowledge base involving both import and export compliance and planning matters. He is actively involved in several projects involving related party pricing in the U.S. and non-U.S. jurisdictions. These projects include Customs Transfer Pricing (CTP) Studies for documentation and planning purposes. Todd is also actively involved in projects involving the First Sale for Export principle and multi-country compliance and cost savings projects for both U.S. and non-U.S. multinationals.

Burcin Nee, *Managing Director*
Economic and Valuation Services, KPMG LLP



Burcin is a managing director with the Economic & Valuation Services group in KPMG's Los Angeles office. She is an economist by training. Since joining KPMG in 2000, Burcin assisted her clients with transfer pricing documentation, restructuring, controversy, and advance pricing agreements (APAs). Her client base spans a wide array of industries, including financial services, automotive, telecommunications, and consumer products. Prior to joining KPMG in 2000, Burcin worked as a research assistant at the Wharton School of Business, Department of Finance.

Speakers (continued)

**Erin Collins, *Managing Director*
Tax Controversy Services, KPMG LLP**



Erin is the Tax managing director in charge of KPMG's Tax Controversy Services practice for the Western area. Since joining KPMG in 1999, she has represented clients in federal examinations and IRS appeals on domestic and international tax issues including transfer pricing disputes, foreign tax credits, research and experimentation credit claims, and net operating loss utilization calculations, restructurings, treaty interpretations, executive compensation, and application of accounting methods. She has assisted a broad range of corporate clients in the technology, banking, telecommunications, consumer products, and entertainment industries.

Agenda

- I. Introduction
- II. Customs valuation rules
- III. Transfer pricing/adjustments
- IV. CBP's approach to post-importation adjustments
 - Historic approach
 - New policy
 - Five factors
- V. CBP's arm's length rules
- VI. Considerations/observations
- VII. Q & A

I. Introduction



Introduction

- Multinational enterprises need to comply with both:
 - Transfer pricing rules
 - Customs valuation rules
- Similarities
 - Both customs and tax rules are designed to reach arm's length values
- Challenges
 - For related party transactions, taxpayers must efficiently determine inter-company prices while facing different and distinct guidelines, principles, and objectives of customs and income tax

Introduction (continued)

- Rules are set by organizations with different objectives
 - **Customs:**
 - The World Trade Organization (WTO)
 - U.S. Customs and Border Protection (CBP)
 - **Transfer Pricing:**
 - Organization for Economic Co-operation and Development (OECD)
 - U.S. Internal Revenue Service (IRS)
- How does a taxpayer bridge the differences to enable one inter-company pricing policy to work for both customs and transfer pricing?

Introduction (continued)

- One challenge is coordinating changes in tax transfer pricing with changes in customs valuations
- Historically, CBP has not allowed duty refunds on post-importation transfer pricing adjustments
- CBP's *new policy* on post-importation transfer pricing adjustments *may allow taxpayers to claim duty refunds* if they comply with certain factors
- Taxpayers may want to revise their current transfer pricing policies and processes to adhere to CBP's new policy

II. Customs valuation rules



Customs product valuation

- Goods imported in the United States must be valued under one of the following customs valuation methods (hierarchical):
 - Transaction Value of Imported Merchandise (preferred method)
 - Transaction Value of Identical or Similar Merchandise
 - Computed Value
 - Deductive Value
 - Fallback Method
- Transaction value is an acceptable basis of appraisement **only if**, inter alia, the buyer and seller are not related, or if related, an **examination of the circumstances of sale indicates that the relationship did not influence the price actually paid or payable**, or the transaction value of the merchandise closely approximates certain “test values.”
19 U.S.C. §1401a(b)(2)(B).

Customs product valuation (continued)

Transaction Value

- *Price actually paid or payable for the merchandise when sold for exportation to the United States, plus:*
 - Packing costs
 - Selling commissions
 - Assists
 - Royalties or License Fees that are paid as a “condition of sale”
 - Proceeds of subsequent resale, disposal, or use

¹ 19 C.F.R. § 152.103(b).

III. Transfer pricing and adjustments



Transfer pricing overview

What are transfer prices?

- Transfer prices are prices charged in transactions between related parties in multinational enterprises
- Transfer prices can be:
 - Prices for goods
 - Prices for services and management fees
 - Royalties for intellectual property (patents, copyrights, trademarks, other know-how)
 - Interest on related-party loans

It's really about the *allocation of global profits*

- Transfer prices may have an important impact on a group's taxable income in the different countries in which it operates

Transfer pricing overview (continued)

- Each function or entity receives a share of total global profits that reflects its contribution
- Need to identify comparable transactions or firms
- Employ “Best Method” rule in the United States:
 - “The arm’s length result of a controlled transaction must be determined under the method that, under the facts and circumstances, provides the most reliable measure of an arm’s length result”¹
- A commonly used methodology is the Comparable Profits Method (CPM)
 - The taxpayer’s profit margin on the intercompany transaction is compared to profit margins of benchmark (or comparable) companies
 - Transfer prices are set so that the taxpayer earns a profit margin within the range of profit margins earned by the comparable companies

¹ 26 C.F.R. § 1.482-1(c).

Transfer pricing overview (continued)

Transfer Pricing Adjustments

- What if the profit margins are *outside the range*?
 - Taxpayers often *adjust transfer prices* to get back into the range
 - Adjustments can occur throughout the year or, in some cases, as a single, year-end adjustment
- Adjustments within the financial year (period 13 adjustments) generally are reported in the financial accounts
- Adjustments made after the financial year generally should be reported on the tax return (Schedule M adjustments)
 - Adjustments that are deemed a *capital contribution or dividend* do not require a financial account adjustment
 - Adjustments treated under *Revenue Procedure 99-32* require an adjustment to the financial accounts and a repatriation

IV. CBP's approach to post-importation adjustments



Background

Historically, CBP's policy with respect to post-importation transfer price adjustments has been inconsistent under Transaction Value:

- **Upward Adjustments**

- Importer must tender additional duties
- Part of the “price actually paid or payable”

- **Downward Adjustments**

- Disallowed duty refunds
- Adjustment was viewed to be a “rebate” or decrease under 19 U.S.C. § 1401a(b)(4)(B):
 - “Any rebate of, or other decrease in, the price actually paid or payable that is made or otherwise effected between the buyer and the seller *after the date of importation* of the merchandise into the United States *shall be disregarded* in determining [transaction value].”

- **Prices which require adjustment must be arrived by the application of a fixed objective formula in place at the time of importation:**

- Final sales price must be determined at a later time on the basis of some future event or occurrence ***over which neither the seller nor the buyer have any control.***

CBP's new policy: Post-importation adjustments

On May 16, 2012, CBP broadened its interpretation of an objective “formula”, thereby allowing adjustments under Transaction Value (including downward adjustments)

HQ W548314 (5/16/12)

“Notwithstanding that there may be some element of control”

The “Five Factors”

1. A written Intercompany “Transfer Pricing Determination Policy” (TP policy) is in place *prior to importation* and the policy is prepared taking IRC section 482 into account;
2. The U.S. taxpayer uses its TP policy in filing its income tax return, and any adjustments resulting from the transfer pricing policy are reported or used by the taxpayer in filing its income tax return;
3. TP policy *specifies* how the transfer price and any adjustments are determined with respect to all products covered by the transfer pricing policy for the which the value is adjusted;
4. The company maintains and provides accounting details from its books and financial statements to support the claimed adjustments in the United States; *AND*
5. No other conditions exist that may affect the acceptance of the transfer price by CBP (e.g., the adjusted price must be an arm’s length from a CBP perspective).

CBP's two step post-importation analysis

1. Is there a “formula” (see Five Factors); *and*
2. Does the transactions satisfy the arm's length requirements under the U.S. customs valuation statute 19 U.S.C. § 1401a.

Note:

- The five factors are ***necessary for Transaction Value*** (not just for duty refunds);
- The five factors address the “payable” aspect of the price actually paid or payable, not the arm's length requirements;
- The importer's adjusted transfer price *must satisfy CBP's related-party arm's length rules* in order to be eligible under the new policy;
- On their own, transfer pricing studies undertaken for IRS purposes do not satisfy CBP's distinct related-party requirements or arm's length tests.
- Must perform and document a *customs related-party analysis* consistent with the U.S. customs valuation statute 19 U.S.C. § 1401a.

V. CBP's arm's length rules



CBP related party requirements

- Transaction value (transfer price) will be acceptable only if the importation meets ***either*** of two tests:

1. Circumstances of Sale Test

- Relationship *not influenced* if:
 - i. Prices settled under **normal pricing practices** of industry
 - ii. Prices consistent with sales to **unrelated buyers**
 - iii. Prices adequate to ensure **recovery of all costs plus a profit equivalent to the “firm’s” overall profit** realized over a representative period of time in sales of goods of the **same class or kind**

2. Test Values

- The value closely approximates certain test values pertaining to **identical or similar goods exported at or about the same time** as the imported merchandise under review

CBP related party requirements: Circumstances of sale test – Cost plus a profit

Option #3 under Circumstances of Sale Test: The price is adequate to ensure recovery of all costs plus a profit that is equivalent to the firm's overall profit realized over a representative period of time from sales of goods of the same class or kind.

How to Meet the Test

1. Compile evidence of product-related costs incurred by the seller and compare the transactional profit to the firm's overall profit (financial statements, bills of materials, general and administrative expense records, etc.) for similar goods
2. "Firm overall" means the parent entity's overall sales
3. Profit must relate to the profit realized over a representative time in sales of merchandise of the same class or kind

VI. Considerations and observations



Reconciling transfer pricing and customs policy

- Transfer pricing intercompany agreements and policies should be documented and specific
 - Include an objective formula for adjusting transfer prices and take into account CBP's five factors
- Take into account *both customs and tax considerations* when determining or modifying intercompany transfer pricing policies
- *Plan in advance* to satisfy the applicable CBP administrative filing requirements to timely report adjustments:
 - CBP “strongly encourages” the *Reconciliation Program*
 - May make “post-entry amendments” or “protests” to the customs entry
 - Consider CBP’s new audit rules, effective 12/27/11, which allow offsetting of duty overpayments against underpayments in a Prior Disclosure.

Reconciling transfer pricing and customs policy (continued)

- Enhance communication and standard operating procedures between the tax and customs functions within an organization.
- Maintain supporting accounting details, financial statements and tax returns
- Establish, periodically test and document how the transfer pricing policy satisfies the “customs” arm’s-length rules (integrate with “Tax” transfer pricing study).
- Obtain a binding ruling from CBP to ensure eligibility, when appropriate.

VII. Q & A





cutting through complexity

Tax Operations – Observations and Emerging Trends

Jeff Bogan

Managing Director, Federal Tax

jbogan@kpmg.com

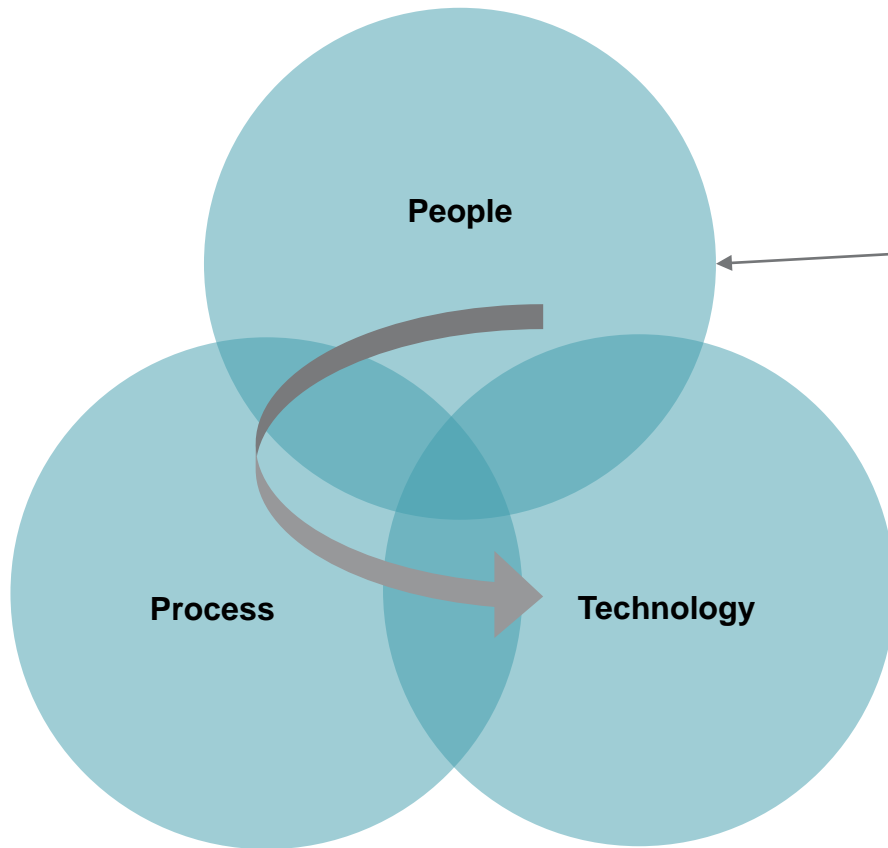
480-459-3475



Agenda

- Introduction
- Tax department observations
- Tax intelligence – Data management
- Audit readiness
- Questions
- Appendix

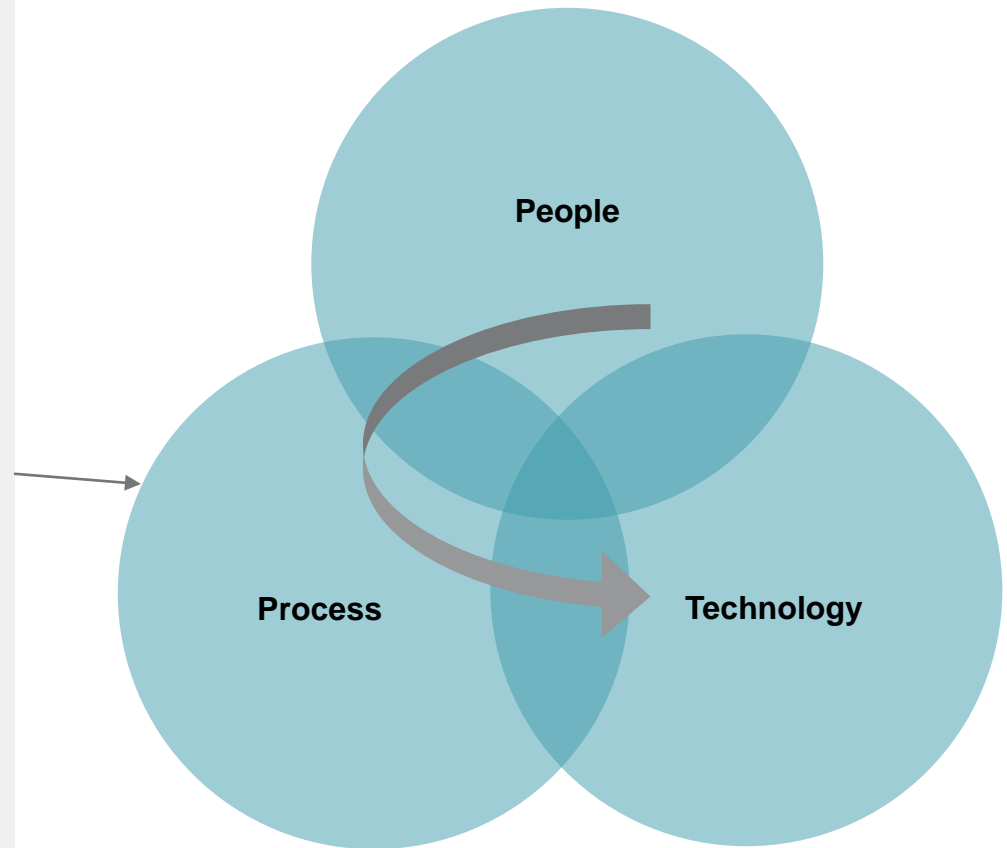
Observations and trends for tax functions – People



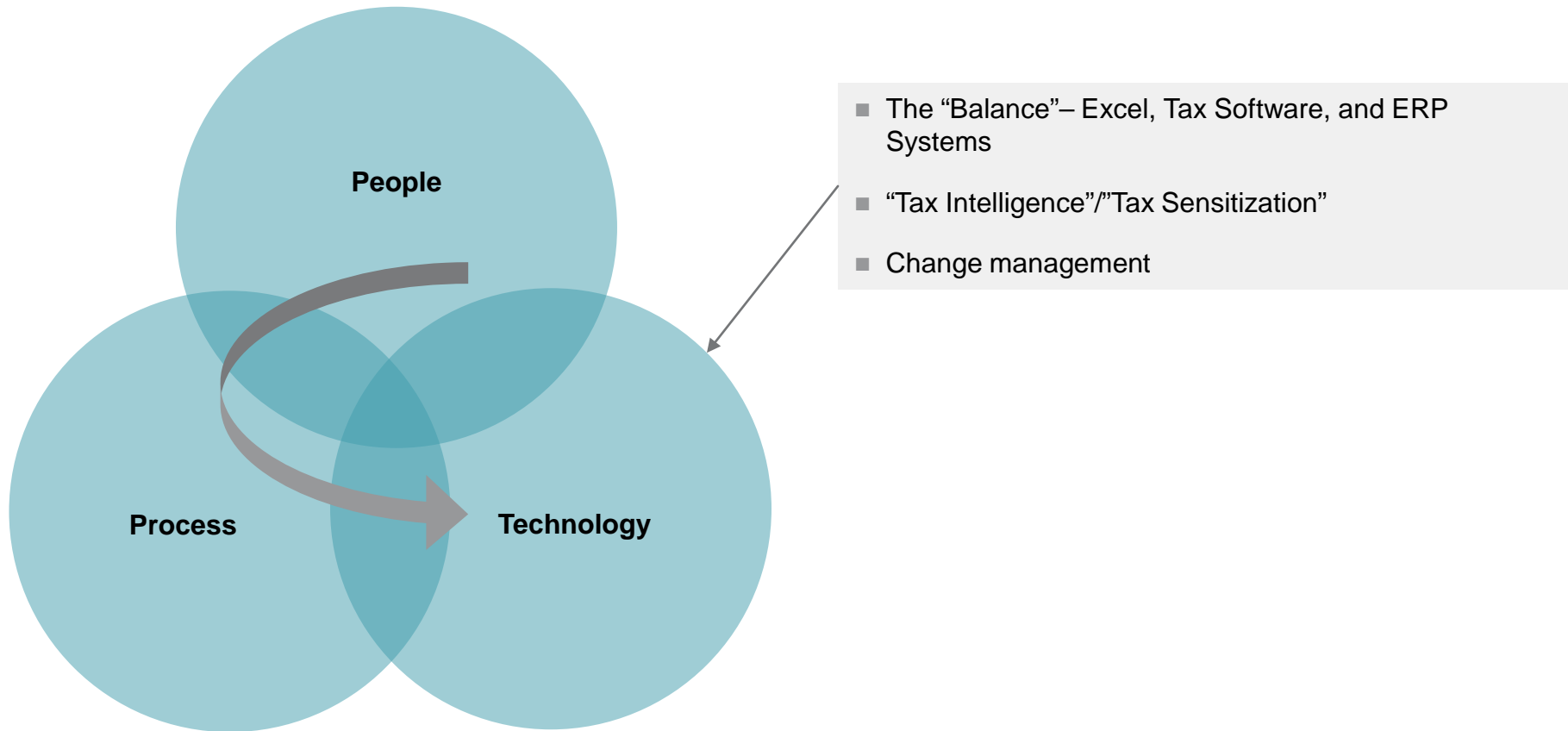
- Evolving Skill Sets for Tax Functions
 - Accounting for Income Taxes
 - Audit Management
 - Tax Technologist
- Allocation of Tax Resources
 - Lack of skilled tax professionals
 - Budget constraints
- Co-Sourcing – The Balance of External vs. Internal Resources

Observations and trends for tax functions – Process

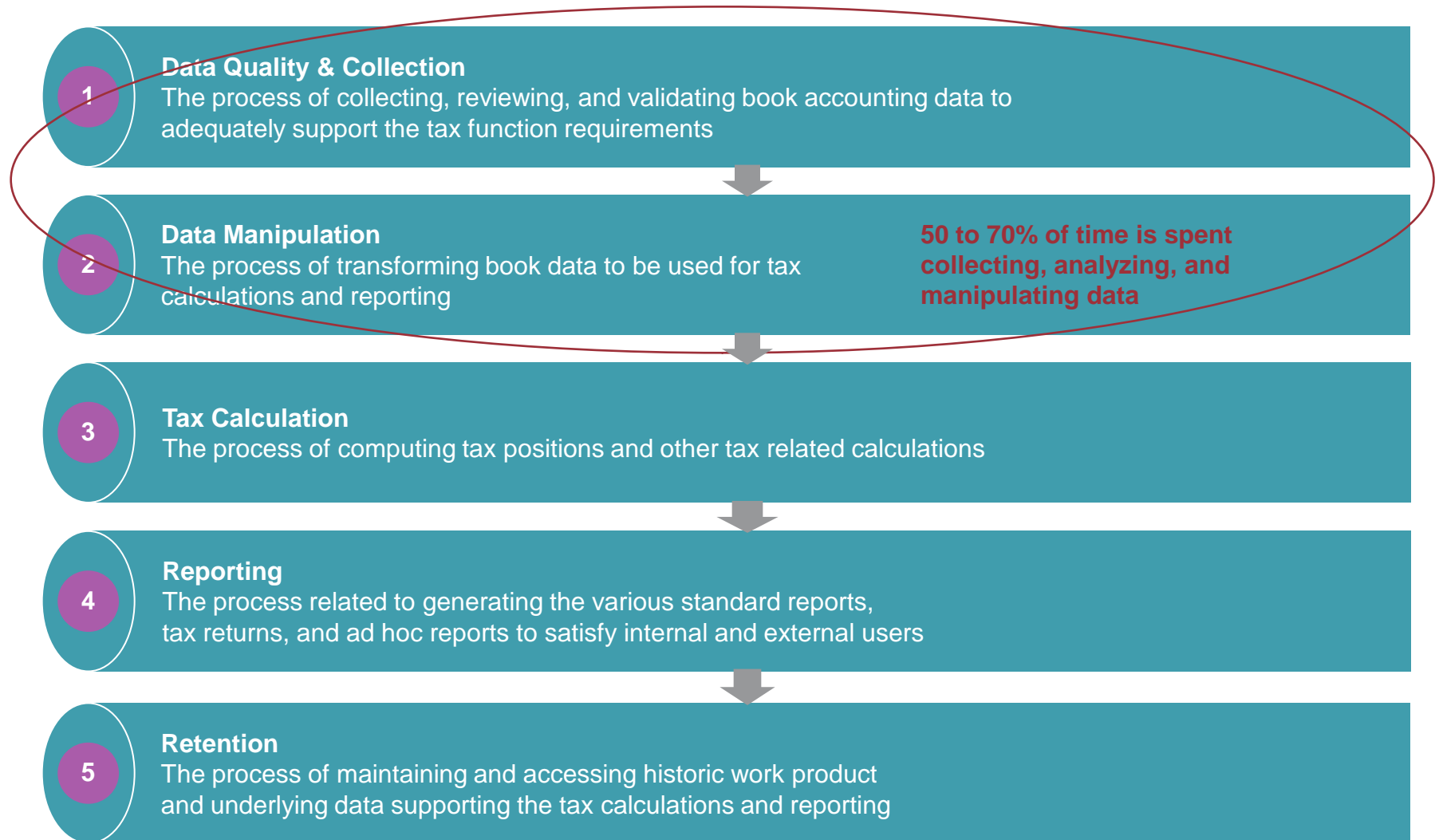
- Time Management/Deadline Expectations – “Time Compression”
- Data Management – “One source of truth”
- Quality of Documentation – “Audit Readiness”
- Balancing Risk, Efficiency, and Effectiveness
 - SD and MW
- Tax Department Silos
 - Tax Processes
 - Tax Provision
 - Tax Compliance
 - Tax Planning
 - Audit Management
 - Tax Jurisdictions
 - Federal
 - State
 - International
- Lack of integration between tax department, accounting, treasury, and legal



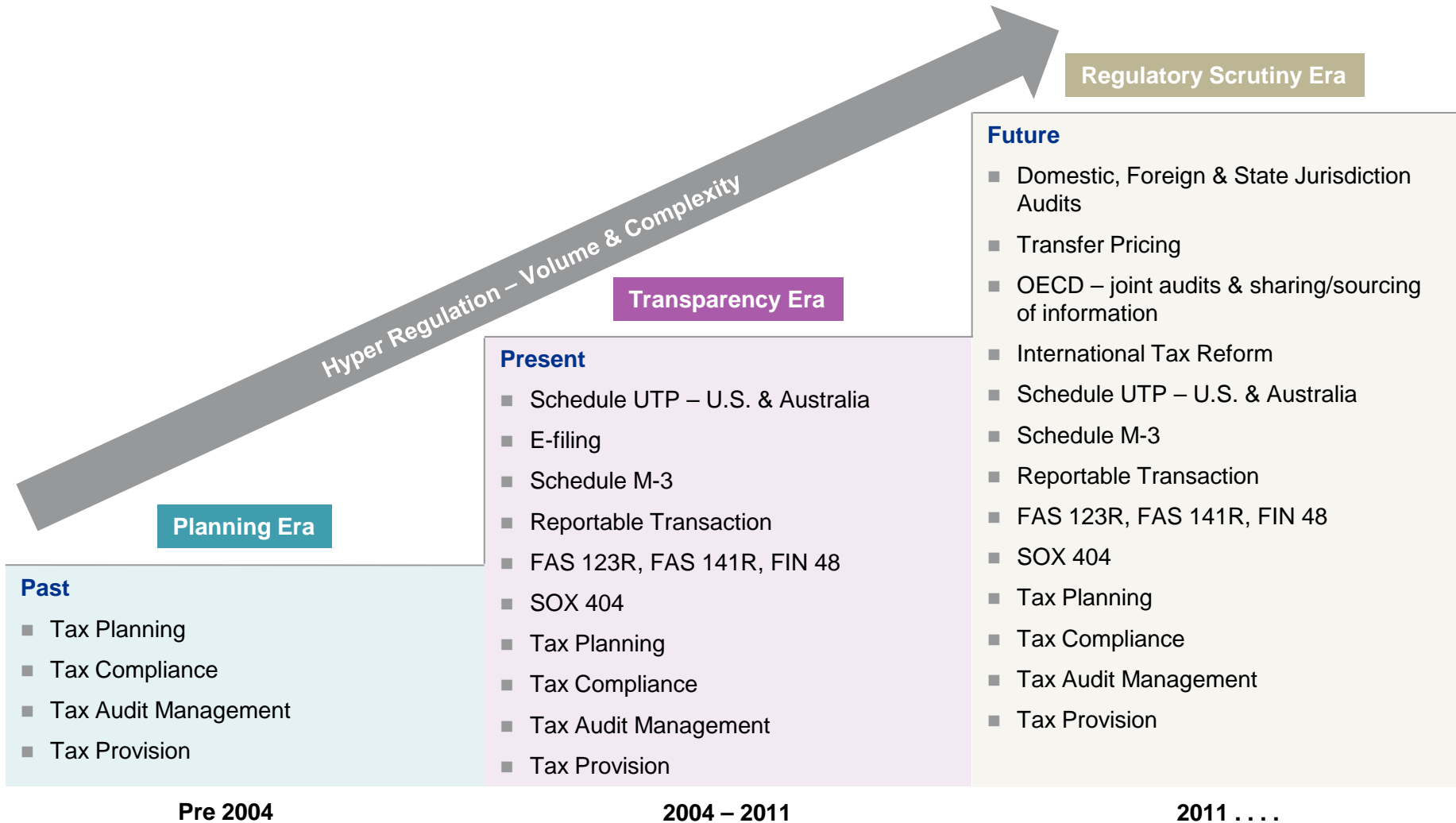
Observations and trends for tax functions – Technology



The anatomy of a tax process



Hyper regulation – “Data explosion”

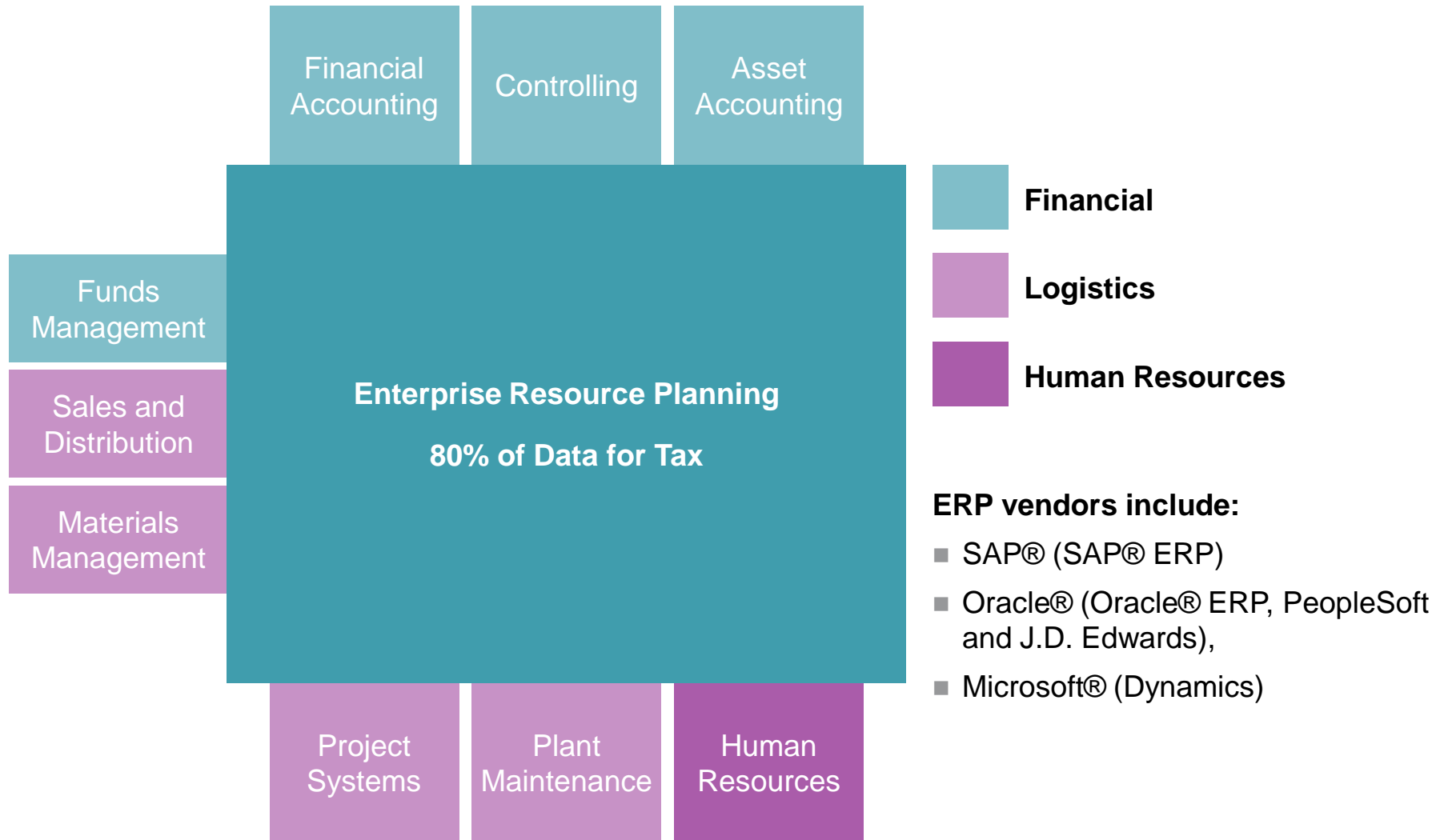


Data – A value added activity

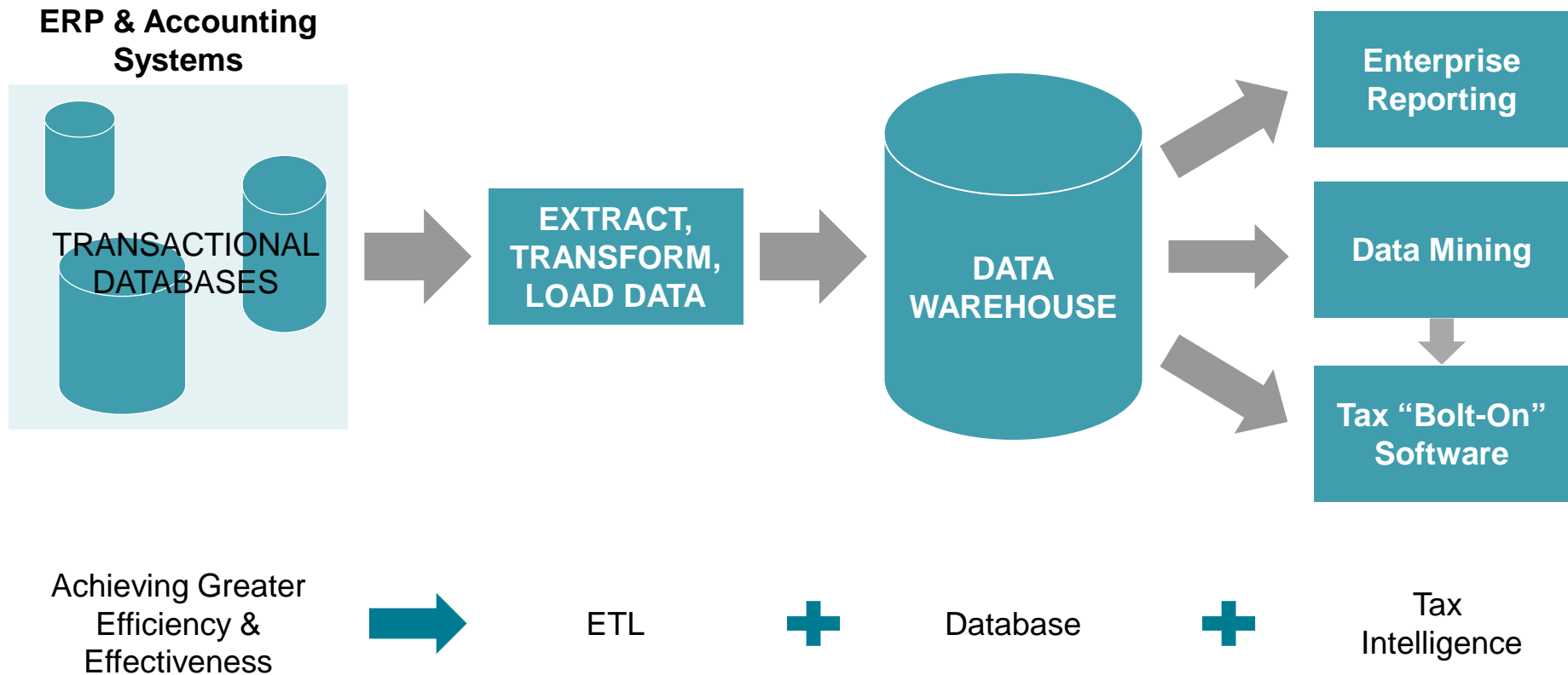
Misconception

“Managing data is not a value added activity of the tax function”

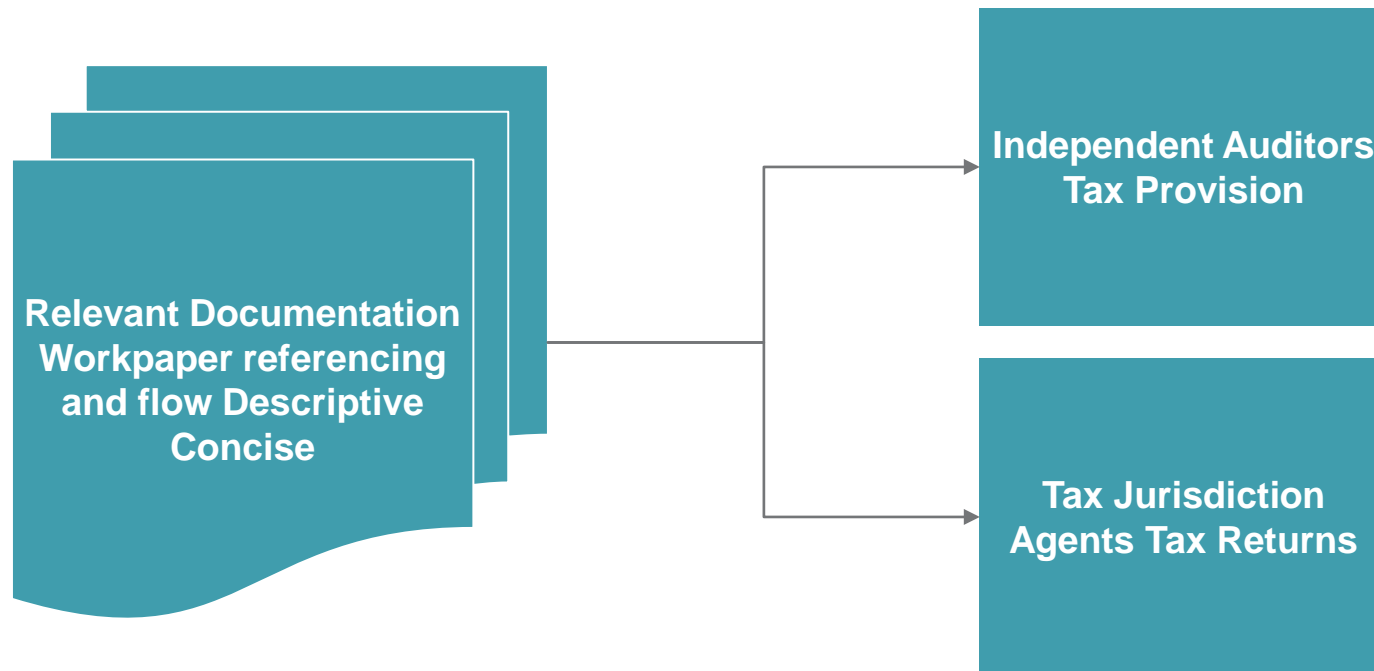
ERP architecture – Tax data



Tax intelligence/tax sensitization – The strategy



“Audit readiness”



Audit readiness – Example of “light” documentation for a temporary difference

Amortization Workpaper

Book Expense	\$ 15	
Tax Expense	\$ 10	
Temporary Difference	\$ 5	Add back

Audit readiness – Best practice for temporary differences

Amortization Workpaper

Description of Transaction:

On January 1, 2012 the Company acquired a software license from Company X for \$150 cash. Refer to workpaper 1 for detail regarding the purchase of the license.

GAAP Treatment

Under U.S. GAAP the asset is amortized pro rata over 10 years.

Federal Income Tax Treatment:

Under Section 197, the asset is amortized pro rata over 15 years. This will result in a DTA which will be fully reversed to zero at 12/31/2027.

ASC 740-10 Analysis:

The tax position meets the recognition and MLTN analysis, accordingly, no ASC 740-10 reserve had been recorded.

Valuation Allowance:

It has been determined that no valuation allowance is required. Refer to w/p 2 – Valuation Allowance memo for period ending 12/13/2012.

Year of Amortization: 1

Calculation:

Book Basis 1/1/12	Original Cost	\$ 150	
Book Amortization Expense	150/10 years	\$ 15	C
Book Basis 12/31/12	Trial Balance	\$ 135	B
Tax Basis 1/1/12	Original Cost	\$ 150	
Tax Amortization Expense	150/15 years	\$ 10	D
Tax Basis 12/31/12		\$ 140	A
Ending Gross Deferred Tax Asset (Liability)	A-B	\$ 5	Deferred Tax Rollforward
Current Year Book/Tax adjustment (M-1)	C-D	\$ 5	Unfavorable Current Provision

Appendix



Year-end tax provision – Action item timeline to streamline your provision

November

- Assess and prioritize risk – high, medium, low
- Address human resource issues
- Conduct “Kaizen” session – include accounting, finance, internal audit
- Preliminary analysis of Schedule UTP impact – Tax positions
- ASC 740 analysis
- Analysis of DTA/DTLs – documentation
- Streamline Excel templates
- Consider “data challenges”
- Revise data requests
- Determine impact of new accounting and/or tax technical developments
- Create workplan/timeline

December

- Pre-year-end meeting with external auditors
- “Areas of focus”
- Simpler permanent and temporary differences
- Update footnote disclosures
- 1st year of tax provision software – calculate tax provision using software “Parallel-run” and address discrepancies
- Update tax provision workpapers – “audit ready”
- Distribute information requests
- Conduct technical training on new accounting and tax matters

January – February

- Receive and review information requests
- Prepare income tax provision
- Contend with “non-routine” and last minute issues
- Meet with independent auditors to address “non-routine” and last-minute issues
- Prepare and finalize tax related footnote disclosures
- Perform technical review
- Address post closing entries
- Ensure frequent communications with independent audit team.
- Ensure workpapers are “audit-ready”
- Create workpaper referencing

Characteristics of efficient and effective tax functions – Best practices

- Excellent time management skills
 - Prioritize – focus on what is important and relevant
 - Effective decision making – don't agonize
- Tax technical skill set(s) – includes ability to operationalize –“Input, process, output”
- Effective change management
- Manage workload – busy season vs. non busy season
- Structured/organized
 - Status updates
 - Manage expectations – data suppliers & key stakeholders
- Assess skill sets of tax team & cultivate “knowledge transfer”
- Tax Processes
 - Data – “one source of truth”
 - Integrate – Tax provision, tax compliance planning, audit management processes
 - Streamlined
 - Standardized
 - Simple
 - Relevant documentation
- Assess & monitor risk
 - Strategic
 - Operational
 - Compliance
 - Financial (SOX)
- Efficiently use technology – balance Excel, tax software, & accounting systems
 - Needs vs. functionality

FATCA

(in plain English)

Justin Weiss

Managing Director, Federal Tax

justinweiss@kpmg.com

213-955-8735



FATCA (in plain English)

FATCA is not a tax.

It's a penalty dressed up as a tax.

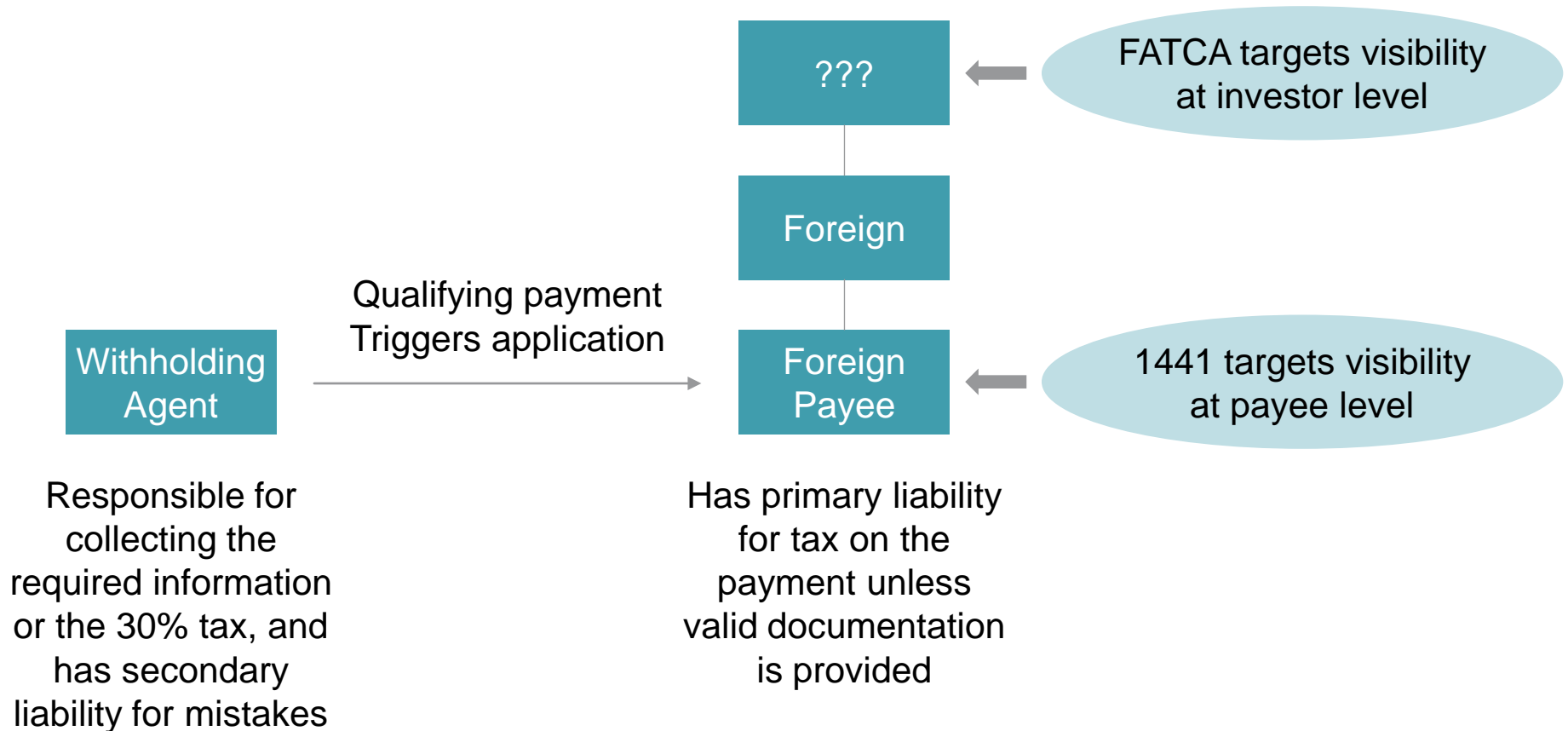
FATCA (in plain English) – Background

In the fallout of various U.S. tax evasion scandals, Congress passed the Foreign Account Tax Compliance Act (“FATCA”), IRC sections 1471 through 1474

- Aimed at identifying U.S. tax evaders, FATCA forces foreign payees to disclose their involvement with significant U.S. investors (i.e., U.S. persons who should be declaring income and assets on their U.S. tax returns)
- Foreign payees who fail to provide the required information suffer a 30% charge on their own cross-border payments
- Withholding agents are required to report U.S. tax information to the IRS or, in cases of no information, withhold the 30% tax
- Non-compliant withholding agents take secondary liability for the 30% FATCA charge

FATCA (in plain English) – Background (continued)

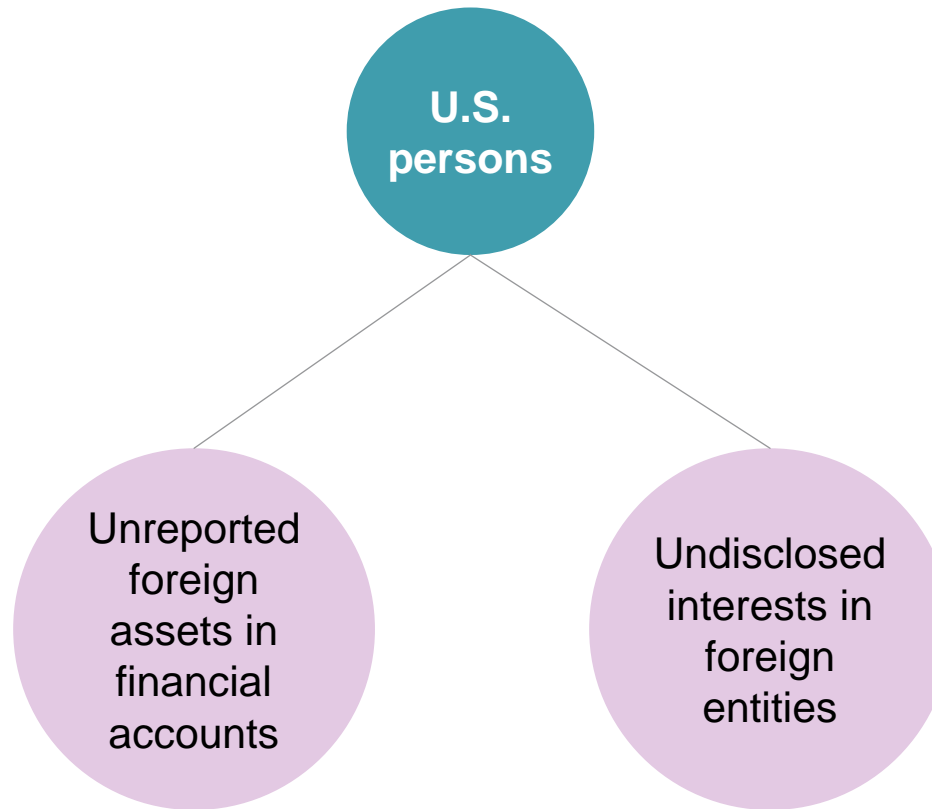
There is currently a U.S. withholding regime, and while FATCA uses similar operating mechanisms, it is incremental and targets a different problem (finding U.S. persons with foreign assets vs. finding foreign persons with U.S. assets).



FATCA (in plain English) – Basics

FATCA addresses two basic mechanisms for evading U.S. tax –

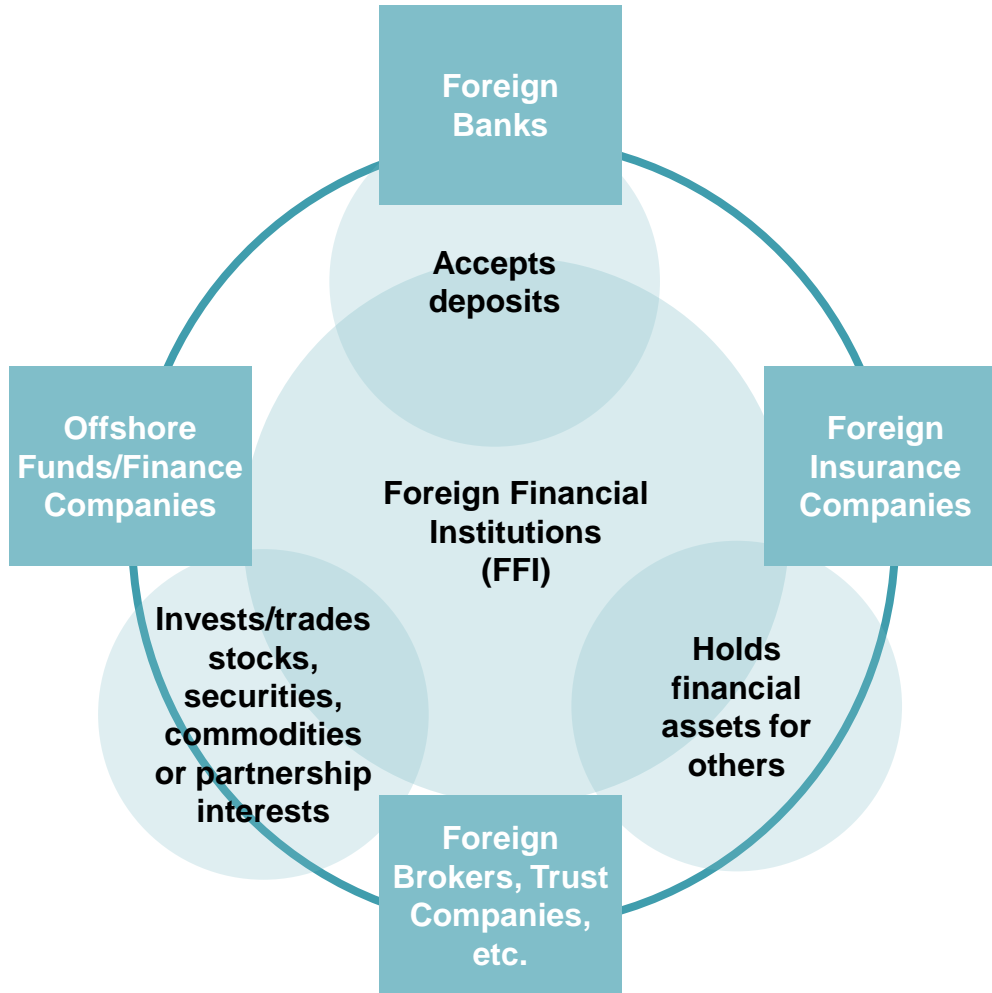
Foreign financial institutions (FFIs) are required to identify their substantial U.S. accounts, obtain U.S. accountholder tax information, and report to the IRS



Non-financial foreign entities (NFFEs) are required to report their substantial U.S. owners, or to certify that they are eligible for excepted, “low risk” status

FATCA (in plain English) – Basics (continued)

Foreign Financial Institution



Non-Financial Foreign Entity

An NFFE is any foreign entity that is not an FFI.

Once the foreign entity is classified as an FFI or NFFE, it should be further classified to its appropriate “Chapter 4 status.”

FATCA (in plain English) – Captive finance companies

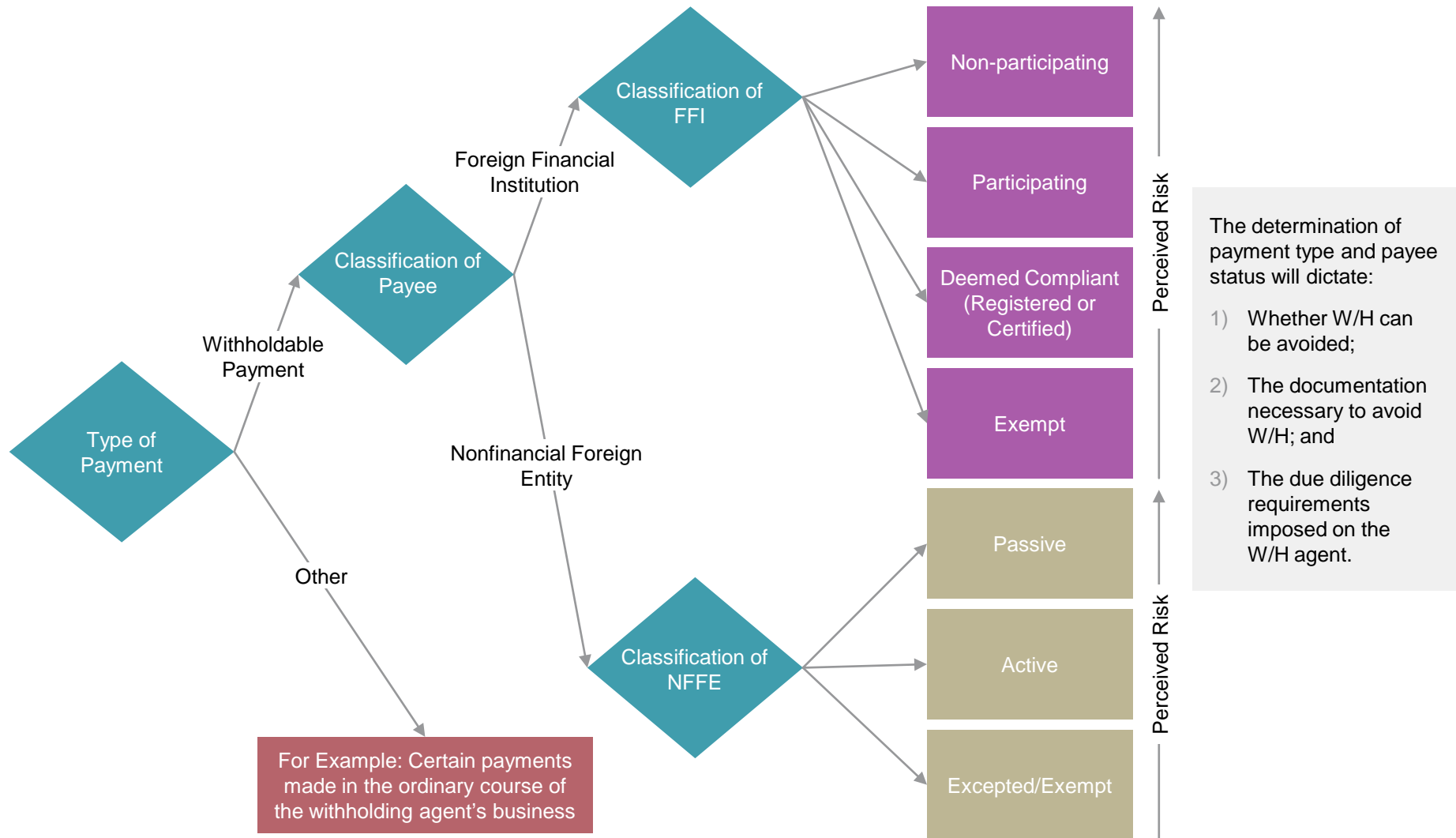
Under the Proposed Regulations, FFIs include a foreign entity that:

Is engaged (or holding itself out as being engaged) primarily in the business of investing, reinvesting, or trading in debt, such as auto loans.

- This makes foreign captive finance companies subject to the FFI requirements under FATCA.
 - The Intercompany Hedging/Financing Center exception does not apply when financing is provided to third-parties.

Under the Model I Intergovernmental Agreement, this category of FFI is replaced with an “Investment Entity” category, which would likely exclude most foreign captive finance companies. Many expect the final regulations to reflect this change as well.

FATCA (in plain English) – Example classification flow



FATCA (in plain English) – What to do about FATCA?

Understand your FATCA obligations, both as a payor/withholding agent and as a payee/recipient.

On the payment side:

- Inventory and characterize your payments
- Determine how, as a strategic/systems matter, you will handle excepted (OCB and grandfathered) payments
- Educate your vendors regarding upcoming requests for FATCA information
- Modify vendor intake questionnaires to solicit additional data
- Update your written withholding procedures to address FATCA issues
- Formulate internal validation procedures for the new W-8BEN-E
- Update third party agreements (e.g., shareholder services) to address FATCA-related risk
- Expand your data systems so that your 1042s/1042-Ss capture FATCA information
- Create reporting mechanisms for any U.S. ownership disclosures made to you

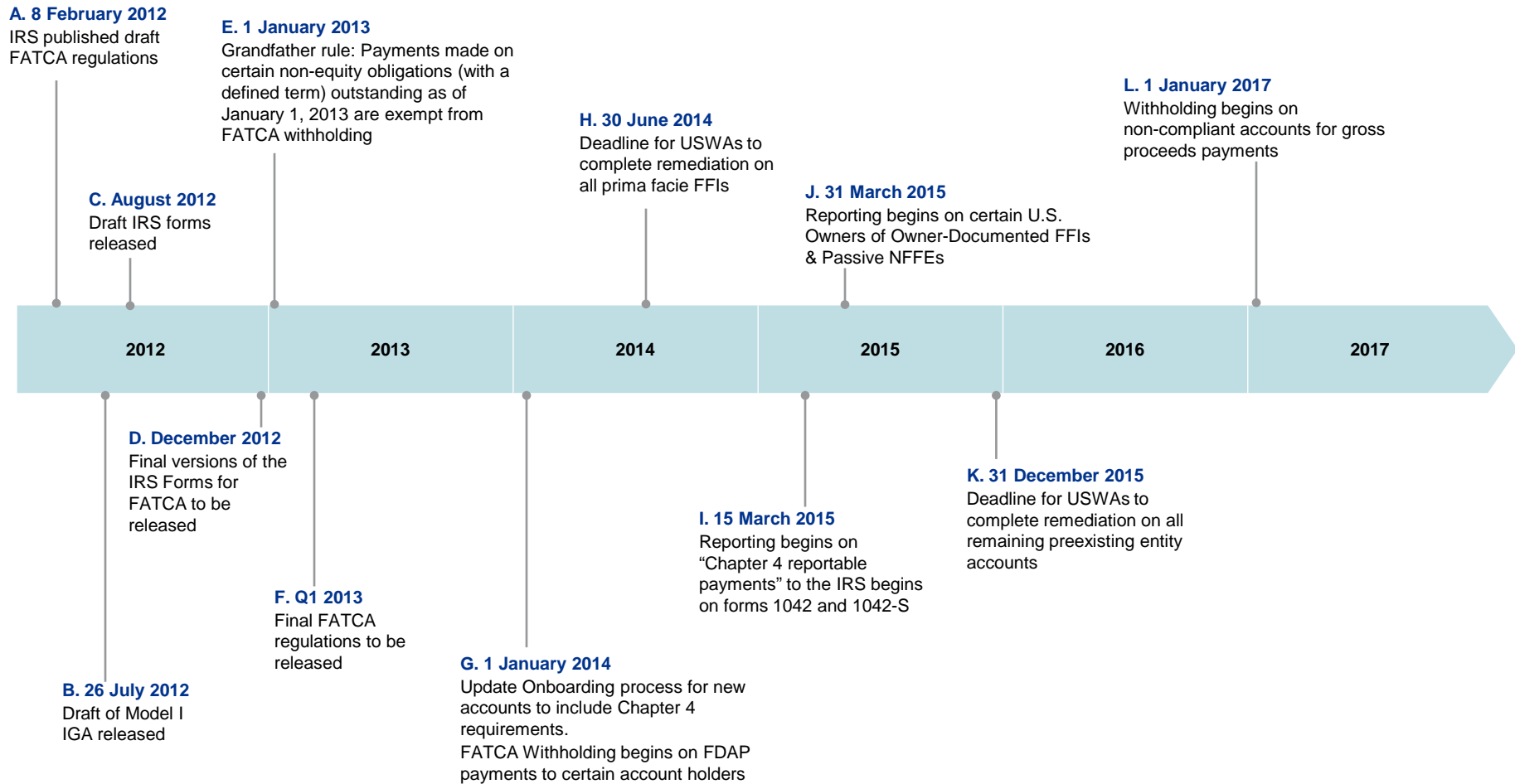
FATCA (in plain English) – What to do about FATCA? (continued)

On the recipient side: Analyze your foreign affiliates' status to determine their FATCA disclosure obligations (if any) before the effective date.

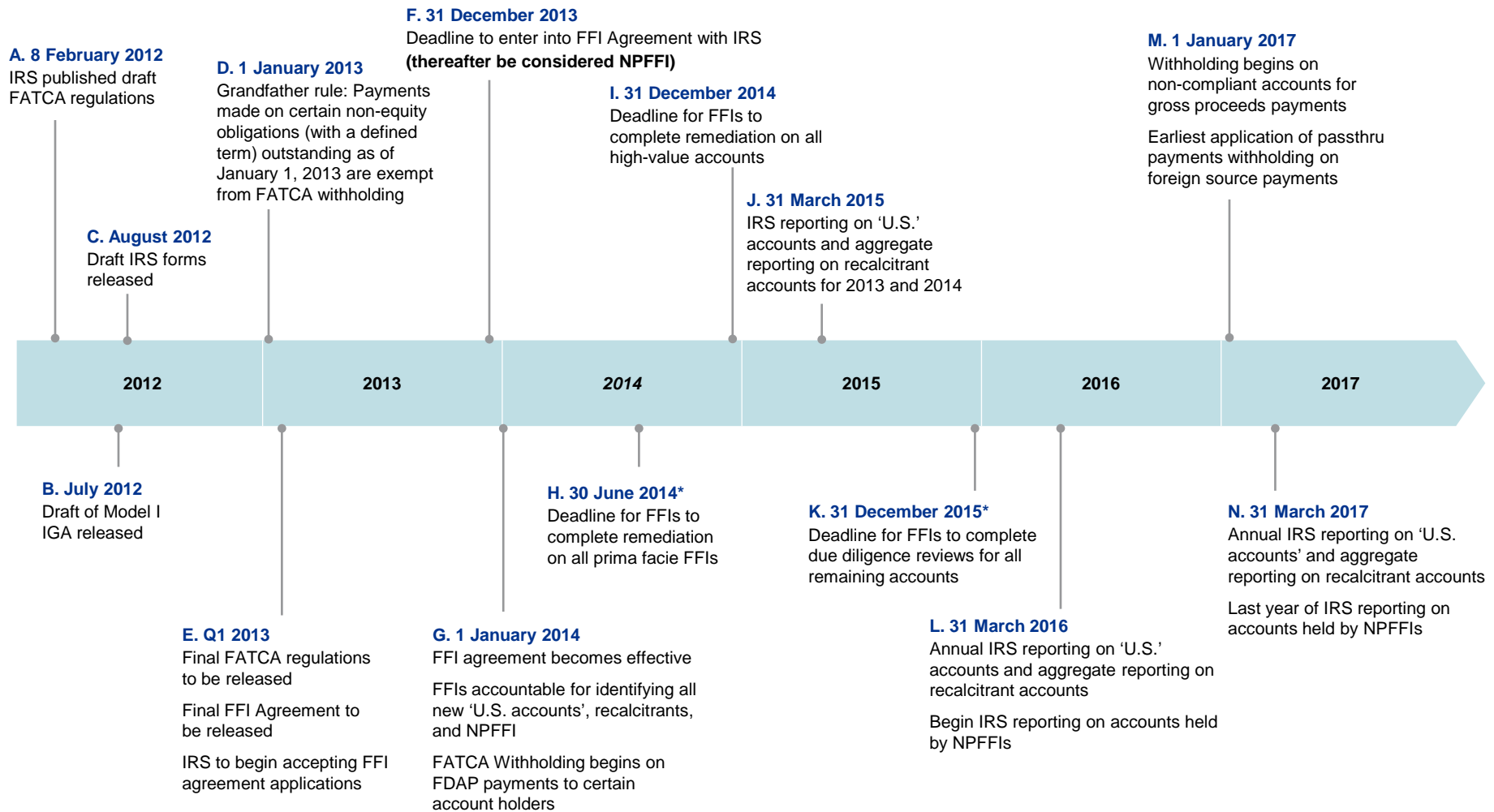
<i>Action taken</i>	<i>Material foreign entities</i>
No disclosure	Affiliates having no U.S. source income and holding no U.S. securities or derivatives
Assert excepted status or disclose U.S. ownership	Publicly traded corporations and their affiliates Affiliates with predominantly active income and assets Holding companies having no financial subsidiaries Purely intercompany treasury or hedging centers IP or other nonfinancial “passive” companies
Disclose U.S. ownership	Passive companies that are not affiliated with a publicly traded parent (i.e., entities that are not corporations or are not within a public company's controlled group)
Comply with FFI rules	Finance, treasury or hedging companies transacting with noncontrolled persons or FFIs Holding companies having FFIs within their controlled group

* *Note, FFIs within your organization may affect availability of excepted status for other entities.*

FATCA timeline – U.S. withholding agent



FATCA timeline – Foreign financial institution



* These dates assume that the FFI's PFFI agreement is approved by the IRS and is effective on 1 January 2014.



cutting through complexity

R&D, Manufacturing Deduction and Repair Regulations

Adam Boyar

Principal, Federal Tax

aboyar@kpmg.com

213-955-8332



Agenda

- R&D tax credit
- Manufacturing deduction
- “New” repair regulations
- IRS audit & documentation support standards
- The preferred approach: Assessment & implementation
- Q&A

R&D tax credit overview & benefits

- The research and development tax credit is a tax incentive for performing qualified research in the U.S. to develop a *new* or *improved* business component
 - Develop a *new* product or process (i.e. manufacturing)
 - *Improve* a product or process
 - Develop or improve computer software (internal use and/or for sale)
- The tax credit is also available in various state jurisdictions
- The credit is available for “incremental” qualified research expenditures (“QRE”) over a historic “base amount”

R&D tax credit overview & benefits (continued)

- In general, the Federal & State “net” credit benefit is approximately 10% – 15% of total QRE
- Permanent Tax Benefits:
 - Reduce tax payments --> Increase cash flow
 - Generate tax refunds (plus interest)
 - Positive Financial Statement Impact
- Federal credit:
 - 1 year carry back & 20 year carry forward
- State credit:
 - Varies by state

What expenses/activity qualify for the R&D credit?

- Expenses:
 - Internal Wages
 - Supplies – prototypes, fuel for test cars, trial runs and testing
 - Contract Research – third party contractors
- Examples of Qualifying Activity:
 - Design and development of product – cars and parts
 - Pilot/Prototype test cars & sub-assemblies – validation testing
 - Design and development of manufacturing process
 - Automation of manufacturing process
 - Pilot/Prototype test cars & sub-assemblies – validation testing
 - Roush – endurance testing
 - Development related to environmental and regulatory compliance
 - Software Development – design/modeling studio

Manufacturing deduction

- Special tax deduction for taxable income attributable to products manufactured in the United States
 - Up to 9% of taxable income
 - Permanent deduction which reduces the effective tax rate
 - Requires only a significant part of the production to occur in the US
- Optimization Review to Increase Deduction/Reduce Cost
 - Changes in business operations
 - Can include income generated from the sales to the distributor AND subsequently to the dealer/retail channel
 - Leased vehicles may be eligible
 - Intercompany income (sales, royalties) may be eligible
 - Use of technology (data analytics/statistical sampling) to reduce cost of implementation and maintenance
 - Adequate work paper/documentation support

“New” repair regulations

- The applicable law determines whether to deduct or capitalize expenditures relating to tangible property
- The law affects most businesses, in particular: Manufacturing facilities, retail outlets, service centers, corporate administrative offices
 - Refreshing/updating retail facilities
 - Modernizing/remodeling office buildings
 - Updating manufacturing facility
- GAAP typically capitalizes the entire project
- However, tax permits current expensing of expenditures relating to structural components that maintain the property’s existing use

“New” repair regulations (continued)

■ Transition Rules

- Notice 2012 – 73: The effective date of the temporary & final regulations is 2014 (tax years beginning on or after Jan 1, 2014)
- Taxpayers have the *option* to adopt in 2012 or 2013
- The government continues to expect that final regulations will be issued in 2013

■ All changes to comply with these regulations are accounting method changes

- Compliance – tax return and financial statement
- Benefits – significant 481(a) adjustment

IRS audit experience & documentation support standards

- Adequate documentation support is required to sustain tax benefits
 - IRS Tiered Directives – terminated August 2012
 - However audit techniques and tools from the Tiered Issues Process will still be used in the field (ex. Tier I IDRs)
 - Internal Revenue Code & Case Law – judicial evidentiary standards
 - IRS Audit Technique Guidelines
- IRS Audit Experience
 - A quality work paper file = efficient & successful resolution
 - Good Strategy – involve a tax controversy professional from project implementation thru completion of the IRS audit

Assessment & implementation process

■ Assessment:

- High level assessment of opportunity and related benefits
- Determine areas of focus for implementation
- Calculate tax benefit estimates --> business decision to move onto implementation
- Prepare a work plan for implementation

■ Implementation:

- Detailed analysis and determinations regarding application of company facts to pertinent law
- Preparation of required memorandum & work paper files – meeting IRS standards
- Tax benefit calculations & forms



cutting through complexity

Appendix



Current Topics in IRS Controversies

Erin Collins

Managing Director, Tax Controversy Services

emcollins@kpmg.com

213-955-8568

Burcin Nee

Managing Director, Economic & Valuation Services

bnee@kpmg.com

213-593-6699



IRS LB&I's moving pieces



Overall IRS context

- General environment – significant rhetoric focused on potential tax reform
- Leadership changes
 - Commissioner Shulman departure
 - Dep. Comm., Steve Miller, designated as acting commissioner
 - Secretary of the Treasury
- Mission strains
 - Implementation demands of Affordable Care Act (ACA) and Foreign Account Tax Compliance Act (FATCA) crowding traditional tax guidance
 - Uncertainty around “extenders” builds pressure on filing season operations

LB&I priorities

- Increase the use of pre-filing resolution alternatives
 - Compliance Assurance Process (CAP)
 - Uncertain Tax Position (UTP) disclosures
 - Pre-filing Agreements (PFA); Advance Pricing Agreements (APA); and Industry Issue Resolution (IIR)
- Enhance overall organizational capabilities
 - Structural design
 - Human capital
- Review and strengthen the large taxpayer examination processes
 - Coordinated Industry Cases (CIC)
 - Appeals

Expand pre-filing alternatives

CAP, UTP, PFA, APA, and IIR



Pre-filing alternatives – CAP

- Pilot begun in 2005 with 17 taxpayers – grown to 160 in current program
- Original pilot participants were hand-picked by the IRS
- Program now permanent and is available to general applicants
 - Commissioner promised expansion of CAP in conjunction with introduction of the Uncertain Tax Position (UTP) regime
 - Rationale – UTP filers should have more opportunity to secure pre-filing certainty

- Prerequisites for entry to CAP:
 - Assets are \$10 million or more
 - A publicly held entity with legal requirement to prepare and submit Forms 10K, 10Q, 8K or 20F – or other disclosure type forms to the SEC or equivalent regulator.
 - If privately held – agree to provide to IRS certified audited financial statements on a quarterly basis or equivalent documentation
 - Not under investigation, or in litigation with, the IRS or other federal or state agency that would limit IRS access to current corporate tax records

Three phases of CAP

■ ***Pre-CAP***

- Resolves intervening open years and prepares parties for CAP

■ ***CAP***

- Contemporaneous disclosure of material transactions and tax positions

■ ***CAP Maintenance***

- Company may matriculate to a maintenance mode (quarterly review) on basis of IRS assessment of risk
- May move back and forth between CAP → Maintenance

Primary CAP motivations

- Obtain *earlier certainty* on material positions
 - Ease of access to information/personnel
 - Avoidance of financial reserves
- Enjoy being an early-adapter
 - Reputational advantages
 - Potential substantive leverage
- Seeking a *re-set* to their current IRS relationship
 - Opportunity to engage above the team level

Experience with CAP

- Taxpayers generally report their CAP experience as better than conventional IRS post-filing audits
- Average “cycle time” for CAP – from return filing to closure – is significantly reduced from traditional post-filing exams
- CAP requires substantial resource investments
- Few taxpayers have exited CAP

Despite CAP's appeal ...

- Some companies experience difficulty securing engagement and agreement on scope and materiality
 - Overcoming historic habits and perspectives of both sides can prove to be challenging
- Resource savings have been slow to materialize
- Emerging and highly technical issues can complicate process
- Some cycles take longer than anticipated to close
- Turnover in CAP team members – especially the Account Coordinator – can be problematic

CAP tactical considerations

■ **Considerations**

- It is the company that enters CAP, not just the tax department – both must engage and invest
- CAP builds on quality of current IRS relationships
 - The current relationships will carry over to CAP
 - Many team members will rollover
- Resource availability
 - Important to know up-front that you can invest requisite resources – internal/external
- Compressed timeframes – can help focus scope and drive decisiveness
- Easier to escalate important issues

Other countries adopt similar approaches

Australia:

- Utilizes Annual Compliance Agreement.

Dutch Revenue Service:

- Implemented Horizontal Monitoring (“HM”).

U.K.:

- Tax Compliance Risk Management Process. Business risk review. Higher risk relationship means more targeted intensive project to improve compliance. Low risk means more support.

Ireland:

- Irish Revenue introduced cooperative approach to tax compliance in 2005. CAP-type approach to transparency.

Canada:

- Begun project of implementing a risk “score” approach like U.K. and Netherlands.

South Korea:

- Launched HM program based on Dutch system

Pre-filing significance of *UTP* regime

- For 2010 – public or privately held corporations required to report uncertain tax positions if it:
 - Issued or was included in audited financial statement
 - Filed Forms 1120, 1120-F, 1120-L or 1120-PC
 - Possessed total assets equal to or greater than \$100 million
- Asset threshold declines for 2012 (\$50m); 2014 (\$10m)
- Very few “technical” questions emerged
 - Instructions and FAQs addressed most implementation issues
- Some taxpayers remain apprehensive about how IRS will use the disclosed UTP information

2010 UTP filings

■ Schedule UTP filed with 2010 Returns

- Through May 15, 2012, IRS received 1,947 Schedules UTPs containing 4,186 UTP disclosures
- Majority of disclosures *not from CIC* taxpayers (79%)
- Non-CIC returns averaged 1.9 UTPs
- CIC returns averaged 3.1 UTPs
- 49% of all returns reporting UTPs had only one uncertain position
- 36 CAP taxpayers reported 136 UTPs

■ Top 3 Code Sections

- Section 41 Research tax credits
- Section 482 Allocation of income including transfer pricing (20%)
- Section 162 Trade and business expenses

* UTP statistics assembled from a series of public statements by IRS officials.

UTP influence on audits

- IRS Stated Goals
 - Create earlier certainty for taxpayers
 - Reduce time required to find issues and complete audits
 - Prioritize selection of taxpayers and issues for examination
 - Increase consistency of taxpayer treatment
 - Systematically identify issues where their uncertainty makes them ripe for further IRS guidance
- Specific benefits and impacts still to be determined

UTP – Initial experience

- LB&I guidance for agents
 - Three installments
 - Message – avoid questions which implicate Tax Accrual Workpaper (TAW) issues
 - Involve managers when UTP to prompt audit issue
- 2010 UTP/CAP reconciliations accomplished
- IRS corresponded with taxpayers that submitted 133 disclosures considered to have inadequate “concise descriptions”
 - No corrective action required; IRS will review their 2011 filing
- Only change in 2011 Instructions was incorporation of FAQs into the instructions
- 2012 instructions not yet available – “transition” questions exist

Relevant “use” guidance

- Three internal memoranda provide examiners with explicit interim instructions on use of UTP information:
 - **Centralized Management of LB&I Returns with UTP Schedules*** (*LB&I Commissioner – May 11, 2011*)
 - **UTP Guidance and Procedures for the Compliance Assurance Process (CAP) Program*** (*LB&I Commissioner – August 31, 2011*)
 - **LB&I Schedule UTP Guidance*** – (*LB&I Commissioner – November 1, 2011*)

* All guidance memoranda can be found at irs.gov.

Jurisdictions – Adopting similar approaches

Australia:

- Adopted legislative requirement to disclosure of Reportable Tax Positions effective for years beginning on or after July 1, 2011.

Canada:

- New reporting rules proposed for “avoidance transactions,” i.e., transactions with hallmarks.
- Begun project of implementing a risk “score” approach like U.K. and Netherlands.

Enhance LB&I's organizational capabilities

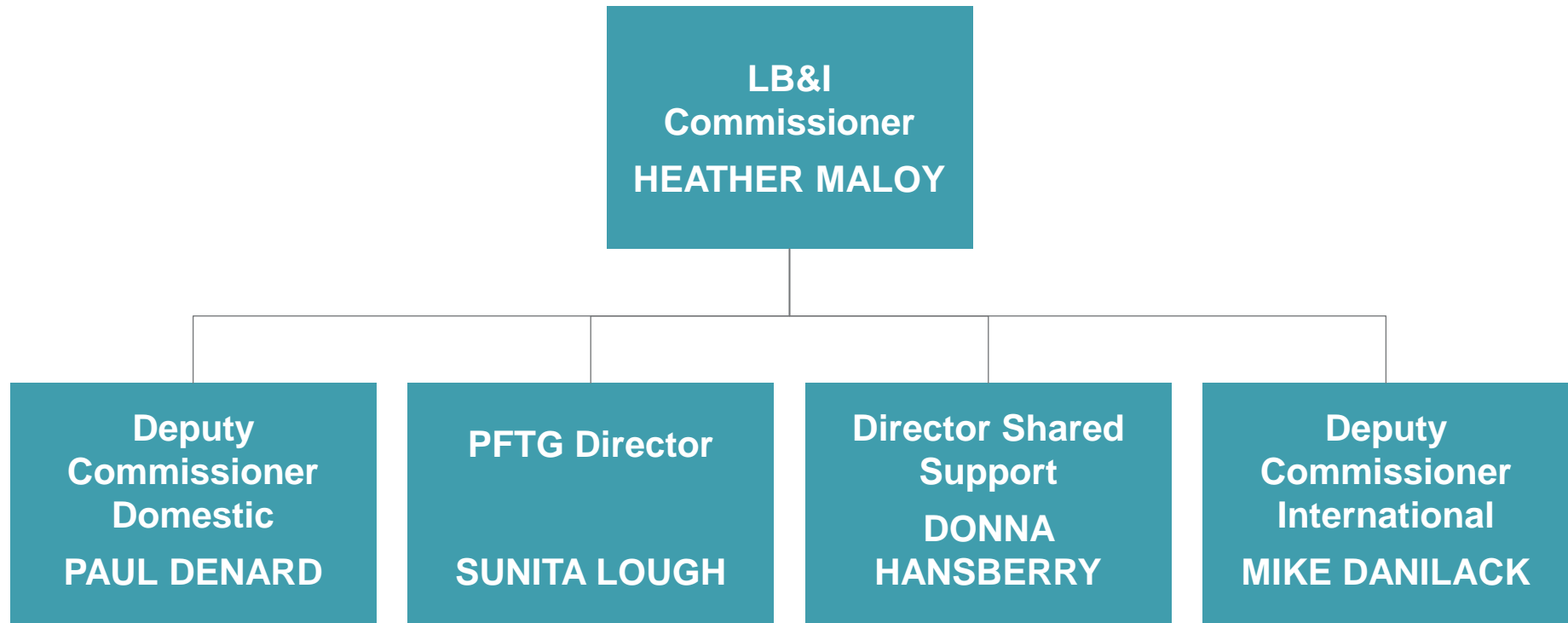
Revised organizational footprint; prioritized international focus; and
introduction of new knowledge management processes



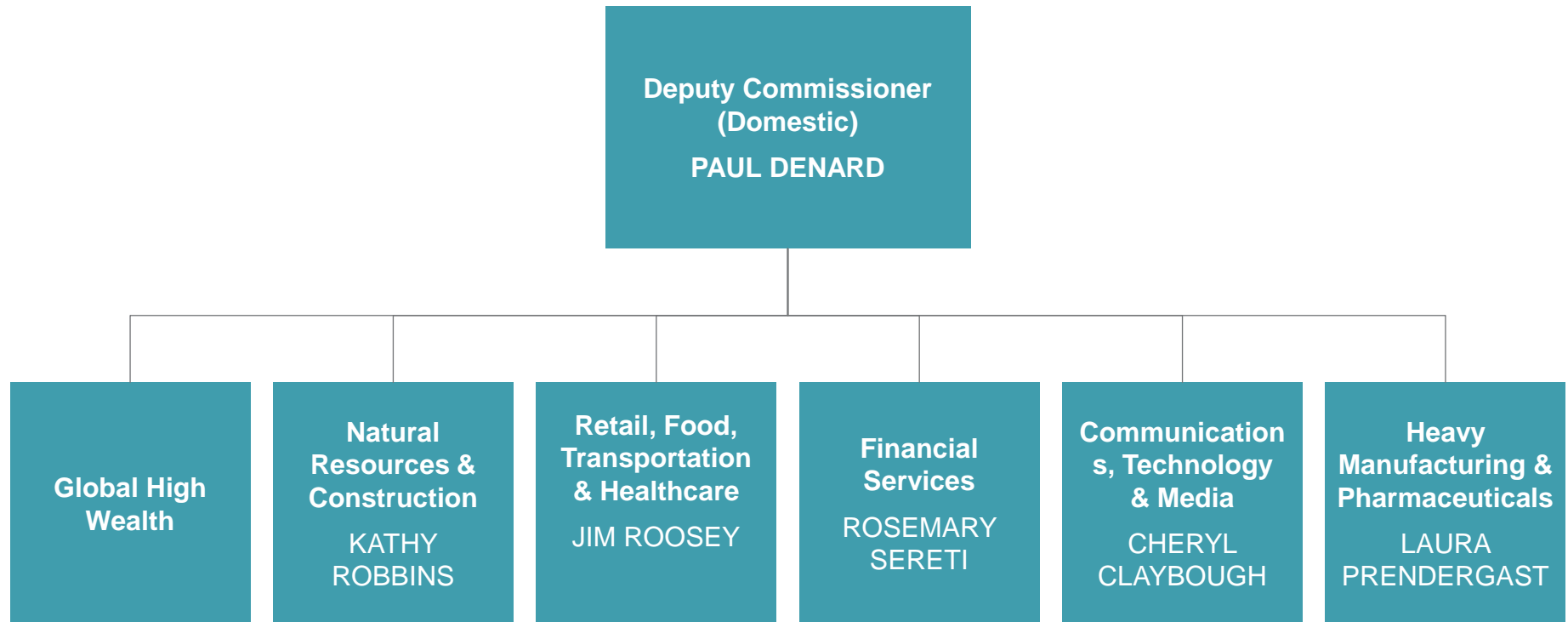
LB&I organizational changes

- Field sub-structure still retains “industry” matrix, but cases are managed by geography
 - Some changes in alignment of sub-industries
 - Specialists – financial products, engineers, computer audit – now supervised within a single industry rather than dispersed among 6
- All but one of the industry directors are new to their positions – many DFOs and Territory Managers also new
 - Opportunity for Taxpayers to establish/improve rapport
 - Surface issues, engage senior personnel where issues or relationships are bogged down

LB&I headquarters

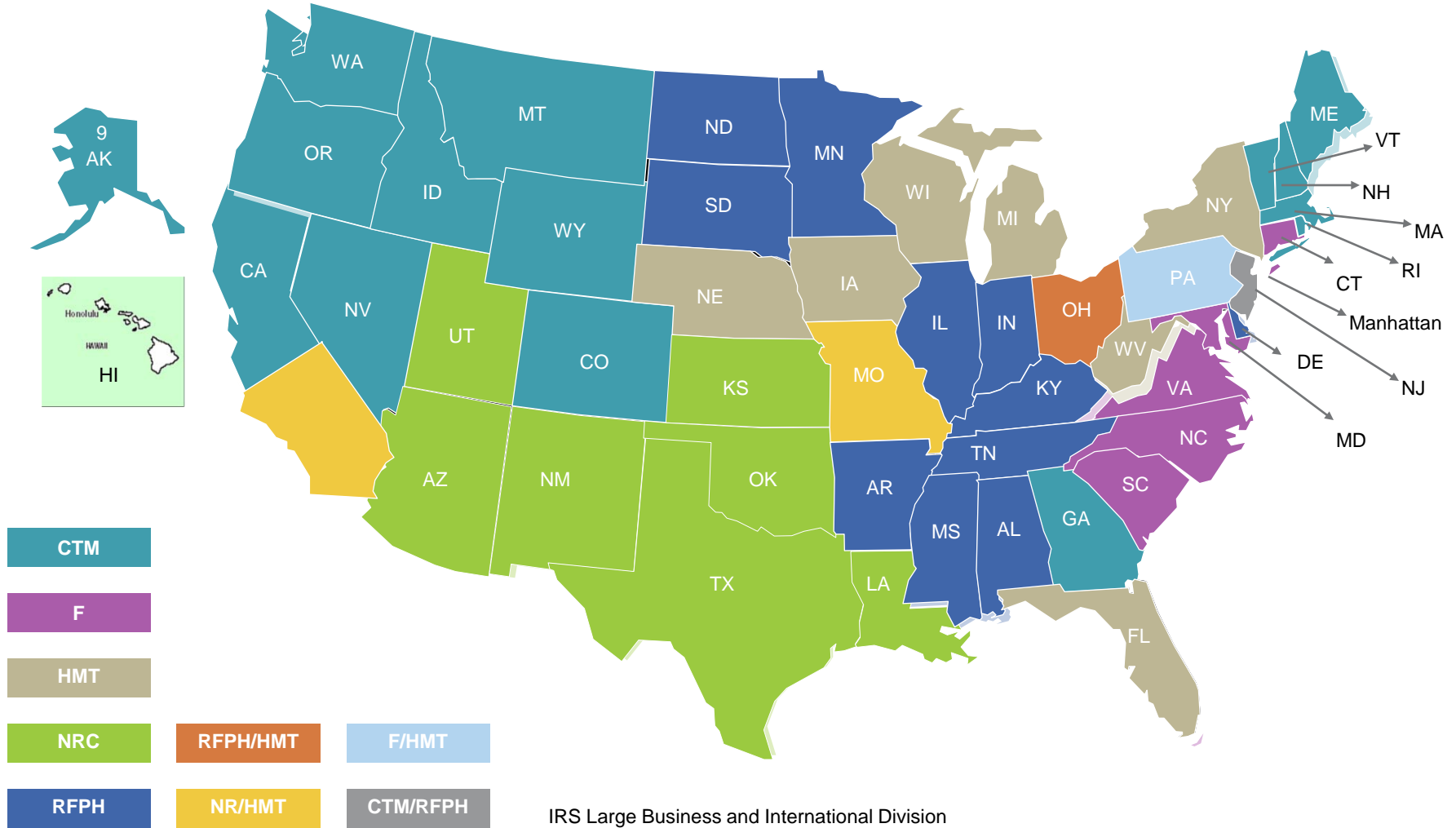


IRS Large Business and International Division

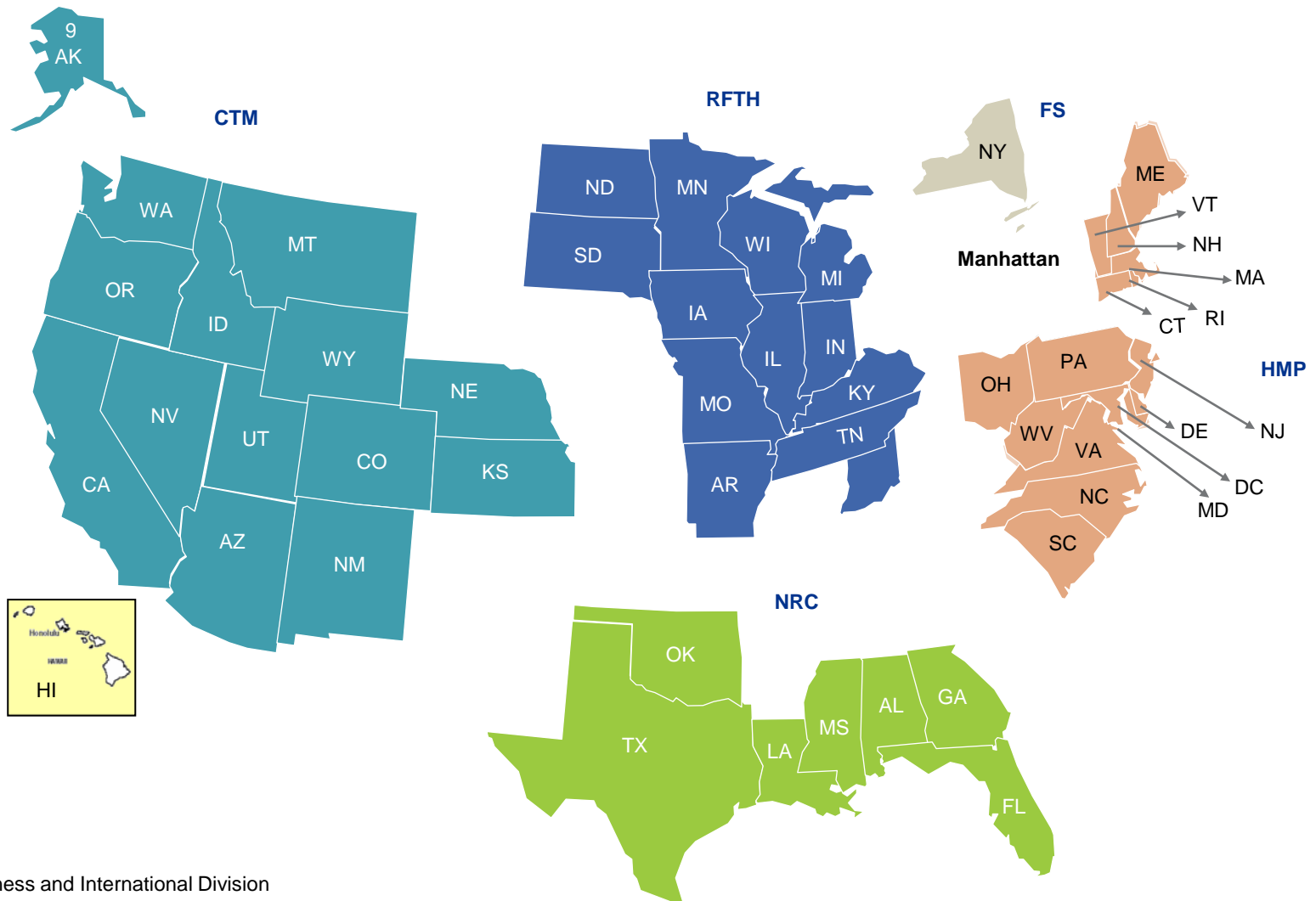


IRS Large Business and International Division

LB&I industries by state – Prior



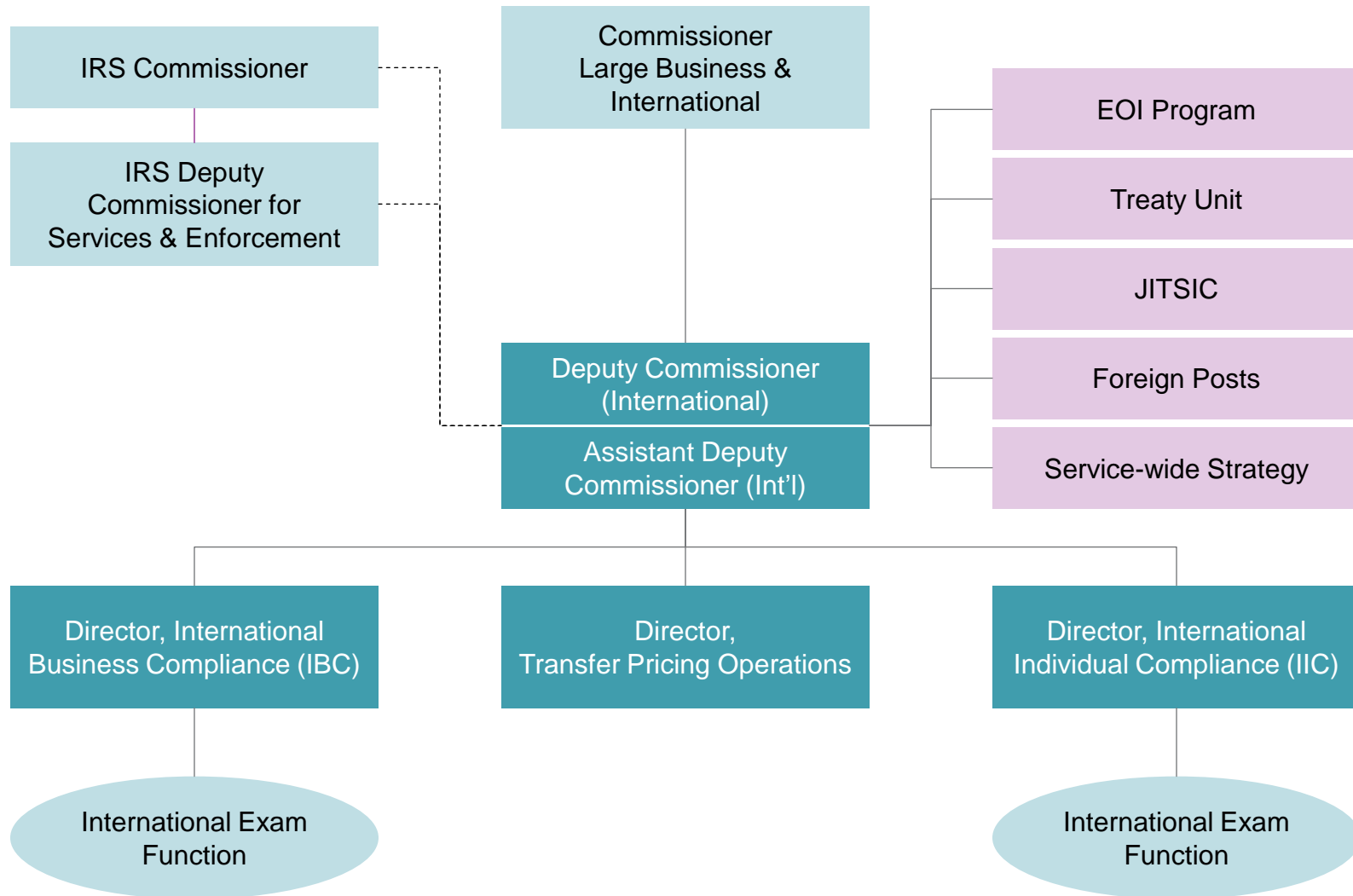
LB&I domestic realignment



IRS Large Business and International Division

LB&I's international focus

- Emerged as highest priority
 - Commissioner's personal engagement
- Resources expanded and consolidated
- Assembling new skills
- Reconfigured the deployment and supervision of all international functions



International assigned elevated status

- All international functions aligned under supervision and control of Deputy Commissioner LB&I/Competent Authority – Michael Danilack
 - New national director of transfer pricing – Sam Maruca; determining priority issues and their treatment; creating transfer pricing “practice”
 - International information reporting – increased significance

Reorganization of IRS transfer pricing

- IRS recently announced a major overhaul of the transfer pricing function with respect to:
 - Advance Pricing Agreements (APAs)
 - Mutual Agreement Procedures (MAP) with treaty partners
 - Strategic development of cases in Exam and litigation
- Certain functions relocated from Chief Counsel to the Deputy Commissioner LB&I
- Key objectives: expand overall APA/CA capacity; reduce backlogs and timeframes

International at the case level

- All international resources now under single line of authority – produces new frontline reality
 - Practical impact – taxpayers may effectively encounter two examinations
 - Despite “domestic” case management, scope and timing issues may be under “international” control
 - Planning, resolution, escalation – all occur up separate IRS “line”
 - New attention to international information reporting
 - *Note: 2012 Offshore Voluntary Disclosure Initiative – FAQ 17 & 18 opportunities to secure penalty relief for delinquent information reporting*

Expanding cross-border collaboration

- OECD's Forum on Tax Administration (FTA) spawning range of new initiatives
- OECD Projects: *Enhanced Relationships; Transfer Pricing; High Net Wealth Individuals; Hybrid Mismatches; Transparency*
- Joint audits – early developments
- Potential expansion of JITSIC roles
- UTP regimes emerging in multiple jurisdictions
- FATCA collaboration

Knowledge management: Retiring tiered issues

- *Tiered issues* process – produced challenges
 - Tiered came to imply “avoidance”
 - Internal guidance coordination – constrained resolution
 - IRS announced (August 17, 2012) that it was abandoning tiered issue process
- IRS piloting *Issue Practice Groups (IPG)* and *International Practice Networks (IPN)* as knowledge management networks
 - Emphasis is on ready access to advice/expertise
 - Modeled after practices of accounting and legal firms

Issue Practice Groups (IPG) – Domestic issues

- IPG designed to
 - Provide exam teams technical advice needed to manage cases efficiently, consistently, and with a high degree of technical proficiency
 - Foster effective collaboration and the sharing of knowledge and expertise across LB&I and IRS Chief Counsel
- Agents encouraged to consult – especially when they encounter issues with which they are not familiar or is especially complex
 - Agents not obligated to secure or follow IPG advice

Issue practice group inventory

- Current inventory includes:
 - Changes in accounting methods
 - Deductible and capital expenditures
 - Non-life insurance
 - Life insurance
 - RICs, REITs, and REMICS
 - Inventory Costs and Accounting
 - Flow-Throughs
 - General Business Credits
 - Financial Instruments
 - General Corporate Issues
 - Penalties

International practice networks

- Every international examiner (IE) expected to be a member of one or more IPN
- IPNs distinguished from IPGs
- Current networks:
 - International Business Compliance
 - International Individual Compliance
 - Transfer Pricing
 - Treaties, APAs, Competent Authority

Transition to knowledge management

- Issues to monitor as LB&I transitions from tiered issues to an IPG/IPN environment:
 - Practical effects of withdrawing tiered issue tools – directives, IDRs, and other guidance
 - Taxpayer visibility into the IPG/IPN processes
 - Will taxpayer and advisor know when case personnel consult IPG/IPN and the results of that consultation?
 - Will IPG/IPN personnel be accessible to taxpayers/advisors?
 - How will the advice and consultations be memorialized inside the IRS and will taxpayers have access to that information?
 - What methods will be used to ensure taxpayer/industry information and perspective helps inform the government's technical views?

Review and strengthen the large taxpayer examination processes



Revise Large Case (CIC) examinations

- Deputy Commissioner outlined review of current CIC exam process
 - TEI mid-year speech (3/26/12)
 - *Hinges on IRS ability to become comfortable with compliance levels of more taxpayers*
 - Highlights elements that warrant improvement
- IRS goal is to reallocate resources from CIC to:
 - International
 - Mid-market (\$10 – \$250 million in assets)
 - Financial products
 - Passthroughs

Gaining comfort with taxpayer compliance

- Largest entities will stay on the radar
 - Corporations with assets of \$250 million or more account for 95% of corporate assets and 81% of total income reported on returns filed in 2011
- IRS will rely on various inputs to increase its awareness of compliance risks
 - IIR
 - CAP
 - UTP

Exam process issues under review

- Government's view: examination and appeals processes have become too lengthy and elaborate
 - Concerned that new facts/arguments are often held back and only presented at appeals
 - Inference – some taxpayers undercut issue development during the examination by purposefully failing to provide complete responses to IDRs
 - IRS acknowledges that taxpayer views may differ on why issues inadequately developed at the examination stage
 - LB&I currently reviewing steps that will improve the IDR management process
 - Reportedly, greater emphasis to be placed on use of summons when government believes taxpayer responses are slow or inadequate

Exam process review

- Also intend to re-focus on exam initiation phase – scope, timing, information flows
 - Revisiting original Quality Examination Process (QEP) principles
 - Potential that summons will be used more routinely
- Broad quality review effort currently underway – designed to independently evaluate CIC cases; includes taxpayer input
- LB&I also pursuing “commercial awareness” initiative designed to inform process improvement efforts

IRS appeals review

- Appeals inventories continue to strain existing resources
- Fast track numbers increasing
 - 74% increase 2012 over 2011
 - Still less than 100 per year
- Number of “Review and Concurrence” issues reduced in effort to increase AO resolution (*14 issues recently de-coordinated*)
- Emphasizing the availability of “Rapid Appeals”
- Strengthened “ex-parte” guidance

Alternative Dispute Resolution (ADR) emphasis

- LB&I and Appeals emphasize use of ADR as means of reducing resolution time – creating earlier taxpayer certainty
 - Delegation Order resolution
 - Early issue referral to Appeals
 - Fast Track Resolution
 - Post- Appeals Mediation

Transfer pricing dispute resolution – Current environment



Current global transfer pricing environment

- Global TP environment and increased worldwide enforcement efforts
 - Impact of Global Economy—increased fiscal demands on countries, which is aggravated by the worldwide economic downturn
 - Many Tax Authorities, including the IRS, are auditing more aggressively in the downturned global economy:
 - Prevention of Base Erosion
 - Focus on tax havens and intermediary structures
 - Enforcement Efforts—including multi-country coordinated investigations and audits by tax administrations and “simultaneous” examinations
 - Tax Authorities are paying attention! They are surfing the internet to learn about companies and industries
 - Commercial Drivers
 - Multi-national Enterprises (MNEs) are actively trying to manage their global effective tax rates in order to be competitive
 - Changing business structures
 - Pressure on FTC utilization
 - Emergence of new markets

Current global transfer pricing environment (continued)

- Global TP environment and increased worldwide enforcement efforts
 - World-Wide Implementation of Burdensome TP Documentation
 - Increased Regulations, Transparency and Disclosure
 - More and more countries are releasing TP documentation requirements/guidance
 - Severe penalty regimes for failing to comply
 - OECD and United Nations actively in the game trying to establish global “norms”

Global transfer pricing environment

- What Does This Mean for MNEs?
 - Premium on controversy-avoidance approaches: Ex ante Review of Structures and Proposed Transactions
 - Preparation of audit defense files in advance of audits
 - Coordination by Parent of global audits—the “readiness is all”
 - Material tax adjustments, controversies and disputes
 - Issues and Approaches are Evolving:
 - E.g., cost-sharing audits; permanent establishment assertions and allocations, business restructuring/goodwill allocation, marketing intangibles (GlaxoSmithKline case), as well as more plain vanilla approaches
 - Industry Focused Audits
 - Increased pressure on alternative and traditional dispute resolution mechanisms
 - Competent Authority and Advance Pricing Agreements and Arbitration (where Treaties and Programs are in place and viable)
 - Administrative and judicial recourse
 - Financial Reporting Pressure: FIN 48 (and ASC 740-10) analyses

Transfer pricing controversies: What route to take?

- Where there is no audit/adjustment
 - APAs
 - APAs can be an ideal vehicle for companies wanting certainty (for stable or for changing business models) and to resolve TP exposure that extends beyond one year
 - Can also be deployed strategically to try to roll-out and resolve potential audits in similar geographic regions
- Where there is an Audit/Adjustments
 - Domestic Appeals
 - Competent Authority (where this recourse through an income tax treaty)
 - Accelerated Competent Authority Procedures
 - Combination of Appeals and Competent Authority: concurrent or not and implications
 - Combination of Competent Authority plus APA—for future years if adjustments for later years are probable

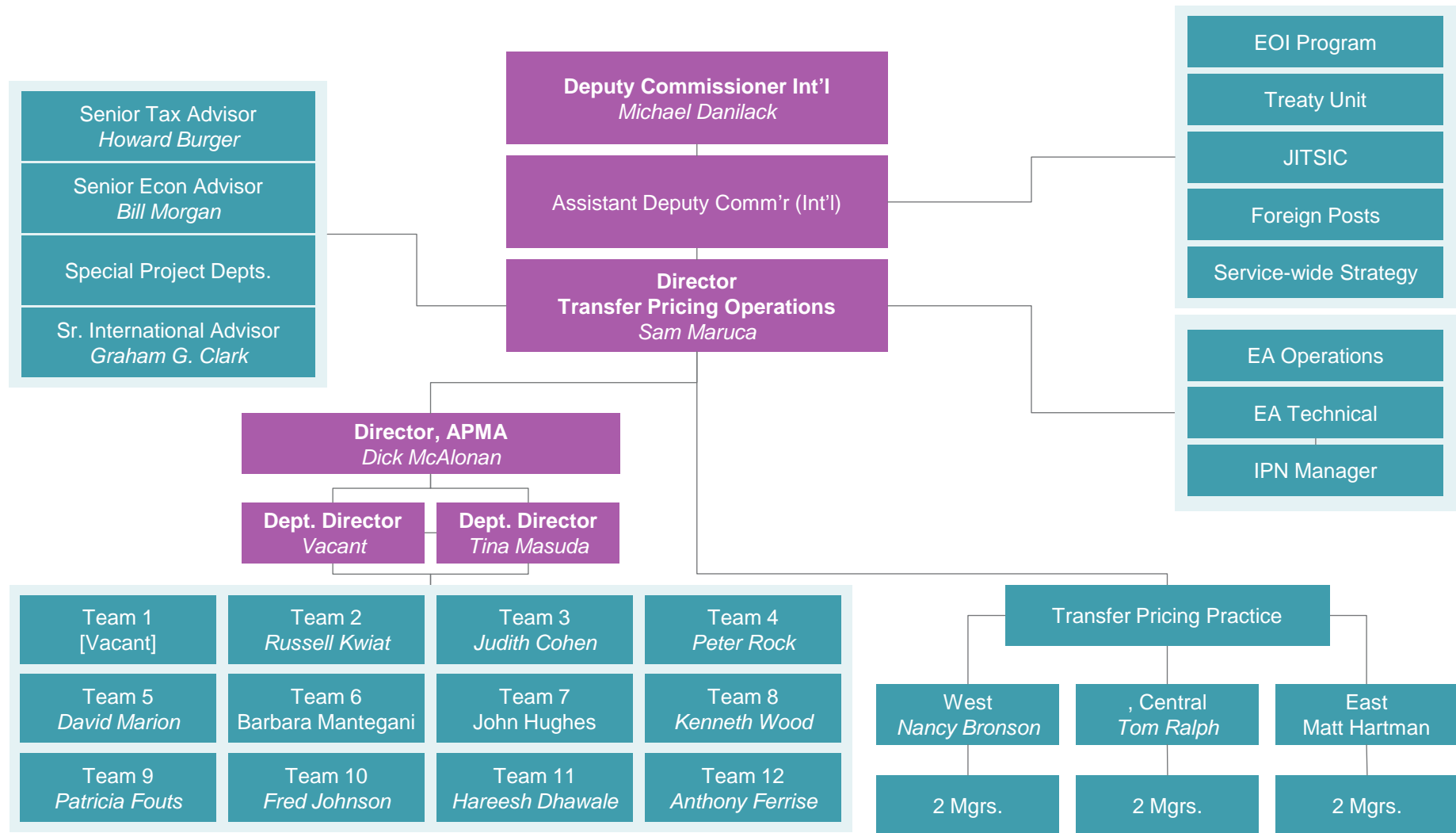
Transfer pricing controversies: What route to take? (continued)

- Is the judicial process viable in-country? Is privacy an issue?
- Strategies – robust analysis of pros and cons as to which option to employ first, depending upon the countries involved, the size of the adjustment, the nature of the issues, the appetite and experience of the company for handling these types of issues
- Protect and Preserve—necessity of keeping abreast of deadlines and, where necessary, of keeping statutes open!!

The establishment of the advance pricing and mutual agreement program

- The former APA and Competent Authority staffs have merged as of February 27, 2012 into a single group: APMA
 - Group is located on the Commissioner's side of the IRS
 - Newly appointed Director of APMA is Richard McAlonan
 - Two Deputy Director positions under the Director
 - There are 12 groups under them, located on both coasts
 - Over 40 new hires (including many economists) into APMA and more are planned
 - APMA will have principal jurisdiction over APAs and Competent Authority cases (double tax cases as well as certain treaty interpretive matters)
 - Much is in flux

LB&I transfer pricing operations



Objectives of APMA

- Goal of APMA is to increase efficiencies in case processing.
 - This is particularly the case with respect to APAs. In 2011, 43 APAs were completed as opposed to 69 in 2010
 - One team will lead the APA from beginning to end: no “hand-off” from APA to Competent Authority anymore
- What will replace recommended negotiating positions?
- What will be taxpayer involvement in the development of the negotiating positions?
 - Very little Chief Counsel involvement: only for “strategic cases”
 - Big cases should get more scrutiny than small cases or plain vanilla renewals
 - Pressure will be on both the APMA team and the taxpayer/representative to move along cases

Increases in staffing and update of procedural guidelines

- Currently, 12 Groups in APMA
 - Two groups are on West Coast; ten are in Washington, DC
 - Two of the groups are Economist Groups (with economists also located in New York and Chicago)
 - More groups may be formed in different locations
- Japanese and Canadian cases are allocated among several groups—located on both Coasts
- Remainder of the Treaty Countries are divided among the other groups (other than the Interpretive Group)
- Assignment of countries within the Groups has changes several times since the establishment of APMA
- Revenue Procedures for APAs and CA are being updated
 - Not the “first priority” of APMA, but these projects are moving forward
 - Taxpayers and representatives will have some opportunity to comment
 - What needs to be fixed? What can be done better? What needs to be clarified?
 - Initiatives within APMA: update templates; consistency in internal and external documents

New IRS transfer pricing enforcement structure

- The Internal Revenue Service Large Business and International (“LB&I”) division plans has created an advisory group under its transfer pricing practice.
 - Advisory group will serve as a bridge between the national office and the field.
- The IRS’s goal is to create an integrated transfer pricing practice within LB&I.
 - Give better visibility all the way down to ground level and share experiences.
- In certain cases, the transfer pricing practice will work shoulder-to-shoulder with the international examiners and exam teams to “develop the very best case we can based on the facts.”
 - These cases will be selected on the basis of several criteria, including size but whether the case is part of a pattern, represents an emerging issue, or is otherwise strategic for the IRS.
- The transfer pricing practice has been actively assessing the current inventory of transfer pricing cases, including cost sharing cases, and will soon focus on future inventory and decide how the IRS will tailor its various risk assessment tools.
- The new managers and their teams in the field have been working closely with APMA leadership to develop models for audits and to coordinate with the field

Ramping up within LB&I of technical transfer pricing experts

- There are now three teams of transfer pricing specialists in the field who are led by experienced managers: Tom Ralph (Central), Nancy Bronson (West) and Matt Hartman (East Region).
 - The three managers report directly to Sam Maruca, the Director of Transfer Pricing Operations
 - Currently, these groups are still small in number but the plan is to grow them out and even add new groups in other regions
 - The new economists include both junior and senior economists and many are from the private sector
 - Ultimate objective of these specialists—according to statements made by APMA leadership—is to produce some litigation “winners” for the IRS

How to work with the transfer pricing specialists: Best practices

- Be proactive!
- Leverage among the different relationships
- Optimize opportunities from improved technical quality of IRS questions and analyses
- Know your avenues of recourse and IRS procedural rules
- Respond timely and with appropriate thoroughness
- Know when to elevate issues
- Pick your battles wisely

Opportunities for penalty relief – Foreign information reporting failures



Agenda

- Introduction
- 2012 Offshore Voluntary Disclosure Program
- FAQ Nos. 17 & 18 – Penalty relief for failure to file FBAR and foreign information returns
- Section 6501(c)(8) considerations
- Importance of curing past errors and omissions now

FAQ nos. 17 and 18

Another opportunity to cure past errors and omissions

- 2012 Offshore Voluntary Disclosure Program
 - Announced January 9, 2012
 - New Frequently Asked Questions (FAQs) Released June 26, 2012, including New FAQ Nos. 17 & 18!
- FAQ Nos. 17 & 18 establish alternative procedure to the 2012 OVDP for eligible taxpayers to obtain an automatic waiver of certain information reporting penalties with respect to foreign bank/financial accounts and assets, and transactions with foreign entities

New FAQ nos. 17 and 18

What is new?

- Program open for indefinite period, but could be terminated by IRS at any time
- New restrictions on obtaining automatic penalty relief

New FAQ nos. 17 and 18

What is the same?

- Reporting provisions covered under new FAQ Nos. 17 & 18: same international-related information returns as under the 2011 FAQ Nos. 17 & 18
- Automatic penalty relief – no demonstration of reasonable cause
- Eligible participants: individuals and entities (corporations, partnerships, trusts)
- Eliminate uncertainty – substantially incomplete information returns

Delinquent FBAR filings

Automatic penalty relief under FAQ no. 17

- Available to U.S. persons that reported, and paid tax on, all their taxable income for the years at issue but inadvertently did not file FBARs
 - Available to U.S. entities or individuals that failed to report a financial interest in a foreign financial account or U.S. individuals with signature or other authority over such an account
 - Filer must not have been previously contacted regarding an income tax examination or a request for delinquent returns (for the year(s) at issue)
 - Under FAQ #17, delinquent FBARs are **not** filed under the OVDP, but rather are filed (in the “normal” manner) with the IRS in Detroit
 - Six-year SOL applies to FBAR filings (statute starts on the due date of the FBAR, regardless of whether filed or not)

FAQ No. 17 – Form TD F 90-22.1

Report of Foreign Bank and Financial Accounts (FBAR)

Q. 17 I have properly reported all my taxable income but I only recently learned that I should have been filing FBARs in prior years to report my personal foreign bank account or to report the fact that I have signature authority over bank accounts owned by my employer. May I come forward under this new initiative to correct this?

A. 17 The purpose for the voluntary disclosure practice is to provide a way for taxpayers who did not report taxable income in the past to come forward voluntarily and resolve their tax matters. Thus, if you reported and paid tax on all taxable income but did not file FBARs, do not use the voluntary disclosure process.

For taxpayers who reported and paid tax on all their taxable income for prior years but did not file FBARs, you should file the delinquent FBAR reports according to the instructions . . . and attach a statement explaining why the reports are filed late. The IRS will not impose a penalty for the failure to file the delinquent FBARs if there are no underreported tax liabilities and you have not previously been contacted regarding an income tax examination or a request for delinquent returns.

Delinquent FBAR filings

Automatic penalty relief under FAQ no. 17

- Attach a statement to each delinquent FBAR that states:
 - The filing omission was only recently discovered;
 - Prompt corrective action is being taken;
 - All income has been reported and all taxes have been paid;
 - The filer has not been contacted by the IRS for the year at issue; and
 - The filing is being done in accordance with FAQ #17 and therefore penalty relief should be provided

Delinquent international-related information returns

Automatic penalty relief under FAQ no. 18

Available to U.S. persons who:

- Reported, and paid tax on, all taxable income attributable to ownership of, and transactions with, foreign entities and accounts
- Have not been contacted by IRS regarding an income tax examination or a request for delinquent returns
- Eligible forms – Penalty relief limited to failure to comply with foreign information reporting rules
 - Income tax returns do not qualify (e.g., Form 1120-F)

FAQ No. 18

International-related information returns

Q. 18 Question 17 states that a taxpayer who only failed to file an FBAR should not use this process. What about a taxpayer who only has delinquent Form 5471s or Form 3520s but no tax due? Does that taxpayer fall outside this voluntary disclosure process?

A. 18 A taxpayer who has failed to file tax information returns, such as Form 5471 for controlled foreign corporations (CFCs) or Form 3520 for foreign trusts but who has reported, and paid tax on, all their taxable income with respect to all transactions related to the CFC or foreign trusts, should file delinquent information returns with the appropriate service center according to the instructions for the form and attach a statement explaining why the information returns are filed late. (The Form 5471 should be submitted with an amended return showing no change to income or tax liability.)

The IRS will not impose a penalty for the failure to file the information returns if there are no underreported tax liabilities and you have not previously been contacted regarding an income tax examination or a request for delinquent returns.

International-related information returns

Automatic penalty relief under FAQ no. 18

- Form 926, Return by a U.S. Transferor of Property to a Foreign Corporation
- Form 3520, Annual Return to Report Transactions with Foreign Trusts & Receipt of Certain Foreign Gifts
- Form 3520-A, Annual Information Return of Foreign Trust with a U.S. Owner
- Form 5471, Information Return of U.S. Persons With Respect to Certain Foreign Corporations

International-related information returns

Automatic penalty relief under FAQ no. 18 (continued)

- Form 5472, Information Return of a 25% Foreign-Owned U.S. Corporation or a Foreign Corporation Engaged in a U.S. Trade or Business
- Form 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities
- Form 8865, Return of U.S. Persons With Respect to Certain Foreign Partnerships
- Form 8938, Statement of Specified Foreign Financial Assets

International-related information returns

Automatic penalty relief under FAQ no. 18 (continued)

Additional foreign information returns for which the OVD Unit has indicated FAQ No. 18 is available:

- Form 5713, International Boycott Report
(\$25,000 penalty if willful failure to file, plus loss of tax benefits, including FTCs)
- Form 8833, Treaty-Based Return Position Disclosure under Section 6114 or 7701(b)
(\$10,000 penalty for failure to file by corporation)
- Are there any other foreign information returns eligible for FAQ No. 18 penalty relief?

Delinquent international-related information returns

Automatic penalty relief under FAQ no. 18

Process for requesting relief

- File delinquent returns in normal manner
- Include a letter of explanation why returns are late and clearly indicate that:
 - Taxpayer requests automatic penalty relief under FAQ No. 18 and cite conditions for relief
 - Taxpayer meets conditions of FAQ No. 18, and therefore, automatic penalty relief should be granted because taxpayer:
 - Reported, and paid tax on, all taxable income attributable to foreign entities & assets; and
 - Not contacted by IRS regarding an income tax examination or a request for delinquent returns

Delinquent international-related information returns

Automatic penalty relief under FAQ no. 18 (continued)

- Consider whether it is beneficial for the taxpayer to make a joint FAQ No. 18/reasonable cause relief request submission
 - Implications of Section 6501(c)(8)

FAQ Nos. 17 and 18

Another opportunity for automatic penalty relief

- FAQ Nos. 17 & 18 present a significant opportunity for taxpayers who properly reported, and paid tax on, all their taxable income to obtain automatic penalty relief for delinquent filings, including opportunity to cure returns which may be considered substantially incomplete.
- More important than ever for taxpayers to cure past omissions and errors given:
 - Increased IRS scrutiny of international transactions and ownership of foreign assets
 - Increased IRS enforcement of international-related information reporting provisions and applicable penalties

Current topics in state tax dispute resolution



Pitfalls of incorporating state tax decisions into compliance

- On October 2, 2012, the California appeals court issued its second opinion in *Gillette Co. vs. Franchise Tax Board*. The court vacated the July 24, 2012, decision in which it had held that a taxpayer could apportion its income to California using the Multistate Tax Compact's evenly-weighted three factor formula, despite statutory language mandating the use of a three-factor double-weighted sales formula for general corporations.
- The impact of this decision *should* be considered for 10/15 original return filings in all Compact full member states.

Pitfalls of incorporating state tax decisions into compliance (continued)

- The *Gillette* decision raises many questions for taxpayers considering whether they should elect to use the Compact's allocation and apportionment provisions on originally filed 2011 returns. Recently, the Franchise Tax Board (FTB) issued guidance addressing (1) whether taxpayers will be able to avoid the imposition of California's large corporate understatement penalty on originally-filed returns as a result of the October 2, 2012 decision, and (2) the procedures taxpayers should follow if they wish to file protective refund claims under *Gillette*.
 - Large Corporate Understatement Penalty
 - Need for taking position on an originally filed return

Pitfalls of incorporating state tax decisions into compliance (continued)

- A Louisiana appellate court held that two corporations were not subject to the Louisiana franchise tax by virtue of owning limited partnership interests in a partnership that was doing business in Louisiana. *Utelcom, Inc. and Ucom, Inc. vs. Bridges*, 2010 CA 0654 (La. Ct. App. September 12, 2011).
- Compliance considerations:
 - Pay the tax and file for refund – La. R.S. 47:1621
 - Pay the tax under protest – La. R.S. 47:1576
 - Don't pay – penalty provisions

Recent trends in state controversy – Class action lawsuits against taxpayers

- *Kean vs. Wal-Mart Stores, Inc.*, 235 Ill.2d 351, 919 N.E.2d 926 (2009) (tax on delivery charges)
- *In re AT&T Mobility Wireless Data Servs. Sales Tax Litig.*, 789 F. Supp. 2d 935 (N.D. Ill. 2011)
- *P.J.'s Concrete Pumping Service Inc. vs. Nextel West Corp.*, No. 2-02-1219, 2004 WL 171546 Ill. App. Ct. 2d Dist., 01/27/04.

Recent trends in state controversy – Qui Tam actions

■ *Qui Tam Actions:*

- Brought by a private plaintiff (“relator”)
- Brought for and in name of the state
- Allows relator with knowledge of “fraud” against state to sue on behalf of the government
 - Intended to encourage true “insiders”
- Action filed under seal
- State investigates and may join action
- Relator may receive percentage of recovery

Recent trends in state controversy

- Typical Qui Tam Actions
- Sales and Use Tax Collection
 - Lawsuits against remote or internet sellers:
 - Direct mail and online retailers
 - Investigate nexus, returns, affiliates
 - Shipping and handling charges
 - Brought in 3 states: IL, NV and TN (pre-amendment)

Recent trends in state controversy (continued)

- Qui Tam Actions
- Unclaimed Property
 - Lawsuits for failing to remit unused amounts on prepaid calling cards
 - Actions against MetLife and Prudential for allegedly failing to turn over unclaimed life insurance funds
- Possible Future Actions
 - Corporate income tax
 - New York AG is reportedly investigating private equity firms (including Bain Capital) for alleged FCA violations

Complex interest opportunities



Opportunity

- Are you leaving money on the table by assuming that interest as calculated by the IRS is correct?



Refund claimed	Reason
\$ 2,610,079	Abatement of erroneous penalties and interest
\$ 2,082,806	Application of interest rate netting provisions
\$ 2,965,145	Application of Rev. Rul. 99-40 to 6 years
\$ 4,523,423	Correction of misapplied LCU rate and erroneous penalty
\$ 9,990,319	Application of interest rate netting provisions
\$ 19,484,159	Calculation errors related to Form 2285
\$ 10,835,033	Correction of payment application method

Opportunity (continued)

KPMG's Complex Interest Services benefit our clients by identifying opportunities to reduce the **amount of deficiency interest** to be paid to the IRS or increase the **amount of refund interest** payable to the taxpayer.

- Many organizations may not have the internal resources and personnel with sufficient skills and experience to perform the burdensome tasks of determining the accuracy of IRS interest computations.
- Transcript analysis can uncover IRS errors, which can generate additional cash benefits to our clients.
- The IRS requires taxpayers to be proactive with respect to the “use of money” principle and interest netting—the taxpayer must quantify the benefit by filing a claim with supporting computations.



Typical areas for opportunities

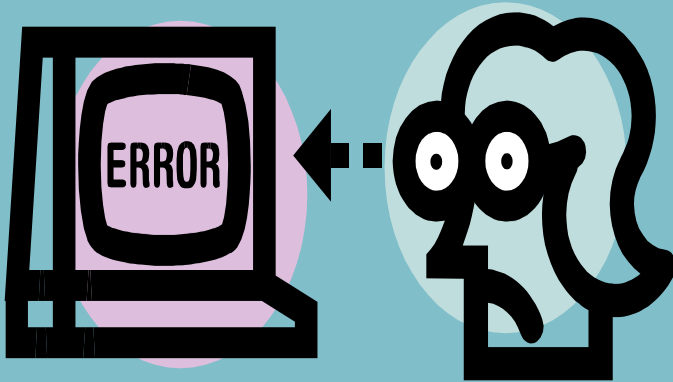


- In exam/appeals? Or exam completed within the past 2 – 3 years?
- Any adjustments (assessments or abatements) for one or more years?
- Filed net operating loss carryback claims within the last 2 to 3 years?
- Filed amended returns and paid additional tax and interest?
- Elected to have overpayments applied to the next tax year instead of having them refunded?

Other services

■ Account Problem Resolution

- Requesting correction or abatement of penalties
- Misapplied tax payments
- Erroneous account postings
- Confusion related to more than one EIN



■ Modeling of Options and Impacts

■ Tax Provision Analysis

- Reviewing reserve items under FIN 48 to determine the potential impact of penalties and interest
 - Audit clients for which KPMG reviews FIN 48 analyses
 - Non-audit clients for which KPMG prepares FIN 48 analyses

■ Tax Payment Planning

- Analyzing the tax account to see if the client can postpone a current payment without incurring interest



cutting through complexity

© 2012 KPMG LLP, a Delaware limited liability partnership and the U.S. member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.
NDPPS 107154

The KPMG name, logo and “cutting through complexity” are registered trademarks or trademarks of KPMG International.