CAPLIN & DRYSDALE

Published by Financier Worldwide Ltd
©2023 Financier Worldwide Ltd. All rights reserved.
Permission to use this reprint has been granted by the publisher.

**INDEPTH FEATURE** Reprint May 2023

# TRANSFER PRICING

Financier Worldwide canvasses the opinions of leading professionals around the world on the latest trends in transfer pricing.

# UNITED STATES

## *Caplin & Drysdale Attorneys*

### *Respondents*

**J. CLARK ARMITAGE**
**Member**
**Caplin & Drysdale Attorneys**
**+1 (202) 862 5078**
**carmitage@capdale.com**


J. Clark Armitage is a member of Caplin & Drysdale. He served for eight years with the IRS APA Program and uses that experience to advise multinational corporations on transfer pricing matters. He also advises on other US international tax issues, including sourcing of income and expense, US trade or business issues, the US federal income tax implications of bona fide Puerto Rican residency and status under Puerto Rico Act 20, Act 22, Act 60, and Act 73, and issues arising under the Tax Cuts and Jobs Act of 2017, such as GILTI, FDII, BEAT and foreign tax credit basketing.


**ELIZABETH STEVENS**
**Member**
**Caplin & Drysdale Attorneys**
**+1 (202) 862 5039**
**estevens@capdale.com**


Elizabeth Stevens is a member at Caplin & Drysdale, where her practice centres on transfer pricing and international tax planning and advocacy for corporate clients. In addition to advising on transfer pricing planning, documentation and compliance, she regularly represents companies in the negotiation of advance pricing agreements and in mutual agreement procedure cases. In the broader international tax context, she assists clients in the structuring of US inbound and outbound investment and business activities and cross-border transactions. She also frequently advises on income tax treaty issues.

*Caplin & Drysdale Attorneys*

**Q. Could you outline some of the significant developments in the transfer pricing arena over the last 12 to 18 months? In what ways have these developments impacted how organisations go about implementing their tax planning strategies?**

**A.** A key US transfer pricing (TP) development is the publication of the 3M Tax Court decision. That decision, which was joined by the slimmest possible majority of Tax Court judges, found in favour of the Internal Revenue Service (IRS) in a Brazilian blocked income case. The court required the US taxpayer to include in income arm's length royalties from its Brazilian subsidiary rather than the lower maximum royalties permitted to be paid under Brazilian law. The decision stands for the proposition that TP trumps inconsistent foreign law. This can have both positive and negative implications for taxpayers, depending on the impact of the local law on the taxpayer's global reporting position.

**Q. To what extent are the tax authorities in the US placing greater importance on the issue of transfer pricing? Have they increased their monitoring and enforcement activities?**

**A.** For more than a decade, the IRS has focused closely on TP enforcement. In 2012, it created the Treaty and Transfer Pricing Operations office, which has authority over the competent authority process and, through its Transfer Pricing Practice (TPP) unit, issue control in TP audits. The TPP has 170 employees whose sole focus is identifying and making TP adjustments. The US Inflation Reduction Act dedicated some $80bn to providing additional IRS resources. One focus of the increased budget is international enforcement. TP enforcement can be expected to grow.

**Q. Could you outline the challenges that companies face as they try to maximise their tax efficiencies while staying within the bounds of transfer pricing regulations? Is it becoming tougher to balance the drive for efficiency with compliance requirements?**

**A.** A significant and relatively new TP challenge is uncertainty in the law of TP. The OECD's introduction of the

development, enhancement, maintenance, protection and exploitation (DEMPE) concept has led countries to adopt varying views on what functions play key roles in developing intangibles. This has produced numerous controversies, including litigation in many countries, and challenges to achieving resolution in the competent authority process. Many companies, especially those whose residual profits are driven by something other than product patents, are hard-pressed to know how to predict what types of positions countries might take.

**Q. What kinds of challenges arise in calculating appropriate transfer prices, both for tangible and intangible assets? How crucial is it to have consistent supporting documentation?**

**A.** Method selection and application are now more challenging due to uncertainties in the law of TP and its application. This uncertainty makes it critical for taxpayers to document their facts, and method selection processes and applications, in a manner that is both robust and consistent across their main countries of operation. Taxpayers with relatively weak documentation may be more vulnerable to adjustments and should strive to improve their TP support with each passing year.

**Q. Have you seen an increase in transfer pricing disputes between companies and tax authorities in the US?**

**A.** The IRS continues to review US companies' TP approaches as a matter of first order. At the start of each IRS audit, companies can expect to see a request for TP penalty documentation and, in some cases, background information. One benefit of the IRS's focus on TP is that its audit personnel are generally well-trained. Our experience has been that, once apprised of the taxpayer's TP approach and provided with supporting documentation, the IRS will cease an audit that lacks the probability of an adjustment.

**Q. What steps should companies take if they become the subject of a tax audit or investigation?**

**A.** As with any investigation, taxpayers should not respond before consulting with their professional advisers, should be conscious of the potential for waiving

attorney-client and other privileges, and should preserve documentation that supports or harms their positions. For TP audits, the taxpayer also should ensure that any available path to a competent authority process is kept open. For example, under the US-Canada and US-Mexico double tax treaties, the taxpayer will have access to mutual agreement procedures (MAP) only if it provides notice of a potential adjustment within a fixed period after the close of the relevant taxable year or the filing of the return.

**Q. In general, what advice would you give to companies on reviewing and amending their transfer pricing policies and structures?**

**A.** When amending TP policies, US and other taxpayers should evaluate the potential for retrospective TP adjustments. A method change that produces more income in Country A and less in Country B may be challenged prospectively by Country B, and Country A may challenge lower results from pre-change years. Also, a change in method that coincides with, or even causes, changed facts can be a taxable event, for example if US intangible

*"Method selection and application are now more challenging due to uncertainties in the law of TP and its application."*

*Caplin & Drysdale Attorneys*

property is treated as transferred to a foreign subsidiary. Care should be taken to avoid that outcome or, if desirable, to price it properly. ❑

**www.caplindrysdale.com**

For more than half a century, **CAPLIN & DRYSDALE** has been a leading provider of a full range of tax, tax controversy and related legal services to companies, organisations and individuals throughout the US and around the world. With offices in New York City and Washington DC, the firm also offers counselling on matters relating to bankruptcy, complex litigation, corporate law, creditors' rights, employee benefits, exempt organisations, political activity, private client services and white-collar defence.

**J. CLARK ARMITAGE** Member
+1 (202) 862 5078
carmitage@capdale.com

**ELIZABETH STEVENS** Member
+1 (202) 862 5039
estevens@capdale.com

CAPLIN & DRYSDALE