

## Transfer Pricing’s Next Generation

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In this article, the authors detail the successful second year of a mentorship program that pairs students interested in pursuing transfer pricing careers with in-house corporate tax and transfer pricing leaders, and they share four students’ summaries of a capstone exercise that culminated in a mock India-U.S. competent authority meeting.

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Watch out, transfer pricing world. The next generation of transfer pricing professionals is waiting in the wings, and it is full of stars.

Formulary apportionment and the arm’s-length principle may be strange bedfellows in pillar 1, and pillar 2 seems to signal the sunset of rate arbitrage. Nevertheless, law and economics graduates continue to flock to the transfer pricing field. Emerging graduates possess an intuitive grasp of digital business models as well as keen analytical skills and self-confidence. They are more diverse in terms of education, experience, and perspective as well as ethnicity, race, and religion, and possess more global familiarity than the generation of transfer pricing practitioners who preceded them. Their only arguable deficit might be a meaningful understanding of how their prospective clients — large multinational enterprises — operate their internal tax and transfer pricing functions.

Until now.

In the fall of 2020, the American Bar Association Section of Taxation’s Transfer Pricing Committee launched an educational outreach program called “Transfer Pricing: From Classroom to Boardroom” (TP C2B), a first-of-its-kind curated mentorship program that pairs motivated law and graduate taxation and economics students who are interested in pursuing transfer pricing careers with in-house corporate tax and transfer pricing leaders. The program’s broad goal is to educate and nurture a diverse and well-rounded next generation of transfer pricing professionals by providing opportunities for real-world grounding alongside classroom studies. For students, a structured look into how transfer pricing policies are designed and administered provides a balanced and informed view of a multinational corporation’s priorities and operations. For the corporate mentors, the program offers an opportunity to share the wisdom and experience garnered over many years of working in a critical finance

function and to thereby enhance the transfer pricing profession.

The success of the pilot program exceeded all expectations,<sup>1</sup> and TP C2B returned — bigger and better — for its sophomore year in the fall of 2021. The fiscal 2021-2022 program featured 14 mentor-protégé pairs and culminated in a capstone exercise that leveraged the students' newly acquired transfer pricing knowledge and practical perspectives as well as their negotiating skills: a mock India-U.S. competent authority meeting, held in a hybrid (Zoom and in-person) format in conjunction with the ABA tax section's May 2022 meeting.

Once again, the program succeeded. The students had enriching and unique opportunities to learn about transfer pricing practices in major multinationals. The mentors enjoyed sharing their inside perspectives and teaching students the art of applied transfer pricing. Despite their demanding in-house roles, the mentors gave generously of their time and knowledge, meeting regularly with their protégés throughout the academic year to discuss topics ranging from operational transfer pricing to how a tax department operates and interfaces with other corporate stakeholders, to the students' career paths and interests. In particular, the mentors were instrumental in preparing their students for the challenging capstone exercise. The mentors once again went above and beyond — they deserve not only our gratitude but also public recognition for their contributions.

The TP C2B mentors for fiscal 2021-2022 included Nabeel Anwar of Pfizer Inc., Jessica Arthars of Tapestry Inc., Azedine Assassi of General Electric, Liz Chien of Protocol Labs, Mark Colabella of Dell Technologies, Abhinav Mehta of HSBC Bank USA, Kathryn O'Brien of Carrier Corp., Wade Owen of Visa, Jonathan Palmer of Takeda Pharmaceuticals, David Paul of American Honda Motor Co., Ognian Stoichkov of PepsiCo, Debora Talutto of Veritas Technologies LLC, Joel Wilpitz of Sazerac Co., and Terri Ziacik of Microsoft.

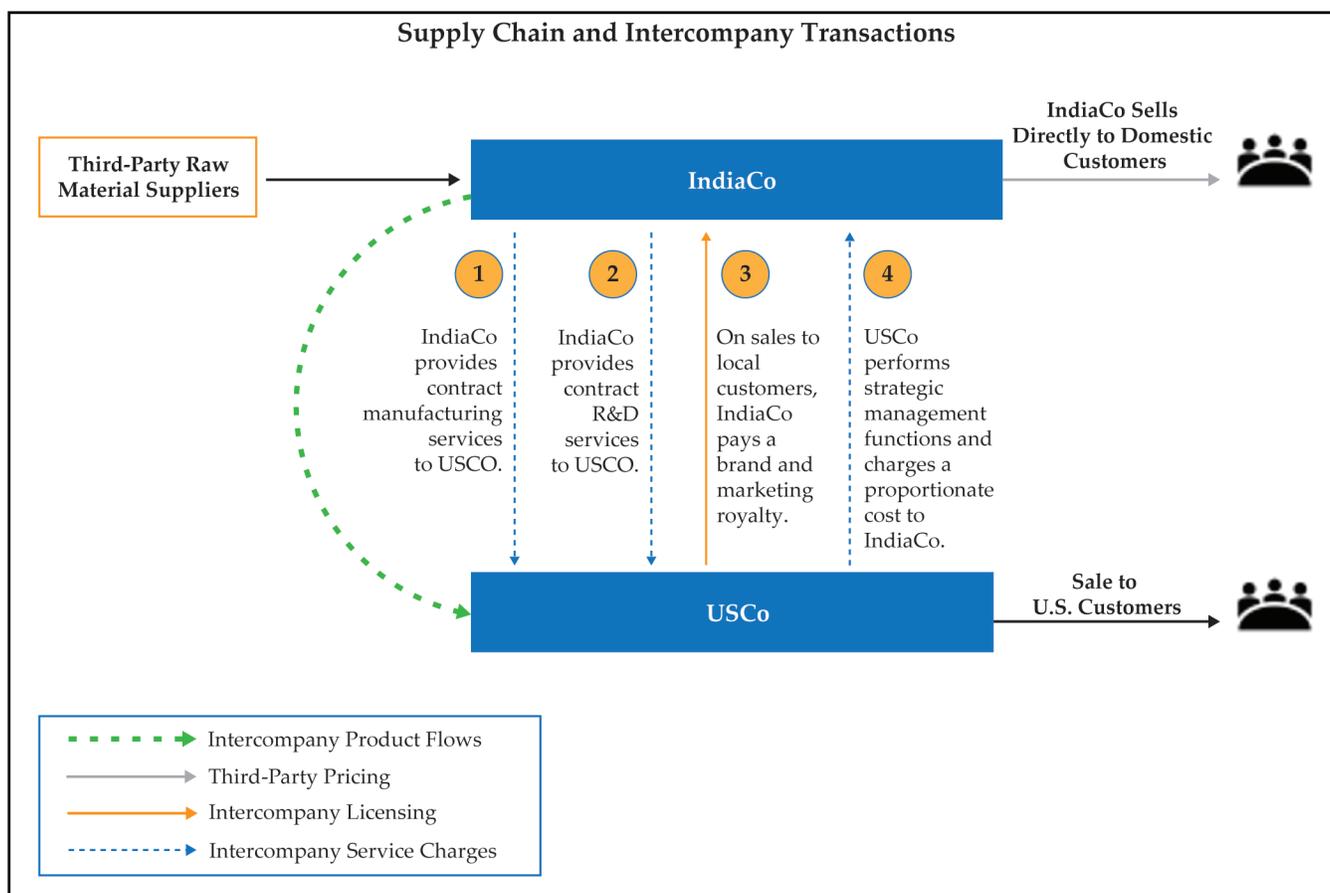
Praise is also in order for our TP C2B mentees: Henrique Annicchino of the University of Florida Fredric G. Levin College of Law (UF Law) (LLM), Colin Casey of the University of Maine School of Law (JD), Brandon K. Cato of the New York University School of Law (LLM), Felipe Restrepo Tamayo of the Georgetown University Law Center (LLM), Carolina Figueroa of Georgetown Law (LLM), Chidera Eugene Igweagu of Georgetown Law (LLM), Pablo Gongora Jercic of UF Law (LLM), Lily Lei Kang of NYU Law (LLM), Scott Kunde of the University of Kentucky College of Law (JD), Chuks Okoriekwe of UF Law (LLM), Ashley Seah of NYU Law (LLM), Michael Splendore of the University of Minnesota Law School (JD), Wei Bin Tan of NYU Law (LLM), and Hannah Gayle Welch of the Texas A&M University School of Law (JD).

### I. The Capstone Exercise

The 2021-22 TP C2B program culminated in a dynamic and challenging capstone exercise: a mock competent authority meeting regarding the request of a U.S. taxpayer (USCo) for mutual agreement procedure relief and a bilateral advance pricing agreement for its Indian subsidiary (IndiaCo). The students were given a detailed case study, including functional analyses and transfer pricing policies for four intercompany transactions, high-level financial data, and hypothetical Indian transfer pricing audit adjustments for the MAP years. They were assigned to three teams. The U.S. taxpayer team's objective was to convince the competent authority teams that its tax return position should be sustained despite the different arguments and the position taken by the Indian tax authority. The U.S. and Indian competent authority teams were expected to negotiate in good faith to relieve double taxation and provide prospective certainty to the taxpayer.

Through dialogue with their mentors and analysis of the case study materials, the students developed negotiating positions and strategies that were put to the test in a live session on May 13, at which they benefited from further coaching by three expert panelists: Howard Berger of Covington & Burling LLP, David Farhat of Skadden, Arps, Slate, Meagher & Flom LLP, and Patricia G. Lewis of Caplin & Drysdale Chtd.

<sup>1</sup>Elizabeth J. Stevens and Niraja Srinivasan, "The Future of Transfer Pricing," *Tax Notes Federal*, Aug. 2, 2021, p. 773.



### The Parties' Positions

|               | Taxpayer                        |           | Indian TPO          |                   |
|---------------|---------------------------------|-----------|---------------------|-------------------|
|               | FY 2017-FY 2019                 | APA Years | FY 2017 and FY 2018 | FY 2019           |
| Transaction 1 | 10% markup on total costs (MTC) |           | 45% MTC             | 35% MTC           |
| Transaction 2 | 15% MTC                         |           | 5% of U.S. sales    | 10% of U.S. sales |
| Transaction 3 | 4% of India sales               |           | 1% of India sales   |                   |
| Transaction 4 | 10% MTC                         |           | Disallowed          | 25% allowed       |

The results were not only impressive but also arm's-length(ish). Before an audience of ABA tax section members and their mentors, who were assembled in person and through Zoom, the students presented their positions and arguments and successfully negotiated an outcome *in under two hours*. In response to a former team leader's quip that they might well be better at this than he was, one student replied, "Then you should hire us!"

Governments and other employers, take note.

We invited the students to each submit a short summary describing their approaches to the capstone exercise, focusing on key arguments and negotiating strategies. Four students, two from the U.S. taxpayer team and two from the Indian competent authority team, chose to participate. Below we present their original, copy-edited submissions followed by a look ahead to the next year of TP C2B.

The case study involved India-initiated transfer pricing adjustments to four transactions

for the taxpayer's 2017-2019 fiscal years. The proposed APA would cover all four transactions for fiscal years 2020-2024 (see figure).

The positions of the taxpayer and the Indian transfer pricing officer (TPO) are as indicated in the table.

## II. India Competent Authority Team Perspectives

### A. Hannah Gayle Welch

After several months learning about transfer pricing from my mentor, David Paul, in the TP C2B mentorship program, I participated in the capstone project as part of the Indian competent authority team. Our team began by reviewing the capstone materials together and discussing them separately with our mentors. During our next team meeting, we collected our preliminary conclusions about the different transactions, which our mentors then helped shape into strong arguments.

Our team determined that our strongest argument was for transaction 3 (brand royalty paid on domestic sales by IndiaCo to its U.S. parent, USCo). We argued that India had its own market for luxury brands, and USCo contributed nothing more than a routine advertising company would in the form of supplies and basic templates. This argument was supported by the fact that IndiaCo had its own team of designers who produced \$10 million in revenue from Indian consumers. We also determined that the most important transaction was transaction 2 (IndiaCo receiving a cost-plus markup from USCo for research and development services). If we were able to successfully argue that USCo owed IndiaCo a 5 percent royalty for its part in R&D, the income from that transaction would have been enough to cover the other transactions combined. Unfortunately, this was also our weakest argument, and we understood that we would have to bargain to receive any amount of royalty.

After a suggestion from one of the program directors, we adjusted some of the numbers determined by the Indian TPO auditor to bring them closer to what we believed the U.S. competent authority would find acceptable. Changing these numbers strengthened our arguments and showed our willingness to remain reasonable, but our demands were still more than

we believed we could successfully negotiate. We left these numbers on our presentation to keep our position strong, but our team also discussed the lowest numbers we would be willing to accept and which transactions we would be willing to forgo altogether in order to settle.

Before the negotiation, we met with our team's coach to discuss our strategy. He suggested that we should also use our requests for the previous years to bargain for future years, and vice versa — advice we used zealously. During the negotiation, the U.S. competent authority seemed much more amenable after we began leveraging this bargaining strategy. Between our transaction arguments, our willingness to drop lower than our initially demanded numbers, and our coach's advised strategy, we were able to negotiate a reasonable settlement that was satisfactory to all teams.

### B. Pablo Gongera Jercic

I was a member of the Indian competent authority team. Over four strategic meetings, our group assigned tasks to team members depending on our level of understanding of the case.

First, we focused on understanding the facts, in which the assistance of our mentors was crucial. Then we assigned the analysis of specific transactions to team members. Each analysis was later presented to other team members, who raised questions, suggestions, and possible rebukes to build up a case theory that best represented our understanding of the positions.

Regarding our negotiation strategy, we agreed that the Indian tax authorities' assessment on transaction 2 was crucial to maintain. If we were able to get to an agreement on that, we could give up some of our position on the remaining transactions. In this transaction, the U.S. taxpayer claimed that IndiaCo was a contract R&D services provider, since it only performed R&D activities based on the instructions that were given by USCo. However, the Indian tax authorities concluded that the main R&D activities were performed by people located and hired by IndiaCo; thus, the entity was in reality a technology intellectual property developer.

Our research taught us that this debate is not new. Several MNEs have established subsidiaries

in India for R&D activities on a contract basis to profit from the large pool of skilled workers available at a lower cost. The parents of these R&D centers justify low cost-plus markups on the grounds that they control all the risks and their subsidiaries;<sup>2</sup> therefore, determining whether Indian subsidiaries are bearing economically significant risks on the business is a key issue when determining the transfer prices. As a result, Indian law has specific rules on the matter.<sup>3</sup>

Our strategy was to present a very strong position on this transaction, giving the impression that it was going to be hard for us to renounce it. Then, when it was time to reach an agreement, if we decided to relinquish a part of it, it would give the impression that we understood the position of our counterparty. This strategy was shared with our coach at the capstone, and he fully supported it. In the mock negotiation, our strategy was successful.

I found the capstone to be truly helpful, since it presented an opportunity to apply the knowledge learned throughout the year in a teamwork setup. I truly believe that my understanding of transfer pricing was enhanced by this program. I can't recommend it enough.

### III. U.S. Taxpayer Team Perspectives

#### A. Chuks Okoriekwe

Having studied U.S. transfer pricing in my first semester at UF Law, it was a delight to be selected by the ABA Section of Taxation Transfer Pricing Committee to participate in the TP C2B mentorship program. It gave me an opportunity to practice transfer pricing and have conversations with practitioners (mentors) in the program on transfer pricing's technical nuances, especially MAP and negotiation. The highlight of the mentorship program was the capstone project with three teams: the taxpayer team (USCo and IndiaCo), the Indian competent authority team, and the U.S. competent authority team.

After the teams' briefing on the capstone, mentors were consulted to provide clarity on

some of the issues raised. However, as a rule, mentors were not expected to solve any of the problems but only to provide pointers on possible areas of further research.

Thus, the taxpayer team consisting of economists and lawyers isolated the issues that could affect the taxpayer after the Indian tax authority's TPO report said that all the intercompany transactions between USCo and IndiaCo were not at arm's length.

Accordingly, there were four transactions being disputed. These included: transaction 1 — contract manufacturing services provided by IndiaCo to USCo; transaction 2 — contract R&D services provided by IndiaCo to USCo; transaction 3 — brand and marketing IP licensing by IndiaCo; and transaction 4 — a management services fee charged by USCo to IndiaCo.

The team's strategy going into the negotiation was to have the best possible outcome for the taxpayer while also being prepared to concede on some grounds that may be raised by the Indian tax authority, inasmuch as it would not increase the taxpayer's tax exposure in India and subsequently in the United States.

In preparing the team's submission to the Indian tax authority, an analysis of its audit of IndiaCo was carried out against the backdrop of transfer pricing documentation submitted by the taxpayer to the Indian tax authority. The functions, assets, and risks undertaken by each of the parties in the transactions were analyzed to better extrapolate the obligations of both USCo and IndiaCo.

The question that often arose during the team's research and discussions with mentors was whether the transfer pricing method used by the taxpayer was the best method given the facts and circumstances of each transaction. In defending its position, different analyses were conducted for their activities, including manufacturing, R&D, brand royalty, and strategic management services. As shown by the analysis of the taxpayer, the sample size, profit-level indicator, and interquartile range with which the transactions were benchmarked were reasonable — as opposed to the independent analysis of the Indian competent authority, which, among other things, disallowed the deduction of payments made by

<sup>2</sup>United Nations, *Practical Manual on Transfer Pricing for Developing Countries* 594 (2021).

<sup>3</sup>See Government of India, Department of Revenue, Circular No. 02/2013, "On the Application of the Profit Split Method" (2013).

IndiaCo for management services without conducting a benchmarking analysis.

In conclusion, the research, presentation, and coaching session at the capstone were all invaluable experiences in building my capacity to become an expert in transfer pricing practice.

### B. Chidera Eugene Igweagu

Our task as the U.S. taxpayer team began with a preliminary meeting to understand and discuss the case study and expectations for the capstone exercise. We agreed that for efficiency and in keeping with the timeline (considering ongoing finals), each person was to work on a specific disputed transaction and speak with our mentors for more insight and guidance.

I handled transaction 2, which is contract R&D services provided by IndiaCo to USCo. In analyzing the relevant functions, assets, and risks, we identified that USCo performed a combined 65 percent of the functions and 100 percent of the R&D and production risk, while IndiaCo appeared to have contributed 100 percent of the manufacturing know-how. However, IndiaCo's research and design center, which develops new products, operated under the direction of the U.S. R&D team. Since the know-how was not a legally registered intangible, the control test should be applied to determine what portion of the profits was attributable to each party. We reasoned that since IndiaCo relies on USCo for direction in developing the intangible, USCo bore the significant risk and should be attributed a greater portion of the profits. As such, the compensation should be determined *ex ante* — that is, at the time the contract for the transaction was entered into and before the risks associated with the intangible play out.

Therefore, it was our position that the comparable profits (transactional net margin) method was the best method for determining the arm's-length result. This method determines the arm's-length result based on objective measures of profitability (profit level indicators) derived from uncontrolled taxpayers that engage in similar business activities under similar circumstances. We argued that since USCo provided direction and oversight for the development of the know-how, it made a unique intangible contribution, while IndiaCo's functions were relatively simple

and routine. We then argued that the net profit indicators (the ratio of operating profits to total costs) are more tolerant to functional differences between controlled and uncontrolled transactions. We concluded that IndiaCo should earn a cost-plus markup — that is, a return on total costs. The interquartile range for the uncontrolled transactions was between 5 and 25 percent, with a median of 10 percent. So we argued that IndiaCo's earning 15 percent was arm's length and should be respected.

We followed a similar pattern in analyzing the rest of the disputed transactions. It was instructive to learn that dividing up functions, assets, and risks in percentages (as we did) was not the best approach because each party could assign whatever percentage it felt comfortable with and/or create more functions and associated risks. Also, although we maintained that the returns filed by IndiaCo should be respected, we left a bit of wiggle room in anticipation of hard-line negotiations by the other team. More importantly, we considered what the tax differential would be if concessions were required. This tax differential was weighed *vis-a-vis* the costs of litigation and made us amenable to an agreement.

### IV. 2022-2023 TP C2B Launch

Planning is underway for the third year of TP C2B. We believe — and our mentors and protégées heartily agree — that the program adds a valuable new dimension to the transfer pricing profession. It serves the educational and diversity objectives of the ABA, the tax section, and the Transfer Pricing Committee. It builds connections between people and invests in the future of our profession. Our mentors are already leaders in this field; our students are the next generation. With the continued sponsorship of the ABA and growing engagement from the corporate sector, the success of TP C2B is assured for many years to come.

Watch this space. ■