

Rev. Proc. 2003-37

SECTION 1. PURPOSE

This revenue procedure describes documentation and information a taxpayer that uses the fair market value method of apportionment of interest expense may prepare and make available to the Internal Revenue Service (“Service”) upon request in order to establish the fair market value of the taxpayer’s assets to the satisfaction of the Commissioner as required by § 1.861-9T(g)(1)(iii). It also sets forth the procedures to be followed in the case of elections to use the fair market value method.

SECTION 2. BACKGROUND

Section 901 of the Internal Revenue Code (“Code”) allows taxpayers to elect to receive a credit, subject to the limitations of section 904, for any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country or to any possession of the United States. Section 904 generally limits the amount of credit taken under section 901 to the portion of the taxpayer’s U.S. tax attributable to the taxpayer’s taxable income from sources without the United States.

Sections 862(b) and 863(a) provide that taxable income attributable to gross income from foreign sources shall be determined by deducting the expenses, losses, and other deductions properly apportioned or allocated thereto and a ratable part of any expenses, losses, and other deductions that cannot be definitely allocated to some item or class of gross income. Section 864(e)(2) provides that all allocations and apportionments of interest expense must be made on the basis of assets rather than gross income. Sections 1.861-8T and 1.861-9T provide general rules governing the asset method of interest expense apportionment, and §§ 1.861-8T(c)(2) and 1.861-9T(g)(1)(ii) provide that a taxpayer apportions its interest expense on the basis of the tax book value of its assets or, at the election of the taxpayer, the fair market value of its assets. Under both methods, § 1.861-9T(g)(3) requires assets to be characterized according to the source and type of income that they generate, have generated, or may reasonably be expected to generate.

Section 1.861-9T(g)(1)(iii) requires a taxpayer that elects to apportion its interest expense using the fair market value method to establish the fair market value of its assets to the satisfaction of the Commissioner for each taxable year. If a taxpayer fails to establish the fair market value of an asset to the satisfaction of the Commissioner, the Commissioner may determine the appropriate asset value. If a taxpayer fails to establish the value of a substantial portion of its assets to the satisfaction of the Commissioner, the Commissioner may require the taxpayer to use the tax book value method. Section 1.861-9T(h) provides specific rules for valuing assets for taxpayers that use the fair market value method of interest expense apportionment.

SECTION 3. DOCUMENT AND INFORMATION REQUIREMENTS

.01 If a taxpayer satisfies the requirements of sections 3.02 and 3.03 of this revenue procedure regarding the preparation and production of documents and other information relating to valuation of assets and the Commissioner determines that the taxpayer’s valuation of an asset is reasonable, then the taxpayer will have established the fair market value of the asset to the satisfaction of the Commissioner pursuant to § 1.861-9T(g)(1)(iii).

.02 A taxpayer satisfies the requirements of this section 3.02 if the taxpayer prepares and makes available to the Service upon request a narrative statement describing the apportionment of interest expense under the fair market value method in sufficient detail such that the Service can

reconcile the information on Schedule H of Form 1118 with such apportionment methodology, which narrative statement incorporates or is accompanied by the following information:

(a) A description of how the taxpayer calculated the aggregate value of the taxpayer's assets on the last day of its taxable year. In the case of a publicly traded corporation, the taxpayer must describe how the taxpayer calculated the aggregate trading value of stock traded on established securities markets at year-end and how the taxpayer calculated year-end liabilities to unrelated persons and *pro rata* share of year-end liabilities of all related persons owed to unrelated persons as required by § 1.861-9T(h)(1)(i). In the case of a corporation that is not publicly traded, the taxpayer must describe how the taxpayer calculated the aggregate value of its assets by reference to the capitalization of corporate earnings as required by § 1.861-9T(h)(1)(i).

(b) A description, by entity, of tangible assets referred to in § 1.861-9T(h)(1)(ii). With respect to assets that have significant value or that generate significant income, the description must include detailed information for the asset. For example, with respect to real property, the description should include location, zoning, and square footage.

(c) An explanation of company structure and an identification of cost centers or other reporting divisions or units to which assets are assigned.

(d) A description of the valuation techniques used to value tangible assets and the reasons for selecting such valuation techniques over alternative techniques. Any valuation study relied upon by the taxpayer must include an explanation describing the valuation of the tangible assets as set forth in § 1.861-9T(h)(1)(ii) in detail sufficient to enable the Service, upon examination, to duplicate the methodology used to obtain those fair market values. The taxpayer must also provide a description of all assumptions made in applying the valuation techniques used in the study, including but not limited to, discount rates, obsolescence factors, and risk adjustments.

(e) An explanation of the manner in which tangible assets were combined into reasonable groupings and the reasons for such grouping.

(f) An identification of any fungible property, such as commodities, that was val-

ued using statistical methods of valuation, and an explanation of such methods.

(g) A description of the apportionment of interest expense to intangible asset values as computed under § 1.861-9T(h)(1)(iii).

.03 If the taxpayer or a third party used any computer software to determine asset values, characterize assets in accordance with § 1.861-9T(g)(3), or calculate the taxpayer's foreign tax credit limitation, the taxpayer satisfies the requirements of this section 3.03 if the taxpayer makes available to the Service upon request the following:

(a) Any computer software executable code used for such purposes, including an executable copy of the version of the software used in the preparation of the taxpayer's return (including any plug-ins, supplements, etc.), and a copy of all related electronic data files. Thus, if software subsequently is upgraded or supplemented, a separate executable copy of the version used in preparing the taxpayer's return must be retained.

(b) Any related computer software source code acquired or developed by the taxpayer or a related person, or primarily for internal use by the taxpayer or such person rather than for commercial distribution.

(c) In the case of any spreadsheet software or similar software, any formulae or links to supporting worksheets.

For these purposes, "software," "computer software executable code," and "computer software source code" have the meanings provided for those terms under section 7612(d). For example, computer software executable code includes any related user manuals or similar documentation. Finally, nothing in this revenue procedure shall affect the limitations and protections applicable to summonses for software under section 7612, or the authority of the Commissioner generally to issue a summons for information in accordance with subchapter A of Chapter 78 of the Code.

SECTION 4. USE OF FAIR MARKET VALUE METHOD

.01 A taxpayer may elect to use the fair market value method with respect to any taxable year for which the statute of limitations has not closed. However, an election to use the fair market value method that

is not made until an audit of the taxable year to which the election relates has commenced, or a taxpayer's failure to provide timely the documentation and other information supporting the valuation of the taxpayer's assets, creates administrative difficulties for the Service. Accordingly, section 4 of this revenue procedure sets forth the procedures the Service will follow in the case of taxpayers using the fair market value method and the actions it will request of taxpayers.

.02 In the case of a taxpayer that has made an election to use the fair market value method prior to the opening conference for the audit of the taxable year to which the election relates or who makes such an election within 90 days of such opening conference, if the Service issues a written information document request asking the taxpayer to provide the documents and other information described in sections 3.02 and 3.03 of this revenue procedure and the taxpayer complies with such request within 30 days of the request, then the Service will complete its examination, if any, with respect to the taxpayer's method of interest expense apportionment for that year as part of the current examination cycle. If the taxpayer does not provide the documents and information described in sections 3.02 and 3.03 within 30 days of the request, then the procedures described in section 4.03 of this revenue procedure shall apply.

.03 If a taxpayer makes an election to use the fair market value method more than 90 days after the opening conference for the audit of the taxable year to which the election relates or the taxpayer does not provide the documents and information as requested in accordance with section 4.02 of this revenue procedure, then the Service will in a separate cycle determine whether an examination of the taxpayer's method of interest expense apportionment is warranted and complete any such examination. The separate cycle will be worked as resources are available and may not have the same estimated completion date as the other issues under examination for the taxable year. The Service may ask the taxpayer to agree to extend the statute of limitations on assessment and collection for the taxable year to permit examination of the taxpayer's method of interest expense apportionment, including an extension limited, where appropri-

ate, to the taxpayer's method of interest expense apportionment.

.04 For a taxable year for which the taxpayer and the Service have agreed to use the Limited Issue Focused Exam (LIFE) process announced in IR 2002-133 (December 4, 2002), the time periods agreed to in that process shall apply for purposes of both the election to use the fair market value method and the provision of documents and other information with respect to such method.

SECTION 5. EFFECTIVE DATE

Section 3 of this revenue procedure is effective for taxpayers using the fair market value method for taxable years ending after May 7, 2003. Section 4 of this revenue procedure is effective for fair market value method elections relating to taxable years for which the opening conference of the audit occurs more than 30 days after May 7, 2003.

SECTION 6. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1833.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid OMB control number.

The collection of information in this revenue procedure is in section 3, under which taxpayers may prepare and make available to the Commissioner upon request the documents and other information described therein in order for the Commissioner to make a determination regarding whether a taxpayer's valuation of an asset is reasonable. This information will be used by revenue agents to assist in determining if the taxpayer has established the fair market value of the taxpayer's assets to the satisfaction of the Commissioner. The likely re-

spondents are multinational businesses or other for-profit institutions.

The estimated total annual reporting and/or recordkeeping burden is 625 hours. The estimated annual burden per respondent/recordkeeper is an estimated average of 5 hours. The estimated number of respondents and/or recordkeepers is 125. The estimated frequency of response is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Melissa Arndt of the Office of the Associate Chief Counsel (International). For further information regarding this revenue procedure, contact Ms. Arndt at (202) 622-3850 (not a toll-free call).