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March 7-8, 2019

Ronald Reagan Building and International Trade Center  
Washington, D.C.

## New World for Resolving Transfer Pricing Disputes

- Panelists:
- John Hughes, Director, Advance Pricing and Mutual Agreement Program, Internal Revenue Service
  - Marissa Rensen, Special Counsel, Associate Chief Counsel (International), Internal Revenue Service
  - Michael Friedman, Partner, McMillan LLP
  - Ed Froelich, Of Counsel, Morrison & Foerster LLP
- Moderator: Richard Slowinski, Partner, Baker McKenzie



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## Agenda

1. How IRS is approaching transfer pricing enforcement, including the LB&I directive on RAB shares, etc.
2. Update on transfer pricing litigation developments, potential effect on intercompany transactions and identifying future trends.
3. What IRS APMA developments mean for taxpayers.
4. Changes in administrative and policy orientations of the Canada Revenue Agency toward transfer pricing in Canada.



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1. How IRS is approaching transfer pricing enforcement, including the LB&I directive on RAB shares, etc.



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## IRS Actions on Reasonably Anticipated Benefit (RAB) Shares in Cost Sharing Arrangements

- IRS LB&I Directive, Instructions for Examiners on Transfer Pricing Issue Selection – Reasonably Anticipated Benefits in Cost Sharing Arrangements, Jan. 12, 2018
- IRS AM 2018-0003 (July 26, 2018)
  - Issued in response to directive
  - Ability to determine multiple RAB shares in a CSA
  - Use of separate RAB share for subsequent PCT



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What involvement does IRS ACCI have in Transfer Pricing issues?

- Campaign development
- Examination stage
- Appeals
- Litigation
- Published guidance



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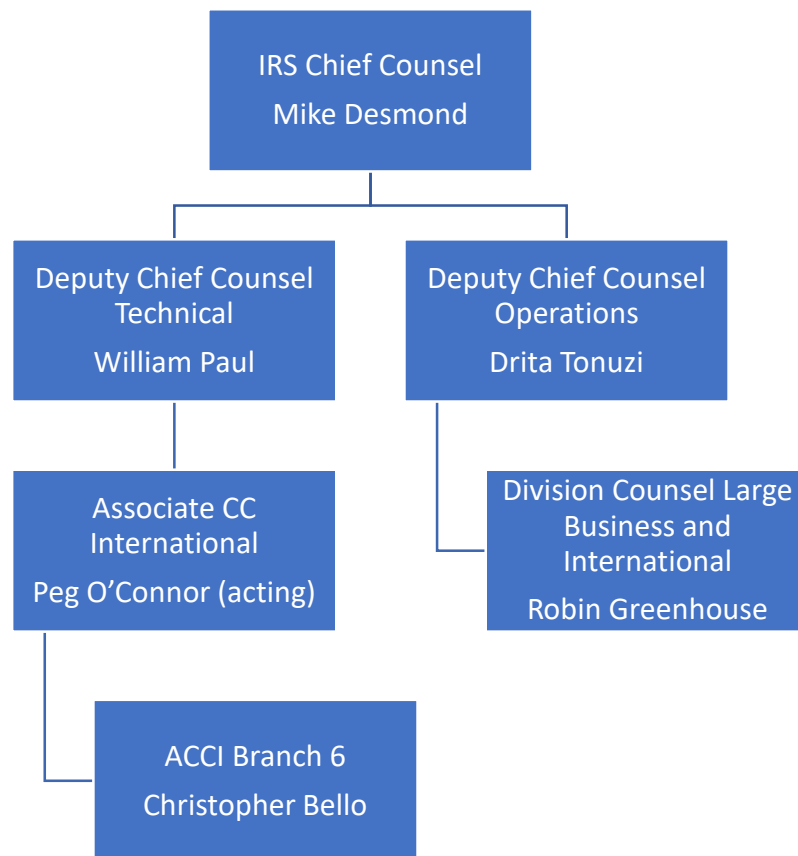


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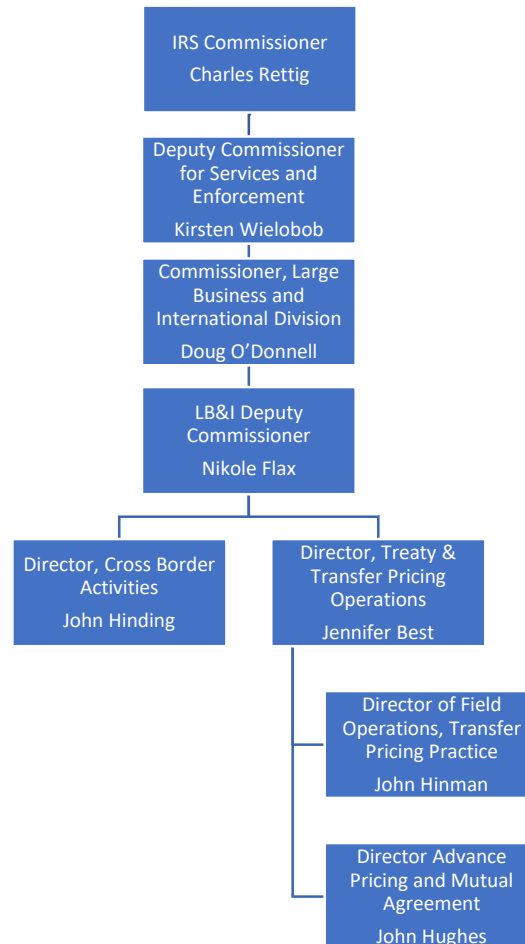


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2. Update on transfer pricing litigation developments, potential effect on intercompany transactions and identifying future trends.



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- Docketed Transfer Pricing Cases (non-exhaustive)
  - Altera
  - Amazon
  - Coca-Cola
  - Eaton
  - Facebook
  - Medtronic
  - Microsoft
  - Perrigo
  - Western Digital
  - 3M
- Examples of the types of issues in docketed cases
  - Cost sharing
  - Licensing
  - Round tripping
  - Blocked income
  - Validity of regulations
  - Interpretation of arm's length standard



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- *Altera Corporation v. Commissioner* (9th Circuit No. 16-70496 and No. 16-70497)
  - Background
    - Tax Court – issuance of final cost-sharing regulation violated the “reasoned decisionmaking standard” imposed by the Administrative Procedure Act
    - Ninth Circuit withdraws initial reversal
    - Supplemental briefing on statute of limitations issue
  - Possible Outcomes?
  - Impact on *3M Co. v. Commissioner*?
  - Impact on arm’s length standard interpretation in other cases?



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- *Medtronic v. Commissioner*, 900 F.3d 610 (8th Cir. 2018)
  - Background
    - Tax Court ruled IRS abused discretion
    - Tax Court rejected taxpayer's transfer pricing and determined its own
    - Eighth Circuit vacated and remanded instructing the Tax Court to better explain its determination
  - Abuse of discretion holding?
    - What if there was no refund claim?
  - What's a poor Tax Court to do?
    - Reopen record
    - Court-appointed expert



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- *Amazon.com v. Commissioner*, 148 T.C. 108 (2017)
  - Background
  - Tax Court ruling
    - IRS abused discretion
      - Improper inclusion of post-buy in intangibles
      - Improper assumption of perpetual life
    - Erroneous application of regulations
      - Aggregation rule cannot override buy-in/CSA structure
      - “Realistic alternative” rule too broadly interpreted
      - Future application?



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- What themes emerge from these cases?
- Is it possible to portend future trends in litigation?



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3. What IRS APMA developments mean for taxpayers.



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- Effect of IRS APMA Reorganization
  - Resources
  - Organization
  - Efficiency
  - Case resolution
- IRS APMA Approach with Treaty Partners
  - Tools to reach resolution
  - Key issues in competent authority negotiations



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- IRS APMA's Functional Cost Diagnostic Model (Feb. 28, 2019)
  - Background and purpose
  - Scope of use
  - Input from taxpayers
- IRS LB&I Interim Guidance on Mandatory Issue Team Consultations with APMA for Examination of Transfer Pricing Issues Involving Treaty Countries (Feb. 19, 2019)
  - Objectives
  - APMA's role in taxpayer's transfer pricing issue



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- Impact of OECD BEPS project on IRS APMA
  - To what extent does IRS APMA incorporate elements from OECD BEPS project in its positions?
  - In which other jurisdictions are tax authorities asserting OECD BEPS-type arguments?
- How TCJA Impacts IRS APMA
  - Changes in IRS APMA workload, case mix, etc.
  - Ability for APAs to address certain TCJA elements
  - Addressing APA and MAP cases straddling pre- and post-TCJA years



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- Consideration of tariffs or customs duties and transfer pricing
  - Potential effect of tariffs or duties on transfer pricing
    - Purchase or sales price
    - COGS
    - Operating profit
  - Comparability adjustment considerations
  - Critical assumption trigger?
  - Ability to consult with IRS APMA



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4. Changes in administrative and policy orientations of the Canada Revenue Agency (the “CRA”) toward transfer pricing in Canada.



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## The Canadian Transfer Pricing Landscape

- Transfer pricing is a key tax compliance issue for the Department of Finance (Canada) and the CRA
- Significant new financial and staffing resources have been allocated to “improve tax compliance” and “crack down on tax evasion and combat tax avoidance”
  - Recent federal Budgets have proposed to invest in excess of CDN\$1 billion over seven years to hire additional auditors and specialists, develop “robust business intelligence infrastructure” and “risk assessment systems”, and increase verification activities
  - The federal government has repeatedly predicted a 5x ROI



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## The Canadian Transfer Pricing Landscape

- Recent Canadian Competent Authority data on the MAP Program
  - 224 negotiable MAP cases in 2017
  - 85% of closed cases resulted in full relief from double taxation
  - 73% of closed cases were initiated by Canada
  - The average time to complete a negotiable MAP case was 21.4 months
  - The transactional net margin method continued to be the most frequently employed transfer pricing methodology (71% of closed cases)



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## Recent Developments in CRA Administrative Practices on Audits

- Immediate requests for contemporaneous documentation at the commencement of all multi-national audits
  - Strict adherence to statutory delivery deadline [*paragraph 247(4)(c) of the ITA*]
- Increasingly aggressive assessment/rejection of taxpayer comparables
  - Heightened focus on screening measures and functional distinctions
- Despite published preference for Traditional Transaction Methods for assessing transfer prices [*CRA Information Circular 87-2R, para. 52*], outside of the Comparable Uncontrolled Price Method, increasing gravitation toward Transactional Profit Methods (Profit Split Method/Transactional Net Margin Method)



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## Recent Developments in CRA Administrative Practices on Audits

- Tendency toward one-sided comparability adjustments when applying transfer pricing methods
- Influence of arbitration provision under Article XXVI(6) of the *Canada-US Treaty*



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## Impact of Recent Canadian Jurisprudence on the CRA's Orientation Toward Transfer Pricing

- *Cameco Corporation vs. The Queen*
  - Case focused on transactions that purportedly transferred economic opportunities outside of the Canadian tax net
  - Tax Court judgment:
    - Narrowly applied the Canadian transfer pricing “recharacterization” provisions
    - Partially rejected CRA transfer of economic opportunity doctrine
    - Narrowed view of sham doctrine in the transfer pricing context



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## Impact of Recent Canadian Jurisprudence on the CRA's Orientation Toward Transfer Pricing

- Future Audit Implications of *Cameco*
  - More cautious CRA approach to transfer pricing litigation
    - Certain pending cases settled for materially less than reassessed amounts [*Silver Wheaton*]
    - CRA revisiting scope of transfer of economic opportunity doctrine



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Thank you!



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