DID YOU GET YOUR BADGE SCANNED?

Transfer Pricing Developments

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Lori Hellkamp, Partner, Jones Day

Moderator:  
Richard Slowinski, Partner, Baker McKenzie
Topics

1. Potential Implications of Tax Reform on Transfer Pricing
2. OECD BEPS Transfer Pricing Developments
3. Recent & Pending Transfer Pricing Cases
4. Transfer Pricing Enforcement Developments
5. IRS APMA Developments
Potential Implications of Tax Reform on Transfer Pricing
Definition of “Intangible Property”

- § 936(h)(3)(B) definition of “Intangible Property” amended to include:
  - Goodwill, Going concern value, Workforce in place
  - Residual category of any other items the value or potential value of which is not attributable to tangible property or services of an individual

- Relevant to § 482 and § 367

- Coupled with the repeal of the active trade/business exception, this eliminates previous uncertainties regarding the treatment of outbound transfers of such items under § 367(a) or § 367(d)
  - Taxpayers now required to recognize a deemed royalty under § 367(d) (in accordance with § 482 principles)

- To what extent are revisions to regulations necessary to reflect changes to IP definition?
Valuation of Intangible Assets

- § 367(d)(2) and § 482 amended to require valuation of transfers of intangible property on:
  - Aggregate basis
  - Realistic alternatives basis
if the Secretary determines such basis is most reliable means of valuation

- Aggregation and realistic alternative principles already found in § 482 regulations
  - Application of these principles must still be the most reliable method, and applied in accordance with arm’s-length standard
  - Codification presumably intended to confirm government’s position and protect existing regulatory principles from challenges

- Query whether additional regulations are necessary
- What is the likely disposition of T.D. 9738 (Temporary regulations regarding aggregation issued Sept. 2015)?
<table>
<thead>
<tr>
<th>Provision</th>
<th>Code Section</th>
<th>Impact</th>
<th>Primary Entities Affected</th>
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<tbody>
<tr>
<td>BEAT Base Eroding Anti-Avoidance Tax</td>
<td>59A</td>
<td>Limit “base eroding” outbound payments</td>
<td>Foreign multinationals with U.S. operations</td>
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<td>GILTI Global Intangible Low-axed Income</td>
<td>951A</td>
<td>Tax “excess” income in foreign markets from intangible property</td>
<td>U.S. multinationals; IP holding companies</td>
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<tr>
<td>FDII Foreign-Derived Intangible Income</td>
<td>250</td>
<td>Deduction of 37.5% for certain foreign-derived intangible income plus 50% of GILTI</td>
<td>U.S. multinationals; IP holding companies</td>
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</tbody>
</table>
Impact of Tax Reform on Transfer Pricing - BEAT

A key feature of the Tax Cuts and Jobs Act is a new Base Erosion Anti-Avoidance Tax (“BEAT”) (§ 59A)

In simplified terms, the BEAT requires an alternative tax calculation, using a base which eliminates deductions for outbound deductible payments that are classified as base-eroding

§ 59A(d)(5)(A) indicates that, where payments for intercompany services are concerned, the BEAT does not apply to the portion of the payment that is eligible for the Services Cost Method (“SCM”) under Treas. Reg. § 1.482-9(b), i.e., the cost-only component of the intercompany services payment

This exclusion applies without regard to the so-called business judgment test in Treas. Reg. § 1.482-9(b)(5)
Impact of Tax Reform on Transfer Pricing - IP

To what extent will the following statutory changes affect amounts charged in intercompany IP transactions?

- Definition of compensable IP
- Aggregate basis valuation
- Realistic alternatives
OECD BEPS Transfer Pricing Developments
OECD BEPS Transfer Pricing Developments

Taxation of the digital economy

Key areas for US and Western European jurisdictions (e.g., sourcing, residency, valuation, characterization)

Potential implications for taxpayers

Taxation of financial transactions

Impact of updated OECD Transfer Pricing Guidelines on tax audits

OECD launch of International Compliance Assurance Programme (ICAP) pilot
Recent & Pending Transfer Pricing Cases
Recent Transfer Pricing Cases

US Transfer Pricing Cases

Altera Corp. v. Commissioner
Amazon.com, Inc. v. Commissioner
The Coca-Cola Co. v. Commissioner
Eaton Corp. v. Commissioner
Facebook, Inc. v. Commissioner
Illinois Tool Works, Inc. v. Commissioner
Medtronic, Inc. v. Commissioner
TBL Licensing LLC v. Commissioner
Thomson Reuters America Corp. v. Commissioner
United States v. Microsoft, Inc.
Wycoff v. Commissioner
Zimmer Biomet Holdings Inc. v. Commissioner

Non-US Transfer Pricing Cases

Chevron Australia Holdings Pty Ltd
Amazon (EC state aid)
Transfer Pricing Enforcement Developments
IRS Campaigns Regarding Transfer Pricing Issues

In recent years, the familiar tiered issue program was eliminated, in favor of “campaigns” which will address priority enforcement areas.

To date, only two campaigns have been initiated that pertain to transfer pricing issues:

- Inbound distribution and
- Related party transactions

Under previous enforcement initiatives, feedback from IRS Examination was considered important over time, as the initiative was rolled out and implemented.

It is uncertain what how such feedback will be obtained, or if it will serve a similar function under the new structure.
IRS LB&I Directives (January 12, 2018)

In November 2017, at the George Washington University/IRS Conference on International Taxation, IRS Assistant Commissioner for Services and Enforcement Kirsten Wielobob made the following comment:

“We are taking a look at our transfer pricing work . . . . We can’t continue to do things as they are . . . .[it’s] a not-so-subtle message we’ve received from the courts.”

Bloomberg BNA Transfer Pricing Report, December 14, 2017
IRS LB&I Directives (January 12, 2018), cont’d

In January 2018, LB&I Commissioner Doug O'Donnell issued a series of directives concerning transfer pricing issues:

- Mandatory transfer pricing information document request
- Application of § 6662(e) penalties
- Evaluation of reasonably anticipated benefits in cost sharing arrangements
- Treatment of stock-based compensation in cost sharing arrangements
- Best method selection

With the exception of the best method selection directive, these directives are consistent with the historic pattern whereby the IRS issues guidance on procedure or process issues that require increased coordination.
IRS APMA Developments
Interaction of BEAT and APAs

BEAT is essentially an AMT imposed on large MNEs with sufficient outbound deductible related-party payments, calculated by adding back such deductions and certain credits.

Existing APAs – based on pre-BEAT U.S. taxation:
- BEAT may introduce (potentially significant) additional U.S. tax, and could affect parties’ understanding of the agreed-upon taxing allocation and results
  - Change in critical assumptions? Material change in governing law?
  - Will Competent Authority re-visit existing APAs?
  - Treasury limited in any regulatory relief it can offer taxpayers?

Consider whether future APAs (and MAP cases) to specify character of transfer pricing payments, since some may be subject to BEAT while others will not.
IRS APMA – Mutual Agreement Procedure Update

Update on mutual agreement discussions with treaty partners

- Developments regarding particular treaty partners
- OECD Peer Review results (BEPS Action 14)
IRS APMA User Fees

IRS announced increases in APMA user fees (for APAs only) on Feb. 6, 2018:

<table>
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<tr>
<th>Type of APA Request</th>
<th>Current</th>
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Thank you!