HIGHLIGHTS

Senate Hearing Puts Caterpillar’s ‘Swiss Tax Strategy’ Under Scrutiny
Under harsh questioning at an April 1 Senate subcommittee hearing, executives from Caterpillar, Inc. and PricewaterhouseCoopers LLP defend a tax strategy that allowed the U.S. construction equipment giant to send billions in profits to Switzerland. Sen. Carl Levin (D-Mich.), chair of the Senate Permanent Subcommittee on Investigations, blasts the structure as a tax dodge and calls on the Internal Revenue Service to more aggressively enforce the arm’s-length standard and the economic substance doctrine. Lead Report, Page 1427

Country-by-Country Template To Require Only ‘Aggregate’ Reporting
A proposed country-by-country reporting template will require multinational companies to report only aggregate figures by country, not to break out financials on an entity-by-entity basis, says Joseph Andrus, head of transfer pricing with the Organization for Economic Cooperation and Development, speaking at a Paris transfer pricing conference sponsored by Bloomberg BNA and Baker & McKenzie LLP. Page 1444

U.S., German Rules Could Present Solution to BEPS, OECD Officials Say
As the OECD considers special measures for pricing related-party intangible transactions, it may take a hard look at rules adopted in Germany and the U.S., and OECD official says … The commensurate-with-income approach could be one solution, according to another OECD official, speaking at the Bloomberg BNA and Baker & McKenzie transfer pricing conference in Paris. Page 1447; Page 1449

Tax Court Orders IRS To Explain Grounds for Canceling Eaton’s APAs
The U.S. Tax Court orders the Internal Revenue Service to explain its grounds for canceling two advance pricing agreements with Eaton Corp. or be prepared to make a top-ranking IRS official available for deposition by the company. Page 1430; Text, Page 1453

PRACTITIONER ANALYSIS

Goodwill, Business Valuation and Coming Transfer Pricing Litigation
John Breen of Skadden, Arps, Slate, Meagher & Flom LLP, in Washington, D.C., examines the U.S. Court of Federal Claims’ ruling in Deseret Management Corp. v. U.S., a domestic case between related parties that highlights the challenges of isolating goodwill from other business assets. Page 1481

U.S. Customs: Slow Going on Transfer Pricing Policy
Damon V. Pike and Cylinda Parga of The Pike Law Firm, P.C., in Decatur, Ga., discuss the impact of a new U.S. Customs and Border Protection policy regarding post-importation transfer pricing adjustments on three subsequent rulings from CBP. Page 1473

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UNITED STATES: March filings with the Securities and Exchange Commission show three major pharmaceutical companies reporting transfer pricing concerns. Page 1432; Text, Page 1454

UNITED STATES: The IRS releases its annual report to Congress on its advance pricing program, showing 145 APAs closed in 2013. Page 1430; Text, Page 1460

OECD: The OECD releases a discussion draft on the digital economy, including proposals that would modify existing PE rules. Page 1447

INDIA: Cairn Energy, a Scottish oil and gas company, says it is suspending its $300 million share buyback program because of an investigation into its accounts by the Indian Tax Department. Page 1442

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In the latest of a series of hearings into international tax planning by U.S. multinationals, Sen. Carl Levin (D-Mich.) blasted executives from Caterpillar Inc. and their tax advisers, PricewaterhouseCoopers LLP, for a restructuring of the manufacturer’s distribution network that led to billions in tax savings. Levin, who has been pushing for an overhaul of international tax rules, said the restructuring was actually a tax dodge. He called for the Internal Revenue Service to more aggressively enforce the arm’s-length standard as well as the economic substance doctrine.

In the latest in a series of high-profile hearings into international tax avoidance April 1, Sen. Carl Levin (D-Mich.) took aim at an old-line manufacturer, Caterpillar Inc., for setting up a distribution network that he said amounted to little more than a legal fiction.

“It’s a tax deal,” Levin said at the conclusion of the hearing. “It’s clear that the Caterpillar license transaction fails the arm’s-length standard, it also fails the economic substance test, because it has no business purpose other than tax avoidance.”

Levin, who is chairman of the Senate Permanent Subcommittee on Investigations, used the hearing to push for changes to U.S. tax laws. But he also implied that the Internal Revenue Service had failed to rely on existing laws—including the economic substance doctrine—to combat abusive structures.

Caterpillar Inc., the Peoria, Ill.-based manufacturing equipment giant, paid tax adviser PricewaterhouseCoopers $55 million in 1999 to help it restructure its distribution chain, according to the subcommittee. PwC set up a system under which the company shifted some $8 billion in profits to a Swiss affiliate, thus escaping $2.4 billion in U.S. taxes in the process.

The subcommittee report on Caterpillar’s practices, released the eve of the April 1 hearing, also recommends that the IRS “clarify” its role for enforcing the arm’s-length principle and the economic substance doctrine.

“The IRS should analyze ... whether the transactions have economic substance apart from deferring of lowering a multinational’s U.S. taxes. The IRS should also clarify what types of transfer pricing transactions, if any, are not subject to an economic substance analysis,” the report states.

However, the subcommittee did not call any witnesses from the IRS to testify at the hearing.

Corporate Restructuring

Caterpillar, the largest producer of construction equipment in the world with nearly $90 billion in assets, hired PwC in the late 1990’s to examine its tax setup, according to the subcommittee report.

The restructuring altered the legal supply chain for the company’s replacement parts business. According to the report, Caterpillar replaced its 40-year-old Swiss subsidiary, Caterpillar Overseas, with Caterpillar SARL, (CSARL), which became “global purchaser” of machine parts from independent suppliers. CSARL also sold the parts to independent dealers—cutting out the role which the parent organization, Caterpillar Inc., had played in the prior arrangement.

Through a series of service and licensing agreements with various subsidiaries which were eventually bundled into one overall contract, Caterpillar Inc. provided logistical and management support to CSARL, as well as the rights to use its trademark and other intellectual property related to the company’s global network of dealers and suppliers for, according to the report, less than 15 percent of the profits from the parts business.

As characterized by the report, little changed in the actual operations of the company.
“In essence, the service agreement required Caterpillar to continue to manage the parts business, since CSARL did not have the personnel, infrastructure or expertise to perform those functions,” the report states.

After the restructuring was complete, Caterpillar said that an analysis of CSARL found it had previously undervalued intangible assets, especially those related to marketing. The subcommittee views those statements skeptically in its report, implying that the company instead intentionally undervalued them while creating CSARL, then artificially enhanced them after the fact in order to justify the company’s large share of the parts’ profits.

“The bottom line is that when CSARL acquired marketing intangibles from [Caterpillar Americas, a previously established subsidiary] it assigned almost no value to them,” the report states. “Yet when CSARL was created, Caterpillar claimed it had found ‘newly recognized’ marketing intangibles that were so valuable they justified increasing the portion of non-U.S. parts profits sent to Switzerland. Those two positions are irreconcilable.”

**Cutting an ‘Unnecessary Middleman’**

Representatives from Caterpillar, who testified at the hearing, said the new tax structure accurately represents a streamlined, simplified supply chain.

“Prior to the restructuring, Caterpillar Inc. acted as an unnecessary middleman buying these parts from independent suppliers and selling them to CSARL, which then sold them to dealers outside of the U.S.,” said Julie Lagacy, vice president of Caterpillar Inc.’s financial services division. “Prudent, lawful business planning required us to eliminate the unnecessary middleman from the transaction flow. We cannot remain competitive, we cannot create jobs, and we cannot increase exports by incurring unnecessary expenses.”

Lagacy also noted that Caterpillar has been doing business in Geneva since the 1960s.

Thomas Quinn of PwC in Chicago, who advised Caterpillar during its reorganization, noted that CSARL was exposed to market risks due to the re-organization.

“In sum, from its outset, Caterpillar SARL carried the business and market risks and received the profits or losses from being the owner and seller of the machines and purchased replacement parts in the international markets,” Quinn said. “Because the sales no longer involved related-party transactions between Caterpillar and its foreign affiliates, or between foreign affiliates themselves, they were subject to the fundamental U.S. tax rule that foreign business income is not currently taxed until the income is remitted to Caterpillar in the United States.”

Quinn also noted that Caterpillar Inc. has had an annual average effective tax rate of 29 percent since instituting the changes.

Rebutting claims that the IRS has been lax in enforcement, Robin D. Beran, the company’s chief tax officer, noted that the IRS has closed examinations of its tax years from 1999-2006.

“The IRS literally sits outside my office,” Beran said. “They ask extensive questions about our business, we’ve provide a lot of information to them, answered a lot of questions, reviewed our transfer pricing positions with them. I think they’ve been very diligent.”

Beran said the IRS has not yet challenged the structure involving the Swiss affiliate in audits from 1999 through 2006, and it is still working on audits from 2007 onwards.

**Prosecutorial Questioning**

Levin—who is retiring in 2015 after 35 years in the Senate—used persistent, prosecutorial questioning to press the witnesses on whether Caterpillar’s set-up made any business sense, other than as a tax maneuver.

“Is there any way in heaven that Caterpillar would transfer its rights to its profits to a company that wasn’t related?” Levin asked Quinn.

When Quinn at first said he didn’t know, Levin fired back: “Sure you know! Sure you know! You’ve been in this business for a long time. ... I’m asking you a straight question. Do you not think it is incredible to believe that Caterpillar would hand over 85 percent of its worldwide profits on parts, keep 15 percent, keep operating the way it always has in Switzerland and everywhere else, with no consideration for that transfer?”

After additional exchanges with Levin, Quinn said it would hinge on the particular of the hypothetical unrelated party deal.

“Were the economics of that deal appropriate, yes they would,” Quinn said. “I can’t answer it without that qualification.”

Levin used the same tactic with Caterpillar’s executives as well.

“I cannot give a ‘yes’ or ‘no’ answer to your question without understanding the full situation of the economics of what you’re talking about,” Lagacy said, under a similar line of questioning from Levin.

**Tax Planning Motive**

In testimony submitted on behalf of Caterpillar but not read at the hearing, New York University School of Law professor John Steines said it was “extremely unlikely” that the company’s arrangement would fail the economic substance test.

Steines compared Caterpillar’s arrangement to the structure that was litigated in United Parcel Service of America Inc. v. Comr., in which the U.S. Court of Appeals for the Eleventh Circuit held that a UPS subsidiary in Bermuda, which handled its excess-value insurance business, met the two-pronged test—whether the structure had an economic effect, and whether it had a business purpose (10 Transfer Pricing Report 150, 6/27/01).

In particular, the court found that a tax planning motive, in and of itself, does not disprove the existence of a business purpose. The creation of genuine obligations enforceable to an unrelated party can constitute an economic effect, the court held.

Steines noted that in both instances, the subsidiary in question was “an existing, mature business, as opposed to a one-time adventure into unfamiliar terrain motivated exclusively by a desire to generate tax benefits in order to shelter tax on unrelated income.”

**Whistleblower Lawsuit**

The subcommittee had a wealth of material to draw upon for its conclusions, in part because of a civil case that has already examined many of these issues. In 2009, former Caterpillar global tax strategy manager Daniel Schlicksup filed a lawsuit in U.S. District Court, claiming that the company retaliated against him after
he raised concerns about its “Swiss structure,” which he said was a tax dodge. The case was settled in 2012, but court records from the proceedings were used by Levin and his subcommittee to put PwC and Caterpillar managers under pressure.

For instance, the subcommittee included into evidence a deposition by Rodney Perkins, former international tax manager for Caterpillar, from Schlicksup’s case. Under questioning by Schlicksup’s attorney, Perkins said in the deposition that the benefit to Caterpillar Inc. to license CSARL as its purchaser for replacement parts was to “alter the character of the income from CSARL from includable deemed distribution income to the U.S.”

Asked if there was any business advantage to this arrangement other than the avoidance or deferral of income taxes, Perkins replied: “No, there was not.”

At the hearing on April 1—then, as before, under oath—Perkins confirmed that his statement was true at the time, but he sought to clarify.

“The activities associated with the rules of the supply chain did in fact have significant business activities accompanying them,” Perkins said.

However, when asked whether the legal restructuring changed the supply chain, Perkins said that there were minimal changes.

“The physical goods moved the same way after the restructuring as they did prior to the restructuring,” Perkins said.

An 80-Year-Old Doctrine

The economic substance doctrine dates back to Gregory v. Helvering, 293 U.S. 465, a 1935 Supreme Court decision which determined that the IRS can disregard a tax structure if it finds it has no other purpose, in terms of business or economics, than to avoid taxes.

Despite its 80-year history, the economic substance doctrine was only recently incorporated into the U.S. legal code, as part of the Patient Protection and Affordable Care Act of 2010. U.S.C. 26 §7701(o) states:

in the case of any transaction to which the economic substance doctrine is relevant, such transaction shall be treated as having economic substance only if — (A) the transaction changes in a meaningful way (apart from Federal income tax effects) the taxpayer’s economic position, and (B) the taxpayer has a substantial purpose (apart from Federal income tax effects) for entering into such a transaction.

After the law’s passage, a Treasury Department official said the codification of the principle would not change how the IRS determined whether to apply the test (19 Transfer Pricing Report 739, 11/4/10).

Pressure on the IRS

Reuven Avi-Yonah, professor at the University of Michigan Law School, who testified at the hearing, told Bloomberg BNA that he hoped the pressure from Levin would cause the IRS to consider using the economic substance doctrine more aggressively in similar cases.

“My position is, there’s a limit. When you transfer 100 percent of your profits for a 15 percent royalty, that would never be done at arm’s length,” Avi-Yonah said. “It’s hard to see how you can have a reasonable expectation of profits.”

Bret Wells, a professor at the University of Houston Law Center, said Congress could inhibit similar structures by mandating the use of a profit split method for residual profits, and as a backstop against other transfer pricing methods.

“The supply chain restructuring implemented by Caterpillar is premised on a transfer pricing mistake. The mistaken notion is that Caterpillar’s residual profits attributable to the integrated spare parts business system can be allocated away from the functions that economically generate those profits, and instead simply assign to a Swiss entrepreneur entity, whose functions did not meaningfully contribute to the Caterpillar’s proprietary spare market, nor participated in its on-going development,” Wells said.

While both parties have proposed tax overhaul plans in the past months, most see the chances of Congress taking action in the short-term as remote (22 Transfer Pricing Report 1311, 3/6/14).

The chances of passage took another hit after Rep. Dave Camp, the Republican chairman of the House Ways and Means Committee and author of one of the key Republican tax plans, announced his intention to retire when his term ends in 2015.

During the hearing, Levin said the need to close perceived tax loopholes “couldn’t wait” until Congress managed to agree on an overall tax overhaul.

BY ALEX M. PARKER

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United States

IRS APA Report for 2013 Shows Falling Inventory, 145 Completions

In 2013, the Advance Pricing and Mutual Agreement Program of the Internal Revenue Service executed 145 APAs, with a median processing time of 32.7 months, according to APMA’s annual report to Congress, released March 27. [Announcement 2014-14, 2014-16 I.R.B. __ 4/14/14]

The full report can be found in the Text section of this issue.

In 2012, the program completed 140 APAs, with a median processing time of 39.8 months.

These milestones reflect significant improvements in performance at a time when the program is operating with reduced staff, according to APMA Director Richard McAlonan.

“I’m happiest that our time to completion is down by seven months,” McAlonan said. “That is a big deal.”

At the same time, he noted, inventory has dropped—from 391 pending cases in 2012, to 331 at year-end 2013.

But there is a limit to how far inventory can fall without increases in APA staff.

“The population is down about 20 percent compared to what it was at the peak,” he said. “We are down a few economists as well.”

McAlonan said he has authority to hire new staff between now and September and hopes to increase the number of team leaders from 55 to 65 and to add three or four economists to the 26 now on staff.

If that happens, APMA might also hire a few more managers.

“Getting the numbers down is driven by the number of people we have,” he said. “You can make improvements in the process, but it will only take you so far.”

Without additional staff, he said, “this may be as good as it gets.”

Applications Down. One disappointing figure is that the number of applications received during 2013 is down compared to the year before. APMA received 111 APA applications in 2013, compared to 126 in 2012.

McAlonan noted that another 42 taxpayers had submitted a user fee in 2013, but had not completed an application by year-end. Those taxpayers will be included in the figures for 2014 applicants.

As in the past, the bulk of the APAs executed—105 out of 145—were bilateral agreements. One APA was a multilateral agreement, and 39 were unilateral.

New APAs accounted for 47 percent of the total agreements executed, the report said. The rest were renewals.

Of the bilateral agreements completed, Japan accounted for the bulk of the activity—51 percent of applications received and 53 percent of APAs executed. Canada accounted for 22 percent of bilateral applications and 19 percent of the APAs concluded.

The United Kingdom and Australia also were active partners in the process, accounting for 8 percent and 5 percent, respectively, of the bilateral APAs completed in 2013, according to the report.

Among the bilateral APAs pending in 2013, South Korea accounted for 8 percent and Germany for 5 percent, the report said.

Also in 2013, six bilateral applications and three unilateral applications were withdrawn.

By Dolores W. Gregory

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Tax Court Orders IRS to Explain Grounds for Canceling Eaton’s APAs

More than two years after the Internal Revenue Service retroactively canceled two advance pricing agreements with Eaton Corp.—on the ground that the company violated the terms of the APAs—the agency finally must explain what those violations were, the U.S. Tax Court said. [Eaton Corp. v. Comr., T.C., Docket No. 5576-12, IRS objection to motion for partial summary judgment and memorandum in support of objection filed 3/4/14, order issued 3/14/14]

In a March 14 order, Judge Diane L. Kroupa directed the IRS to provide that explanation to the taxpayer or be prepared to make available for deposition Associate Chief Counsel (International) Steven Musher or “another IRS representative with first-hand substantive knowledge of the specific ground(s) that respondent relied on in canceling the APAs and the specific facts supporting each ground.”

The deposition must be completed by May 12, and the parties must provide an oral status report during the special trial session that begins that day.

Kroupa’s order, which appears in the Text section, marks a significant win for the taxpayer, according to practitioners.

“You can’t use privilege as both a shield and a sword,” said Chris Faiferlick of Ernst & Young LLP in Washington, D.C. “You can’t say the taxpayer did something wrong and then not explain it.”

Mike Patton of DLA Piper in Los Angeles agreed.

“If the IRS expects—as it clearly does—that taxpayers have a legitimate expectation that the
IRS will also be transparent in explaining the basis for IRS decisions,” Patton told Bloomberg BNA.

From that perspective, Patton said, calling a senior IRS official to give a sworn statement is unusual, but it is not unprecedented. “Because there are so few APA cancellations or revocations, the issue here is not a big deal in the sense that the decision will apply to a large number of cases,” Patton said. “However, I do think the outcome is important from the perspective of transparency, especially given that the APA Program has historically promoted itself as open and transparent.”

During the same trial session, Kroupa also will hear arguments in Eaton’s second motion for partial summary judgment and the IRS’s motion to bifurcate the proceedings into two trials.

In a March 4 amended notice of objection, the IRS challenged the veracity of assertions made by Eaton in its partial summary judgment motion and argued that the tax court cannot decide as a matter of law that the agency abused its discretion in canceling the APAs.

In a supporting memorandum filed the same day, the IRS charged that the company presents “a materially distorted and incomplete version” of the methods the agency used in calculating Eaton’s income adjustments resulting from the cancellation of two APAs governing tax years 2001-05 and 2006-10. The APAs relate to the sale of electrical breaker products from two Cayman Islands subsidiaries to Eaton’s U.S. subsidiary, Eaton Electrical Corp. (EEI).

As a result of the adjustments, Eaton faces a deficiency of $127 million in taxes and penalties for 2005-06.

The company filed its first motion for partial summary judgment in June 2012, arguing that the IRS could not cancel the APAs unilaterally without first showing a breach of contract. Kroupa ruled in June 2012 that the APAs were not contracts but administrative determinations (22 Transfer Pricing Report 316, 7/11/13).

Because the court’s jurisdiction is limited to reviewing the merits of deficiency determinations and the appropriateness of Section 482 allocations, Kroupa ruled, Eaton must show that the IRS’s Section 482 allocations were “arbitrary, capricious, or without sound basis in law.”

In an effort to make that case, Eaton tried and failed to gain access to four internal IRS memos it believes explain the IRS’s rationale for the cancellations. Citing attorney work product and deliberative process privileges, the IRS refused to produce the documents (22 Transfer Pricing Report 61, 5/16/13).

**Motion to Compel.** In April 2013, Eaton filed a motion to compel the IRS to produce the memos. It argued that in canceling the APAs, the IRS had effectively waived any privileges that might attach. The documents it seeks are:

- A Dec. 5, 2011, memorandum from Patricia Lacey, APA branch chief, to Musher and John Hinding, then APA director, with the subject line “Eaton Corporation—APA Team Review of Eaton APA Annual Reports, 2005-2008”;
- A Dec. 13, 2006, memo to Musher from APA Director Matthew Frank; Richard Osborne, chief of APA Branch 3; and APA economist Mark Bronson with the subject line “Eaton Corporation Unilateral APA Renewal.”
- Two versions of a Dec. 12, 2003, memo from Frank, APA Branch 1 Chief Mindy Piatoff, and attorney Leslie R. Paul to Associate Chief Counsel (International) Hal Hicks, with the subject lines “Unilateral Advance Pricing Agreement with Eaton Corporation.”

The IRS provided a redacted version of the 2006 memo to Eaton, but declined to produce the other documents on the basis that they had been prepared in support of litigation.

Following an in camera review of the documents, Special Trial Judge Daniel A. Guy issued an order Oct. 30, 2013, upholding the IRS’s privilege claims.

In December, Eaton filed a motion for reconsideration as well as a motion to certify the issue for an interlocutory appeal to the U.S. Court of Appeals for the Sixth Circuit.

**Motions in Abeyance.** In her March 14 order, Kroupa held both motions in abeyance, but acknowledged Eaton’s “substantial need to understand” the IRS’s justifications.

“It is unclear,” she said, “that the disputed documents are the only means to access that information.”

Thus, she ordered the parties to resolve their differences through informal consultation and voluntary exchange—and failing that, authorized Musher’s deposition. Kroupa also noted that the agency may continue to assert privileges with respect to the content of the documents and related communications.

In addition, Kroupa noted that the IRS also failed to directly address the question of whether it would have produced Lacey’s 2011 memo in “substantially similar form but for the prospect of litigation.”

This, she said, “remains an open question on the record before the Court.”

Kroupa ordered the IRS by April 28 to supplement its objection to Eaton’s motion for reconsideration by providing supporting information to address that question.

**Central Question.** Why the IRS chose to cancel the APAs—and did so retroactively—is the central question in the case.

Musher informed the company of the cancellations in a Dec. 16, 2011, letter citing “numerous grounds, including the failure of a critical assumption, misrepresentation, mistake as to a material fact, failure to state a material fact, failure to file a timely annual report, or lack of good faith compliance.” But Musher’s letter did not spell out the specific actions or failures of the taxpayer.

Despite myriad filings in the litigation, the IRS has never explained what Eaton did—or failed to do—that constituted a violation of its APAs.

Rather, the IRS has repeatedly cited Greenberg’s Express v. Comr., which provides that the tax court cannot “look behind” a deficiency notice to examine how the IRS arrived at its determination.

Patton noted that the tax court has made exceptions to the Greenberg’s Express holding in cases such as Eaton, where the taxpayer is arguing that the IRS abused its discretion.

“While the Greenberg’s Express decision generally prohibits taxpayers from obtaining discovery to ‘go be-
Eaton never refuted the IRS’s earlier allegation that the tax returns for the years at issue are “markedly inconsistent with the APAs.”

Petitioner claims that Dr. Hatch’s methodology is dubious, because the allocations resulting from his analysis differ significantly from Petitioner’s tax return reporting and, by extension, the APA methodology,” the IRS said. It noted that this claim depends on the assumption that Eaton’s tax returns for the years at issue were consistent with the APAs.

“Petitioner, however, failed to offer any evidence that this assumption is correct,” the IRS said. In fact, Eaton never refuted the IRS’s earlier allegation that the tax returns for the years at issue are “markedly inconsistent with the APAs.”

Under the APAs, the agency noted, Eaton’s U.S. distribution operations were guaranteed a profit of 20 percent for distribution of breaker products. Instead, those operations were guaranteed a profit of 20 percent consistent with the APAs.

“Petitioner never mentions this fact and conceals the relatively small universe of OEM sales” by combining them with the other sales to arrive at a higher figure, the IRS said.

The company was one of three pharmaceutical firms reporting major transfer pricing issues to the SEC in March. The others are Durata Therapeutics Inc. and Sanofi.

Excerpts from the SEC filings can be found in the Text section of this issue.

Below is an alphabetical listing of companies that filed SEC reports with significant transfer pricing issues. In addition to AstraZeneca:

**Astrazeneca Plc** reported to the Securities and Exchange Commission that, because of expected government settlements over transfer pricing audits, it had a tax receivables balance of $494 million at the end of 2013.

In a filing with the SEC in March, the London-based pharmaceutical company said it has a total net accrual of $523 million to cover worldwide exposure to transfer pricing audits, an increase of $100 million from 2012. The company also said it estimates the potential for reasonable possible additional losses from transfer pricing audits at $529 million, but that its management doesn’t believe it is likely that additional losses will occur.

The company was one of three pharmaceutical firms reporting major transfer pricing issues to the SEC in March. The others are Durata Therapeutics Inc. and Sanofi.

Excerpts from the SEC filings can be found in the Text section of this issue.

**BioAmber Inc.**, a Montreal-based sustainable chemicals company, reported $7.67 million in unrecognized tax benefits, largely relating to transfer pricing issues. The company said it is reasonably possible it will recognize $2.58 million of its unrecognized tax benefits because of the lapse of statute of limitations.

**Boyd Gaming Corp.**, of Paradise, Nev., said that its unrecognized tax benefits, currently at $37.1 million, could decrease by $28.1 million to $33.4 million because of the resolution of various issues, including transfer pricing.
Chiquita Brands International Inc., the Charlotte, N.C., produce and agriculture company said it has assessed $15 million of income taxes, penalties, and interest relating to its transfer pricing in 2008-09, as part of that country’s efforts to challenge the transfer pricing practices of major banana exporters.

CNH Industrial Capital LLC, the financial services arm of CNH Industrial N.V., a British agricultural and construction equipment firm, said it is “reasonably possible” it will reach a settlement with competent authority by the end of 2014, which could provide correlative relief from various proposed adjustments to its transfer pricing positions. The potential deficiency assessments could affect CNH Industrial Capital’s cash flow by $3 million to $4 million over 2014.

Cooper Companies Inc., a Pleasanton, Calif.-based medical company, said that as of Nov. 1, as much as $3.6 million in unrecognized tax benefits could decrease in the next 12 months due mainly to transfer pricing issues.

Crown Holdings Inc., a Philadelphia-based metal packaging company, said it had $31 million in unrecognized tax benefits as of Dec. 31, 2013, which includes potential liabilities related to transfer pricing. The company said its tax years going back to 2005 are under examination in France; going back to 2006 in Spain and the U.K.; going back to 2009 in Germany and Italy; and back to 2010 in the U.S. and Canada.

Durata Therapeutics Inc., a Chicago-based pharmaceutical firm, said it entered into an advance pricing agreement with the Dutch Tax Administration in March 2013. The APA involves a wholly owned foreign subsidiary Durata created in June 2012 to hold the worldwide rights for Dalbavancin, a prescription drug it acquired from Pfizer in 2009, the same year the company was founded.

ExlService Holdings Inc., a New York-based outsourcing and information technology company, said the total amount of income taxes being requested by the Indian tax authorities in disputes over permanent establishment and transfer pricing issues from 2003-09 as of Dec. 31, 2013, is $14.7 million.

Fortinet Inc., a Sunnyvale, Calif.-based network and computer security company, said it had an effective tax rate of 42 percent for fiscal 2013, compared with 36 percent for fiscal 2012. The company said its income tax provision included the inclusion of stock option benefits and cost allocations, which affected its transfer pricing calculations.

Gates Global Inc., a Denver-based industrial engineering and manufacturing company, said it had unrecognized tax benefits of $90.4 million as of Dec. 31, 2013, due largely to transfer pricing issues.

Interactive Data Corp., a Bedford, Mass.-based financial services firm, said during 2013 its gross unrecognized tax benefits increased by $3 million and $8.8 million for “current year and prior years’ build, respectively,” due in part to changing its presentation with respect to transfer pricing from a net basis to a gross basis in the U.S.

Interactive Intelligence Group Inc., an Indianapolis-based software company, said it recognized a reduction of its U.S. taxable income by $9.9 million because of a change in transfer pricing method, with respect to its foreign subsidiaries, in the second quarter of 2013.

IPass Inc., a Redwood Shores, Calif.-based cloud-based mobility management and wireless connectivity services company, said its unrecognized tax benefits increased from $5.13 million as of Jan. 1, 2012, to $6.57 million on Dec. 31, 2013, primarily because of the “establishment of federal and state net operating loss reserves related to the timing of deducting transfer pricing payments made to controlled foreign corporations.”

J2 Global Inc., a Los Angeles-based technology firm, said it has appealed an IRS tax examiner’s decision regarding transfer pricing for tax years 2009-10, and it has received notice from the IRS that its 2011 tax year was also under audit.

MakeMyTrip Ltd., an Indian travel site, said in May 2013 it received an assessment for its 2009-10 tax years for additional tax payments of 276 million rupees ($4.5 million), which included challenges to its transfer pricing. An additional penalty for allegedly concealing the matter was issued in November, but was set aside in January 2014 after an adjustment of refunds for 2012-13. The company has appealed the assessment and is awaiting a hearing.

In the March 14 filing, the company said the Income Tax Appellate Tribunal had scheduled a hearing for March 19 on a disputed February 2012 assessment of 43 million rupees ($0.7 million) in additional taxes for 2008-09, including transfer pricing issues. The company said it expected the ITAT also would consider an assessment related to its 2007-08 tax years. MakeMyTrip Ltd. was successful in appeals on both tax years with the Commissioner on Income Tax.

The ITAT has also scheduled a hearing on Aug. 6, 2014, to consider appeals related to its 2005-06 tax years and its 2006-07 tax years, involving issues that also include transfer pricing.

Lantheus Medical Imaging Inc., a North Billerica, Mass.-based medical technology firm, said that it had $13.1 million in unrecognized tax benefits as of Dec. 31, 2013, related in part to transfer pricing. The company said it is “more-likely-than-not” that it will receive competent authority relief for potential adjustments in those countries.

The company also said within the next 12 months unrecognized tax benefits of $6.9 million may be recognized, partly because of the statute of limitations for some transfer pricing issues will expire.

Lionbridge Technologies Inc., a Waltham, Mass.-based translation and global marketing and services company, said its unrecognized tax benefits—which include transfer pricing exposures—could decrease by $800,000 by the end of 2014 because of the lapse of statutes of limitations.

The company also said it has received assessment orders from the Indian taxing authorities for fiscal years 2007-2010, each ended March 31, primarily because of transfer pricing issues. The company said it is contesting all of the assessments and is at various stages of the appeals process.

Lululemon Athletica Inc., a Vancouver-based athletic apparel company, said its effective tax rate for fiscal 2013 was 29.6 percent—lower than its 36.1 percent rate in fiscal 2011, because of the “ongoing impact of revised intercompany pricing agreements.”

Polymer Group Inc., a Charlotte, N.C.-based engineered materials company, said that in July 2013, it filed for amnesty with Colombian tax authorities for a 2007 tax year transfer pricing issue. The request was approved, and Polymer paid $0.5 million to settle the outstanding issue.
QVC Inc., a West Chester, Pa.-based television company, said that its unrecognized tax benefits—related to issues that include transfer pricing—could decrease by $24 million in 2014 because of potential settlements, lapsing statutes of limitations, and revisions of settlement estimates.

Rosetta Stone Inc., an Arlington, Va.-based software company, said its value-added tax expenses increased by $600,000 during 2012 because of a change in its transfer pricing agreements.

Sanofi, a Paris-based pharmaceutical company, said its income tax expense for 2012 was 1.1 billion euros ($1.5 billion), which included favorable effects from an advance pricing agreement for 2012-14.

Support.com Inc., a Redwood City, Calif.-based technology and online tech support company, said the Indian tax authorities challenged the transfer pricing of one of its subsidiaries for the 2004-09 fiscal years.

Visant Corp., a scholastic memorabilia and direct marketing company, said during the fourth quarter of 2013, U.S. and French tax authorities agreed to transfer pricing for its holding company, Visant Holding Corp., related to adjustments for 2005-06, consistent with an APA they had negotiated for 2007-11. The company also said the IRS has not yet issued final reports for the “affected tax periods” from 2006-10.

BY ALEX M. PARKER

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United States

Examiners’ Views Key to Treasury Writing Administrable PE Rules, IRS’s Wollman Says

The ongoing coordination among key areas and individuals at the Internal Revenue Service and Treasury is critical to writing administrable international tax rules, including permanent establishment rules, the IRS’s director for international strategy said recently.

Diana Wollman, addressing a March 18 conference by the American Bar Association Section of Taxation and Tax Executives Institute, said a new, more focused approach at the IRS’s Large Business & International division involves “having input of all the different bodies deciding what we want to strategically attempt. And that is something that was not previously done.”

She said the four-way interaction among Michael Danilack, deputy commissioner (International) of LB&I; Robert Stack, deputy assistant secretary for international tax affairs with Treasury; the IRS’s international practice networks; and Steven Musher, IRS Associate Chief Counsel (International), is “important because in the international context, we are making pacts with other governments that are not easy to change.”

Treasury is in charge of drafting the PE definition found in U.S. tax treaties, Wollman told those at the conference. However, IRS examiners and the Advance Pricing and Mutual Agreement (APMA) Program—which now resides in LB&I—should “have a say into what the PE rules are” and be able to convey to Treasury which proposed PE definitions will not work in practice, she said.

Wollman said examiners should be able to tell Stack their concerns about proposed PE definitions—for example, what problems are likely to arise in a transfer pricing context, in applying the foreign tax credit rules, or in competent authority.

“There is no way to getting to an answer that is close to the right answer without there being a lot of collaboration and lot of coordination,” Wollman said.

The official, along with Stack, Musher and moderator Joan Arnold of Pepper Hamilton LLP in Philadelphia spoke on a panel about the interaction of policy and law and how the development of the law and its application is changing. In addition to PE and treaty issues, Wollman and Musher discussed the IRS’s more collaborative approach to audits.

Wollman joined the IRS in September and reports directly to Danilack, advising him on a wide range of high-level international tax issues (22 Transfer Pricing Report 535, 9/5/13).

PE Rules. Stack noted that in many countries, the policy and enforcement functions of Treasury and the IRS are not divided the way they are in the United States. “A lot of people who are my counterparts in other countries are heading up both the policy side and the audit and enforcement side,” he said.

Stack said many of the initiatives in the international project on base erosion and profit shifting (BEPS) are driven by foreign tax administrators reacting to the creation of commissioner arrangements and related transfer pricing issues. To some degree, he said, one can explain BEPS “as working backwards from the bad experience of tax administrators and that is how a lot of these items have wound up on the table.”

Action 7 of the Organization for Economic Cooperation and Development’s plan to combat BEPS, released in July, contemplates changes to the PE definition in the OECD Model Tax Convention to prevent the artificial avoidance of PE status (22 Transfer Pricing Report 365, 7/25/13).

In addition, the OECD’s draft template on country-by-country reporting released Jan. 30 would require a company for each country in which it operates to list its “constituent entities,” including a PE that “prepares a separate income statement for regulatory, financial reporting, internal management or tax purposes” (22 Transfer Pricing Report 1214, 2/6/14).

Stack, a delegate to the OECD’s Committee on Fiscal Affairs, noted that discussions of PE have become much more practical and less erudite in recent years. Many tax administrations today “want every tool in the toolbox” to deal with these issues, he said.

As a representative of the U.S. government, Stack said, “I don’t unnecessarily want every tax administration to have every tool, because I don’t want double and triple taxation of U.S. multinationals.” From a U.S. perspective, he said, measures commonly used to combat PE avoidance, such as broad anti-abuse rules, “give taxpayers real difficulty in avoiding double tax around the world.”

Field Experience. Stack said he is “almost in constant communication” with Danilack and Musher on international tax matters, including some difficult issues bubbling up from the examination function.
Wollman said the experience of LB&I’s APMA Program—which handles double tax cases as well as advance pricing agreements—is important to Treasury because part of the U.S. government’s job is making sure that other governments are not treating U.S. taxpayers unfairly.

Wollman said LB&I has “a great sensitivity to how things that are agreed to in a treaty, or in the context of an OECD discussion, could have ramifications where we think another country could apply them unfairly.”

Stack, in negotiating at the OECD, needs to know “the experience of what is going on in our field, but [also] the experience of what is going on in the field in other countries [which] is going to be known first and foremost at LB&I,” she said.

International Practice Networks. Musher said the IRS international practice networks (IPNs) are creating a treasure trove of “rich, in-depth and constantly renewed knowledge” that can be mined for compliance purposes and “for purposes of cooperation across international tax administrations.”

Wollman said the IPNs involve counsel in developing how agents approach an issue from the beginning. This is not something the IRS has done before, and “it is really exciting,” she said.

An IPN is composed of all relevant stakeholders including staff who run the network events, chief counsel, field counsel, managers from the exam function, and other specialists, including sometimes international examiners and those from the transfer pricing practice.

She described the networks as “totally ground up.” During audits, examiners take their legal questions to field counsel. In some cases the questions are elevated to Musher’s office and in some cases they can be resolved at the field level. The IPNs, Wollman said, enable field counsel to look at inquiries and “come over to the exam function and say, ‘We are getting a lot of questions about X. I think maybe there is a lot of noncompliance in that area. You guys should maybe think about that.’”

LB&I then can work with the IPNs on how agents should approach possible areas of noncompliance. LB&I can identify the relevant returns and push them out to the agents with practice notes giving agents the tools to work the issue “that we believe is present in this return,” she said.

In some cases, Wollman said, the IPNs suggest focusing more resources on a particular problem. She urged taxpayers and their advisers to provide feedback on the networks.

Early Involvement. Musher said an important purpose of the IRS’s realignment of its international resources “is to deploy the best expert resources to the international examiners in the most strategic way.” This, he said, often means making expert resources available “early on and not at the end of the case when there has been polarization, frankly, of positions on both sides.”

Strategic deployment is key, he added, noting that resources are limited in LB&I and are even more limited in Counsel.

Wollman said that although the IRS prefers to settle issues at the audit level, involving Counsel early on ensures that the government is “ready for the next steps” if a case progresses.

Musher said that making expert resources available to examiners earlier on “is going to maximize the opportunities for resolution” as well as ensuring that the IRS has a well developed case in the event it goes to IRS Appeals or litigation.

Wollman agreed. “What we don’t want is for taxpayers to think, ‘Well, the agent hasn’t really seen the issue so I am better off going to Appeals.’”

Collaboration. Wollman described one collaborative call that in which agents seemed to be able to work out an approach to a case. In one 45 minute discussion, she said, the agents discussed who was the best person for the IRS to interview at the taxpayer to get the facts needed to develop an issue. The agents on the call discussed whether the interviews should take place over the phone or in person and how to deal with a taxpayer who is reluctant to schedule interviews.

“It worked really well,” Wollman said. While she said these conversations used to happen around the water cooler at a single office, “now we are able to facilitate that happening with agents all over the country—and we have Counsel on those calls.”

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United States

Managing Pre-Exam Phase of Audit Leads To Better Outcome, Practitioners, IRS Agree

A key element of the Internal Revenue Service’s recently released Transfer Pricing Audit Roadmap is a greater emphasis on dialogue between examiners and taxpayers at the beginning of the process, practitioners and IRS officials said March 26.

“The most important part of the road map is in the pre-examination period, where you are working with the IRS to get them the relevant information up front, so they can make a determination whether they want to pursue transfer pricing or not,” said Marc Levey of Baker & McKenzie LLP in New York.

Taxpayers can influence that determination by inviting personnel who are most knowledgeable of their business to explain the operations to the exam team.

“There is no substitute for having someone from the company tell you what really drives the business,” Levey said.

Howard Berger, senior adviser to the IRS’s director of Transfer Pricing Operations in the Large Business and International division, said the road map is an attempt to find “the right balance” between too much information and not enough.

“We all can acknowledge there may have been horror stories when the IRS might have asked for too much information,” Berger said. “What we hope will come out of this is the IRS asking for relevant information.”

Levey and Berger were among several panelists speaking about transfer pricing audits at Tax Executives Institute Inc.’s midyear conference in Washington, D.C.
**Best Practices.** The IRS released the transfer pricing road map Feb. 14. The document sets out best practices for conducting a transfer pricing audit, anticipating an average time line of 24 months from opening conference to closing the case (22 Transfer Pricing Report 1251, 2/20/14).

Before the opening conference, examiners are expected to spend several months in preparing, analyzing the taxpayer’s business, reviewing documentation and assessing the case’s potential.

During this phase, examiners are expected to “get familiar with the facts of what is going on in a particular company,” said Natalie Hodapp, supervisory tax law specialist in the IRS’s Transfer Pricing Practice, who is based in New York.

The preliminary phase also includes taxpayer orientations, initial risk analysis—as well as the development of a working hypothesis—and the preparation of an examination plan and setting key milestones. The execution phase—of up to 14 months—involves fact finding, information gathering and issue development.

The final phase involves issue presentation, resolution, and closing of the case.

The time line is an average, Hodapp said, and the process is meant to apply across a variety of transfer pricing issues. Some cases will take much longer and others may move more quickly.

“The team should come up with a theory of the case and the facts to disprove the theory,” Hodapp said. If it emerges that the team has a bad working hypothesis, it must be willing to take the taxpayer’s facts, “understand them, digest them, and then make a correct decision, adjust the hypothesis, or throw it out if need be.”

The road map presents a tool not just for IRS examiners, but for taxpayers as well, because it sets a clear sequence of events and a time line for completion, something taxpayers did not have before, said Colleen C. Brown, senior tax adviser with mining company Barrick Gold of North America Inc.

For this reason, Brown told Bloomberg BNA, the roadmap is a “huge, huge deal.”

**Forcing a Dialogue.** Levey noted that the process documented in the road map has been applied “in one form or another” over the past 18 months.

“It’s been involved in many audits we’ve been involved in,” he said, “and there have been hiccups.”

A positive development, he said, is that “it really has caused a dialogue with the IRS up front, to get them the information they think they need and that is relevant.”

Levey said he initially was concerned that the IRS teams were asking for so much information they were becoming overwhelmed. But discussions with Hodapp and other officials, he said, “added a certain sanity to the process.”

Berger said that under the new process, the taxpayer has an opportunity at the beginning of an examination to make a presentation to the IRS explaining “why there is nothing there.”

If the IRS gets the information at the outset, he said, “then hopefully we don’t find ourselves in a situation of spending months and months to find there is nothing there.”

**Critical Elements.** Two elements are critical for the IRS at the early phases of the audit, Levey said:

- to understand the taxpayer’s business, and
- to analyze the entire supply chain, making sense of intercompany transactions and the functions of the companies within the chain.

“It doesn’t take a rocket scientist to figure out that what is being looked at by the IRS and most taxing authorities around the world is whether the functional analysis matches up with the returns of all the companies along the supply chain,” he said.

For these reasons, a transfer pricing study is an important starting point, but it is not enough.

A transfer pricing study, he said, “does not necessarily deal with what place in the industry you occupy, whether you are at a high level or a low level. It does not necessarily mean that the way you brand and market your business is consistent with the way everybody else does it in your industry. Each company has its own DNA, and it is important to get that out there, early on.”

Eric Ryan of DLA Piper LLP in East Palo Alto, Calif., agreed.

“Most transfer pricing reports nowadays follow a fairly common format,” he said. “When it comes to the best method selection, a lot of times the report does give a fairly expansive discussion of profit targets, if you are using the comparable profits method” or the transactional net margin method, he said. “But a lot of times it hops over other methods,” such as comparable uncontrolled price (CUP) or comparable uncontrolled transaction (CUT).

A taxpayer might say it has no comparable licenses or comparable internal sales, Ryan said, adding, “I am sympathetic to the IRS that they might want to kick the tires on that assertion.”

Hodapp noted that the issue of best method is something examination teams might want discuss in a meeting with the taxpayer.

“The meeting would be a great opportunity for the team to talk with whoever prepared the study and ask, ‘How did you get comfortable with the idea that there are no CUPs out there or CUPS out there? How did you confirm that?’” Hodapp said.

“One thing we have done in a number of cases that has been helpful,” she added, “is request this presentation after we have digested the study. And so, before we have it, we provide the taxpayer with questions and ideas of the points we really want to touch on, so that have an idea of what we are interested in dialoguing about.”

Levey stressed that the taxpayer’s most important task is to “get the right people into the pre-examination stage”—not only the people who prepared the study, but the experts in the company that they talked to in putting the study together.

Doing so can ensure there will be no transfer pricing issues—or if there are, “those issues will be small ones,” he said.

**By Dolores W. Gregory**

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United States

IRS Files Brief in BMC Software, Saying Other Federal Issues Apply

The Internal Revenue Service filed a brief in a federal appeals court March 26, arguing that taxpayer BMC Software must use accounts receivable established under a Rev. Proc. 99-32 closing agreement to offset a Section 936(b)(3) dividends-received deduction.

**BMC Software v. Comr., 5th Cir., Docket No. 13-60684, brief for appellee filed 3/26/14**

BMC Software Inc. is appealing a U.S. Tax Court decision upholding a $13 million deficiency related to the disallowance of a dividends-received deduction it claimed in 2006 under Section 965. The section was enacted as part of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, to encourage the repatriation of funds from foreign subsidiaries by making some dividends eligible for an 85 percent dividends-received deduction (22 Transfer Pricing Report 1198, 2/6/14).

To prevent abuse, however, Section 965(b)(3) also provides that repatriated dividends must be offset by any increase in related-party indebtedness during the tax year for which the deduction is claimed. Under Rev. Proc. 99-32, 1999-34 I.R.B. 296, taxpayers can treat amounts that are held by foreign subsidiaries as debt owed to the parent in order to avoid adverse tax consequences of secondary adjustments.

In requiring the offset, BMC argued, the U.S. Tax Court misconstrued the meaning of "indebtedness" under Section 965 and in doing so, used one taxpayer relief provision "as a sword" to deny it a benefit under another section of the tax code.

The IRS, in its brief to the U.S. Court of Appeals for the Fifth Circuit, says that is the intended result.

**Taxpayers Must Choose.** "Those taxpayers facing §482 adjustments in the same year they claim the §965 deduction have been offered two generous tax-relief provisions in Rev. Proc. 99-32 and §965," the agency said. "Companies are free to make a choice, after balancing the benefits of a Rev. Proc. 99-32 election against the consequence such treatment has in terms of limiting any §965 deduction they may have claimed."

BMC Software, which develops and licenses computer software, is the parent of BMC Software European Holding (BSEH), based in both Ireland and the Cayman Islands. BSEH is a controlled foreign corporation of BMC under U.S. law.

The parties were involved in research and development cost sharing arrangements for taxable years before April 1, 2001. Following the termination of these agreements, BMC took sole ownership of the software and agreed to pay buy-out royalties to BSEH.

On audit, the IRS determined the royalties were not at arm’s length. As part of a closing agreement that increased BMC’s income by more than $100 million in tax years 2003-06, BMC was required to make secondary adjustments to conform its accounts.

To avoid a tax consequence, BMC chose Rev. Proc. 99-32 relief, and entered a second closing agreement that established accounts receivable to reflect debt owed from BSEH to BMC. Accounts receivable from BSEH to BMC were established on March 31 for each of the years 2005 and 2006 in the amount of $21.7 million per year.

This sum of $43.4 million was subject to the debt limitations under Section 965 and led to a 6 percent reduction in the allowable deduction.

At trial, BMC argued that Section 965(b)(3), requiring that related-party indebtedness reduce the allowed deduction, was intended only to address abusive transactions in which related-party debt was used to fund the repatriation of assets. The tax court in its Sept. 18, 2013, ruling rejected that argument, as well as the argument that the accounts receivables should be exempted from Section 965(b)(3) as trade payables (22 Transfer Pricing Report 674, 9/19/13).

**Taxpayer Has No Argument.** In its brief to the Fifth Circuit, the IRS also argued that in its appeal, BMC Software—and amici curiae Microsoft Corp. and Medtronic Inc.—erroneously cited substance-overform cases in which the IRS challenged the characterization of transactions as debt.

Such cases have “no relevance,” the IRS said. "Taxpayer has presented no meritorious argument establishing that the Tax Court’s construction of the agreement was wrong,” the IRS said. “The agreement’s language does not provide, as taxpayer contends, that debt was established only for the limited purpose of protecting taxpayer from the secondary adjustments flowing from the primary adjustments under §482, or that taxpayer is protected from all collateral tax consequences.”

Where a closing agreement binds the parties to specific matters, the agency said, it is well established that the IRS and the courts can apply other federal tax adjustments that normally would result—unless the agreement specifically provides otherwise.

Thus, the agreement in this case requires BMC to treat debt as having been established on the dates specified for all federal tax purposes, including Section 965.

**By Dolores W. Gregory**

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United States

Tax Court Grants IRS Two-Month Extension In Medtronic, Sets Trial for February 2015


In its motion filed March 7, the IRS asked for a five-month delay, saying it needs more time to complete discovery and prepare for trial. It noted that the government shutdown in October had put the agency behind schedule.

“Due to government budgetary issues, respondent’s ability to contract with experts has been delayed for months, again hampering respondent’s trial preparation,” the IRS said.
Further, the agency argued, a Dec. 1 trial date would inconvenience key witnesses because the trial, expected to run three to four weeks, likely would be split into two sessions around the year-end holidays.

Judge Kathleen Kerrigan granted the continuance over the objection of the taxpayer, but warned that the court “will not be inclined to grant any further continuances in the case.”

Kerrigan in October denied an earlier motion by the IRS to seek a continuance of the trial until Jan. 26, 2015 (22 Transfer Pricing Report 796, 10/31/13).

Puerto Rican Affiliate at Issue. Minneapolis-based Medtronic Inc. challenged $2.7 billion in upward income adjustments for 2005-06, including $1.4 billion in transfer pricing adjustments related to licensing and manufacturing deals involving affiliates in Switzerland and Puerto Rico. In protesting the adjustment, the medical device maker said the IRS inappropriately treated its Puerto Rican affiliate as a contract manufacturer.

Medtronic and the IRS have settled some issues, according to a Jan. 16 joint status report, which indicates that the agency conceded proposed adjustments of nearly $600 million (22 Transfer Pricing Report 1322, 3/6/14).

In its motion for a continuance, the IRS said it needs more time to develop a “more efficient presentation of evidence and more time to engage in the stipulation process.”

Under the current schedule, the agency said, formal discovery was to be completed by May 9, but as of early March, the parties were still engaged in informal discovery.

Kerrigan ordered the parties to file a joint status report by March 27 that will reflect a new trial schedule. According to the order, trial is to take place at a special session of the court that begins at 10 a.m. on Feb. 2, 2015, in Room 3908 of the Kluczynski Federal Building, 230 S. Dearborn St., Chicago.

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Brazil

Brazil Extends List of Expenses For Transfer Pricing Calculations

Brazil’s federal tax department March 20 issued a ruling that included several items in the list of expenses that can be considered in transfer pricing calculations.

According to Normative Instruction 1458, companies are permitted to consider port shipping costs, domestic transportation of goods and warehousing as legitimate expenses. Shipping costs include import taxes and duties charged by the receiving country.

These expenses may be used by both exporting and importing firms. The ruling applies to companies calculating their transfer prices by Brazil’s uncontrolled price method and its quotation on exports method.

Marco Monteiro of the law firm Veirano Attorneys in São Paulo told Bloomberg BNA March 26 that the changes will assist companies in making transfer pricing adjustments to reduce their income tax payments.

“To the extent that the objective of the tax department is to verify if the transaction was conducted for a reasonable price, the government should permit the use of any adjustment that is relevant to the formation of the price,” he said.

By Ed Taylor

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United States

IRS Official Defends Draft APA Procedure: Foreign Authorities Want ‘Granular’ Data

Kenneth Wood, senior manager at the Internal Revenue Service’s Advance Pricing and Mutual Agreement (APMA) Program, defended a draft revenue procedure against claims from former directors of the predecessor program that it takes a strident, uncooperative tone.

“We are only there to help people,” Wood said. “But we aren’t there to concede our tax base, unilaterally,” said Wood, who spoke at a transfer pricing conference at the University of San Diego March 27.

Six former directors of the IRS’s Advance Pricing Agreement Program—the predecessor to APMA—urged the IRS in written comments to reconsider the language in the draft revenue procedure governing APA applications. They expressed concern that the new language signaled a “less-supportive” attitude towards APAs within the agency (22 Transfer Pricing Report 1393, 3/20/14).

Wood claimed that the opposite is true. He joked that APMA is “kind of a ‘Jerry Maguire’ operation,” quoting one of the 1996 movie’s signature lines, “Help me help you.” He said the program’s primary focus is still on resolving double taxation issues and achieving consistency through APAs.

“These cases are intensely factual, and taxpayers have the facts. We need the facts so we can apply the principles and [Organization for Economic Cooperation and Development] guidelines,” Wood said.

‘Granular’ Data. Wood said increased up-front information would help the IRS defend positions against foreign jurisdictions during mutual agreement procedures. Even with the information currently required through the MAP and APA processes, foreign tax authorities want “granular” data showing how assets—in particular, intellectual property—are used to create value.

“This is kind of a chronic problem, and it normally starts with the foreign jurisdiction saying, ‘Well, [the asset] is worth nothing, because I don’t know what it is,’” Wood said.

He added that the IRS was hoping to have more perspective from “operational” employees, as opposed to tax practitioners, on how intangibles are exploited for profit. “It’s not really helpful to talk to the [representatives] or talk to the tax guys, often because

By Ed Taylor

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Brazil Extends List of Expenses For Transfer Pricing Calculations

Brazil’s federal tax department March 20 issued a ruling that included several items in the list of expenses that can be considered in transfer pricing calculations.

According to Normative Instruction 1458, companies are permitted to consider port shipping costs, domestic transportation of goods and warehousing as legitimate expenses. Shipping costs include import taxes and duties charged by the receiving country.

These expenses may be used by both exporting and importing firms. The ruling applies to companies calculating their transfer prices by Brazil’s uncontrolled price method and its quotation on exports method.

Marco Monteiro of the law firm Veirano Attorneys in São Paulo told Bloomberg BNA March 26 that the changes will assist companies in making transfer pricing adjustments to reduce their income tax payments.

“To the extent that the objective of the tax department is to verify if the transaction was conducted for a reasonable price, the government should permit the use of any adjustment that is relevant to the formation of the price,” he said.

By Ed Taylor

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United States

IRS Official Defends Draft APA Procedure: Foreign Authorities Want ‘Granular’ Data

Kenneth Wood, senior manager at the Internal Revenue Service’s Advance Pricing and Mutual Agreement (APMA) Program, defended a draft revenue procedure against claims from former directors of the predecessor program that it takes a strident, uncooperative tone.

“We are only there to help people,” Wood said. “But we aren’t there to concede our tax base, unilaterally,” said Wood, who spoke at a transfer pricing conference at the University of San Diego March 27.

Six former directors of the IRS’s Advance Pricing Agreement Program—the predecessor to APMA—urged the IRS in written comments to reconsider the language in the draft revenue procedure governing APA applications. They expressed concern that the new language signaled a “less-supportive” attitude towards APAs within the agency (22 Transfer Pricing Report 1393, 3/20/14).

Wood claimed that the opposite is true. He joked that APMA is “kind of a ‘Jerry Maguire’ operation,” quoting one of the 1996 movie’s signature lines, “Help me help you.” He said the program’s primary focus is still on resolving double taxation issues and achieving consistency through APAs.

“These cases are intensely factual, and taxpayers have the facts. We need the facts so we can apply the principles and [Organization for Economic Cooperation and Development] guidelines,” Wood said.

‘Granular’ Data. Wood said increased up-front information would help the IRS defend positions against foreign jurisdictions during mutual agreement procedures. Even with the information currently required through the MAP and APA processes, foreign tax authorities want “granular” data showing how assets—in particular, intellectual property—are used to create value.

“This is kind of a chronic problem, and it normally starts with the foreign jurisdiction saying, ‘Well, [the asset] is worth nothing, because I don’t know what it is,’” Wood said.

He added that the IRS was hoping to have more perspective from “operational” employees, as opposed to tax practitioners, on how intangibles are exploited for profit. “It’s not really helpful to talk to the [representatives] or talk to the tax guys, often because
they don’t really know how the intellectual property benefits the company,” Wood said.

Craig Sharon of Ernst & Young in Washington, D.C., a former APA Program director and one of writers of the letter, attended the panel as an audience member and continued to raise objections with the draft revenue procedure during a question-and-answer period. “All of the obligations are on the taxpayer, and the IRS reserves all of the discretion. That’s not inherent to the APA process; that’s supposed to be voluntary and transparent,” he said.

By Alex M. Parker

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United States

Foreign Relations Committee Approves Tax Accords Fostering Better Communication

The Senate Foreign Relations Committee approved by a unanimous voice vote five proposed treaties and treaty amendments that seek to improve the sharing of tax information with foreign jurisdictions.

Amendments to treaties with Switzerland and Luxembourg would improve communication on tax matters and help reduce double taxation, with the Swiss agreement containing a mandatory arbitration provision designed to encourage the resolution of tax disputes.

Treaties with Hungary and Chile would additionally address “treaty shopping,” or the structuring of a multinational corporation to take advantage of a particular tax regime, according to treaty text.

“These treaties are important for American companies and our relationship between the United States and these countries,” Sen. Robert Menendez (D-N.J.) said during the committee meeting. “They are a crucial component of U.S. trade and tax policy, they’ve played a key role in facilitating greater and more transparent trade and investment for decades protecting American companies from double taxation and making it easier for them to explore new markets.”

The fifth accord amends the Organization for Economic Cooperation and Development’s multilateral Convention on Mutual Administrative Assistance in Tax Matters to bring the 1988 convention in line with the international group’s Model Tax Convention on Income and Capital and similar U.S. standards. The amendment updates information exchange and confidentiality rules and opens the convention to states outside of the OECD and Council of Europe.

Privacy Concerns. The accords received a hearing Feb. 26 and now move to the full Senate.

During the February hearing, a senior Treasury Department official called on the committee to move quickly on the accords. Treasury Deputy Assistant Secretary Robert B. Stack also said the U.S. would not share information with a jurisdiction if it held doubts about the government’s privacy protections.

“The IRS, on an ongoing basis, through the Office of Competent Authority, monitors these jurisdictions,” Stack told the committee during February hearing. “Through their experience, if there’s ever a word or we hear about a breach in confidentiality, the IRS does, and has in the past, held up the exchange of information pending a resolution.”

Sen. Benjamin Cardin (D-Md.) signaled during the April committee meeting that he was confident about taxpayer privacy in the treaties.

“These are basically helping American companies, they conform to the international norm for the exchange of information to help avoid tax fraud and protect U.S. citizens’ privacy,” Cardin said.

The agreements with Luxembourg, Switzerland and Hungary were approved by the committee in 2011, but were placed on hold by Sen. Rand Paul (R-Ky.).

By Casey Wooten

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Europe

United Kingdom

U.K. Publishes BEPS Position Paper, Will Retain Competitive Tax Regime

A recent position paper by H.M. Treasury and H.M. Revenue and Customs suggests that although the U.K. government is committed to the international project to combat base erosion and profit shifting (BEPS), it will not dismantle aspects of its internationally competitive tax regime.

In a foreword to the March 19 paper, George Osborne, head of the U.K. Treasury, said the United Kingdom has created the most competitive tax environment in the Group of 20 countries by reducing its corporate tax rate to 20 percent effective April 2015, reforming the country’s controlled foreign company rules, and introducing a patent box.

At the same time, Osborne said the United Kingdom is aggressively tackling corporate tax evasion and avoidance. “The U.K. has led the way in this international action, driving the international tax, transparency and trade agenda forward under the U.K.’s G8 presidency in 2013, and fully backs the OECD’s Base Erosion and Profit Shifting project.”

He noted that the United Kingdom has provided 550,000 euros ($758,000) to ensure that the BEPS work is delivered on time and said he is committed to the timetable under the Organization for Economic Cooperation and Development’s 15-action plan, published in July (22 Transfer Pricing Report 365, 7/25/13).

Osborne said that if the goals of the BEPS project—the last of which are due to be completed by the end of 2015—are achieved, “we will succeed in fundamentally changing the international tax landscape, and shift the balance of the rules in favour of tax authorities, enabling us to clamp down on those who refuse to play by the rules.”

In December 2012, Osborne announced that the government was committing 77 million pounds ($124 million) to combat tax evasion by individuals and corporations, especially when carried out through multinational arrangements and offshore accounts (21 Transfer Pricing Report 815, 12/13/12).

New CFC Rules. Action 3 of the BEPS plan tasks the G-20 countries and the OECD with designing recom- mended CFC rules for countries to implement.

Treasury and HMRC’s joint March 15 paper, “Tackling aggressive tax planning in the global economy: UK priorities for the G20-OECD project for countering Base Erosion and Profit Shifting,” said the United Kingdom does not anticipate changing the U.K.’s new controlled foreign company rules, enacted in 2012, following a five-year consultation with the business community.

The U.K. CFC rules effective from Jan. 2013 provide that a foreign subsidiary’s general business profits are outside the CFC rules if the foreign subsidiary meets one of the three conditions:

- management or control of the foreign subsidiary’s assets or risks is not carried on to a significant extent in the United Kingdom;
- the foreign subsidiary has the capability to carry on its business without the U.K. activities referred to in the first condition and may replace the activities by buying back office services from a third party; or
- the arrangements from which a foreign subsidiary derives its profits do not have a main purpose of achieving a U.K. tax reduction (20 Transfer Pricing Report 1033, 3/8/12).

Having just completed its own major reform, the government said “it is not anticipated that the U.K.’s rules will require further substantive changes.”

The U.K. government said it is contributing actively to OECD Working Party No. 11 discussions on Action 3 and is sharing the United Kingdom’s experience gathered during its five-year consultation with the business community, and that the BEPS project should encourage more countries to “adopt and enforce workable CFC rules.”

Given the high level of foreign investment in U.K.-based multinational enterprises, the paper said, attempting to tax foreign shareholders on profits relating to genuine overseas activity simply because a business is headquartered in the United Kingdom cannot be justified—and “would likely result in foreign shareholders investing directly in the third (foreign) country, or via a [multinational enterprise] which is based outside the U.K.”


The government said the United Kingdom fully supports the need for clear rules to help determine what constitutes a harmful tax measure.

In deciding whether a tax regime has substance, the FHTP must consider whether it “encourages purely tax-driven operations or arrangements,” the paper said. “[M]any harmful preferential tax regimes are designed in a way that allows taxpayers to derive benefits from the regime while engaging in operations that are purely tax-driven and involve no substantial activities.”

The government said a better understanding of what constitutes substance is needed to effectively address cases where preferential regimes in fact present an opportunity to shift profits. “This will give certainty to the operation of legitimate tax regimes, such as the U.K.’s Patent Box, which is currently under consideration in the FHTP, and the Government believes that most of the activities currently qualifying for the U.K. Patent Box would meet any such substance test.”

By Kevin A. Bell

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Iceland

Icelandic Legal Amendment Entails New Documentation Requirements

New Icelandic transfer pricing rules may imply revised documentation requirements for multinationals and other companies, two tax practitioners based in nation’s capital, Reykjavik, told Bloomberg BNA.

While amendments to Article 57 of the Icelandic Income Tax Act (90/2003) initially were approved by the Icelandic Parliament Jan. 1, 2014, a new regulation that will provide additional guidelines on documentation and pricing is in the process of being drafted.

Multinationals that are active in Iceland include U.S. mineral companies Century Aluminum Co. and Alcoa Inc., and the Canadian company Rio Tinto Alcan Inc. These and other companies are active in the nation’s aluminum industry, Iceland’s largest onshore industrial sector.

The rules, based on Organization for Economic Cooperation and Development transfer pricing guidelines, require companies undertaking related-party transactions valued at 1,000 million Icelandic kroner ($8.7 million) or more to maintain documentation about the nature and extent of these transactions. This includes information on permanent establishments and subsidiaries, the nature of the related-party relationship and the basis for the price or prices asserted.

The requirement becomes effective in the company’s next year of operation. While a general anti-avoidance rule based on the arm’s-length principle was applied in the past, no such documentation rules have previously existed for transfer pricing.

Rules’ Introduction Postponed. In a March 24 statement provided to Bloomberg BNA, Asta Kristjansdottir of Ernst & Young noted that the introduction of specific transfer pricing rules was on the agenda of Iceland’s Finance Ministry for a number of years. However, she said, their introduction was stalled in 2008 due to the collapse of the financial system and the subsequent need to prioritize recovery measures.

“Tax authorities have in the past reassessed taxable income if transfer prices do not reflect market value,” she said. Kristjansdottir added that the tax authorities “have always had very extensive authorization to gather information” but “those authorizations were general and not aimed especially at transfer pricing.”

The EY practitioner said she does not believe the legal amendment was prompted by increased cases of tax avoidance. Rather, she said the amendment is aimed at eliminating uncertainty and giving the tax authority more powerful tools against tax avoidance.

“Also, I think Icelandic authorities looked to the fact that it is vital to have uniformity in rules on international taxation,” Kristjansdottir said. That is a factor even though the transfer pricing law applies to domestic as well as cross-border transactions, she said, and the documentation requirements “also make tax surveillance easier.”

Agust K. Gudmundsson of KPMG, who also provided a statement to Bloomberg BNA March 24, said the new amendment likely was prompted by a combination of international pressure multinationals’ desire to “know what they are getting into” when doing business in Iceland. Multinationals with subsidiaries in Iceland should ensure that their practices adhere to the OECD guidelines, he said.

Ukraine

Ukraine Mulls Amendment Of Transfer Pricing Provisions

Ukrainian lawmakers released a bill to amend the country’s Tax Code and change controlled transactions reporting requirements.

On Mar. 25, the country’s parliament, Verkhovna Rada, released Bill No. 4527 to set forth new transfer pricing provisions. It stipulates that calendar year 2014 will become the first reporting period for the purposes of the country’s transfer pricing legislation.

This means that businesses will not have to report controlled transactions done in 2013 by May 1, 2014, as set forth in recent regulations (22 Transfer Pricing Report 517, 8/8/13).

The bill cites Article 39.4 of the country’s Tax Code that regulates controlled transactions reporting rules. Article 39.4 stipulates that the reporting period for the purposes of the transfer pricing legislation is a calendar year.

The proposed amendments followed enactment of the country’s transfer pricing legislation in July 2013. Ukraine’s Law No. 408-VII amended the Tax Code and set forth transfer pricing provisions so as to regulate transactions between related parties and counter tax evasion. The transfer pricing provisions now apply to transactions totaling more than 50 million Ukrainian hryvnia ($5 million) per annum. Law No. 408-VII took effect from Sept. 1, 2013.

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India

U.K. Oil and Gas Company Suspends Plan For Share Buyback Due to Indian Tax Dispute

Cairn Energy, an oil and gas company headquartered in Edinburgh, announced March 18 that it is suspending its $300 million share buyback program because of an investigation into its accounts by the Indian Tax Department.

The company was planning to use the money from selling its 10.3 percent stake in Cairn India to finance the buyback. But in January, the tax department ordered the company not to sell its stake. The reason is that the tax authorities want to be sure that, in the event a tax demand is made, Cairn Energy would have sufficient funds, given that it has no assets in India that can be seized. The authorities have told Cairn India not to allow the sale of the stake or to allow the shares to be pledged or mortgaged.

“The Board has decided to suspend the previously announced share buyback programme as of March 21 until the position regarding the Cairn India shareholding is resolved,” the company said in a statement. Cairn India also is running a share buyback offer that started Jan. 23 and will continue for six months, but Cairn Energy will not be able to participate in that offer.

Cairn Energy sold its majority stake in the Indian unit in 2011 to mining company Vedanta for $8.67 billion. The current value of its remaining 10.3 percent stake in Cairn India is estimated at $1 billion.

Cairn: No Tax Demand Received. A Cairn Energy spokesman told Bloomberg BNA March 19 that there is no tax dispute as such because the company has received no tax demand. “We have received a request for information relating to the internal company restructuring that we carried out in 2006 before Cairn India was floated on the stock exchange. The tax people have certainly been in touch but I don’t know where this figure of a tax demand for around $4 billion mentioned in the media has come from,” he said.

The spokesman nevertheless said the company will give the tax department the information it wants “very shortly.” The data “goes back around 10 years but we are getting it together,” he said.

The $4 billion figure has been mentioned by Indian tax officials. At a recent New Delhi conference, Manas Ray, Director of Income Tax, International Taxation, criticized the Cairn Energy for taking too long to respond to questions and mentioned the same amount (22 Transfer Pricing Report 1399, 3/20/14).

Retroactive Amendment. The Cairn Energy spokesman told Bloomberg BNA the tax department’s demand for information arose from India’s controversial 2012 retrospective amendment to the tax laws, which allows the tax authority to reopen cases going back to 1962.

The amendment overrode a Supreme Court verdict that had gone in favor of U.K. telecommunications company Vodafone, which is still locked in a tax dispute with the government (22 Transfer Pricing Report 1259, 2/20/14).

Vijay Iyer of Ernst & Young in New Delhi told Bloomberg BNA the inquiry into Cairn Energy is not surprising. “As long as tax officers have an enabling law”—the retrospective amendment—“that permits them to do this, they will do it, no matter what positive signals the Finance Minister might send out about making tax administration non-adversarial,” he said.

Gaurav Shah of the accounting firm MZSK & Associates in Mumbai also said he is not surprised. “While you have the promotions and postings of tax officers determined on the basis of how much revenue they have generated, we are going to continue seeing the kind of tax adjustments that multinationals have been facing,” he said.

By Amrit Dhillon

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India

CBDT Signs Its First Five APAs, All Unilateral Deals, Government Says

The Indian government announced March 31 that the Central Board of Direct Taxes (CBDT) has signed the nation’s first advance pricing agreements.

In a press release, the government said that the five unilateral agreements cover a period of five years from assessment year 2014-15 to 2018-19. The government said the five agreements govern related-party interest payments, corporate guarantees, non-binding investment advisory services and contract manufacturing. The agreements involve the pharmaceuticals, telecom, exploration and financial services industries.

The government also said that the CBDT concluded the five agreements within one year, compared with the internationally accepted norm of at least two years.

Miller Williams of Ernst & Young LLP in Washington, D.C., told Bloomberg BNA that the five signed APAs demonstrate that the Indian APA program is working and that the government was able to process the cases and reach a resolution in a timely manner.

“From an international perspective, a one-year completion from filing to signing is really good even on a unilateral APA,” he said.

The Indian APA Program launched July 1, 2012, and it received its first batch of 146 APA applications in March 2013.
**Inventory.** The India APA Program will now have to show the world that it can timely process the remaining unilateral APA applications “and reach a reasonable answer that taxpayers can accept, and in the case of bilateral APA applications, a reasonable answer that foreign governments can accept,” Williams said.

Over the past two filing seasons, taxpayers have filed approximately 300 APA applications, most of which are unilateral applications, he said. However, “there may be as many as 50 of the 300 that are bilateral,” Williams said.

The number of APA applications “validates that companies see this as a viable means to resolve transfer pricing controversy in India,” he said. However, Williams said, the government will need to start completing as many as 10 agreements each month in order to work through its inventory of applications.

**Site Visit.** The government said that the APA process has been designed to create “a taxpayer friendly environment in transfer pricing matters and to minimize the transfer pricing disputes.”

Before filing their APA applications, taxpayers are given the opportunity to share their expectations during the pre-filing consultations, and the APA team shares its understanding of the APA procedure. According to the government, after having received an APA application, the APA team works towards establishing the appropriate economic analysis of the covered related-party transactions, a process that involves a site visit.

The government described the site visit as a “physical verification of the business of the applicant with regard to the said transactions.

“It is this detailed fact finding exercise which lends credibility to the determination of arm’s-length price under the APA,” the government said.

The APA team then furnishes a report to the CBDT, which includes an analysis of the taxpayer’s functions, assets and risk. The CBDT then submits the report to the Central Government for final approval.

By Kevin A. Bell

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**In Brief**

**Japan’s Pricing Rules to Apply to Third-Party Services**

As part of Japan’s 2014 tax reform, third-party transactions governed by the country’s transfer pricing law would include those involving services as well as assets, a government official told Bloomberg BNA March 24. Currently, Japan’s transfer pricing rules, in addition to governing transactions between related parties, apply to third-party transactions including the provision, sale, transfer or lease of assets. The change will mean that the transfer pricing rules also will apply to third-party services such as loans, insurance and credit guarantees, according to Yasuhiro Okano, Deputy Director at the Tax Bureau for the Ministry of Finance. The revision is scheduled to be approved in a ministerial meeting by the end of March, and implementation is scheduled to start April 1.

By Yuriko Nagano
OECD

Country-by-Country Template Won’t Require Entity-by-Entity Financial Details, Andrus Says

A proposed country-by-country reporting template will not require multinational companies to break down financial details by legal entity, an official with the Organization for Economic Cooperation and Development announced March 31.

Joseph Andrus, head of the OECD’s transfer pricing unit, said that Working Party No. 6 has tentatively “concluded that the CbC template will only require aggregate countrywide reporting of financial information as opposed to legal-entity-by-legal-entity reporting.”

However, Andrus said, the working party decided to add a second page to the country-by-country template to “require a listing of all group entities by country who are aggregated into the country number.”

“This country-by-country list should include codes reflecting business activities in each entity,” said Andrus, who described the decision as “something of a compromise.”

The proposed template for country-by-country reporting, released Jan. 30, is a key initiative under the OECD’s Action Plan on Base Erosion and Profit Shifting (BEPS). The template would require companies for the first time to provide tax administrations with exhaustive details of how they allocate their income, taxes, and business activities on a country-by-country basis (22 Transfer Pricing Report 1214, 2/6/14). Andrus spoke at a March 31-April 1 transfer pricing conference in Paris sponsored by Bloomberg BNA and Baker & McKenzie.

Andrus said the OECD received 1,400 pages of comments on its January discussion draft. The OECD met with interested stakeholders in late March, and afterwards, the working party had a “good discussion” and reached some tentative decisions on the draft, he said.

**Reporting Template.** Andrus told the Paris conference that the working party also tentatively decided that companies will report their financial data for each country “including revenue, profit before tax, cash taxes paid, current year tax accrual, the total number of full time employees, tangible assets, and capital and accumulated earnings, for the entities in the relevant country.”

He said the working party also concluded that the country-by-country reporting template will not be part of the master file but will be a separate document. The U.S. and U.K. delegates to the OECD’s Committee on Fiscal Affairs recently urged that the new template strike a reasonable balance between the transfer pricing risk assessment needs of tax authorities and the compliance burden that it will impose on companies.

The officials—Mike Williams, H.M. Treasury’s director of business and international tax, and Robert Stack, deputy assistant secretary for international tax affairs with the U.S. Treasury—spoke at a Tax Council Policy Institute conference Feb. 20 (22 Transfer Pricing Report 1333, 3/6/14)

**Final Six Columns.** Andrus said the working party also tentatively decided to eliminate “the transactional reporting of related party royalties, interest and service fees required by the last six columns of the discussion draft’s CbC template.”

Under the January discussion draft, the final six columns of the proposed template would have required a group’s ultimate parent company to list:

- royalties paid to constituent entities,
- royalties received from constituent entities,
- interest paid to constituent entities,
- interest received from constituent entities,
- service fees paid to constituent entities, and
- service fees received from constituent entities.

Andrus said that “transactional reporting will be included in the local file for transactions that affect the local entity.”

The country-by-country reporting rules will provide flexibility for businesses regarding their source of financial data, he added.

“Either the use of statutory financial data from the statutory reports, or data from the reporting package for consolidation, will be permitted if applied consistently across all countries from year to year.”

The discussion draft’s language relating to the global master file also will be “modified to some extent” to reflect the working party’s original intention that the objective of the master file is to provide a high-level overview. “We will have to work on the language there,” he said.

The working party also will delete from the master file the requirement that companies report their 25 highest paid employees, he said.

Andrus said there are some remaining issues for the working party to resolve.

“The working party is still talking about the most effective way to require the filing of the report, and while we had a good conversation about that topic, we did not reach any conclusions. We have another meeting to go before we get there.”

**By Kevin A. Bell**

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**United Nations**

**Tax Committee To Revise Commentary To Article 9 of UN Model, Will Meet Oct. 27**

The United Nations Committee of Experts on International Cooperation in Tax Matters will hold its 2014 annual meeting in Geneva Oct. 27-31 and will revise the Commentary to Article 9 of the UN Model Tax Convention, which refers to Organization for Economic Cooperation and Development guidelines, according to a UN report.

According to the recently released report, Stig Sollund, coordinator of the subcommittee on transfer pricing, “predicted that any necessary changes to the commentary would not be revolutionary and were unlikely to require modifications” to the UN Practical Manual on Transfer Pricing for Developing Countries.

Sollund, who is the director general and head of the tax law department at Norway’s Ministry of Finance, noted that the current version of the Article 9 commentary establishes a strong connection to the OECD guidelines.

The report, detailing the actions taken by the UN tax committee at its October 2013 meeting, said that some members of the transfer pricing subcommittee are not “comfortable with the statement that a document issued by an organization of which their country was not a member ought to be followed by everyone, and had considered that it needed to be borne in mind that the document represented only guidelines.”

Past discussions of changes to the Article 9 Commentary have centered on paragraph 3 of the 2001 version, which recommends that countries follow the principles set out in the OECD transfer pricing guidelines in applying the arm’s-length principle to determine the correct prices for the transfer pricing of goods, technology, trademarks and services between associated enterprises and the methods that may be applied (22 Transfer Pricing Report 866, 11/14/13).

Critics of the current language have questioned whether the UN model needs to adhere to the arm’s-length principle, the cornerstone of the OECD transfer pricing guidelines.

**UN Manual.** Sollund said the UN Practical Manual on Transfer Pricing for Developing Countries stands “as a proud achievement of the Committee.”

Because the commentary to the UN Model Tax Convention is the framework for updating the manual, Sollund stressed that it was important “to have it in place while the transfer pricing subcommittee was working on revising the manual.”

Sollund said the Committee of Experts will discuss the treatment of related-party transactions involving intangibles at its October 2014 annual meeting, “together with intra-group services and management charges, which were of great importance for developing countries.”

He cited work by the OECD and the Group of 20 countries under a 15-point Action Plan on Base Erosion and Profit Shifting (BEPS), which seeks to ensure transfer pricing outcomes are in line with value creation.

The BEPS project is scheduled to deliver transfer pricing action items in September 2014 and September 2015.

Sollund said the OECD’s schedule would give the UN transfer pricing subcommittee sufficient time to incorporate the outcomes into their update of the manual. The work of the transfer pricing subcommittee and the Committee of Experts “would need to be informed by such developments.”

**OECD**

**Former OECD Official Calls for Multilateral Dispute Resolution Mechanisms ‘Post-BEPS’**

To deal with a coming “tsunami” of tax and transfer pricing disputes in a “post-BEPS” world, global policy makers should establish multilateral mechanisms to help companies reach resolution more efficiently, a former tax chief of the Organization for Economic Cooperation and Development said April 1.

Jeffrey Owens, who resigned as head of the OECD’s Center for Tax Policy and Administration in 2012, predicted a surge of dispute cases worldwide as governments begin to implement an international action plan on base erosion and profit shifting. Owens predicted “chaos” as new rules on business profits take effect.

To help deal with that confusion, Owens proposed “multilateral cooperative compliance agreements, backed up by multilateral advanced pricing agreements, with multilateral joint audits, and then topped off with multilateral mutual agreement procedures, that companies can effectively use” to build trust with governments, but also to get relief in disputes.

“Why can’t the OECD and the UN get together to create a joint arbitration panel financed by business, with a group of experts that reflects the diversity of opinions, including lawyers. It can be done,” Owens said.

Owens, currently a consultant for Ernst and Young and director of the Global Tax Policy Center at the Vienna University of Economics and Business, made his comments on the final day of a transfer pricing conference in Paris sponsored by Bloomberg BNA and Baker McKenzie LLP.

**Need to Build Trust.** Owens spoke on a panel that considered how a new era of tax “transparency” has seen intense focus on the issue of BEPS by nongovernmental organizations and media, which has forced governments to crack down on perceived tax avoidance by multinational companies.

These actions include increasing global tax cooperation and information sharing among tax authorities, conducting investigations and raids, and imposing country-by-country reporting and new transfer pricing documentation requirements, among other things, the panel said.
In this environment, companies are under pressure to take action to avoid potentially damaging public perceptions that they avoid paying their fair share of taxes, Owens said.

William Morris, chair of the tax committee of the OECD’s Business and Industry Advisory Committee and director of global tax policy with GE International, also urged businesses to engage in cooperative compliance programs to build trust with tax authorities and the public.

“It makes senses to talk to tax authorities. In the end we both want relatively similar results: we do relatively well enough to pay the taxes that they want, and they get the taxes pretty quickly, [while] we get the certainty that we are looking for,” he said.

Lack of Resources. Owens said that, in addition to lack of trust, one of the big constraints for companies in dealing with tax authorities is a shortage of resources. Cooperative compliance programs require high-level commitment by governments and companies, he said, “so companies don’t get one story from a top official and another story from the auditor.”

But instead of increasing resources for compliance programs, many governments are cutting them, he said.

Owens said he is “very concerned” about the MAP process, in particular, because governments are not ready for the “interim transitional period” after the Group of 20 countries approves the BEPS action plan.

“Some governments are actually decreasing the resources they have for dispute resolution. Businesses have to be telling government that you are [cooperating] with them on BEPS but that government should be doubling or tripling their resources for MAPs. They are going to need it for the tsunami of disputes that is coming,” said Owens.

By RICK MITCHELL

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OECD

UN’s Lennard Says BEPS Action Plan Needs ‘Global Acceptance’ To Be ‘Global Standard’

An international plan by the Organization for Economic Cooperation and Development to fight base erosion will not achieve the status of a “global standard” until it has been accepted as such by all such countries, not just rich and big ones, the United Nation’s top tax official said March 31.

“Just because the OECD and G-20 say something, [that] does not make it a global standard, said Michael Lennard, chief of the UN’s international tax cooperation unit, speaking at the Bloomberg BNA and Baker & McKenzie transfer pricing conference in Paris.

“What will make [the BEPS action plan] a global standard is the acceptance that it works globally, not just for OECD and G-20 countries.”

Lennard, a keynote speaker at the conference March 31, also discussed work that the UN subcommittee on transfer pricing is doing to revise the Commentary to Article 9 of the UN Model Tax Convention, which refers to the OECD transfer pricing guidelines.

The transfer pricing subcommittee has a “good mix” of people from business, advisers and governments of both OECD and non-OECD countries, he said, but stressed that his focus is on looking out for less-developed countries.

Arm’s-Length Principle. “The update has to reflect Article 9 and the arm’s-length principle, so it’s not going to be about formulary apportionment,” he said. It must “be consistent with the UN Model commentary, which is very much the same as the OECD commentary,” and “it must reflect realities of developing countries and their stages of capacity development.”

“We very much believe transfer pricing is a journey and we shouldn’t expect developing countries from day one to have the same regime that the U.S. and other big countries have developed over a long time.”

When he originally announced the work in November, Lennard said the committee expected to have a draft ready for approval by October 2014 (22 Transfer Pricing Report 866, 11/14/13).

Two Mandates. Lennard said the committee has been tasked with providing drafts of new chapters on the issues of intragroup services, management fees, intangibles and cost-contribution arrangements.

The subcommittee has decided to look at the issue of intangibles from the perspective of developing countries, “but we won’t actually start working in earnest until we are satisfied that the OECD work [on intangibles] is concluded,” he said.

The UN’s subcommittee on transfer pricing has a mandate to give due consideration to the OECD and G-20’s BEPS action plan but it must also take into consideration the special situation of less developed economies.

“We hope those two goals don’t clash with each other,” Lennard said, but he noted that while the UN has 193 members, the OECD has 34, and the G-20 has eight large emerging- economy members in addition to its 12 OECD members.

Lennard said he is “annoyed” by arguments that the UN should not be doing work on BEPS.

“We don’t take that view. We take the view that BEPS work needs to be very balanced and careful, but if our members want a second opinion, then that is something we should be willing to give them,’’ he said.

“Ultimately we have to be responsible to our members,” Lennard said.

By RICK MITCHELL

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OECD

OECD’s Saint-Amans Says BEPS Debate Over Formulary Apportionment Is Finished

The OECD’s top tax official said March 31 that the debate over the arm’s-length standard versus formulary apportionment is over.

Pascal Saint-Amans, Director of the Center for Tax Cooperation and Development, said that the idea behind the transfer pricing action items of the international base erosion and profit shifting (BEPS) project “is to save the arm’s-length principle.”

Speaking at the Bloomberg BNA and Baker & McKenzie LLP transfer pricing conference in Paris, Saint-Amans said the goal of saving the arm’s-length standard does not mean that countries participating in the BEPS project love the arm’s-length principle.

“It is the worst system with the exception of all the others, like democracy. But that is why we want to save it,” Saint-Amans said, noting that there are plenty of challenges in using the arm’s-length standard “but if you move to any other system then you find even more challenges.”

He also cited the administrative costs of moving to a different system.

“So that kills, I think, the debate over unitary taxation and formulary apportionment, in my view.”

However, Saint-Amans said the BEPS project wants to adapt the arm’s-length principle in ways that give comfort both to tax administrations and to the business community by providing as much certainty as possible.

The OECD, he said, cannot explain to senior government officials that the transfer pricing rules work well in allocating all of a group’s profit in a jurisdiction “because you have funding there, and because you have the ownership within a group of companies. That is something which just doesn’t fly.”

BY KEVIN A. BELL

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OECD

Andrus Says BEPS Project Will Consider U.S., German Transfer Pricing Legislation

When the international base erosion and profit shifting (BEPS) project starts to evaluate potential special measures for pricing related-party intangible transactions, the Organization for Economic Cooperation and Development will consider rules adopted by the United States and Germany, an official said March 31.

“I am sure when Working Party No. 6 comes to talk about special measures the first thing we will look at are things that countries have done, not things that they wish they could do,” said Joseph Andrus, head of the OECD’s transfer pricing unit, speaking a transfer pricing conference in Paris sponsored by Bloomberg BNA and Baker & McKenzie.

Special measures that the working party will evaluate include the U.S. commensurate-with-income principles, look-back rules and cost-sharing regulations as well as German rules on the transfer of functions, Andrus said.

U.S. and German transfer pricing legislation “are things we will look at,” he said.

Action 8 of the BEPS plan tasks the joint OECD/Group of 20 Countries project with developing transfer pricing rules, or special measures, to value transfers of hard-to-value intangibles and to then update the OECD transfer pricing guidelines. The deadline to complete this work is September 2015.

Eye of the Beholder. Andrus told the conference that “one man’s arm’s-length principle is not necessarily another man’s arm’s-length principle.” The U.S. and Germany both will say that their legislation is “fully compatible with the arm’s-length principle,” he said, but if he asked the conference audience “to raise their hand about how many think they are [compatible], you would get a mixed vote.”

That complicates the issue for Working Party No. 6 “because there will be disagreements about where the boundary of the arm’s-length principle rests,” he said.

Speaking on the same panel as Andrus, Michael McDonald, a financial economist with the U.S. Department of Treasury, said, “let us assume that something akin to the U.S. commensurate-with-income rules is implemented as a BEPS measure.”

Regardless of whether such a measure would be appropriate under the arm’s-length principle, he said, “that might be an example of a special measure where we don’t care whether or not it is [appropriate, if we like the outcome, we think it serves a good policy objective.”

Gary Sprague of Baker & McKenzie in Palo Alto, Calif., said the German transfer-of-functions legislation is not an arm’s-length principle. “Whilst my German colleagues dispute that—it is a formulary rule.”

BY KEVIN A. BELL

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OECD

OECD Draft Issued on Digital Economy Seen Echoing Past Work, Moving Toward Formulary

The Organization for Economic Cooperation and Development has released a discussion draft including proposals for modifying existing permanent establishment rules or creating new rules to address tax challenges linked to digital businesses.

Published March 24, the draft, “BEPS Action 1: Address the Tax Challenges of the Digital Economy,” gathers observations and proposals from the task force that the OECD created in October 2013 to identify base erosion and profit shifting issues related to the digital economy and ways to address them (22 Transfer Pricing Report 1191, 2/6/14).

The Group of 20 countries has asked the OECD to report such proposals to it by September and the new 81-
The OECD noted the new draft does not reflect consensus views of the task force.

**September Deadline.** In September 2013, G-20 leaders endorsed the OECD’s 15-action plan aimed at curbing what the organization has called practices that allow multinationals to use “aggressive tax planning” and transfer pricing schemes to shift profits from jurisdictions in which they are earned to low- or no-tax jurisdictions (22 Transfer Pricing Report 368, 7/25/13).

The OECD has said that international tax rules and treaties need to be updated to close gaps in rules and standards that have allowed certain multinational companies, in particular big Internet companies and those that primarily exploit intangible assets, to pay extremely low effective tax rates (22 Transfer Pricing Report 162, 6/13/13).

As part of the action plan, the organization in October 2013 created the digital task force to identify issues raised by taxation of the digital economy and possible actions to address them (22 Transfer Pricing Report 925, 11/28/13).

In February, OECD officials said the joint BEPS project is on track to meet its deadline to deliver the first concrete proposals developed by the plan to the Sept. 20-21 meeting of G-20 finance ministers and central bank governors in Cairns, Australia.

G-20 leaders would then consider the reports at their summit in Brisbane, Nov. 15-16.

**No Precise Definition.** The new draft said many key features of the digital economy, in particular those linked to asset mobility stemming from heavy reliance on intangibles, and mobility of customers, employees and functions, “exacerbate” opportunities for base erosion and profit shifting.

The draft discusses ways that the digital economy allows some companies, particularly those whose profits primarily come from intangible assets, to avoid taxation, and it makes several recommendations for restoring taxation on so-called stateless income. The draft also addresses concerns regarding consumption taxes.

Ernick said the draft does not provide a precise definition for the term “digital economy” or indicate how its growth and development creates new problems applying current international tax rules as compared with the non-digital economy.

“All of the perceived problems discussed in the draft, from issues regarding transfer pricing and valuation of intangibles, permanent establishment rules, hybrid mismatch arrangements, etc., are no different in kind from any of the problems identified outside of the digital economy,” he said.

**Echoes Previous Work.** The draft asks for comments on a suggested option of creating a new nexus for purposes of determining permanent establishment status based on “significant digital presence” or “virtual permanent establishment.”

Ernick said this echoes questions that the OECD’s business profits technical advisory group (TAG) has asked [in a 2000 report] that addressed business models arising from use of radio, television, and mail-order.

“The conclusion has long been that merely selling into a market without physical presence or a dependent agent within the market is not sufficient to create a permanent establishment allowing that country to claim a share of the enterprises’ profits. There is nothing unique to doing business in the digital economy that should change that conclusion,” he said.

The new BEPS draft also considers whether a country providing the market for an enterprises’ goods and services should be entitled to consider that a share of the profits of the enterprise is derived therefrom, Ernick said.

“The business profits TAG rejected that suggestion and their reasoning still seems valid today. The value creating activities take place at the location of production, not the location of consumption,” Ernick said.

**Klein: Inconsistent Arguments.** Klein said the draft makes inconsistent arguments about whether the digital economy should get special treatment, and she said OECD countries have made inconsistent arguments about so-called people-related returns.

Paragraph 205 of the draft states that the task force decided that “ring-fencing the digital economy as a separate sector and applying tax rules on that basis would be neither appropriate nor feasible.”

That statement, Klein said, “sounds like they don’t think ring-fencing the digital economy is a good idea,” but she noted that, on page 66, the draft also talks about a “new nexus” based on significant digital presence.

The draft states that such a proposal would determine that an enterprise engaged in certain “fully dematerialized digital activities” would have a permanent establishment if it maintained a significant digital presence in the economy of another country.

“Every activity that I am aware of requires human beings to do something with equipment, even so-called fully dematerialized activity,” said Klein.

She said many countries have strongly argued that people functions should get appropriate returns in the context of intangibles, “but when it comes to these fully dematerialized activities, they [lose interest] in the people functions getting their returns.”

**Steps Toward Formulary Apportionment.** The OECD has said the BEPS plan will look beyond the arm’s-length principle, but not abandon it. However, OECD tax chief Pascal Saint-Amans has suggested he is “agnostic” about the subject (22 Transfer Pricing Report 729, 10/3/13).

Klein said the draft’s section 5, “Tackling BEPS in the Digital Economy,” contains suggestions that, if enacted, would be “four significant steps toward formulary apportionment,” which the USCIB has strongly opposed as unworkable.

She said the section—which begins by asserting that other actions in the BEPS action plan will address BEPS
issues arising in the digital economy—suggests, among other things, that on the issue of limiting base erosion via interest deductions and other financial payments, “a formulary type of approach which ties the deductible interest payments to external debt payments may lead to results that better reflect the business reality of [multinational] groups.”

“That at least suggests that intercompany debt would be disregarded and tax authorities would look at allocating total external debt on a globalized basis,” she said.

Under a section on business risks, the draft states that “the work will address questions related to contractual risk allocation by requiring control of risk, financial capacity to bear risk, and management of risk to be more closely aligned.” The draft said the guidance also will identify risks that, by their nature, are borne by the multinational enterprise as a whole and “therefore cannot be readily assigned to a single group entity.”

Klein said that a logical conclusion from this suggestion is that these risks would be ignored.

‘A Measure of Reliance’ on Arm’s Length. The draft states that, depending on the way they are designed, measures to address base eroding payments “could preserve a measure of reliance on the arms length approach but depart from a strict adherence to the arms length principle in targeted circumstances. Examples of such approaches would include caps on certain payments, or formula based allocations.”

The draft says that because multinationals are integrated, attention should be devoted “to the implications of this increased integration in [multinational enterprises] and evaluate the need for greater reliance on value chain analyses and profit split methods.”

Klein said that the OECD “keeps saying it believes in the arm’s-length principle, but I don’t know what’s left of [the principle] if you cap interest and other expenses the way they suggest, disregard risks, and do global value chain analysis and global profit splits.”

Timing Criticized. Ernick suggested the OECD should have made tax challenges of the digital economy the last item on its action plan instead of the first. That would have allowed it to see if any problems remained that were confined solely to the digital economy.

“It is likely there would have been none and the time could have been better invested examining issues common to all sectors of the economy,” he said.

Klein said the BEPS project as a whole is going too fast. “Looking at absolutely core fundamental tax principles to rewrite the entire tax rule book in two years just cannot be done,” she said. “There will be errors in this that could take 20 years to fix.”

The OECD said interested parties have until 5 p.m. on April 14 to e-mail comments on the draft to the OECD at CTP.BEPS@oecd.org. A public consultation on the draft is scheduled in Paris on April 23 and also will be broadcast live on the Web.

BY RICK MITCHELL

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☐ The digital economy and other items on the OECD’s BEPS plan will be discussed at the Global Transfer Pricing Conference in Paris March 31-April 1. For more information, visit http://www.bna.com/agenda-m17179870460/.

OECD

Commensurate-With-Income Approach Could Solve BEPS Problem, De Ruiter Says

Special measures, such as a “commensurate-with-income approach” to the valuation of intangibles, could solve problematic implementations of the arm’s-length principle that lead to base erosion and profit shifting, an Organization for Economic Cooperation and Development transfer pricing official said March 31.

Marlies de Ruiter, head of the OECD’s division on tax treaties, transfer pricing and financial transactions, said the BEPS action plan that the OECD is developing for the Group of 20 countries acknowledges that the arm’s-length standard works well, but there may be limits to what it can do.

In some cases, where implementation of the standard leads to BEPS, special measures may be called for, she said, adding that such special measures would not create double taxation.

De Ruiter spoke during a panel discussion at a transfer pricing conference in Paris sponsored by Bloomberg BNA and Baker & McKenzie LLP.

The panel addressed the future of the arm’s-length principle in the context of the OECD/G-20 BEPS action plan, considering whether the arm’s-length standard is “broken” or too complex to apply, how it relates to emerging and developing economies, cases where it can be applied but gives the wrong policy outcome, and possible alternatives to it. The panel also considered whether the arm’s-length principle can be applied when reliable comparables are not available.

No Plan to Abandon Standard. The OECD has said the BEPS plan will look beyond the arm’s-length principle, but not abandon it. However, OECD tax chief Pascal Saint-Amans has suggested he is “agnostic” about the subject (22 Transfer Pricing Report 729, 10/3/13).

In September 2013, G-20 leaders endorsed the OECD’s 15-action plan aimed at curbing what the organization has called practices that allow multinationals to use “aggressive tax planning” and transfer pricing “schemes” to shift profits from jurisdictions in which they are earned to low- or no-tax jurisdictions.

The OECD has said that international tax rules and treaties need to be updated to close gaps in rules and standards that have allowed certain multinational companies, in particular big Internet companies and those that primarily exploit intangible assets, to pay extremely low effective tax rates (22 Transfer Pricing Report 162, 6/13/13).

Action 8, addressing BEPS when groups move intangibles among group members, calls for developing
transfer pricing rules or special measures for transfers of hard-to-value intangibles and for updating the guidance on cost contribution arrangements.

**Risk ‘Divorce’ From Value.** Michelle Levac, transfer pricing specialist with the Canada Revenue Agency and chair of OECD Working Party No. 6 (which deals with the taxation of multinational enterprises), told the panel that the action plan acknowledges that the arm’s-length standard in most cases deals effectively and efficiently with appropriate allocation of income among jurisdictions.

But as the commercial world becomes more and more integrated, and parts of national economies mainly consist of intangibles, there are cases where “income is divorced from where intangibles are transferred, some entities are over-capitalized, and there are also instances where allocation of risk is divorced from where there is value creation,” she said.

“This is due to misapplication of the standard and something that the action plan aims to deal with,” Levac said.

**Intangible Example.** De Ruiter offered the example of a group that transfers legal ownership of an intangible in development to a low-tax entity, while subsequent development activity is still done by the original entity but paid for by the low-tax entity “that has no substance at all.”

As for the value of the intangible transferred, the business knows what it expects from it in the future, but the tax administration doesn’t, she said.

Based on empirical studies, given that the risk is attributed to the legal owner, “you would expect [random results], that sometime the risk taker would lose and sometimes it would gain,” she said.

“But surprisingly, if you look at transfer pricing outcome and issues of risk being in low-tax jurisdiction [with intangibles], in many cases what you see is that there is a huge profit. So it doesn’t take a random walk at all,” de Ruiter said.

“That’s probably not a problem with the arm’s-length principle, itself but it is an issue with implementation of the principle,” she said.

“One of the ways we can take care of that is to introduce a commensurate-with-income approach. That would solve the issue,” she said.

**Special Measures.** The OECD has to date offered little detail on what Action 8 means by “special measures,” although it has mentioned profit splits and formulary apportionment, and now, a commensurate-with-income approach.

De Ruiter added that she noticed a “misperception” among business that special measures could create double taxation.

“That of course is not the intention of introducing special measures,” she said. “We shouldn’t confuse special measures with anti-abuse measures.”

In some jurisdictions, anti-abuse measures state that they are outside double tax treaties and, thus, treaty double-tax relief does not apply, she noted.

By contrast, “special measures specifically target nontaxation situations and should not lead to double taxation,” she said.

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**United States**

**Stack: U.S. Will Continue Focus on Clear Rules, Maintaining Base in BEPS Project**

The U.S. will continue to focus on clear and administrable rules, maintaining the U.S. tax base and protecting the interests of American companies as the base erosion and profit shifting project goes forward in the Organization for Economic Cooperation and Development, a top Treasury Department official said.

Deputy Assistant Secretary for International Tax Affairs Robert Stack said March 25 that the U.S. will remain committed to the arm’s-length standard as part of the process.

He said the BEPS project reflects the momentum toward stopping tax evasion around the world.

This is also symbolized by the Foreign Account Tax Compliance Act and the move toward a common reporting standard, Stack said at the Tax Executive Institute’s midyear conference.

“There is enormous momentum toward the automatic exchange of information,” Stack said. With FATCA, the intergovernmental agreements used to implement it in numerous countries, and the movement toward a common reporting standard, progress is being made toward “a world where we’re going to see multilateral instruments used to shape tax policy,” Stack said.

**Challenging Environment.** The BEPS project is “a challenging environment,” he said. “I’m optimistic progress will be made. It won’t be a complete rewrite of the rules, but we’re making progress.”

One theme of the BEPS project is that instead of specifically going after tax havens, countries should change the rules to eliminate stateless income and curb abusive tactics, Stack said.

Something to look out for is the “unintended consequences” of matching of rules, Stack said, while there are also consequences driven by tax competition. “We are keenly aware of countries taking unprincipled positions on audits” of U.S. companies, he told practitioners.

A major goal of the U.S.’s position in the BEPS project is rules that are “clear and administrable,” Stack said. Other goals are finding ways to resolve tax disputes and maintaining the U.S. tax base.

The U.S. will be adamant that the process should “respect the arm’s-length standard,” the Treasury official said. “We don’t believe it should be easy to recharacterize among multinational affiliates. We won’t walk toward formulary apportionment.”

**Country-by-Country Reporting.** In addressing country-by-country reporting, Stack said the U.S. will be mindful of protecting taxpayer information and will support exchanging the information only at a government-to-government level. Stack said this has been a “very, very high priority” for the U.S. “We have been extremely
proactive in getting that in some form companies can live with,” he said.

In the BEPS project, focus will continue on hybrids, harmful tax practices and digital issues, among other issues, Stack said.

The OECD released two drafts on hybrid mismatches March 19—one recommending that countries adopt new domestic rules to address the mismatch in tax outcomes from the arrangements and a second recommending related changes to the OECD Model Tax Treaty (22 Transfer Pricing Report 1402, 3/20/14).

A discussion draft on the challenges of taxing digital businesses released March 24 included proposals for modifying existing permanent establishment rules or creating new rules. (See the related story in this issue.)

Asked what the effects of nonconsensus might be in the BEPS project, Stack said the U.S. is working hard on consensus, but at the same time, wants to make clear what it will and won’t agree to. “We’re trying very hard to be very vocal up front about the issues we won’t budge on,” Stack said.

A key goal remains “protecting the U.S. base from endless audits and countries not being fair,” Stack said. “The doors are still open to hear from you.”

By Alison Bennett

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OECD

Saint-Amans Says BEPS Plan Should Include Arbitration Mechanisms to Ease ‘Uncertainty’

A n international action plan to fight base erosion and profit shifting should include “better and more frequent arbitration mechanisms” to increase certainty for business around international tax rules, the top tax official of the Organization for Economic Cooperation and Development said April 2.

Pascal Saint-Amans, head of the organization’s Center for Tax Policy and Administration, said the organization is “very concerned” about complaints from business and governments that the BEPS plan is not improving “certainty” on international tax rules.

In response, the organization wants to improve dispute mechanisms, he said, adding that “we need to reduce the risks of uncertainty.”

Saint-Amans spoke during the OECD’s webcast update on the BEPS project, its first such update since Feb. 5 (22 Transfer Pricing Report 1191, 2/6/14).

Also during the webcast, Joseph Andrus, head of the OECD’s transfer pricing unit, predicted that Action 4 of the BEPS plan—on limiting base erosion through financial transactions—likely would lead to the development of a new chapter for the organization’s transfer pricing guidelines.

The new chapter would address the transfer pricing aspects of financial transactions, Andrus said, but he did not elaborate.

‘Certainty Not Increasing’. Saint-Amans said that the OECD is already very concerned about complaints from the business community and many governments that certainty is not increasing “in the context of BEPS.”

“Governments have not been good at eliminating double taxation where one of the parties has made adjustments and these adjustments [do not] result in the elimination of double taxation in the other country,” Saint-Amans said.

“This is why we definitely want to improve the dispute resolution mechanisms,” he said, noting that the BEPS plan’s Action 14 addresses improving dispute resolution mechanisms.

Saint-Amans’ comments echoed the statements of Jeffrey Owens, his predecessor as OECD’s tax director, who said April 1 that a “tsunami” of dispute cases would arise in the post-BEPS world. Owens called for multilateral dispute resolution mechanisms to deal with them. (See related story in this issue).

Owens spoke on a panel at the March 31-April 1 transfer pricing conference in Paris, sponsored by Bloomberg BNA and Baker & McKenzie LLP. Among other things, Owens proposed that the OECD and UN collaborate to create a joint arbitration panel financed by business.

Mandatory Arbitration in Action 15. Saint-Amans said the OECD wants the action plan to improve dispute resolution, in part, by pushing for mandatory arbitration as part of Action 15.

That action item addresses development of a multilateral instrument to simultaneously update some 3,000 bilateral tax treaties based on the OECD Model Tax Convention on Income and Capital in order to implement rule changes called for by the BEPS plan.

A multilateral instrument would be much more efficient than changing 3,000 bilateral treaties individually, he said.

“We would be keen for arbitration to be included in that [instrument],” he said.

OECD members and G-20 countries will have the final say on the matter, “but we hope that there will be an acknowledgement of a need to push for effective dispute resolution mechanisms, which definitely includes better and more frequent arbitration mechanisms,” Saint-Amans said.

New Chapter in Guidelines. Andrus said the OECD’s Working Party 6 on Taxation of Multinational Enterprises, under the Committee on Fiscal Affairs, is still working on the “scope” of work on Action 4 of the BEPS plan.

Action 4 is one of last actions addressing transfer pricing aspects of BEPS that will be completed, Andrus said. The BEPS agenda lists a target date of December 2015 for making changes to the OECD guidelines on transfer pricing.

Andrus has said previously that that scope of the work will depend on certain decisions made about how to treat interest deductions. But he said the action “suggests that we will do work on transfer pricing aspects of financial transactions [and] we do anticipate that the most likely output would be a new chapter in the guidelines.”
Residual Value and Synergies. Andrus also responded to a question about how the BEPS project treats residual value and synergies of a global multinational enterprise. He said the revised discussion draft on transfer pricing aspects of intangible assets released in July 2013 “for the first time, really tried to take on the question of corporate synergies” ([22 Transfer Pricing Report 441, 8/8/13]).

The draft discusses when such synergies should be taken into account, how they should be shared among group members and “quite clearly” takes the view that if all the valuable inputs of a group of companies are properly valued and rewarded, the notion of some residual pool sitting undefined in the group “should probably not be given much weight.”

Andrus added, “the BEPS intention is to make sure that big pools of residuals don’t get lumped into low-tax jurisdictions, and I think the intangibles draft goes a long way in the direction of setting out rules that will make sure that that’s the case.”

Four Consultations Planned. The OECD plans four public consultations on BEPS work in April and May:

- on preventing treaty abuse, April 14-15;
- the digital economy, April 23;
- hybrid mismatch arrangements, May 15; and
- transfer pricing documentation and the template for country-by-country reporting, May 19.

The organization also plans a G-20 symposium in Australia for May 9-10, in advance of a meeting of Group of 20 country finance ministers and central bankers in September.

Saint-Amans said the joint BEPS project is on track to meet its deadline to deliver the first concrete proposals developed by the plan to the Sept. 20-21 meeting of G-20 finance ministers and central bank governors in Cairns, Australia.

G-20 leaders would then consider the reports at their summit in Brisbane on Nov. 15-16.

BY RICK MITCHELL

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U.S. Tax Court Order on Eaton Corp.’s Motion for Reconsideration of 10/30/13 Order Upholding IRS Privilege Claims [issued 3/14/14]

U.S. Tax Court

EATON CORPORATION AND SUBSIDIARIES, Petitioner, v. COMMISSIONER OF INTERNAL REVENUE, Respondent.

5576-12

March 14, 2014
Diane L. Kroupa

ORDER

This case was assigned to Judge Diane L. Kroupa on July 9, 2012. Petitioner filed, on December 2, 2013, a Motion for Reconsideration of Order Denying Motion to Compel (Motion for Reconsideration) and Motion to Certify Interlocutory Appeal Order Denying Motion To Compel (Motion to Certify). Respondent filed, on February 18, 2014, Notices of Objection to each motion. For the reasons stated, we will hold in abeyance the Motion for Reconsideration and the Motion to Certify.

Background

Petitioner is an industrial manufacturer that purchased products from its foreign subsidiaries. Petitioner and respondent entered into advanced pricing agreements (APAs) governing those transactions that set forth the best method for determining arm’s-length prices under section 482. Respondent determined that petitioner had not complied with the terms and conditions of the APAs and canceled the APAs retroactively (cancellations). Respondent adjusted petitioner’s income under section 482. Petitioner timely filed a petition.

Petitioner and respondent filed cross motions for partial summary judgment related to the standard of review for the cancellations. We issued an opinion holding that petitioner must demonstrate that respondent’s cancellations of the APAs were arbitrary, capricious or without sound basis of law or fact. We noted that the limited record did not indicate in what manner respondent determined petitioner did not comply with the APAs or the facts respondent relied upon to make that determination.

The parties are conducting discovery. Petitioner requested documents related to the cancellations. Respondent identified, and claimed to be privileged, four documents. Respondent contended that the attorney work product doctrine fully protects a memorandum dated December 5, 2011 (2011 memo), and the deliberative process privilege fully protects two drafts of an APA memorandum dated December 12, 2003 (blueline 2003 memo and redline 2003 memo, respectively), and partially protects both a renewal APA memorandum dated September 13, 2006 (2006 memo) and the 2011 memo.

Petitioner filed, on April 16, 2013, Petitioner’s Motion to Compel Respondent to Produce Documents Respective to Petitioner’s Revised First Request for Production of Documents (Motion to Compel). Petitioner also filed, on July 18, 2013 Petitioner’s Motion for In Camera Review of Documents Responsive to Petitioner’s Revised First Request for Production of Documents (In Camera Motion).

We granted the In Camera Motion and assigned the matter to Special Trial Judge Daniel A. Guy to determine whether the documents were protected by privilege. Judge Guy issued an order on October 30, 2013 upholding respondent’s privilege claims (Order). Petitioner filed the Motion to Reconsider and Motion to Certify. Petitioner argues in the Motion for Reconsideration that Judge Guy misapplied the legal standards for determining whether the documents are protected by the privileges.

Motion for Reconsideration Standard

We begin with the standard the Court uses to decide whether to grant a Rule 161 motion for reconsideration. The decision whether to grant a Rule 161 motion rests within the Court’s discretion. CWT Farms, Inc. v. Commissioner, 79 T.C. 1054, 1057 (1982), aff’d, 755 F.2d 790 (11th Cir. 1985). We generally do not exercise our discretion to this end absent a showing of substantial error or unusual circumstances. Haft Trust v. Commissioner, 62 T.C. 145 (1974), aff’d on this ground, 510 F.2d 43, 45 n.1 (1st Cir. 1975).

Motion for Reconsideration

We now turn to the Motion for Reconsideration. Petitioner advances two general arguments. First, petitioner argues that respondent failed to meet his burden that the documents are privileged. Respondent relied on the declaration of Patricia Lacey to establish the 2011 memo is protected by privileged. The record reflects that respondent reasonably anticipated litigation when it produced the 2011 memo. Petitioner contends that respondent failed to establish that the 2011 memo would not have been prepared in substantially similar form but for the prospect of litigation. See United States v. Deloitte LLP, 610 F.3d 129, 138 (D.C. Cir. 2010). Ms. Lacey’s declaration fails to directly address whether respondent would not have produced the 2011 memo in substantially similar form but for the prospect of litigation. Thus, we agree that this remains an open question on the record before the Court.

Second, petitioner argues that the Court failed to appreciate petitioner’s substantial need for the documents to fully uncover the reason for respondent’s cancellations. See Rule 70(c)(3)(A)(ii). Petitioner contends that it will be unable to determine respondent’s justification for the cancellations without the documents. Respondent disagrees and emphasizes that petitioner only recently made an informal request for an explanation of the cancellations. This implies that petitioner is demanding privileged material before using alternative informal and formal discovery mechanisms. We note that
this is the first time the Court has reviewed an APA cancellation. Petitioner has a substantial need to understand respondent's justifications. It is unclear, however, that the disputed documents are the only means to access that information.

Thus, we will direct the parties to undertake two actions. First, respondent shall provide additional information to the Court and petitioner regarding whether respondent would not have produced the 2011 memo in substantially similar form but for the prospect of litigation. Second, in the event the parties are unable to resolve their differences through informal consultation and voluntary exchange of information, respondent shall make available for deposition Mr. Steven A. Musher or any other IRS representative with firsthand, substantive knowledge of the specific ground(s) that respondent relied on in canceling the APAs and the specific facts supporting each ground. See Rule 74(b) (Depositions Upon Consent of the Parties). We note that respondent may continue to assert the privileges with respect to the content of the documents and related communications. We will hold in abeyance the Motion for Reconsideration and the Motion to Certify. The parties shall update the Court at the May 12, 2014 special trial session.

Upon due consideration and for cause, it is

ORDERED that Petitioner's Motion for Reconsideration and Motion to Certify, filed December 2, 2013, are held in abeyance. It is further

ORDERED that respondent shall supplement his objection to the Motion for Reconsideration and provide supporting information as to whether respondent would not have produced the 2011 memo in similar form but for the prospect of litigation on or before April 28, 2014. It is further

ORDERED that, in the event the parties are unable to resolve their differences through informal consultation and voluntary exchange of information, respondent shall make available for deposition Mr. Steven A. Musher or any other IRS representative with first-hand substantive knowledge of the specific ground(s) that respondent relied on in canceling the APAs and the specific facts supporting each ground. The parties shall complete the deposition in accordance with Rule 74(b) before May 12, 2014. It is further

ORDERED that the parties shall provide an oral status report at the May 12, 2014 special trial session.

(Signed) Diane L. Kroupa
Judge
Dated: Washington, D.C.
March 14, 2014

Securities and Exchange Commission Financial Statements Filed During March 2014, Detailing Transfer Pricing Issues

AstraZeneca Plc, 20-F, 3/20/14
Net income tax payable has increased by $523 million to $2,582 million, principally due to cash tax timing differences and an increase in accruals for tax contingencies. The tax receivable balance of $494 million comprises tax owing to AstraZeneca from certain governments expected to be received on settlements of transfer pricing audits and disputes (see Note 25 to the Financial Statements from page 176) and cash tax timing differences. Net deferred tax liabilities increased by $157 million in the year.

The total net accrual included in the Group Financial Statements to cover the worldwide exposure to transfer pricing audits is $523m, an increase of $100m compared to 2012.

AstraZeneca faces a number of transfer pricing audits in jurisdictions around the world and, in some cases, is in dispute with the tax authorities. The issues under discussion are often complex and can require many years to resolve. Accruals for tax contingencies require management to make estimates and judgements with respect to the ultimate outcome of a tax audit, and actual results could vary from these estimates. The international tax environment presents increasingly challenging dynamics for the resolution of transfer pricing disputes. These disputes usually result in taxable profits being increased in one territory and correspondingly decreased in another. Our balance sheet positions for these matters reflect appropriate corresponding relief in the territories affected. Management considers that at present such corresponding relief will be available, but given the challenges in the international tax environment will keep this aspect under careful review.

Management continues to believe that AstraZeneca’s positions on all its transfer pricing audits and disputes are robust and that AstraZeneca is appropriately provided.

For transfer pricing audits where AstraZeneca and the tax authorities are in dispute, AstraZeneca estimates the potential for reasonably possible additional losses above and beyond the amount provided to be up to $529m (2012: $522m; 2011: $375m), however, management believes that it is unlikely that these additional losses will arise. It is possible that some of these contingencies may reduce in the future to the extent that any tax authority challenge is unsuccessful, or matters lapse following expiry of the relevant statutes of limitation resulting in a reduction in the tax charge in future periods.

AVG Technologies N.V., 20-F, 3/25/14
Through May 31, 2011, our effective tax rate was mainly determined by the nominal corporate tax rate of 10% in Cyprus and a relatively low corporate tax rate in the Czech Republic. On June 1, 2011, we entered into an innovation tax regime in the Netherlands and recognized tax benefits (deferred tax assets) which significantly impacted our effective tax rate. As a result, we received a credit, or a benefit to our income statement of $56.3 million in June 2011, and then an offsetting charge of $8.0 million in 2011, $13.6 million in 2012 and $13.1 million in 2013. As a result, our effective tax rate was (96.3)% in 2011, 19.4% in 2012 and 38.0% in 2013.

The primary reason for the increase in tax expense for the year ended December 31, 2013 is due to the deferred tax asset for deferred revenue. Deferred tax assets are measured using the enacted tax rates expected to apply to taxable income in the periods in which the deferred taxes are expected to be settled or realized. As a result of the centralization of all intellectual property in the Netherlands during 2013 and alignment of the intercompany transfer pricing methodology, the enacted
tax rates used for realization of the deferred tax assets decreased significantly. By undertaking these new intercompany transfer arrangements, resulting in a different deferred tax rate allocation, we have incurred an increase in the effective tax rate in 2013, except for a lower effective tax rate in subsequent years. The effective Dutch tax rate is expected to be significantly lower than the statutory tax rate in the Netherlands primarily as a result of the innovation box tax regime in the Netherlands and as a consequence of a tax ruling relating to the relocating of our e-commerce operations in the Netherlands effective January 1, 2014.

As of June 1, 2011, we reorganized our operating model by centralizing the ownership of certain intangible intellectual property rights and the future development of those rights in the Netherlands. In addition, as of January, 2014, we relocated our Cypriot e-commerce entity to the Netherlands and obtained a special deduction which will result in an expected cash tax rate of 11.25% over the following ten years. As a result of these group tax restructurings our future effective tax rate will mainly be determined by the “innovation box” tax regime in the Netherlands and the effective corporate tax rate of AVG e-commerce distribution entity of 11.25% in the Netherlands.

**BioAmber Inc., 10-K, 3/28/14**

[Ed Note: The company reported $7.67 million in unrecognized tax benefits as of Dec. 31, 2013.]

The Company’s unrecognized tax benefits largely include liabilities related to transfer pricing exposures from allocation of income between jurisdictions and intercompany sales of assets. The effect of the unrecognized tax benefit related to intercompany sales of assets has been recorded as a prepaid tax expense. The Company believes that it is reasonably possible that no increase in unrecognized tax benefits related to transfer pricing exposure liabilities may be necessary within the coming year. In addition, the Company believes that it is reasonably possible that an amount of $2,584,650 of its other unrecognized tax benefits will be recognized by the end of 2014 due to a lapse of the statute of limitations.

**Boyd Gaming Corp., 10-K, 3/14/14**

Included in the $37.1 million balance of unrecognized tax benefits at December 31, 2013, are $29.1 million of federally tax effected benefits that, if recognized, would impact the effective tax rate. We recognize accrued interest related to unrecognized tax benefits in our income tax provision. During the years ended December 31, 2013, 2012 and 2011, we recognized accrued interest and penalties of approximately $1.1 million, $0.2 million and $2.4 million, respectively, in our income tax provision. We have accrued $12.0 million and $12.4 million of interest and penalties as of December 31, 2013 and 2012, respectively, in our consolidated balance sheets.

As of 2013 we reached a partial resolution on certain proposed adjustments raised in connection with our 2005-2009 IRS examination. As a result of these agreements, we reduced our unrecognized tax benefits by $2.1 million, of which $0.1 million impacted our effective tax rate. During 2012 we effectively settled our 2001-2004 IRS examination and reduced our unrecognized tax benefits by $20.8 million, of which $0.1 million impacted our effective tax rate. Additionally, in 2013 and 2012 we reduced the interest accrued on our unrecognized tax benefits by $3.1 million and $4.0 million, respectively, and recorded a benefit to our tax provision.

We are in various stages of the examination and appeals process in connection with many of our audits and it is difficult to determine when these examinations will be closed. However, it is reasonably possible over the next twelve-month period that our unrecognized tax benefits as of December 31, 2013, may decrease in the range of $28.1 million to $33.4 million, of which $20.3 million to $25.5 million would impact our effective tax rate. Such reduction is due to the resolution of certain issues, primarily related to the depreciable lives of assets, tax attributes, interest capitalization and transfer pricing, raised in connection with our federal and state examinations. Other than the resolution of the audits discussed above, we do not anticipate any material changes to our unrecognized tax benefits over the next twelve-month period.

**Chiquita Brands International Inc., 10-K, 3/4/14**

Additionally, Ecuador is challenging the transfer pricing practices of major banana exporters and has assessed $15 million of income taxes, penalties and interest related to transfer pricing in 2008 and 2009. The company believes appropriate transfer pricing was used and that more likely than not, it will succeed upon appeal. Therefore, the company does not have unrecognized tax benefits related to this matter.

**Cooper Companies Inc., 10-Q, 3/7/14**

Included in the balance of unrecognized tax benefits at November 1, 2013, is $3.6 million related to tax positions for which it is reasonably possible that the total amounts could significantly change during the next twelve months. This amount represents a decrease in unrecognized tax benefits related to expiring statutes in various jurisdictions worldwide and relates primarily to transfer pricing matters.

**CNH Industrial Capital LLC, 10-K, 3/28/14**

[Ed note: Dollar amounts in thousands.]

The Company is currently under various income tax examinations by taxing authorities for years 2003 through 2006 that are anticipated to be completed by the end of 2014. As of December 31, 2013, certain taxing authorities have proposed adjustments to the Company’s transfer pricing/management service fee positions. The Company anticipates that it is reasonably possible to reach a settlement with competent authority by the end of 2014 that may result in a tax deficiency assessment for which there should be correlative relief under competent authority. The potential tax deficiency assessments could have an effect on the Company’s 2014 annual cash flows in the range of $3,000 to $4,000. The Company has provided for the unrecognized tax benefits and related competent authority recovery according to current guidance.

**Crown Holdings Inc., 10-K, 3/3/14**

A reconciliation of unrecognized tax benefits for 2013, 2012 and 2011 follows. [Amounts in millions.]

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance at Jan. 1</td>
<td>$35</td>
<td>37</td>
<td>37</td>
</tr>
<tr>
<td>Additions for current year tax positions</td>
<td>—</td>
<td>—</td>
<td>8</td>
</tr>
<tr>
<td>Reductions to prior period tax positions</td>
<td>—</td>
<td>—</td>
<td>(5)</td>
</tr>
<tr>
<td>Lapse of statute of limitations</td>
<td>(5)</td>
<td>(3)</td>
<td>(2)</td>
</tr>
<tr>
<td>Foreign currency translation</td>
<td>1</td>
<td>1</td>
<td>(1)</td>
</tr>
<tr>
<td>Balance at Dec. 31</td>
<td>$31</td>
<td>35</td>
<td>37</td>
</tr>
</tbody>
</table>

_TAX MANAGEMENT TRANSFER PRICING REPORT_ ISSN 1063-2069 BNA TAX 4-3-14
The Company’s reserves as presented primarily include potential liabilities related to transfer pricing, foreign net operating losses, state and federal tax deductions, and stock option benefits and their corresponding impact on the deferred income tax expense in our consolidated balance sheet. As of December 31, 2013, the Company had approximately $12.2 million of net unrecognized tax benefits and exclude $2 of penalties as of December 31, 2013. The total interest and penalties recorded in the statement of operations was less than $1 in each of the last three years.

The unrecognized tax benefits as of December 31, 2013 include $26 that, if recognized, would affect the effective tax rate. The remaining balance would have no effect due to valuation allowances in certain jurisdictions. The Company’s unrecognized tax benefits are expected to increase in the next twelve months as it continues its current transfer pricing policies, and are expected to decrease as open tax years lapse or claims are settled. The Company is unable to estimate a range of reasonably possible changes in its unrecognized tax benefits in the next twelve months as it is unable to predict when, or if, the tax authorities will commence their audits, the time needed for the audits, and the audit findings that will require settlement with the applicable tax authorities, if any.

The tax years that remained subject to examination by major tax jurisdiction as of December 31, 2013 were 2005 and subsequent years for France; 2006 and subsequent years for Spain and the U.K.; 2009 and subsequent years for Germany and Italy; 2010 and subsequent years for the U.S. and Canada. In addition, tax authorities, if any.

Durata Therapeutics Inc., 10-K, 3/14/14

In June 2012, we formed a wholly-owned foreign subsidiary to which we transferred the worldwide rights to dalbavancin. This transaction provided us with the ability to fully use all of our available U.S. federal and state net operating loss carryforwards and resulted in cumulative cash tax payments in the United States of $10.5 million through December 31, 2013. In accordance with ASC 810-10-45-8, we recorded these payments as a deferred charge in other assets in our consolidated balance sheet and will amortize it as a component of income tax expense in our consolidated statement of operations over the estimated life of the intellectual property, beginning on the date of approval of dalbavancin for commercial sale in a major worldwide market. We expect that this transaction could potentially lower our blended statutory tax rate once we begin commercial sales of dalbavancin. Losses incurred after the date of such transaction resulted in net operating losses outside the United States which were considered not more-likely-than-not to be realized; therefore, a full valuation allowance was recorded and no financial statement tax benefit was recorded in 2012. During the year ended December 31, 2013, we determined that due to the advanced pricing agreement that we entered into with the Dutch Tax Administration as finalized in March 2013 no net operating losses related to foreign losses incurred since June 2012 exist that would allow us to offset future taxable income. Therefore, we have removed the deferred tax asset related to the foreign net operating losses and the corresponding valuation allowance. This adjustment does not have a net impact on the balance sheet or income tax expense. As a result of the transfer of worldwide rights to dalbavancin described above, we generated taxable income in the United States and recorded income tax expense of $1.3 million for the year ended December 31, 2013.

ExtService Holdings Inc., 10-K, 3/3/14

The aggregate disputed amount demanded by Income tax authorities from the Company related to its transfer pricing issues for various years ranging from tax years 2003 to 2009 and its permanent establishment issues ranging from tax years 2003 to 2007 as of December 31, 2013 and 2012 is $14,742 and $18,624, respectively of which the Company has already made payment or provided bank guarantee to the extent $13,797 and $14,715, respectively. Amounts paid as deposits in respect of such assessments aggregating to $11,653 and $12,307 as of December 31, 2013 and 2012, respectively, are included in “Other assets” and amounts deposited for bank guarantees aggregating to $2,144 and $2,408 as of December 31, 2013 and 2012, respectively, are included in “Restricted cash” in the non-current assets section of the Company’s consolidated balance sheets as of December 31, 2013 and 2012.

Fortinet Inc., 10-K, 3/3/14

Our effective tax rate was 42% for fiscal 2013, compared with an effective tax rate of 36% for fiscal 2012. The provision for income taxes for fiscal 2013 was comprised primarily of federal, state and foreign income taxes as well as the inclusion of stock option benefits and cost allocations, which affected the transfer pricing calculations among the U.S. and some of our foreign subsidiaries. The increase in the effective tax rate for fiscal 2013 as compared to fiscal 2012 was primarily due to an increase in profits subject to U.S. tax, a decrease in stock option benefits, and the corresponding impact on the transfer pricing calculations among the U.S. and some of our foreign subsidiaries.

Gates Global Inc., F-1/A, 3/24/14

As of December 31, 2013, the Group had unrecognized tax benefits of $90.4 million (Fiscal 2012: $86.1 million; Fiscal 2011: $86.5 million), which, if recognized, would affect the Group’s annual effective tax rate. As of December 31, 2013, the Group’s unrecognized tax benefits consist primarily of tax positions related to transfer pricing in multiple international jurisdictions and audits in various jurisdictions. The Group believes that it is reasonably possible that a decrease of up to $43.1 million in the Group’s gross unrecognized tax benefits will occur in the next twelve months as a result of the settlement of an audit or the expiration of the statutes of limitations in various international jurisdictions.

Interactive Data Corp., 10-K, 3/13/14

During 2013, the Company’s balance of gross unrecognized tax benefits increased by $3.0 million and $8.8 million for current year and prior years’ build, respectively, for tax uncertainties. Pursuant to ASC Topic 740 “Income Taxes” the Company has changed its presentation with respect to transfer pricing from a net basis to a gross basis in the US. These increases were offset by a decrease of $1.1 million and $0.3 million upon release of reserves and settlements, respectively, related to various foreign and state tax audits, and decreased $0.4 million upon the lapse of the statute of limitations in various tax jurisdictions. As of December 31, 2013, the Company had approximately $12.2 million of net uncertain tax positions which would affect its effective tax rate if recognized ($22.7 million on a gross basis). The Company believes that it is reasonably possible that a decrease of up to $6.0 million in net unrecognized tax benefits related to federal ($5.2 million), state ($1.0 million) and foreign ($0.6 million) exposure may be necessary within the coming year. The Company believes
that it is reasonably possible that approximately $0.2 million of its currently remaining net unrecognized tax positions may be recognized within the next twelve months as a result of the lapse of the statute of limitations in various tax jurisdictions.

**Interactive Intelligence Group Inc., 10-K, 3/12/14**

Our effective tax rate was 27% for the year ended December 31, 2013 compared to 46% for the year ended December 31, 2012. The tax rate is determined by considering the federal tax rate, rates in various states and international jurisdictions in which we have operations, and a portion of the amount of stock-based compensation that is not deductible for income tax purposes. The decrease in the effective tax rate was primarily due to recognizing research and development tax credits in 2013, of which $1.7 million related to 2013 and $706,000 related to 2012. The 2012 research and development tax credit was recognized in 2013 because the legislation establishing the credit was signed into law in early 2013. We also recognized a reduction of U.S. taxable income of $9.9 million resulting from a change in transfer pricing methodology with respect to our foreign subsidiaries in the second quarter of 2013. These decreases were partially offset by IRS audit adjustments for tax years 2010 and 2011, which were recorded in 2013, and a valuation allowance for prior Indiana research and development credits that will likely expire before being used.

**IPass Inc., 10-K, 3/11/14**

The following table presents a reconciliation of the beginning and ending amounts of unrecognized tax benefits (in thousands):

<table>
<thead>
<tr>
<th>IPass Inc. Unrecognized Tax Benefits</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance at January 1, 2012</td>
<td>$5,131</td>
</tr>
<tr>
<td>Increases for positions taken in prior years</td>
<td>2,438</td>
</tr>
<tr>
<td>Increases for positions related to the current year</td>
<td>419</td>
</tr>
<tr>
<td>Settlements with taxing authorities</td>
<td>(2,215)</td>
</tr>
<tr>
<td>Balance at January 1, 2013</td>
<td>$5,773</td>
</tr>
<tr>
<td>Increases for positions taken in prior years</td>
<td>282</td>
</tr>
<tr>
<td>Increases for positions related to the current year</td>
<td>832</td>
</tr>
<tr>
<td>Settlements with taxing authorities</td>
<td>(320)</td>
</tr>
<tr>
<td>Balance at December 31, 2013</td>
<td>$6,567</td>
</tr>
</tbody>
</table>

The increase in unrecognized tax benefits primarily relates to the establishment of federal and state net operating loss reserves related to the timing of deducting transfer pricing payments made to controlled foreign corporations and certain research and development tax credits.

As of December 31, 2013 and 2012, the company had $0.8 million and $0.7 million, respectively, of unrecognized tax benefits that if recognized will have an impact on the company’s effective tax rate.

**J2 Global, 10-K, 3/3/14**

We are also under income tax audits by the IRS for tax years 2009 and 2010 and during the second quarter of 2013 were notified that the IRS will also be auditing the Company for tax year 2011. We have appealed the IRS tax examiner’s decision regarding transfer pricing for tax years 2009 and 2010 with the IRS appeals office and the process remains ongoing.

**Lantheus Medical Imaging Inc., 10-K, 3/11/14**

As of December 31, 2013 and 2012, the total amount of unrecognized tax benefits was $13.1 million and $13.9 million, respectively, all of which would affect the effective tax rate, if recognized. These amounts are primarily associated with domestic state tax issues, such as the allocation of income among various state tax jurisdictions, transfer pricing and U.S. federal R&D credits. Since the Company operates in a number of countries in which it has income tax treaties, it believes that it is more-likely-than-not that the Company should be able to receive competent authority relief for potential adjustments in those countries. Included in the Company’s uncertain tax positions for transfer pricing exposures are $1.0 million, which is reflected within other long-term liabilities, and an offset of $1.0 million, which is reflected in other long-term assets. The tabular roll-forward reflected above is net of the $1.0 million of competent authority relief.

The Company’s U.S. income tax returns remain subject to examination for three years. The state income tax returns remain subject to examination for three to four years depending on the state’s statute of limitations.

In 2013, as a result of the expiration of the 2009 statute of limitations, the Company has recognized the benefit associated with the reversal of uncertain tax positions including interest and penalties of $2.0 million.

Included in other expense for the year ended December 31, 2013, is $0.9 million relating to the reduction in the indemnification receivable from BMS associated with the expiration of statute of limitations. Within the next twelve months, unrecognized tax benefits of $6.9 million may be recognized associated with potential state settlements and transfer pricing due to the closing of the statute of limitations.

**Lionbridge Technologies Inc., 10-K, 3/14/14**

The Indian taxing authorities issued assessment orders for the fiscal years ended March 31, 2007, March 31, 2008, March 31, 2009, and March 31, 2010 of our Indian subsidiary, Lionbridge Technologies Private Ltd. (“Lionbridge India”). At issue in these assessments were several matters, the most significant of which was the readetermination of the arm’s-length profit related to intercompany transactions (“Transfer Pricing”). We are currently contesting all years under exam, and note that they are all at various stages of the appeals process. If we do not prevail in our appeals, we may incur an ad-
ditional tax liability along with related interest and penalties.

***

The Company’s unrecognized tax benefits include transfer pricing exposures from the allocation of income between tax jurisdictions. Lionbridge believes that it is reasonably possible that approximately $0.8 million of its unrecognized tax positions, consisting of several items in various jurisdictions, may be recognized by the end of 2014 as a result of a lapse of the statute of limitations.

**Lululemon Athletica, 10-K, 3/31/14**

Our effective tax rates for fiscal 2013 and fiscal 2012 were lower than our effective tax rate for fiscal 2011 primarily due to the ongoing impact of revised intercompany pricing agreements. Our effective tax rate in fiscal 2013 was 29.6%, compared to 28.8% in fiscal 2012 and 36.1% in fiscal 2011.

**MakeMyTrip Ltd, 424B5, 3/10/14**

*Income Tax*

**Assessment Year 2005-06**

In November 2008, we received a show cause notice from the Indian income tax authorities for the assessment year 2005-2006 and a demand for an additional payment of approximately Rs. 8.1 million (approximately $0.1 million) (exclusive of any applicable penalties), advising us of an upward revision of our declared income in India for that assessment year as a result of (i) an increase proposed by the transfer pricing officer to adjust our intra-group international transaction prices upwards to an arm’s length price, and (ii) the disallowance of website development depreciation expenses incurred during the year. In January 2009, we filed our objections to both the show cause notice and the demand for the additional payment with the Commissioner of Income Tax (Appeals). In February 2009, the demand for the additional payment was dismissed by the Indian income tax authorities after adjustment against our carried forward losses. Our appeal against the show cause notice in connection with the intra-group international transactions transfer pricing matter was decided in our favor in February 2011. We also received partial relief from the disallowance of website development depreciation expenses. In May 2011, we filed our objection to the partial disallowance of website development depreciation expenses with the Income Tax Appellate Tribunal authorities, and a hearing is currently scheduled for August 6, 2014.

**Assessment Year 2006-07**

In December 2009, we received a draft assessment order from the Indian income tax authorities for the assessment year 2006-2007, allocating certain irregularities in the method of computation of income and, advising us of an upward revision of our declared income in India for that assessment year as a result of (i) an increase proposed by the transfer pricing officer to adjust our intra-group international transaction prices upwards to an arm’s length price, and (ii) an increase on account of the proposed disallowance of website development depreciation expenses incurred during the year. In January 2010, we filed our objections with the Dispute Resolution Panel. In September 2010, the increases in our declared income assessed by the Indian income tax authorities were upheld by the Dispute Resolution Panel. In October 2010, we received a final assessment order from the Indian income tax authorities directing penalty proceedings against us under the Income Tax Act, 1961. However, we did not receive a demand for any additional tax payments because our carried forward losses exceeded our assessed income. In December 2010, we filed our objections to the assessment order with the Income Tax Appellate Tribunal authorities. A hearing is scheduled for August 6, 2014.

**Assessment Year 2007-08**

In January 2011, we received an assessment order from the Indian income tax authorities for the assessment year 2007-2008, alleging certain irregularities in the method of computation of income and, advising us of an upward revision of our declared income in India for that assessment year as a result of (i) an increase proposed by the transfer pricing officer to adjust our intra-group international transaction prices upwards to an arm’s length price, and (ii) an increase on account of the disallowance of website development depreciation expenses incurred during the year. However, we did not receive a demand for any additional tax payments because our carried forward losses exceeded our declared taxable income. In March 2011, we filed an appeal with the Commissioner of Income Tax (Appeals). Our appeal against the assessment order in connection with the intra-group international transactions transfer pricing matter was decided in our favor in February 2013. We also received partial relief from the Commissioner of Income Tax (Appeals) on the disallowance of website development depreciation expenses. We believe that the Income Tax Department appealed the order of the Commissioner of Income Tax (Appeals) to the Income Tax Appellate Tribunal, and we understand that a hearing is currently scheduled for March 19, 2014. However, we have not received any official notice of such appeal.

**Assessment Year 2008-09**

In February 2012, we received an assessment order from the Indian income tax authorities for the assessment year 2008-2009, and a demand for additional tax payments of approximately Rs. 43 million (approximately $0.7 million), advising us of an upward revision of our declared income in India for that assessment year as a result of (i) an increase proposed by the transfer pricing officer to adjust our intra-group international transaction prices upwards to an arm’s length price, (ii) an increase on account of the proposed disallowance of website development depreciation expenses incurred during the year, and (iii) an increase due to the non-payment of sufficient withholding tax in connection with our use of banking payment gateway facilities. The demand for additional tax payments of approximately Rs. 43 million (approximately $0.7 million), was dismissed by the Indian income tax authorities in March 2012 following the adjustment of carried forward losses. In March 2012, we filed our objections with the Commissioner of Income Tax (Appeals). Our appeal against the assessment order in connection with the intra-group international transactions transfer pricing matter was decided in our favor in June 2013. We also received partial relief from the disallowance of website development depreciation expenses and non-payment of sufficient withholding tax in connection with payment gateway charges. Against this partial relief, we and the Income Tax Department each filed appeals in August 2013 with the Income Appellate Tax Tribunal and a hearing is currently scheduled for March 19, 2014.

**Assessment Year 2009-10**

In May 2013, we received an assessment order from the Indian income tax authorities for the assessment year 2009-2010, and a demand for additional tax payments of approximately Rs. 276 million (approximately $4.5 million), advising us of an upward revision of our declared income in India for that assessment year as a result of (i) an increase proposed by the transfer pric-
ing offer to adjust our intra-group international transaction prices upwards to an arm’s length price, (ii) increases due to the non-payment of sufficient withholding tax in connection with our use of banking payment gateway facilities and the cost of air tickets incurred to MMT USA, and (iii) increases for disallowance of excess depreciation expense on computer peripherals and software licenses, and for the disallowance of website development depreciation expenses incurred during the year, and on account of amounts received from business associates, which were treated as deferred revenue. On May 30, 2013, we filed our objections with the Commissioner of Income Tax (Appeals). In November 2013, we also received an order imposing an additional penalty for allegedly attempting to conceal the above matters and a notice of demand amounting to approximately Rs. 330 million (approximately $5.3 million), but this demand was temporarily set aside by the Indian tax authorities in January 2014 after adjustment of refunds for the assessment year 2012-2013. In December 2013, we filed our objections to the penalty with the Commissioner of Income Tax (Appeals). A hearing is yet to be scheduled.

**Natures Sunshine Products Inc., 10-K, 3/17/14**

The Company anticipates that unrecognized tax benefits will increase approximately $1,200 to $1,700 within the next twelve months due to additional transactions related to commissions and transfer pricing.

**Polymer Group Inc., 10-K, 3/28/14**

During 2013, Mexico initiated a tax amnesty program that provides a reduction in taxes owed and the elimination of all related penalties and interest. In May 2013, the Company exercised its right under the amnesty program related to the country’s Asset Tax. As a result, the Company recorded a discrete tax expense of $2.9 million during the second quarter associated with the amnesty program. In July 2013, Colombia initiated a tax amnesty program under which the Company filed for tax amnesty for the 2007 tax year related to a transfer pricing issue. The Colombia tax authorities accepted the amnesty request and as a result, the Company paid $0.5 million to settle the outstanding issue.

**QVC Inc., 10-K, 3/3/14**

The Company has tax positions for which the amount of related unrecognized tax benefits could change during 2014. These include federal transfer pricing and nonfederal tax issues. The amount of unrecognized tax benefits related to these issues could have a net decrease of $24 million in 2014 as a result of potential settlements, lapsing of statute of limitations and revision of settlement estimates.


We reported an operating loss of $5.3 million for the year ended December 31, 2012 compared to an operating loss of $27.9 million for the year ended December 31, 2011. The decrease in operating loss was primarily due to a decrease in operating expenses of $17.6 million and an increase in gross margin of $5.0 million. The decrease in operating expenses was primarily related to a decrease of $12.3 million in kiosk related expenses as the number of worldwide kiosks decreased from 174 as of December 31, 2011 to 87 as of December 31, 2012 and $8.2 million decrease in media and marketing activities related to prior year brand identity campaigns and Version 4 TOTALE launches in the U.K., Japan and Korea, as well as ReFLEX in Korea and Japan. These decreases were offset by a $1.9 million increase in restructuring and other related expenses including severance expense in the U.S., the closing of our Germany office location, and the closure of operations in Japan, a $0.6 million increase in VAT tax related to a change in our transfer pricing agreements, and $0.6 million increase in non-kiosk payroll expenses primarily related to sales and marketing.

**Sanofi, 20-F, 3/7/14**


Income tax expense in 2011 included a significant reduction in the deferred tax liability relating to the remeasurement of the intangible assets of Merrial in response to changes in tax rates and legislation (primarily in the United Kingdom) and the effect of the Franco-American Advance Pricing Agreement (APA) for the period from 2006 through 2011 (see Note D.30. to our consolidated financial statements).

These effects did not impact income tax expense for 2012. However, the rise in income tax expense during the year was limited by the favorable effects of differential income tax rates applicable to our foreign subsidiaries (including the impact of an Advance Pricing Agreement (APA) with the Japanese authorities covering the period from 2012 through 2014), and also by the settlement of tax audits and the effects of some items becoming time-barred.

**Support.com, 10-K, 3/7/14**

We are required to make periodic filings in the jurisdictions where we are deemed to have a presence for tax purposes. We have undergone audits in the past and have paid assessments arising from these audits. Our India entity was issued notices of income tax assessment pertaining to the 2004-2009 fiscal years. The notices claimed that the transfer price used in our intercompany agreements resulted in understated income in our Indian entity. We believe our current transfer pricing position is more likely than not to be sustained.

**Visant Corp., 10-K, 3/31/14**

Holdco’s income tax filings for 2005 to 2012 are subject to examination in the U.S federal tax jurisdiction. In connection with the IRS examination of Holdco’s income tax filings for 2005 and 2006, the IRS proposed certain transfer price adjustments for which the Company disagreed in order to preserve its right to seek relief from double taxation with the applicable U.S. and French tax authorities. During the fourth quarter of 2013, the IRS and French tax authorities agreed to transfer price adjustments for 2005 and 2006. The settlement was consistent with the terms of an advance pricing agreement for years 2007 through 2011, which was also concluded during 2013, and was consistent with the Company’s expectations with only minor adjustments being required to be made to the Company’s existing reserves. The U.S. statute of limitations for years 2005 through 2010 remains open because the IRS has not yet completed its final reports for the affected tax periods. The Company is also subject to examination in certain state jurisdictions, none of which was individually material. During 2013, the French tax authorities concluded their examination of tax filings for 2010 and 2011 with only minor adjustments. During 2011, the Canada Revenue Agency concluded its examination of Canadian income tax filings for 2007 and 2008 without adjustment. Though subject to uncertainty, the Company believes it has made appropriate provisions for all outstanding issues for all open years and in all applicable jurisdictions. Due primarily to the potential
for final resolution of the Company’s current U.S. federal examination and the expiration of the related statute of limitations, it is reasonably possible that the Company’s gross unrecognized tax benefit liability could change within the next twelve months by a range of zero to $7.3 million.

Announcement and Report Concerning Advance Pricing Agreements March 27, 2014

This Announcement is issued pursuant to §521(b) of Pub. L. 106-170, the Ticket to Work and Work Incentives Improvement Act of 1999, which requires the Secretary of the Treasury to report annually to the public concerning advance pricing agreements (APAs) and the Advance Pricing and Mutual Agreement (APMA) Program, formerly known as the Advance Pricing Agreement (APA) Program. The first report covered calendar years 1991 through 1999. Subsequent reports covered separately each calendar year 2000 through 2012. This fifteenth report describes the experience, structure, and activities of the APMA Program during calendar year 2013. It does not provide guidance regarding the application of the arm’s length standard.

During 2013, the APMA Program continued to benefit from the merger and processing efficiencies that began in 2012. For the second year in a row, the number of executed APAs increased (from 140 in 2012 to 145 in 2013). The median completion time fell from 39.8 months in 2012 to 32.7 months in 2013. The increase in efficiency is further illustrated by the fact that the number of executed APAs (145) again surpassed the number of applications filed (111).

Part I of this report includes information on the structure, composition, and operation of the APMA Program; Part II presents statistical data for 2013; and Part III includes general descriptions of various elements of the APs executed in 2013, including types of transactions covered, transfer pricing methods used, and completion time.

Calendar year 2013 provided many challenges to the leadership and staff of the APMA Program, but as illustrated below, the APMA Program has achieved many of its goals for 2013. The APMA Program expects to continue its progress in the years to come.

Richard J. McAlonan, Jr.
Director, Advance Pricing and Mutual Agreement Program


In February of 2012, the former APA Program was moved from the Office of Chief Counsel to the Office of Transfer Pricing Operations, Large Business and International Division of the IRS (TPO) and combined with the United States Competent Authority (USCA) staff responsible for transfer pricing cases, thereby forming the Advance Pricing and Mutual Agreement (APMA) Program. The APMA Program Director, Richard McAlonan, joined the Program in May of 2012.

After the formation of the APMA Program, the team that developed the IRS position in a bilateral or multilateral case and finalized the APA with the taxpayer also became responsible for discussing the case and obtaining an agreement with the treaty partner. This compression of functions into a single APA team has helped to eliminate inefficiencies and decreased the amount of time it takes to reach resolution once a case is set for discussion with the treaty partner.

As of the date of this report, the APMA Program is comprised of 55 team leaders, 26 economists, and 10 senior managers organized in 10 groups (7 team leader groups and 3 economist groups). The team leader groups are organized by country with each group having responsibility for multiple countries. Because of the large volume of cases with certain treaty partners, some countries are the responsibility of more than one group. The APMA Program’s main office is located in Washington, DC, and it also has a significant presence in San Francisco and the Los Angeles area.

During the last quarter of 2013, new proposed revenue procedures governing APA applications and MAP applications were released for public comment in Notice 2013-79, 2013-50 I.R.B. 653, and Notice 2013-78, 2013-50 I.R.B. 633, respectively. These proposed revenue procedures reflect the changes in APMA’s structure, and more importantly, were informed by the cumulative experience of more than 20 years of APA practice in the United States, which has produced more than eleven hundred unilateral and bilateral agreements since 1991.

The model APA agreement, which was last revised significantly in 2009 and is currently under review for future changes, appears in this report as Appendix 1. See Pub. L. 106-170 §521(b)(2)(B). A list of primary APMA contacts is included as Appendix 2.


Table 1: APA Applications Filed §521(b)(2)(C)(i)

<table>
<thead>
<tr>
<th></th>
<th>Unilateral</th>
<th>Bilateral</th>
<th>Multilateral</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Filed 1991-1999</td>
<td>401</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Filed 2000-2012</td>
<td>439</td>
<td>904</td>
<td>1</td>
<td>1344</td>
</tr>
<tr>
<td>Filed in 2013</td>
<td>20</td>
<td>89</td>
<td>2</td>
<td>111</td>
</tr>
<tr>
<td>Total Filed 1991-2013</td>
<td>1856</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

1 The first APA Statutory Report, which compiled APA data from 1991-1999, did not report the cumulative number of applications for those years by submission type, so the cumulative totals cannot be reported in that manner.
The 111 APA applications received during 2013, represent a slight decrease from the 126 received in 2012. The table above illustrates the number of applications filed per year; however, the table does not include situations in which the taxpayer has paid a user fee but has not yet submitted a substantially complete APA request. As of December 31, 2013, APMA had received 42 user fee filings in addition to the 111 complete APA applications.

Almost 75 percent of the bilateral applications filed in 2013 involved either Japan or Canada.

Table 2: Executed and Pending APAs
§521(b)(2)(C)(ii-vi)

<table>
<thead>
<tr>
<th></th>
<th>Unilateral</th>
<th>Bilateral</th>
<th>Multilateral</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total Executed 1991-2012</td>
<td>450</td>
<td>692</td>
<td>13</td>
<td>1155</td>
</tr>
<tr>
<td>Total Executed in 2013</td>
<td>39</td>
<td>105</td>
<td>1</td>
<td>145</td>
</tr>
<tr>
<td>Total Executed 1991-2013</td>
<td>489</td>
<td>797</td>
<td>14</td>
<td>1300</td>
</tr>
<tr>
<td>Total Pending</td>
<td>51</td>
<td>277</td>
<td>3</td>
<td>331</td>
</tr>
<tr>
<td>Renewals Executed in 2013</td>
<td>27</td>
<td>49</td>
<td>1</td>
<td>77</td>
</tr>
<tr>
<td>Renewals Pending</td>
<td>20</td>
<td>126</td>
<td>1</td>
<td>147</td>
</tr>
</tbody>
</table>

The APMA Program increased the number of APAs executed in its second year. The 145 APAs executed in 2013 surpassed the previous record of 140 executed agreements set in 2012. Of the 145 agreements executed in 2013, 68 of the agreements (47 percent) were new APAs (i.e., not renewal APAs), an increase from the 57 (41 percent) new APAs executed in 2012.

As the chart above illustrates, more than half of the total number of bilateral APAs executed in 2013 involved the United States entering into a mutual agreement with Japan. Canada’s 19 percent also represents a significant portion of the bilateral agreements.

The number of pending APAs decreased in 2013, primarily due to increased efficiencies within the new APMA Program. While the number of pending APAs at the end of 2013 was still higher than in some of the prior years reflected in the graph above, APMA’s streamlining of internal processes and implementation of new procedures are expected to result in a continued decrease in the pending inventory in future years.

Table 3: APAs Revoked or Cancelled and Applications Withdrawn
§521(b)(2)(C)(vii)

<table>
<thead>
<tr>
<th></th>
<th>Unilateral</th>
<th>Bilateral</th>
<th>Multilateral</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revoked or Canceled 2013</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total Revoked or Canceled 1991-2013</td>
<td>11</td>
<td>11</td>
<td>11</td>
<td>33</td>
</tr>
<tr>
<td>Applications Withdrawn in 2013</td>
<td>3</td>
<td>6</td>
<td>0</td>
<td>9</td>
</tr>
<tr>
<td>Total Applications Withdrawn 1991-2013</td>
<td>189</td>
<td>189</td>
<td>189</td>
<td>567</td>
</tr>
</tbody>
</table>

Table 4: APAs Finalized or Renewed by Industry
§521(b)(2)(C)(viii)

<table>
<thead>
<tr>
<th>Industry</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Wholesale/Retail</td>
<td>60</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>51</td>
</tr>
<tr>
<td>Services</td>
<td>11</td>
</tr>
</tbody>
</table>

APAs finalized or renewed are the same as APAs executed.
As in prior years, more than half of the APAs executed in 2013 involved transactions between non-U.S. parents and U.S. subsidiaries. In 2013, approximately 55 percent of the APAs executed involved transactions between a non-U.S. parent and a U.S. subsidiary; 40 percent of the APAs executed involved transactions between a U.S. parent and a non-U.S. subsidiary; and the remaining 5 percent involved transactions that included either a partnership or a branch. In 2012, approximately 75 percent of the APAs executed involved transactions between a non-U.S. parent and a U.S. subsidiary, while the remaining 25 percent involved transactions between a U.S. parent and a non-U.S. subsidiary.

Consistent with prior years, the tested parties of the APAs executed in 2013\(^3\) fell primarily into one of two categories, i.e., U.S. distributors and U.S. service providers. Combined, these two types of tested parties represent over 50 percent of the total. No other single type of entity represents greater than 10 percent of the total.

Similar to 2012, 41 percent of the transactions covered in APAs executed in 2013 involved the sale of tangible goods and 36 percent involved the provision of services.

Although more than 75 percent of covered transactions involve tangible goods and services transactions, the IRS also has successfully completed numerous APAs involving transfers of intangibles. While complex transactions involving intangibles may be more challenging than other types of transactions and represent

\(^3\) Not all APAs executed in 2013 included a tested party.
a smaller percentage of the APA inventory than other types of transactions, the IRS continues to seek opportunities to work with taxpayers and treaty partners to provide prospective certainty for such transactions wherever appropriate.

More than 60 percent of the tested parties in the APAs executed in 2013 involved distribution or related functions, e.g., marketing and product support.

The risks borne by the tested parties were primarily business risks, e.g., market risk and general business risk. A small percentage of the tested parties bore other risks such as product liability or research and development risk.

**Transfer Pricing Methods Used §521(b)(2)(D)(iv)**

As shown on the following graphs, and consistent with prior years, the primary transfer pricing method used for transfers of both tangible and intangible property in APAs executed in 2013 was the Comparable Profits Method/Transactional Net Margin Method (CPM/TNMM).

In controlled transactions using the CPM/TNMM, the Operating Margin was the most common profit level indicator (PLI) used to benchmark results for transfers of tangible and intangible property. Per the applicable regulations, Operating Margin is defined as the ratio of operating profits to sales. The Berry Ratio, defined as the ratio of gross profit to operating expenses, was applied as the profit level indicator in 8 percent of the controlled transactions that used the CPM/TNMM. Each other profit level indicator accounted for a smaller share.

For services transactions, the majority of cases applied the Services Cost Method or the CPM/TNMM. The Services Cost Method evaluates the amount charged for certain services with reference to the total services costs.

When the CPM/TNMM is used to benchmark services transactions, the Berry Ratio continues to be the most frequently used PLI.

**Sources of Comparables, Comparables Selection Criteria, and Nature of Adjustments to Comparable or Tested Party Data §521(b)(2)(D)(v-vii)**

For the APAs executed in 2013 that used external comparables data in the analysis, the most widely used data source for comparables was the Standard and Poor’s Compustat database. Other sources were also used in appropriate cases, e.g., where the tested party was not the U.S. entity. The most commonly used sources are listed in the following table:

**Table 5: Commonly Used Sources of Comparable Data**

<table>
<thead>
<tr>
<th>Disclosure</th>
<th>Mergent</th>
</tr>
</thead>
<tbody>
<tr>
<td>Orbis</td>
<td>GlobalVantage</td>
</tr>
<tr>
<td>Worldscope</td>
<td>OneSource</td>
</tr>
</tbody>
</table>

In the majority of cases, the process of selecting comparables included comparison of a potential comparable’s functions, risks, and industry to those of the tested party. The existence of comparable products was also considered in some cases.

In adjusting comparables, the standard balance sheet adjustments identified in Treas. Reg. §1.482-1(d) and §1.482-5(c), including adjustments to payables, receivables, and inventory, were made in the majority of cases. Where appropriate, accounting adjustments were made to convert from LIFO to FIFO inventory accounting, and a small number of cases also involved the accounting reclassification of expenses, e.g., from COGS to operating expenses.

### Ranges, Targets and Adjustment Mechanisms

§521(b)(2)(D)(viii-ix)

Almost 70 percent of the transactions covered in APAs executed in 2013 target an interquartile range as described in Treas. Reg. §1.482-1(e)(2)(iii)(C). Where the transaction involves a royalty payment for the use of intangible property, both points and ranges have been used. In some cases where the covered transaction is the payment of a royalty based solely on external royalty agreements, a secondary method, e.g., a test of the post-royalty operating margin, has been imposed. The testing periods of the APAs executed in 2013 included either: (1) a single year, (2) the term of the APA not including any rollback years, or (3) the term of the APA including rollback years.

APAs executed in 2013 include a number of mechanisms for making adjustments to tested party results when the results fall outside the range or do not match the point required by the APA. The following are examples of the mechanisms used in the 2013 executed APAs: an adjustment bringing the tested party’s results to the closest edge of the range applied to the results of a single year; an adjustment to the closest edge of the range applied to the results over the APA term; an adjustment to the specified point or royalty rate; or an adjustment to the median of the range for a single year.

### Critical Assumptions

§521(b)(2)(D)(iv)

The model APA used by the IRS (included as Appendix 1 of this report) includes a standard critical assumption that there will be no material changes to the taxpayer’s business or to its tax or financial accounting practices during the APA term. Each of the APAs executed in 2013 included this standard critical assumption. A few bilateral cases have included critical assumptions tied to either the taxpayer’s profitability in a certain year or over the term of the APA, or to the amount of non-covered transactions as a percentage of the taxpayer’s revenue. Under §11.03(2) of Rev. Proc. 2006-9, the IRS may require the taxpayer to show compliance with all the critical assumptions included in the APA. If the taxpayer’s results violate the critical assumption, then the taxpayer is required to report to the IRS the event or events creating the violation. Pursuant to §11.06(3) of Rev. Proc. 2006-9, when a critical assumption is violated, the APMA Director may agree to modify the APA. However, if there is no agreement to modify the APA, then the APA may be cancelled.

### Term Lengths for APAs

§521(b)(2)(D)(x)

Table 6: Term Lengths (Including Rollback Years)

<table>
<thead>
<tr>
<th>Term Length (years)</th>
<th>Number of APAs</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>≤3</td>
</tr>
<tr>
<td>2</td>
<td>≤3</td>
</tr>
</tbody>
</table>

As described in §4.07 of Rev. Proc. 2006-9, taxpayers should request at least a 5-year term in an APA submission, although the appropriate APA term is decided on a case-by-case basis. Of the APAs executed in 2013, 41 percent had a 5-year term while more than half had terms of 6 years or longer. For APAs with terms of greater than 6 years, a substantial number of those were submitted as a request for a 5-year term, and the additional years were agreed to between the taxpayer and the IRS (or, in the case of a bilateral APA, between the IRS and the foreign government upon the taxpayer’s request). In 2013, 10 percent of the executed APAs included terms of 10 years or longer. The longer terms were agreed to based on the particular circumstances of each individual case and were often granted to ensure a reasonable amount of prospectivity in the APA term. The prospectivity of APA terms improved in 2013 from an average of 1 year in 2012 to 2 years in 2013. It is expected that the number of APAs with terms exceeding 10 years will decrease in future years as completion times continue to improve.

### Amount of Time Taken to Complete New and Renewal APAs

§521(b)(2)(E)

Table 7: Months to Complete New and Renewal APAs

<table>
<thead>
<tr>
<th>Term Length (years)</th>
<th>Number of APAs</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>4</td>
<td>≤3</td>
</tr>
<tr>
<td>5</td>
<td>60</td>
</tr>
<tr>
<td>6</td>
<td>23</td>
</tr>
<tr>
<td>7</td>
<td>23</td>
</tr>
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<td>8</td>
<td>14</td>
</tr>
<tr>
<td>9</td>
<td>4</td>
</tr>
<tr>
<td>10</td>
<td>8</td>
</tr>
<tr>
<td>11</td>
<td>≤3</td>
</tr>
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<td>12</td>
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<td>17</td>
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<tr>
<td>18</td>
<td>≤3</td>
</tr>
<tr>
<td>19</td>
<td>≤3</td>
</tr>
<tr>
<td>20</td>
<td>≤3</td>
</tr>
</tbody>
</table>

Average 7 years
The median time required to complete the 145 APAs executed in 2013 was approximately 7 months less than the median time in 2012. Most of the improvement in completion time is attributable to bilateral APAs where agreements were reached more quickly with our treaty partners. These bilateral APA agreements were reached more quickly because of increased correspondence in advance of face-to-face meetings, elimination of the handoffs that took place prior to the merger, and a streamlined post-agreement process that moved from sequential processing to parallel processing once an agreement is reached.

Before the merger, a developed APA position was “handed off” from an APA team leader to a USCA analyst who would then discuss the case with the treaty partner. When the USCA office reached agreement with the treaty partner and entered into a mutual agreement under the treaty, the agreement was “handed off” from the USCA analyst back to the APA Director and team leader to draft the domestic APA.

For example, APMA would send a draft APA to the taxpayer in advance of receiving the signed agreement from the treaty partner.
Financial statements and any necessary account detail to show compliance with the TPM, with a copy of the opinion from an independent CPA or other documentation required by paragraph 5(f) of the APA.

Where required by paragraph 5(f) of the APA, certified public accountant’s opinion that financial statements present fairly the financial position of Taxpayer and the results of its operations, in accordance with a foreign GAAP.

Where applicable, financial statements as prepared in accordance with a foreign GAAP.

Where applicable, a review of the financial statements by a certified public accountant.

Approaches for Sharing of Currency or Other Risks

§521(b)(2)(D)(xii)

In appropriate cases, APAs may provide specific approaches for dealing with currency risk, such as adjustment mechanisms and/or critical assumptions.

APPENDIX 1– Model APA (based on Rev. Proc. 2006-9)  
[§521(b)(2)(B)]

ADVANCE PRICING AGREEMENT between 
[Insert Taxpayer’s Name] and 
THE INTERNAL REVENUE SERVICE

PARTIES

The Parties to this Advance Pricing Agreement (APA) are the Internal Revenue Service (IRS) and [Insert Taxpayer’s Name], EIN ________.

REQUITALS

[Insert Taxpayer Name] is the common parent of an affiliated group filing consolidated U.S. tax returns (collectively referred to as “Taxpayer”), and is entering into this APA on behalf of itself and other members of its consolidated group.

Taxpayer’s principal place of business is [City, State]. 
[Insert general description of taxpayer and other relevant parties].

This APA contains the Parties’ agreement on the best method for determining arm’s-length prices of the Covered Transactions under I.R.C. section 482, the Treasury Regulations thereunder, and any applicable tax treaties.

If renewal, add: [Taxpayer and IRS previously entered into an APA covering taxable years ending ______ to _______, executed on _________.] 

AGREEMENT

The Parties agree as follows:

1. Covered Transactions. This APA applies to the Covered Transactions, as defined in Appendix A.

2. Transfer Pricing Method. Appendix A sets forth the Transfer Pricing Method (TPM) for the Covered Transactions.

3. Term. This APA applies to the APA Term, as defined in Appendix A.

4. Operation.

a. Revenue Procedure 2006-9 governs the interpretation, legal effect, and administration of this APA.

b. Nonfactual oral and written representations, within the meaning of sections 10.04 and 10.05 of Revenue Procedure 2006-9 (including any proposals to use particular TPMs), made in conjunction with the APA Request constitute statements made in compromise negotiations within the meaning of Rule 408 of the Federal Rules of Evidence.

5. Compliance.

a. Taxpayer must report its taxable income in an amount that is consistent with Appendix A and all other requirements of this APA on its timely filed U.S. Return. However, if Taxpayer’s timely filed U.S. Return for any taxable year covered by this APA (APA Year) is filed prior to, or no later than 60 days after, the effective date of this APA, then Taxpayer must report its taxable income for that APA Year in an amount that is consistent with Appendix A and all other requirements of this APA either on the original U.S. Return or on an amended U.S. Return filed no later than 120 days after the effective date of this APA, or through such other means as may be specified herein.

b. [Use or edit the following when U.S. Group or Foreign Group contains more than one member.] [This APA addresses the arm’s-length nature of prices charged or received in the aggregate between Taxpayer and Foreign Participants with respect to the Covered Transactions. Except as explicitly provided, this APA does not address and does not bind the IRS with respect to prices charged or received, or the relative amounts of income or loss realized, by particular legal entities that are members of U.S. Group or that are members of Foreign Group.]

c. For each APA Year, if Taxpayer complies with the terms and conditions of this APA, then the IRS will not make or propose any allocation or adjustment under I.R.C. section 482 to the amounts charged in the aggregate between Taxpayer and Foreign Participant[s] with respect to the Covered Transactions.

d. If Taxpayer does not comply with the terms and conditions of this APA, then the IRS may:

i. enforce the terms and conditions of this APA and make or propose allocations or adjustments under I.R.C. section 482 consistent with this APA;

ii. cancel or revoke this APA under section 11.06 of Revenue Procedure 2006-9;

iii. revise this APA, if the Parties agree.

e. Taxpayer must timely file an Annual Report (an original and four copies) for each APA Year in accordance with Appendix C and section 11.01 of Revenue Procedure 2006-9. Taxpayer must file the Annual Report for all APA Years through the APA Year ending [insert year] by [insert date]. Taxpayer must file the Annual Report for each subsequent APA Year by [insert month and day] immediately following the close of that APA Year. (If any date falls on a weekend or holiday, the Annual Report shall be due on the next date that is not a weekend or holiday.) The IRS may request additional information reasonably necessary to clarify or complete the Annual Report. Taxpayer will provide such requested information within 30 days. Additional time may be allowed for good cause.
f. The IRS will determine whether Taxpayer has complied with this APA based on Taxpayer’s U.S. Returns, the Financial Statements, and other APA Records, for the APA Term and any other year necessary to verify compliance. For Taxpayer to comply with this APA, use the following or an alternative: an independent certified public accountant must render an opinion that Taxpayer’s Financial Statements present fairly, in all material respects, Taxpayer’s financial position under U.S. GAAP.

g. In accordance with section 11.04 of Revenue Procedure 2006-9, Taxpayer will (1) maintain the APA Records, and (2) make them available to the IRS in connection with an examination under section 11.03. Compliance with this subparagraph constitutes compliance with the record-maintenance provisions of I.R.C. sections 6038A and 6038C for the Covered Transactions for any taxable year during the APA Term.

h. The True Taxable Income within the meaning of Treasury Regulations sections 1.482-1(a)(1) and (i)(9) of a member of an affiliated group filing a U.S. consolidated return will be determined under the I.R.C. section 1502 Treasury Regulations.

i. (Optional for US Parent Signatories) To the extent that Taxpayer’s compliance with this APA depends on certain acts of Foreign Group members, Taxpayer will ensure that each Foreign Group member will perform such acts.

6. Critical Assumptions. This APA’s critical assumptions, within the meaning of Revenue Procedure 2006-9, section 4.05, appear in Appendix B. If any critical assumption has not been met, then Revenue Procedure 2006-9, section 11.06, governs.

7. Disclosure. This APA, and any background information related to this APA or the APA Request, are: (1) considered “return information” under I.R.C. section 6103(b)(2)(C); and (2) not subject to public inspection as a “written determination” under I.R.C. section 6110(b)(1). Section 521(b) of Pub. L. 106-170 provides that the Secretary of the Treasury must prepare a report for public disclosure that includes certain specifically designated information concerning all APAs, including this APA, in a form that does not reveal taxpayers’ identities, trade secrets, and proprietary or confidential business or financial information.

8. Disputes. If a dispute arises concerning the interpretation of this APA, the Parties will seek a resolution by the Director of the Advance Pricing and Mutual Agreement Program, to the extent reasonably practicable, before seeking alternative remedies.

9. Materiality. In this APA the terms “material” and “materially” will be interpreted consistently with the definition of “material facts” in Revenue Procedure 2006-9, section 11.06(4).

10. Section Captions. This APA’s section captions, which appear in italics, are for convenience and reference only. The captions do not affect in any way the interpretation or application of this APA.

11. Terms and Definitions. Unless otherwise specified, terms in the plural include the singular and vice versa. Appendix D contains definitions for capitalized terms not elsewhere defined in this APA.

12. Entire Agreement and Severability. This APA is the complete statement of the Parties’ agreement. The Parties will sever, delete, or reform any invalid or unenforceable provision in this APA to approximate the Parties’ intent as nearly as possible.

13. Successor in Interest. This APA binds, and inures to the benefit of, any successor in interest to Taxpayer.

14. Notice. Any notices required by this APA or Revenue Procedure 2006-9 must be in writing. Taxpayer will send notices to the IRS at the address and in the manner set forth in Revenue Procedure 2006-9, section 4.11. The IRS will send notices to:

<table>
<thead>
<tr>
<th>Taxpayer Corporation</th>
<th>Attn: Jane Doe, Sr. Vice President (Taxes)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1000 Any Road</td>
</tr>
<tr>
<td></td>
<td>Any City, USA 10000</td>
</tr>
<tr>
<td></td>
<td>(phone: __________)</td>
</tr>
</tbody>
</table>

15. Effective Date and Counterparts. This APA is effective starting on the date, or later date of the dates, upon which all Parties execute this APA. The Parties may execute this APA in counterparts, with each counterpart constituting an original.

WITNESS,

The Parties have executed this APA on the dates below.

[Taxpayer Name in all caps]

By:
Date: ______________, 201___
Jane Doe
Sr. Vice President (Taxes)

IRS
By:
Date: ______________, 201___
Richard J. McAlonan, Jr.
Director, Advance Pricing and Mutual Agreement Program
APPENDIX A

COVERED TRANSACTIONS AND TRANSFER PRICING METHOD (TPM)

1. Covered Transactions.
[Define the Covered Transactions.]

2. APA Term.
This APA applies to Taxpayer’s taxable years ending through __________ (APA Term).

3. TPM.
(Note: If appropriate, adapt language from the following examples.)
[The Tested Party is ___]

- CUP Method
The TPM is the comparable uncontrolled price (CUP) method. The Arm’s Length Range of the price charged for ___________ per unit.

- CUT Method
The TPM is the CUT Method. The Arm’s Length Range of the royalty charged for the license of ___________ per unit.

- Resale Price Method (RPM)
The TPM is the resale price method (RPM). The Tested Party’s Gross Margin for any APA Year is defined as follows: the Tested Party’s gross profit divided by its sales revenue (as those terms are defined in Treasury Regulations sections 1.482-5(d)(1) and (2)) for that APA Year. The Arm’s Length Range is between ___________ and ___________, and the Median of the Arm’s Length Range is ___________.

- Cost Plus Method
The TPM is the cost plus method. The Tested Party’s Cost Plus Markup is defined as follows for any APA Year: the Tested Party’s Cost Plus Markup divided by its operating expenses (as those terms are defined in Treasury Regulations sections 1.482-5(d)(1) and (2)) for that APA Year. The Arm’s Length Range is between ___________ and ___________, and the Median of the Arm’s Length Range is ___________.

- CPM with Berry Ratio PLI

- CPM using an Operating Margin PLI

- CPM using a Three-year Rolling Average Operating Margin PLI

APPENDIX B

CRITICAL ASSUMPTIONS
This APA’s critical assumptions are:
1. The business activities, functions performed, risks assumed, assets employed, and financial and tax ac-
counting methods and classifications [and methods of estimation] of Taxpayer in relation to the Covered Transactions will remain materially the same as described or used in Taxpayer’s APA Request. A mere change in business results will not be a material change.

[Insert additional provisions as needed.]

APPENDIX C

APA RECORDS AND ANNUAL REPORT

APA RECORDS
The APA Records will consist of all documents listed below for inclusion in the Annual Report, as well as all documents, notes, work papers, records, or other writings that support the information provided in such documents.

ANNUAL REPORT
The Annual Report (and each of the four copies required by paragraph 5(e) of this APA) will include:

1. Two copies of a properly completed APA Annual Report Summary in the form of Appendix E to this APA, one copy of the form bound with, and one copy provided separately from, the rest of the Annual Report.
2. A table of contents, organized as follows:
   a. All material differences between the U.S. Group’s business operations (including functions, risks assumed, markets, contractual terms, economic conditions, property, services, and assets employed) during the APA Year from the business operations described in the APA Request. If there have been no material differences, the Annual Report will include a statement to that effect.
   b. All material differences between the U.S. Group’s accounting methods and classifications, and methods of estimation used during the APA Year, from those described or used in the APA Request. If any change was made to conform to changes in U.S. GAAP (or other relevant accounting standards) Taxpayer will specifically identify the change. If there has been no material change in accounting methods and classifications or methods of estimation, the Annual Report will include a statement to that effect.
   c. Any change to the Taxpayer notice information in paragraph 14 of this APA.
   d. Any failure to meet any critical assumption. If there has been no failure, the Annual Report will include a statement to that effect.
   e. Whether or not material information submitted while the APA Request was pending is discovered to be false, incorrect, or incomplete.
   f. Any change to any entity classification for federal income tax purposes (including any change that causes an entity to be disregarded for federal income tax purposes) of any Worldwide Group member that is a party to the Covered Transactions or is otherwise relevant to the TPM.
   g. The amount, reason for, and financial analysis of (1) any primary adjustments made under Appendix A for the APA Year; and (2) any (a) secondary adjustments that follow such primary adjustments or (b) accounts receivable that Taxpayer establishes, in lieu of secondary adjustments, by electing APA Revenue Procedure Treatment pursuant to paragraph 5 of Appendix A and Revenue Procedure 2006-9, section 11.02(3), for the APA Year, including but not limited to:
      i. the amounts due or owed, and paid or received by each affected entity;
      ii. the character (such as capital, ordinary, income, expense) and country source of the funds transferred, and the specific affected line item(s) of any affected U.S. Return;
      iii. the date(s) and means by which the payments are or will be made; and
      iv. whether or not APA Revenue Procedure was elected pursuant to paragraph 5 of Appendix A and Revenue Procedure 2006-9, section 11.02(3).
   h. The amounts, description, reason for, and financial analysis of any book-tax difference relevant to the TPM for the APA Year, as reflected on Schedule M-1 or Schedule M-3 of the U.S. Return for the APA Year.
   i. Whether Taxpayer contemplates requesting, or has requested, to renew, modify, or cancel the APA.
   j. The Financial Statements, and any necessary account detail to show compliance with the TPM, including consolidating financial statements, segmented financial data, records from the general ledger, or similar information if the assets, liabilities, income, or expenses relevant to showing compliance with the TPM are a subset of the assets, liabilities, income, or expenses presented in the Financial Statements.
   k. [Use the following or the alternative prescribed by paragraph 5(f) of this APA:] A copy of the independent certified public accountant’s opinion required by paragraph 5(f) of this APA.
   l. A financial analysis that reflects Taxpayer’s TPM calculations for the APA Year. The calculations must reconcile with and reference the information required under item 4 above in sufficient account detail to allow the IRS to determine whether Taxpayer has complied with the TPM.
   m. A penalty of perjury statement, executed in accordance with Revenue Procedure 2006-9, section 11.01(6) and (7).
   n. Whether or not any Worldwide Group organizational chart for the Worldwide Group, revised annually to reflect all ownership or structural changes of entities that are parties to the Covered Transactions or are otherwise relevant to the TPM.
**APPENDIX D**

**DEFINITIONS**

The following definitions control for all purposes of this APA. The definitions appear alphabetically below:

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Report</td>
<td>A report within the meaning of Revenue Procedure 2006-9, section 11.01.</td>
</tr>
<tr>
<td>APA</td>
<td>This Advance Pricing Agreement, which is an “advance pricing agreement” within the meaning of Revenue Procedure 2006-9, section 2.04.</td>
</tr>
<tr>
<td>APA Records</td>
<td>The records specified in Appendix C.</td>
</tr>
<tr>
<td>APA Request</td>
<td>Taxpayer’s request for this APA dated __________, including any amendments or supplemental or additional information thereto.</td>
</tr>
<tr>
<td>APA Year</td>
<td>This term is defined in paragraph 5(a) of this APA.</td>
</tr>
<tr>
<td>Covered Transaction(s)</td>
<td>This term is defined in Appendix A.</td>
</tr>
<tr>
<td>Financial Statements</td>
<td>Financial statements prepared in accordance with U.S. GAAP and stated in U.S. dollars.</td>
</tr>
<tr>
<td>Foreign Group</td>
<td>Worldwide Group members that are not U.S. persons.</td>
</tr>
<tr>
<td>Foreign Participants</td>
<td>[name the foreign entities involved in Covered Transactions].</td>
</tr>
<tr>
<td>Transfer Pricing Method (TPM)</td>
<td>A transfer pricing method within the meaning of Treasury Regulation section 1.482-1(b) and Revenue Procedure 2006-9, section 2.04.</td>
</tr>
<tr>
<td>U.S. GAAP</td>
<td>U.S. generally-accepted accounting principles.</td>
</tr>
<tr>
<td>U.S. Group</td>
<td>Worldwide Group members that are U.S. persons.</td>
</tr>
</tbody>
</table>
| U.S. Return           | For each taxable year, the “returns with respect to income taxes under subtitle A” that Taxpayer must “make” in accordance with I.R.C. section 6012.  
                                         \ Or substitute for partnership: For each taxable year, the “return” that Taxpayer must “make” in accordance with I.R.C. section 6031.  
                                          |
| Worldwide Group       | Taxpayer and all organizations, trades, businesses, entities, or branches (whether or not incorporated, organized in the United States, or affiliated) owned or controlled directly or indirectly by the same interests. |

**APPENDIX E**

**APA ANNUAL REPORT SUMMARY FORM**

The APA Annual Report Summary on the next page is a required APA Record. The APA Team Leader supplies some of the information requested on the form. Taxpayer is to supply the remaining information requested by the form and submit the form as part of its Annual Report.
### APA Annual Report
#### SUMMARY

| Department of the Treasury–Internal Revenue Service | APA No. ___________________________
| Large Business and International Division | Team Leader ___________________________
| Transfer Pricing Operations | Economist ___________________________
| Advance Pricing and Mutual Agreement Program | Intl Examiner ___________________________

#### APA Information

- **Taxpayer Name:** ___________________________________________________
- **Taxpayer EIN:**_________________
- **NAICS:**_________________
- **APA Term:** Taxable years ending ________ to ____________
- **Original APA [ ] Renewal APA [ ]**
- **Annual Report due dates:**
  - _____________, 201__ for all APA Years through APA Year ending in 200__; for each APA Year thereafter, on _________________ [month and day] immediately following the close of the APA Year
- **Principal foreign country(ies) involved in covered transaction(s):** _______________________________________
- **Type of APA:** [ ] unilateral [ ] bilateral with_________________
- **Tested party is** [ ] US [ ] foreign [ ] both
- **Approximate dollar volume of covered transactions (on an annual basis) involving tangible goods and services:**
  - [ ] N/A [ ] <$50 million [ ] $50-100 million [ ] $100-250 million [ ] $250-500 million [ ] >$500 million
- **APA tests on (check all that apply):**
  - [ ] annual basis [ ] multi-year basis [ ] term basis
- **APA provides (check all that apply) a:**
  - [ ] range [ ] point [ ] floor only [ ] ceiling only [ ] other_____________
- **APA provides for adjustment (check all that apply) to:**
  - [ ] nearest edge [ ] median [ ] other point

#### APA Annual Report Information

- **APA date executed:** _____________ , 201__
- **This APA Annual Report Summary is for APA Year(s) ending in 200__ and was filed on _____________, 201__
- **Check here [ ] if Annual Report was filed after original due date but in accordance with extension.
- **Has this APA been amended or changed?** [ ] yes [ ] no **Effective Date:** _________________
- **Has Taxpayer complied with all APA terms and conditions?** [ ] yes [ ] no
- **Were all the critical assumptions met?** [ ] yes [ ] no
- **Has a Primary Compensating Adjustment been made in any APA Year covered by this Annual Report?** [ ] yes [ ] no **If yes, which year(s):** 200___
- **Have any necessary Secondary Compensating Adjustments been made?** [ ] yes [ ] no
- **Did Taxpayer elect APA Revenue Procedure treatment?** [ ] yes [ ] no
- **Any change to the entity classification of a party to the APA?** [ ] yes [ ] no
- **Taxpayer notice information contained in the APA remains unchanged?** [ ] yes [ ] no
- **Taxpayer's current US principal place of business: (City, State) _____________________________________**

#### APA Annual Report Checklist of Key Contents

- **Financial analysis reflecting TPM calculations** [ ] yes [ ] no
- **Financial statements showing compliance with TPM(s)** [ ] yes [ ] no
- **Schedule M-1 or M-3 book-tax differences** [ ] yes [ ] no
- **Current organizational chart of relevant portion of world-wide group** [ ] yes [ ] no
- **Attach copy of APA** [ ] yes [ ] no
- **Other APA records and documents included:**

#### Contact Information

- **Authorized Representative**
- **Phone Number**
- **Affiliation and Address**
## APPENDIX 2 – APMA Contacts

### APMA LEADERSHIP

<table>
<thead>
<tr>
<th>Role</th>
<th>Name</th>
<th>Phone</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Director</td>
<td>McAlonan, Richard</td>
<td>202-515-4706</td>
<td><a href="mailto:richard.j.mcalonanjr@irs.gov">richard.j.mcalonanjr@irs.gov</a></td>
</tr>
<tr>
<td>Deputy Director</td>
<td>Dhawale, Hareesh</td>
<td>202-515-4306</td>
<td><a href="mailto:hareesh.dhawale@irs.gov">hareesh.dhawale@irs.gov</a></td>
</tr>
</tbody>
</table>

### ECONOMISTS

<table>
<thead>
<tr>
<th>Role</th>
<th>Name</th>
<th>Phone</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior Manager</td>
<td>Larson, Chuck</td>
<td>312-292-3663</td>
<td><a href="mailto:charles.r.larson@irs.gov">charles.r.larson@irs.gov</a></td>
</tr>
<tr>
<td>Senior Manager</td>
<td>Thayer, Victor</td>
<td>949-360-3435</td>
<td><a href="mailto:victor.e.thayer@irs.gov">victor.e.thayer@irs.gov</a></td>
</tr>
</tbody>
</table>

### AUSTRALIA, AUSTRIA, GERMANY, ISRAEL, JAPAN, KAZAKHSTAN, NETHERLANDS, NEW ZEALAND, RUSSIA & UKRAINE

<table>
<thead>
<tr>
<th>Role</th>
<th>Name</th>
<th>Phone</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior Manager</td>
<td>Cohen, Judith</td>
<td>202-515-4312</td>
<td><a href="mailto:judith.c.cohen@irs.gov">judith.c.cohen@irs.gov</a></td>
</tr>
</tbody>
</table>

### CHINA, INDONESIA, JAPAN, SOUTH AFRICA & THAILAND

<table>
<thead>
<tr>
<th>Role</th>
<th>Name</th>
<th>Phone</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior Manager</td>
<td>Rock, Peter</td>
<td>415-547-3776</td>
<td><a href="mailto:peter.c.rock@irs.gov">peter.c.rock@irs.gov</a></td>
</tr>
</tbody>
</table>

### CANADA, ITALY & LUXEMBOURG

<table>
<thead>
<tr>
<th>Role</th>
<th>Name</th>
<th>Phone</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior Manager</td>
<td>McOmber, Jim</td>
<td>202-515-4742</td>
<td><a href="mailto:james.b.mcomber2@irs.gov">james.b.mcomber2@irs.gov</a></td>
</tr>
</tbody>
</table>

### DENMARK, INDIA, IRELAND, NORWAY, SWEDEN, SWITZERLAND & UK

<table>
<thead>
<tr>
<th>Role</th>
<th>Name</th>
<th>Phone</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior Manager</td>
<td>Hughes, John</td>
<td>202-515-4307</td>
<td><a href="mailto:john.c.hughes@irs.gov">john.c.hughes@irs.gov</a></td>
</tr>
</tbody>
</table>

### ARGENTINA, CANADA, CARIBBEAN, MEXICO, PORTUGAL, PUERTO RICO, SPAIN & VENEZUELA

<table>
<thead>
<tr>
<th>Role</th>
<th>Name</th>
<th>Phone</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior Manager</td>
<td>Wood, Kenneth</td>
<td>202-515-4736</td>
<td><a href="mailto:kenneth.w.wood@irs.gov">kenneth.w.wood@irs.gov</a></td>
</tr>
</tbody>
</table>

### BELGIUM, CANADA, FRANCE, GREECE, HUNGARY, ROMANIA & TURKEY

<table>
<thead>
<tr>
<th>Role</th>
<th>Name</th>
<th>Phone</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior Manager</td>
<td>Fouts, Patricia</td>
<td>202-515-4740</td>
<td><a href="mailto:patricia.a.fouts@irs.gov">patricia.a.fouts@irs.gov</a></td>
</tr>
</tbody>
</table>

### GUAM, JAPAN, KOREA, MOROCCO & PHILIPPINES

<table>
<thead>
<tr>
<th>Role</th>
<th>Name</th>
<th>Phone</th>
<th>Email</th>
</tr>
</thead>
<tbody>
<tr>
<td>Senior Manager</td>
<td>Bracken, Dennis</td>
<td>310-414-3617</td>
<td><a href="mailto:dennis.j.bracken@irs.gov">dennis.j.bracken@irs.gov</a></td>
</tr>
</tbody>
</table>

As of March 27, 2014
More than 18 months have passed since U.S. Customs and Border Protection (CBP) implemented a new policy regarding post-importation transfer pricing adjustments. In this article, the authors discuss the impact of the new policy on three subsequent rulings of CBP. They conclude that taxpayers with U.S. import operations should continue to document all aspects of their intercompany pricing (including any post-importation adjustments) with the kinds of contractual, financial, and accounting support set forth in the rulings.

DAMON V. PIKE AND CYLINDA PARGA
THE PIKE LAW FIRM, P.C.

More than 18 months have passed since the new policy of U.S. Customs and Border Protection (CBP) regarding post-importation transfer pricing adjustments became effective. Effective as of July 30, 2012, this long-awaited policy is set forth in HQ W548314 (CBP HQ Ruling Letter), which officially revoked HQ 547654 (21 Transfer Pricing Report 162, 6/14/12).

CBP issued the final policy after completing a notice, comment, and review process, during which it received numerous comments on its initial draft of the policy.

Widely regarded as the most significant development in customs valuation law since the passage of the Trade Agreements Act of 1979, the new policy provides much-needed guidance on the impact of transfer pricing policies on the declared customs values (and attendant duty liability) for related-party sales of tangible goods.

Nevertheless, since the policy went into effect, CBP has issued only three new rulings applying the policy to import transactions.

While many more ruling requests concerning the new policy are in the pipeline, the three rulings issued to date provide the only published guidelines for importers/taxpayers to follow since the new policy was announced. This article summarizes those new rulings with the details necessary for proper planning and compliance. Overall, the rulings further cement CBP’s reputation as a global leader among customs authorities in interpreting its own statute (customs valuation) in light of the business reality that customs values for related-party imports are based largely on another agency’s statute (transfer pricing). CBP’s focus on the “total evidence” also portends a more flexible approach that will be developed through the issuance of further rulings.

Policy Background

Under the new policy, when companies use intercompany transfer prices for purchases from related-party sellers, any post-importation price adjustments may form part of the customs value and should therefore be reported to CBP if the adjustments meet the requirements of a new, five-factor test for formula pricing. In addition, importers must continue to demonstrate that the “circumstances of sale” test is met, showing that the related-party status does not influence the price declared as the customs value.1

First Ruling: HQ H219515

On Oct. 11, 2012, CBP issued HQ H219515, in which it considered whether an importer could properly use “transaction value” as the method for appraising the customs value of merchandise it wished to import in future transactions.2 For the contemplated prospective transactions, the importer would purchase the subject merchandise (analytical instruments described as “chemistry products, data products, and mass spec-
trometry instruments”) from a number of foreign related companies.

In examining whether the contemplated import transactions would qualify for valuation under the transaction value method, CBP identified and addressed the following three issues:

- **Do transactions between the importer and the related manufacturers constitute bona fide sales?**
- **Do the circumstances of sale establish that the price actually paid or payable by the importer to the related manufacturers is not influenced by the relationship of the parties and is acceptable for purposes of transaction value?**
- **Is it acceptable to take post-importation price adjustments (upward and downward) into account in determining transaction value?**

**Bona Fide Sales**

CBP first examined whether the prospective importation sales transactions between the buyer and seller qualified as bona fide sales within the meaning of U.S. laws and regulations. This bona fide sale inquiry is generally the first issue examined by CBP in any valuation inquiry, because, by definition, the transaction value method of appraisal may only be used for transactions where a bona fide sale for export to the U.S. exists.

When considering whether a transaction constitutes a bona fide sale, CBP considers a range of factors, such as “whether the purported buyer assumed the risk of loss for, and acquired title to, the imported merchandise. Evidence to establish that consideration has passed includes payment by check, bank transfer, or payment by any other commercially acceptable means.” CBP may also examine “whether the purported buyer paid for the goods, and whether, in general, the roles of the parties and the circumstances of the transaction indicate that the parties are functioning as buyer and seller.”

Additional factors CBP will consider are “whether the buyer provided or could provide instructions to the seller, was free to sell the transferred item at any price he or she desired, selected or could select its own downstream customers without consulting with the seller, could order the imported merchandise and have it delivered for its own inventory.”

In HQ H219515, the importer submitted various documentation to CBP to substantiate its bona fide sale claim, such as sample purchase orders, invoices, and proof of payment. The importer also submitted distributor agreements with its foreign manufacturers, clearly outlining the terms governing passage of title and risk of loss. Finally, the importer established that it could provide instructions to the seller, that it would be free to resell the imported goods at any price, that it could select its own customers, and that it would import the merchandise for delivery to its own inventory. Based upon all of these factors, CBP concluded that the contemplated transactions qualified as bona fide sales.

**Circumstances of Sale**

After concluding that the sale from the related party constituted a bona fide sale, CBP next considered whether the related-party relationship between the buyer and seller influenced the sales price. When considering this question, CBP will generally examine the “circumstances of the sale” (COS) to determine whether those circumstances indicate that the relationship influenced the sales price. (In cases where such a relationship does influence the sales price, CBP will not permit the use of transaction value as the method of appraisal.)

As explained by CBP in HQ H219515, the regulations set forth several illustrative (not exhaustive) examples of specific factors CBP may consider when conducting a COS analysis to determine if the relationship between the buyer and the seller influenced the price:

- **Customers will consider pertinent details of the transaction, for example, the manner in which the parties organize their commercial relations and the methods used to derive the price in question, to determine whether the relationship influenced the price actually paid or payable.**
- **In making this determination, Customs will also seek evidence that the price has been settled in a manner consistent with the normal pricing practices of the industry in question, or with the manner in which the seller settles prices for sales to unrelated buyers.**
- **Furthermore, if it is shown that the price is adequate to ensure recovery of all costs plus a profit that is equivalent to the seller’s total profit realized over a representative period of time, in sales of merchandise of the same class or kind, then Customs will accept that the relationship did not influence the price.**

In HQ H219515, the importer submitted evidence intended to show that the sales at issue were unaffected by the related-party status of the buyer and seller. This evidence included:

- Information comparing its own profitability to that of its competitors;
- An independent report commissioned by the importer’s parent company and conducted by Ernst & Young (EY), which discusses pricing practices in the analytical instruments industry;
- A transfer pricing study; and
- Detailed information regarding the way the related parties establish their intercompany transfer prices in order to demonstrate that such prices are set consistently with the methodology described in the transfer pricing study.

Although CBP noted that “this evidence provided by the Importer is not entirely objective,” it considered the EY report about the pricing practices of the industry to be “highly relevant for our overall analysis of the Importer’s pricing structure because it further substantiates the Importer’s practice of setting its prices.” CBP found information in the report regarding the importer’s gross profits to be particularly persuasive, because it demonstrated that the importer’s gross profits were “fairly consistent” with the gross profits earned by “dominant players” in the analytical instrument industry. Despite the fact that “the gross margins of the competitors were not used in the Importer’s transfer

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3 HQ H219515 at 5.
4 Id. at 6, citing HQ 545705 (Jan. 27, 1995).
5 Id., citing HQ H005222 (June 13, 2007).
6 Id.
CBP took issue with several aspects of the importer's transfer pricing study. First, it noted that the transfer pricing study had not yet been approved by the IRS. Additionally, CBP noted that the transfer pricing study used the comparable profits method (CPM) to conduct its analysis. CBP views the CPM as "the least relevant [transfer pricing] method for customs purposes," and is therefore disinclined to give it significant weight during its own COS analysis. Finally, CBP noted that the comparable companies selected for the transfer pricing analysis did not distribute or sell products "of the same class or kind" as the imported merchandise. Because of this fact, CBP stated that "the comparison between the Importer and these other companies cannot be considered consistent with the market as a whole."

However, despite these issues, CBP ultimately concluded that the transfer pricing study's "underlying facts and the conclusions reached" did present information relevant to the COS between the related parties. In particular, CBP noted that the transfer pricing study confirmed the gross profit margins of the importer that were discussed in the EY report regarding the pricing practices of the industry.

Based upon the totality of evidence submitted by the importer, CBP concluded that the related-party sales price for the import transactions at issue would not be influenced by the related nature of the buyer and seller. Thus, CBP stated that transaction value should be used to appraise the merchandise upon importation into the U.S.

### Post-Importation Adjustments

The final issue considered by CBP in HQ H219515 was whether the importer should take post-importation price adjustments (either upwards or downwards) into account when calculating the transaction value of the imported merchandise. CBP noted that such adjustments may frequently occur pursuant to a transfer pricing study, such as the one commissioned by the related parties involved in the ruling.

In discussing the impact of transfer price adjustments on the customs value of the prospective imported merchandise, CBP took note of the new policy and five-factor test set forth in HQ W548314, noting that:

In order to claim the post-importation adjustments (upward and downward), all of the following factors must be met:

1. A written transfer pricing policy in place prior to importation, and the policy is prepared taking IRS code section 482 into account;
2. The U.S. taxpayer uses its transfer pricing policy in filing its income tax return, and any adjustments resulting from the transfer pricing policy are reported or used by the taxpayer in filing its income tax return;
3. The company's transfer pricing policy specifies how the transfer price and any adjustments are determined with respect to all products covered by the transfer pricing policy for which the value is to be adjusted;

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13 Id.
14 Id. at 10, citing HQ H037375 (Dec. 11, 2009) and HQ 546979 (Aug. 30, 2000).
15 Id.
16 As noted by CBP, "[a]ccording to the Importer's submission, there is no Advance Pricing Agreement ('APA') with the Internal Revenue Service ('IRS'). However, the Importer states that it applied for an APA and submitted its transfer pricing study for the IRS' approval." HQ H219515, at 4. This phrasing is awkwardly worded because transfer pricing studies under Section 482 are never "approved" by the IRS. They are simply prepared by the taxpayer "for the file" as a means of penalty avoidance and are never presented to the IRS unless requested (such as during an audit). Instead, as an alternative to preparing a transfer pricing study, U.S. importers/taxpayers may seek an APA (which can be unilateral or bilateral) with the IRS. While the APA begins with a submission by the taxpayer to the IRS that covers the requirements of Section 482—but is not a "transfer pricing study" per se—the APA process results in an "approval" because an APA is a binding contract between the IRS and the taxpayer (normally covering a five-year period) that is signed by both parties. Thus, an APA and a transfer pricing study are separate and distinct documents and processes under Section 482.
17 Id.
18 Id. at 11.
19 Id. at 10. It is worth noting that during its discussion of the importer's gross profit margin, CBP stated that "CBP is of the view that the operating profit margin is a more accurate measure of a company's real profitability because it reveals what the company actually earns on its sales once all associated expenses have been paid. Nevertheless, in certain circumstances, gross profit can be considered." Id. However, it is not entirely clear how CBP reached the conclusion that the transfer pricing study "confirmed" the gross margins of the industry study given that the study used the CPM as the transfer pricing method. The CPM uses operating margin, not gross margin, as the profit level indicator (PLI).
20 Id. at 11.
4. the company maintains and provides accounting details from its books and/or financial statements to support the claimed adjustments in the U.S.; and

5. no other conditions exist that may affect the acceptance of the transfer price by CBP.

Therefore, if the importer meets the above referenced factors, CBP will accept the adjusted values because the prices would be established pursuant to a “formula,” even though the prices were not fixed at the time of the importation.21

Applying the above test to the import transactions at issue, CBP concluded that the importer had submitted evidence establishing all five factors. Such evidence included its written transfer pricing study and information establishing that the company would book any future profit adjustments directly to its cost of goods sold account. In this case, the importer had a written transfer pricing study in place prior to importation and prepared in accordance with Section 482—confirming the gross profits which were verified by other substantiating information.22 In conclusion, CBP stated that “as long as the Importer maintains and provides accounting details from its books and/or financial statements to support the post-importation adjustments upon making a claim with CBP, the Importer may claim downward and upward post-importation adjustments.”23

Second Ruling: HQ H018314

On March 18, 2013, CBP HQ issued HQ H018314. The case underlying this ruling began when the importer of record filed six “Reconciliation” entries with the Port of Boston in order to make a post-importation, downward adjustment to the transaction value of imported merchandise it purchased from a related party.24

The Port of Boston questioned the sufficiency of the importer’s documentation to support the use of transaction value, and thus denied the importer’s downward adjustments. Consequently, it liquidated the Reconciliation entries without taking the adjustments into account. This decision prompted the importer to file a protest with CBP, which in turn prompted the issuance of this ruling.25

In determining whether it should grant the importer’s protest, CBP performed the same general analysis as that discussed above in HQ H219515, identifying the following three issues for further examination:

1. Do transactions between the [related-party] middleman . . . and the Protestant/Importer constitute bona fide sales?

2. Is the related party price fixed or determinable pursuant to an objective formula at the time of importation for purposes of determining transaction value?

3. Do the circumstances of the sale establish that the adjusted price actually paid or payable by the Protestant/Importer to the middleman was not influenced by the relationship of the parties and is acceptable for purposes of transaction value?26

Bona Fide Sales

As in HQ H018314, CBP began its analysis by examining whether the related-party transactions at issue met the definition of a bona fide sale. The importer submitted various evidence to support its bona fide sale claim, including a distributor agreement defining the passage of title and risk of loss, information regarding the payment of freight costs, a representative purchase order and commercial invoice including the terms governing the sales transaction, and payment records establishing proof of payment for the specific transactions at issue. The importer also provided additional information to establish the other bona fide sale factors, such as its ability to select its own customers and to sell the imported merchandise at any price. Based upon the information and evidence presented by the importer, CBP concluded that the transactions at issue qualified as bona fide sales.

Objective Formula

CBP next considered whether “the related party price [was] fixed or determinable pursuant to an objective formula at the time of importation for purposes of determining transaction value.”27 Note that CBP took a slightly different approach to examining the valuation questions at issue in this ruling, compared to HQ H219515. In the previous ruling, CBP first conducted its COS analysis and then considered whether the transfer price was set pursuant to a formula such that post-importation price adjustments should be reported by the importer. CBP conducted its analysis in this later ruling in an inverse order, first considering the “formula/post-importation adjustment” question before engaging in the COS analysis. This seems to be “out of order,” i.e., because the formula issue relates to whether post-importation adjustments can be considered, CBP would not even reach this issue if it found that the COS test was not met—and, thus, that transaction value did not apply. Thus, the more logical approach seems to be the one set forth in HQ H219515.

Nonetheless, in performing its analysis of whether the importer set its intercompany prices pursuant to an existing formula, CBP considered a variety of evidence and information submitted by the importer:

- a memorandum of understanding (MOU) memorializing an agreement that was allegedly in place be-

21 Id. at 12.
22 Again, it is not entirely clear how CBP reached the conclusion that a transfer pricing study using operating margin as the profit level indicator could confirm the gross profits of the industry study.
23 Id. at 13.
24 Reconciliation is a CBP program that allows importers to “flag” various issues at the time of entry for later reconciliation because the final information needed for the respective declaration is not available at the time of entry. Value is one of the issues that can be flagged. Any final information (such as the adjusted customs value) must be reported no later than 21 months from the date of the first entry covering by the Reconciliation flagging.
25 A protest is filed on Custom Form 19 whenever an importer wishes to challenge a CBP decision that would result in a duty refund if approved. Protests must be filed within 180 days of the subjection entry’s liquidation date. Liquidation represents the final assessment of duty by CBP and normally occurs 314 days after the filing of an entry.
26 HQ H018314 at 5.
27 Id. at 7.
between the buyer and seller for many years prior to the MOU’s date of execution, setting forth the formula used by the related parties to set their transfer prices; see id.
- excerpts of transfer pricing studies covering three separate fiscal years;
- a submission prepared by the importer’s accounting firm; and
- several manufacturing and distributor agreements containing various terms governing the transactions between the related parties.

Based upon the totality of evidence submitted by the importer, CBP concluded that the intercompany transfer prices were set pursuant to a pre-existing formula, such that they were acceptable for use in the transaction value method of appraisement. Pursuant to this finding, CBP also concluded that the importer should report any post-importation adjustments made to the intercompany prices.

The specific analysis CBP performed to reach these conclusions involved examining each of the five factors set forth in HRL W548314 (and specifically enumerated in the discussion of the previous ruling). In the course of its analysis, CBP noted that “[the importer] sets its preliminary prices based on budgeted financials and in accordance with the MOU . . . [and its] prices are later adjusted so that [the importer] can realise the targeted operating margin . . . consistent with the range set in the . . . formal transfer pricing study.” In addition to the MOU, CBP also considered the importer’s transfer pricing study and various intercompany agreements. The totality of these documents convinced CBP that the importer had a written transfer pricing policy in place prior to importation, thus satisfying the first factor of the “five factor” test.

Regarding the second of the “five factors”—whether the U.S. taxpayer uses its transfer pricing policy in filing its income tax return, and any adjustments resulting from the transfer pricing policy are reported or used by the taxpayer in filing its income tax return—CBP noted that any adjustments made by the importer pursuant to its transfer pricing policy were entered on its accounting books as adjustments to the cost of goods sold account, thus confirming that the adjustments were calculated for income tax purposes.

In order to provide additional support for this factor, the importer provided a variety of relevant documentation showing that the importer’s final financial numbers (taking into account any post-importation price adjustments) were used to prepare the importer’s tax returns. Such documentation included excerpts of transfer pricing studies for three separate fiscal years, financial statements and tax documents for the same three fiscal years, any applicable debit/credit notes (submitted on a quarterly basis), the corresponding journal entries, a book income reconciliation providing the book income used in the tax return, and relevant excerpts from the corporate tax returns. Based upon this information, CBP concluded that the importer met the second of the five factors. Additionally, CBP used the same documentation to determine that the importer met another of the five factors—whether the company maintains and provides accounting details from its books and/or financial statements to support the claimed adjustments in the U.S. Based largely on its examination of this same documentation, CBP concluded that the importer also successfully met this factor.

The next of the five factors examined by CBP was whether the importer’s transfer pricing policy specifies how the transfer price and any adjustments are determined with respect to all products covered by the transfer pricing policy for which the value is to be adjusted. In examining this factor, CBP considered the three years’ worth of transfer pricing studies submitted by the importer, as well as the various intercompany agreements which contained sections referencing both the transfer pricing studies and any adjustments made pursuant to those studies. Additionally, CBP noted that the importer’s Customs Compliance Manual (adopted by the importer prior to importation) provided detailed information regarding the importer’s method for adjusting its transfer prices on a quarterly basis—and referenced the transfer pricing studies. All of this documentation led CBP to determine that the importer had met the requirements of this factor.

Finally, CBP considered the final of the five factors: whether any other conditions existed that could affect its acceptance of the transfer price. CBP concluded no such conditions existed, without any substantive discussion.

To summarize its examination of the “five factor” test, CBP stated that:

[in this particular case and based on the above referenced factors, Protestant’s transfer pricing policy may be considered an objective formula in place prior to importation for purposes of determining the price within the meaning of 19 CFR §152.103(a)(1). Accordingly, CBP is of the view that post-importation adjustments (both upward and downward), to the extent they occur, may be taken into account in determining the transaction value under 19 USC §1401a(b)].

Having established that the importer’s intercompany sales transactions constituted bona fide sales and that the transfer prices were based upon a formula, CBP finally turned to the question of whether the circumstances of the intercompany sales affected the transfer price.

Circumstances of Sale

In support of its assertion that the COS indicated that the relationship between the buyer and seller did not influence the intercompany transfer price for the imported merchandise, the importer submitted a detailed memorandum prepared by its outside accounting firm (and supplemented by excerpts from the importer’s financial statements), outlining its position that intercompany prices were set at arm’s length.

In support of its position, the importer presented pricing information showing that the price it paid to the

28 Note that this MOU was prepared specifically for purposes of the protest at issue, instead of being a pre-existing document.
29 Id. at 8.
30 See id.
31 Id. at 11.
32 Id. at 12–13.
33 Id. at 11–12.
34 Id. at 14.
related seller was comparable to that paid by unrelated buyers located in Japan. Although CBP noted that it "generally requires that the comparison sales to unrelated buyers be sales to buyers in the United States, CBP will consider evidence regarding sales to unrelated buyers in other countries, provided the importer presents an adequate explanation as to why it is relevant to the transactions at issue." 35

In this case, the unrelated Japanese company was the only unrelated entity which purchased the imported merchandise from the seller during the relevant time period. Even though the seller used different pricing methodologies to set its prices to the unrelated Japanese company and the related-party importer, the importer was able to establish to CBP's satisfaction that the prices were comparable over a period of two fiscal years. 36 The importer accomplished this by using a weighted average approach based upon relevant sales volume data provided by the importer.

In addition to this unrelated price comparison analysis, the importer submitted evidence indicating that the intercompany transfer prices resulted in the seller earning all of its costs plus a profit, pursuant to the example set forth in 19 CFR §152.103(l)(1)(iii), stating that "if it is shown that the price is adequate to ensure recovery of all costs plus a profit which is equivalent to the firm's overall profit realized over a representative period of time (e.g., on an annual basis), in sales of merchandise of the same class or kind, this would demonstrate that the price has not been influenced."

Before discussing the evidence submitted by the importer, CBP noted that:

A very important consideration in the all costs plus a profit example is the "firm's" overall profit. In applying the all costs plus a profit test, CBP normally considers the "firm's" overall profit to be the profit of the parent company. Thus, if the seller of the imported goods is a subsidiary of the parent company, the price must be adequate to ensure recovery of all the seller's costs plus a profit that is equivalent to the parent company's overall profit. The regulations do not give us the definition of "equivalent" profit; however, if the profit of the seller is equal to or higher on the U.S. imports than the firm's overall profit, the purchase price would not be artificially low for Customs' purposes. Finally, CBP regulations do not define what profit we are to consider—gross profit or operating profit. However, CBP is of the view that the operating profit margin is a more accurate measure of a company's real profitability because it reveals what the company actually earns on its sales once all associated expenses have been paid. Nevertheless, in certain circumstances, gross profit can be considered. 37

To support its case, the importer presented the following profit information:

- the operating profit of the related-party seller (a middleman rather than the actual manufacturer of the merchandise);
- a separate calculation representing the combined profit of the seller/middleman and the actual contract manufacturer, representing the total profit attributable to the manufacture of the imported merchandise; and
- the global operating profit of the parent company.

In comparing these profit figures, CBP concluded that over a four-year period and with or without the inclusion of the manufacturer's profits, the profit of the seller/middleman "exceeds both the operating margin of the parent company and of the middleman's profit in global sales in goods of the same class or kind. Therefore, the profits earned by the middleman (independently, or in conjunction with the contract manufacturer) on sales to the Protestant exceed the global profits earned by both the middleman and the parent company on sales of [the imported merchandise]." 38

CBP added this profit analysis to the other information and evidence provided by the importer, and concluded that:

In view of the information submitted by the importer concerning the prices of the [imported merchandise] sold by the middleman to the unrelated party in Japan compared to the [related-party transfer prices] and the examination of the all costs plus a profit method, supported by the MOU and EY transfer pricing study, CBP finds the use of the transfer pricing study (prepared for tax purposes) to satisfy the circumstances of the sale test to be unnecessary. Protestant sufficiently explained the differences in prices between the related and unrelated parties and provided the necessary evidence to show that taking the adjusted prices into account, the seller's operating profit was higher than the profit of the parent company. Thus, Protestant has satisfied the circumstances of the sale test. Accordingly, the transaction value is an acceptable method of appraisement in the instant case. 39

Having completed its analysis of all three valuation issues it identified as relevant to the importer's claim, CBP ordered the port to grant the protest, thus ratifying the importer's use of transaction value as the method of appraisement and permitting it to make post-importation adjustments to its intercompany transfer prices.

Third Ruling: HQ H024857

On Jan. 7, 2014, CBP HQ issued HQ H024857. Similar to the two rulings discussed above, HQ H024857 involved an importer requesting the use of the transaction value method of appraisal for importations of goods purchased from its German parent company. In performing its analysis of the acceptability of the importer’s intercompany prices, CBP again examined the following three issues:

- Do transactions between the importer and the related manufacturer/seller constitute bona fide sales?
- Is it acceptable to take post-importation price adjustments (upward and downward) into account in determining transaction value?
- Do the circumstances of the sale establish that the price actually paid or payable by the importer to the related manufacturer/seller is not influenced by the rela-

35 Id. at 15-16, citing W548314 (May 16, 2012).
36 Id.
37 Id. at 17.
38 Id.
39 Id. at 18.
tionship of the parties and is acceptable for purposes of transaction value.40

The importer in this ruling prepared and submitted a variety of information to CBP in support of its use of the intercompany prices. The first document was a global price list established by the parent company/seller for its sales to both related and unrelated customers. This seller created the global price list using a variety of historical data, e.g., historical pricing data relating to the sale of similar machines by competitors. The seller used this price list to set the intercompany prices it charged to the related-party importer, minus a certain percentage based on various product lines. In addition to the global price list, the importer also submitted sample invoices from the seller to unrelated parties, marketing contracts between the buyer and the seller, and a transfer pricing study to document the importer’s compliance with the transfer pricing requirements of U.S. and German tax authorities.

Bona Fide Sale

To begin its analysis of the first issue—whether the transactions constituted bona fide sales—CBP examined the variety of documentation supplied by the importer relating to the transfer of title between the parties. This included written purchase orders for each sales transaction, a sample entry summary, accounts payable reconciliation linking payments by the importer to specific invoices from the manufacturer, and wire transfer records documenting the transfer of funds from the importer to the manufacturer pursuant to specific invoices.

CBP first noted that the documents established that the imported merchandise was shipped directly to the U.S. pursuant to specific purchase orders, thus meeting the requirement that the imported good be clearly destined for the U.S. at the time of sale. The importer issued a purchase order to manufacturer/seller for machines and spare parts based on purchase orders from its customers in the U.S.

CBP next noted that the prices on the sample invoices reflected the formula specified by the marketing contract, and that the importer could mark up the product upon resale to any of its customers so long as it achieved the profit margin formula set forth in the marketing contract. The marketing contract formula was based upon the transfer pricing formula set forth in the transfer pricing study. Also relevant to CBP’s analysis was the fact that the importer could select its own customers without consulting the seller. According to CBP’s bona fide sales analysis, all of these factors weighed in favor of a finding that the import transactions did qualify as bona fide sales.

Finally, CBP noted that, according to the submitted documentation, title did not transfer between the importer and the seller until after the merchandise was imported into the U.S., when the importer would remit payment to the seller. Post-importation passage of title is somewhat unusual in a bona fide sale analysis, resulting in the following commentary from CBP:

‘‘[P]assing of title after the date of importation, where all of the factors lead to the conclusion that a sale for export takes place, does not disqualify a sale from being a bona fide sale. See HRL H012659, dated November 17, 2007. Additionally, HRL 545504, dated May 5, 2005, states that for purposes of the transaction value provision, a bona fide sale may be found to exist even though actual payment has not been made for the goods.41

CBP ultimately concluded that because all of the other factors it examined supported the existence of a bona fide sale, it was immaterial that the title did not transfer between the parties until after importation; thus, a bona fide sale did indeed exist between the importer and the seller.

Post-Importation Adjustments

After establishing the presence of a bona fide sale, CBP turned to the second part of its analysis—whether the importer could take post-importation price adjustments (both upward and downward) into account in determining transaction value. CBP began by reciting the new ‘‘five factor’’ test set forth in HQ W548314.

In this case, CBP examined the five factors and determined that the importer could claim any post-importation price adjustments, both upward and downward adjustments. The most notable part of CBP’s analysis is the fact that CBP explicitly stated that ‘‘when a related party price is determined in accordance with a formal transfer pricing policy that is in place prior to importation, the transfer price will be considered ‘fixed’ for purposes of applying transaction value even though the policy provides for post-importation adjustments to be made to the transfer price.’’42

CBP further stated that ‘‘[i]t is our position that in this case where the Importer provided us with its formal transfer pricing study [prepared in accordance with the IRS Code Section 482 and the OECD Transfer Pricing Guidelines], there is a valid transfer pricing formula, which establishes the price in effect prior to the importation.’’43 This explicit ratification of the use of a formal transfer pricing study to establish a valid transfer pricing formula is the first time that CBP has so clearly articulated such a position. (Such a position should provide companies with a powerful ‘‘customs incentive’’ for preparing a formal transfer pricing study in addition to the already-existing penalty avoidance incentive offered by Section 482).

Upon establishing that a valid transfer pricing formula existed at the time of importation (pursuant to the transfer pricing study), CBP completed its ‘‘five factor’’ analysis. First, CBP noted that the importer had been reporting post-importation adjustments to Customs (made in accordance with Section 482) for many years.44 Also relevant was the fact that the importer’s documentation (the transfer pricing study and its mar-

40 Id. at 6.
41 HQ H024857 at 7.
42 Id.
43 Id.
44 The importer reported them via ‘‘administrative letters’’ to the local port of entry accompanied by duty payments for the upward adjustments because it was not enrolled in Reconciliation during those years. It should be noted that an ongoing controversy exists whether such payments are subject to the ‘‘Prior Disclosure’’ process for self-reporting violations to the CBP. Some ports of entry think they are, but such a view is misplaced—for the simple reason that no violation has taken place when an importer follows CBP’s policy and reports the ‘‘price actually paid or payable’’ as a result of its transfer pricing formula and tenders any duties owed.
marketing contract, both in place prior to importation) set forth the method by which any compensating adjustments would be calculated, should the importer’s gross margin fall outside of the acceptable range established by the transfer pricing study. CBP also noted that “the transfer pricing policy and the Marketing Contract specifically cover all merchandise, the price of which is to be adjusted, as necessary. Both documents are signed by all parties and clearly specify how the transfer price is to be determined, what adjustments are to be made, and how these adjustments are to be determined. At the end of each year, the Importer uses the formula to determine the final price.”

Finally, CBP concluded that, based on the documentation provided by the importer, no other conditions existed that could affect CBP’s acceptance of the transfer price by CBP. Thus, after reviewing the totality of the information regarding the importer’s post-importation adjustments, CBP stated that “as long as the Importer maintains and provides accounting details from its books and/or financial statements to support the post-importation adjustments upon making a claim with CBP and describes the method of allocation of such adjustments, the Importer may claim downward and upward post-importation adjustments.”

Circumstances of Sale

CBP then turned to the last issue remaining in its analysis—whether the COS establish that the relationship between the importer and seller did not affect the price actually paid or payable—thus permitting the transfer price to be used for the purposes of transaction value. CBP noted that this COS analysis remained necessary even after its ruling in HQ W548314, where it “determined that the Importer needed to show that the relationship of the parties did not influence the adjusted prices.”

In this case, the importer could actually establish that the seller also sold the same imported merchandise to unrelated parties outside of the U.S. In fact, only three global distributors out of 57 were related to the seller—including the U.S. entity. Such a scenario is highly unusual in related-party valuation rulings because the seller almost always sells to related distributors on a global basis, i.e., there are no sales of the imported merchandise (or very few; usually in small, developing markets) to unrelated importers. Even though the unrelated buyers in this ruling were located outside of the U.S., CBP stated that it would still “consider evidence regarding sales to unrelated buyers in other countries, provided the Importer presents an adequate explanation as to why it is relevant to the transaction at issue.”

In this case, the importer successfully established that the seller’s transactions with unrelated buyers were relevant to the COS analysis because the seller used the same global price list for all of its sales, regardless of the location of the purchaser or whether the purchaser was related or unrelated. Additionally, the importer also established its marketing contract with the seller was identical to the marketing contracts existing between the seller and unrelated purchasers/distributors. CBP noted that:

These marketing contracts further show that the manufacturer/seller settles its prices to the importer in a manner consistent with those to unrelated distributors—both use pricing formulas that seek to return a profit to the manufacturer/seller based on the global price list price minus the discount. These documents indicate that the manufacturer/seller charges all of its unrelated distributors and the related importer the same price, with the only difference being that the provisional price to the related distributors is settled after the importation due to the post-importation adjustments made in accordance with the income-tax mandated requirements. Therefore, the foreign manufacturer/seller deals with unrelated buyers in the same way that it deals with related buyers.

Having accepted that the importer successfully established that its transfer prices were “settled in a manner consistent with the way the seller settles prices in sales to unrelated buyers,” CBP ended its COS analysis without considering the other elements of the COS test, e.g., whether the transfer pricing study demonstrated that the prices were settled according to the normal pricing practices of the industry or that the transfer prices satisfied the all costs plus a profit test. Having thus concluded its analysis, CBP held that the importer could use its transfer prices to establish a transaction value for customs valuation purposes, and that the importer should report any post-importation adjustments to its prices to CBP.

Conclusion

Although CBP HQ has issued only three rulings to date expounding upon its new policy regarding transfer pricing and post-importation adjustments, those rulings are instructive. For global traders and taxpayers, the “roadmap” established by the so-called “five-factor” test sets forth the kinds of documentation needed to support the finding of an existing “formula” for intercompany pricing that will be acceptable to CBP.

CBP’s conclusion in HQ H024857 that a transfer pricing study can be used to establish the existence of a transfer pricing formula raises new questions about the weight such studies will be afforded going forward. While awaiting further guidance, taxpayers with U.S. import operations should continue to document all aspects of their intercompany pricing (including any post-importation adjustments) with the kinds of contractual, financial, and accounting support set forth in the rulings discussed herein.

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45 Id. at 8.
46 Id. at 9.
47 Id.
48 Id., citing HQ W548314 (May 16, 2012).
Analysis

Goodwill, Business Valuation, and the Next Round of Transfer Pricing Litigation

The author says the U.S. Court of Federal Claims’ treatment of goodwill in Deseret Management Corp. v. U.S., a domestic case between unrelated parties, highlights the challenges of isolating goodwill, a residual amount, from a group of other business assets. He also suggests that in cost sharing cases under pre-2007 regulations, foreign goodwill and going concern value may offer a way to close the “valuation gap” between the IRS and the taxpayer.

BY JOHN M. BREEN, SKADDEN, ARPS

In recent years, the Internal Revenue Service and Treasury have taken steps to classify goodwill, going concern value and additional unspecified intangibles as compensable items under Section 482, and to subject them to the so-called deemed license requirements of Section 367(d). The final 2011 cost sharing regulations under Section 482 implicitly include goodwill and going concern value for purposes of evaluating the platform contribution transaction (PCT) payment, formerly known as the cost sharing buy-in payment.1 In addition, the Obama administration proposes amending the Internal Revenue Code to provide that goodwill and going concern value are within the scope of Sections 482 and 367(d).2

The trend toward expanding the definition of intangible property is not limited to the United States, but extends to international organizations as well. The Organization for Economic Cooperation and Development and its members recently undertook to revise Chapter 6 of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, the chapter that deals with intangible property. That initiative forms part of the OECD’s Action Plan on Base Erosion and Profit Shifting (BEPS) being conducted under the auspices of the OECD and the Group of 20 countries.3 Among the proposed changes to Chapter 6 of the OECD guidelines is one that would include goodwill and going concern value within the definition of intangible property, or alternatively, greatly reduce the importance of goodwill in any substantive analysis.4 The OECD received extensive comments on this and other proposed changes and it recently held a public consultation with practitioners, business representatives and other parties.5

In August 2013, the U.S. Court of Federal Claims ruled on competing applications of the income method for purposes of quantifying goodwill and going concern value. Although the decision dealt with a wholly domestic transaction evaluated under Section 1031, some lessons from the opinion may carry over to the international area.

1 T.D. 9568, 76 Fed. Reg. 80,082 (available at 20 Transfer Pricing Report 702, 1/12/12). The preamble to the rules emphasizes that platform contributions are not limited to traditional intangibles. Foreign goodwill and going concern value are specifically excluded from the scope of Section 367(d) by regulation (see Regs. §1.367(d)-1T(b), second sentence).


3 BEPS action items 8, 9 and 10 relate to possible modifications of the transfer pricing rules. BEPS action item 8 focuses on changes to the rules applicable to intangible property. For the action plan, see 22 Transfer Pricing Report 379, 7/25/13.

4 See the OECD’s July 30 revised discussion draft on intangibles, 22 Transfer Pricing Report 441, 8/8/13. Paragraphs 60-64 of the document address goodwill and going concern value. This section cross-references proposed changes to Chapter 1 of the transfer pricing guidelines, which would take into account “group synergies” for valuation purposes (see the revised intangibles discussion draft, paras. 18-34).


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Deseret Management

Deseret Management Corp. v. U.S. was a tax refund action in the U.S. Court of Federal Claims involving a like-kind exchange of FM radio station assets by two unrelated corporations, Deseret Management and Emmis Communications. In that exchange, Deseret provided the operating assets and the Federal Communications Commission license of KZLA, a country music FM radio station in Los Angeles. On the other side of the exchange, Emmis provided the operating assets and the FCC licenses of four radio stations in the St. Louis market.

Section 1031 afforded Deseret nonrecognition treatment to the extent that the transaction involved a like-kind exchange of property with Emmis. Thus, tax-free treatment was available for traditional assets such as the FCC license, broadcasting facilities and contracts. However, any portion of the transfer classified as goodwill was outside the scope of the like-kind transfer provisions and therefore subject to tax. Thus, the taxpayer in Deseret sought to minimize the amount of goodwill in the transaction, whereas taxpayers in the international context generally have an incentive to maximize the value of goodwill. The Court of Federal Claims was called on to determine how much of the total value of station KZLA, transferred as a going concern, was attributable to goodwill.

Deseret’s tax return position was that nearly all the value on its side of the exchange was attributable to the station’s operating assets and its FCC license. Later, at trial, the parties would stipulate that the value of KZLA’s tangible assets was $3.4 million and the value of its intangible assets (other than the FCC license and goodwill, if any) was $4.9 million. Based on the transfer’s total value of $185 million, this left approximately $176.5 million of additional value to be accounted for.

Based on an economic study and a purchase price allocation prepared by an outside consultant, Deseret determined that the FCC license had a value of $176.8 million. In the taxpayer’s view, this amount, combined with the values of the station’s physical assets and the lease on its broadcast facilities, fully accounted for the total transaction value of $185 million, with no residual.

On examination, the IRS took issue with the taxpayer’s allocation of values to specific categories of assets. In particular, the IRS found that the transferred business assets had a goodwill value of $73.3 million as of the date of the exchange. (See Chart 1.) The IRS issued a deficiency notice that collected additional tax on this amount. Deseret paid the additional tax and filed suit for refund in the U.S. Court of Federal Claims.

**Chart 1: IRS Initial Allocation of Value ($185 million)**

<table>
<thead>
<tr>
<th>Category</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goodwill</td>
<td>$73.3 m</td>
</tr>
<tr>
<td>FCC License</td>
<td>$81.5 m</td>
</tr>
<tr>
<td>Non-FCC License</td>
<td>$4.9 m</td>
</tr>
<tr>
<td>Tangible Property</td>
<td>$3.4 m</td>
</tr>
</tbody>
</table>

The court began by performing what it termed a qualitative analysis. Reviewing the Los Angeles FM radio market at the time of the like-kind exchange, the court concluded that a radio station with KZLA’s profile might be found to possess some goodwill. On one hand, advertisers did not consider KZLA’s country music format particularly desirable. The record indicated that independent media survey companies, using various objective criteria, ranked KZLA at or below the median of radio stations in the Los Angeles market. On the other hand, KZLA was the only country music station in a major metropolitan market with a large number of country music listeners. On balance, the court found that a purchaser might be willing to pay some premium for KZLA’s assets, given that they included favorable broadcasting facilities and offered the prospect of generating advertising revenues in the large and growing Los Angeles market.

The court then analyzed the expert reports in detail. Both experts assigned values to specific asset categories or "exchange groups," including tangible property (mainly the broadcast facilities) and identifiable items of intangible property, primarily the FCC license and the station call-letters. The taxpayer’s expert assigned most of the station’s value to the FCC license. In the process, he relied on the accounting definition of goodwill and on his own interpretation of precedent in the Court of Federal Claims. He then used a residual value of all exchange groups. See Regs. §1.1031(j)-1(b)(2)(iii), (b)(3).

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7 Several Deseret affiliates participated in the like-kind exchange with Emmis. For simplicity, these are referred to collectively as “Deseret.” The Court of Federal Claims opinion also dealt with tangible property depreciation issues, which are outside the scope of this article.
8 See Regs. §§1.1031(a)-2(c)(2), 1.1031(j)-1(b)(2). Technically, items subject to a like-kind exchange must be classified into exchange groups and residual groups. Also see Regs. §§1.338-6(b)(2), 1.1060-1(b)(8).
10 Values are allocated to specific asset categories in accordance with Section 1060 and the regulations under that provision. The value of the residual group under Section 1031 is the difference between the total value of the exchange and the
approach to analyze the FCC license and concluded that its value was $176.8 million. Consistent with the taxpayer’s position on its return, this approach left essentially no residual amount to be allocated to goodwill. (See Chart 2.)

CHART 2: Taxpayer’s Allocation of Value ($185 million)

<table>
<thead>
<tr>
<th>Value</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Goodwill</td>
<td>$156,000</td>
</tr>
<tr>
<td>FCC License</td>
<td>$176.8m</td>
</tr>
<tr>
<td>Non-FCC License</td>
<td></td>
</tr>
<tr>
<td>Intangible Property</td>
<td>$4.9m</td>
</tr>
<tr>
<td>Tangible Property</td>
<td>$3.4m</td>
</tr>
</tbody>
</table>

Diagram is not to scale. Items may not total due to rounding.

The IRS expert applied the same discounted cash flow (DCF) method, but she took a fundamentally different approach. As an initial matter, she determined that the value of the FCC license was $131.4 million, which resulted in a goodwill value of $45.5 million. This was roughly $28 million less than the amount in the IRS deficiency notice, which was $73.3 million. The $28 million figure was based on estimating the net operating cash flow that the station could generate on a startup basis, and reducing that amount to net present value. After backing out the value of the FCC license, goodwill was evaluated on a residual basis. The court observed that such income-based approaches and residual analyses were common in broadcast industry valuations.

The court identified several errors in the IRS expert’s report. To begin with, the expert assigned a “proxy” value of $80 million to the FCC license, based on sales of comparable licenses in other geographic markets. The expert also claimed that the DCF analysis could not be done simultaneously with the valuation of the FCC license. The court found that the model in fact allowed the value of the license and amortization deductions to be modified simultaneously, permitting the resulting values to be reconciled. The court also concluded that various adjustments were necessary to key inputs in the model, including the discount rate, the growth rate and the amortization period for the FCC license. These changes substantially reduced the residual amount allocable to goodwill. In fact, the court concluded, even if only some of these errors were corrected, the value of goodwill became zero or even negative.

After the court made all modifications it considered necessary, the revised DCF model pointed to a goodwill value of zero or less. The court considered the possibility that some goodwill was present in the transfer, but the parties had attributed no value to it:

[By] consistently demonstrating that defendant’s calculations yield values for goodwill that are below zero, plaintiff has shown that, under any set of reasonable assumptions, any goodwill present in this transaction was, at most, negligible. That was true either because KZLA did not possess more than a negligible amount of goodwill or because Emmis did not, for purposes of section 1031, exchange anything of value for KZLA’s goodwill when it transferred its radio station assets for those held by [Deseret].

The taxpayer argued that a hypothetical purchaser might scrap KZLA’s country music format, fire the station’s on-air personalities, and adopt a different program format, in which case it would realize no goodwill from the existing operation. The court rejected this argument, drawing an analogy to a restaurant that is acquired as a going concern. In that case, it would be unreasonable to value the restaurant’s assets by assuming that the purchaser would adopt an entirely new menu and format. Similarly, the court declined to find that goodwill may be present only if the assets of the business have the capacity to generate extraordinary income. Although the court seemed to acknowledge that KZLA was not a standout in the Los Angeles market and that its future income prospects were unexceptional, those facts alone did not preclude a finding that goodwill was present.

To test its final conclusion that KZLA lacked goodwill at the time of the exchange, the court performed what transfer pricing practitioners might classify as a sanity check. Specifically, the court considered the sale at auction of another FM radio station (KFSG) in Los Angeles, which took place roughly one month after the Deseret-Emmis like-kind exchange. The auction price in the KFSG transaction was $250 million. KFSG’s broadcast power rating was lower than KZLA’s, and the purchaser dropped KFSG’s religious-themed format in favor of a Spanish language format immediately after

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15 Perhaps the most important change was the reduction in the weighted average cost of capital (discount rate) from 11.7 percent to 9.9 percent. Deseret, Slip op. at 23. 16 Id. at 25-26. 17 Taxpayers in the media industry have long made arguments to support a zero goodwill finding under like-kind exchanges. See the April 2007 IRS coordinated issue paper (CIP) from the Industry Specialization Program, “Like–Kind Exchanges Involving FCC Licenses.” (The IRS in January 2014 “de-coordinated” all CIPs, saying they will be made available to examiners through community websites for LB&I’s issue practice groups and international practice networks.) In the media industry, the presence of interrelated intangible rights—the FCC license, the network-affiliation contract, and the expectation of renewal of the network affiliation contract—pose difficult valuation issues. 18 Deseret, Slip op. at 17-18.
the purchase.21 While those facts, standing alone, might suggest that KFSG should have lower than normal goodwill, the consideration paid for KFSG was greater than the total value of the KZLA assets, analyzed separately.20 In the court’s view, this supported its conclusion that any goodwill in the KZLA transfer was at best negligible.

Based on its finding that the like-kind transfer of KZLA did not involve a transfer of goodwill, the court granted in full the plaintiff’s motion for refund of tax on the Section 1031 issue.

Although it is not an international case, Deseret is potentially noteworthy in several respects. First and foremost, it shows a federal court grappling with some of the same issues that recently have come to the fore in the international tax area, in particular, how to isolate goodwill and going concern value under so-called “full-value” methods such as DCF, acquisition price, or market capitalization.21 Admittedly, Deseret raised issues specific to the like-kind transaction and the media industry setting in which it arose. For example, the court had the benefit of a “fixed” transaction value ($185 million) and it also had values to which the parties had stipulated for most items of tangible and intangible property other than the FCC license. In that context, the court was able to apply the DCF to identify goodwill (or lack thereof). Even under these relatively controlled conditions, the court performed additional analysis—including qualitative analysis and a transactional sanity check—to ensure that its conclusions were supported.

**Goodwill in the International Context**

As already noted, the goodwill issue under the international provisions of the Code is essentially the mirror image of the comparable issue under Section 1031. That is, the regulations under Section 367(d) treat “foreign” goodwill as outside the scope of Section 367(d), although it still is necessary to distinguish between domestic and foreign goodwill. Likewise, because goodwill is not among the items of intangible property in Section 936(h)(3)(B), the strong inference is that goodwill is not an item of intangible property for purposes of Section 482, which incorporates the Section 936 definition in material respects.22 Regardless of whether a

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19 KZLA was one of the few FM stations in Los Angeles authorized to broadcast from Mt. Wilson, the highest point in the metropolitan area. KZLA also had a grandfather exemption that enabled it to broadcast at a high power rating, making it one of 17 “superstations” in the Los Angeles market. Deseret, Slip op. at 4-5. These factors, which would tend to make KZLA more desirable to potential acquirers, also could be considered subsumed within the value of the FCC license and not associated with goodwill.

20 In the author’s view, the court acted consistently by declining to consider hypothetical post-exchange events in evaluating the KZLA transfer, while also taking into account that the purchaser of KFSG immediately changed the station’s program format. The former was a hypothetical assumption, the latter a factual condition.

21 The term “full-value methods” in connection with particular IRS approaches under Sections 482 and 367(d) was coined by David N. Bowen. See “Full-Value Methods: Has the IRS Finally Hurdled the Holy Hand Grenade?,” 37 TM International Tax Review, 3, 1/11/08.

22 Both Section 936(h)(3)(B)(vi) and Regs. 1.482-4(a)(6) have a residual category consisting of “similar item[s],” which makes it difficult to determine whether a specific item is properly classified as intangible property.

22 Cases potentially subject to both Section 482 and Section 367(d) include the Section 936 exit strategy cases, discussed immediately below.

24 The regulations treat foreign goodwill and going concern value as outside the scope of Section 367(d). See Regs. §1.367(d)-1T(b). This is consistent with the legislative history of the Deficit Reduction Act of 1984, Pub. L. No. 98-369, Stat. 494. See S. Prt. No. 98-169, 98th Cong., 2nd Sess., Vol. 1 362 (1984) (subject to certain exceptions, the Senate Finance Committee did not consider that transfers to a foreign corporation of foreign goodwill or going concern value developed by a foreign branch “will result in abuse of the U.S. tax system (regardless of whether the foreign corporation is newly organized).”); H.R. Rep. No. 98-861, 98th Cong., 2nd Sess. 951-56 (1984) (Conference Report) (stating same principle in less categorical terms).

25 Technical Advice Memorandum 20090724 (11/10/08). The facts in TAM 200907024 were similar to those in a docketed Tax Court case, First Data Corp. v. Comr., No. 7042-09, which was settled before trial. See Kevin Bell, “Western Union Company, IRS Settle Cost Sharing Case on 2003 Restructuring,” 20 Transfer Pricing Report 698, 1/12/12.

26 See, for example, Medtronic Inc. v. Comr., No. 6944-11 (available at 19 Transfer Pricing Report 1294, 4/7/11) and Guidant LLC v. Comr., No. 5989-11 (available at 19 Transfer Pricing Report 1356, 4/21/11). A related case involving Boston Scientific was consolidated with Guidant. See 21 Transfer Pricing Report 646, 11/1/12. Also see Eaton Corp. v. Comr., No. 5576-12 (available at 20 Transfer Pricing Report 1080, 3/22/12). Eaton deals with a post-section 936 structure in tax years for which an advance pricing agreement was in effect but was subsequently canceled by the IRS.

27 IRS Notice 2005-21, 2005-1 C.B. 727 gave guidance on the treatment of Section 936 conversions. See 14 Transfer Pric-
fers of intangible property to Puerto Rican affiliates gave rise to several landmark Section 482 decisions in the 1980s, which addressed not only the arm’s-length return to intangible property but also the potential interaction between Section 482 and nonrecognition provisions of the Code.28

At present, the available facts concerning the Section 936 exit strategy cases are contained in the companies’ U.S. Tax Court petitions and the IRS’s answers. Interestingly, the regulations covering outbound transfers of assets in exchange for stock require that the taxpayer report (on IRS Form 926) the fair market value of each category of property transferred, including intangible property.29 The amounts assigned to foreign goodwill or going concern value in the transfer also must be disclosed on that form.30 Thus, these cases present the question of what qualifies as foreign goodwill in outbound transfers.

In the Section 936 exit strategy cases, the tax court may be called on to determine how much of the total value of a transferred business is attributable to goodwill. In this setting, the IRS might well argue that little or no value is attributable to goodwill, much less to foreign goodwill. A possible sequence of the IRS arguments is as follows:

(1) The transfer pricing with the post-Section 936 affiliate was incorrect under Section 482 (that is, too much income was allocated to the post-Section 936 affiliate).

(2) Assuming for argument’s sake that the transfer pricing with the post-Section 936 affiliate was correct under Section 482, all foreign goodwill and going concern value is subject to Section 367(d).

(3) Assuming that the taxpayer prevails under both arguments (1) and (2), the value of foreign goodwill and going concern is minimal.

In practice, if the IRS prevailed on issue (3), Section 367(d) still would apply, albeit to diminished base of goodwill attributable to foreign operations.31

To illustrate, if a reviewing court found that the post-936 affiliate’s transfer pricing under Section 482 was appropriate, the residual DCF approach would point to a correspondingly high value of goodwill and going concern (measured by the entity’s cash flow potential). Conversely, if the court found that the post-Section 936 entity earned too much income under Section 482, the revised transfer prices would be reflected in the revised cash flow projection, which would yield a lower value under the DCF. Thus, a key feature of the Section 936 exit cases is this reciprocal relationship between transfer pricing and business valuation: the two values interact in seesaw fashion, turning on the projected cash flow of the underlying business.

In other respects, the Section 936 exit strategy cases may present a less than ideal setting in which to test the scope of the outbound transfer rules. When it was in effect, Section 936 incorporated quasi-formulary transfer pricing rules, based only loosely on the arm’s-length standard. Also, it sometimes is overlooked that the transferee of intangible property—the party entitled to claim the Section 936 credit—was in fact a domestic corporation whose operations in Puerto Rico were conducted in branch form. For that reason, the Section 367 rules, once they were reflected in regulations, did not apply to Section 936 corporations. Some additional explanation may be useful on these points.

Before 1993, Section 936 required that essentially all gross income from the use of intangible property in the U.S. possession be attributed to the shareholders of the Section 936 corporation.32 In the alternative, if the Section 936 corporation satisfied specific tests for possession-source income and significant business presence, it could elect one of two special transfer pricing methods—the profit split method or the cost sharing method.33

The profit split method under Section 936, when it was in effect, used an arbitrary 50-50 split, and the calculation was based on combined taxable income rather than operating income.34 Likewise, the cost sharing method under Section 936 did not correspond to cost sharing as reflected in Regs. §1.482-7.35 Rather, it amounted to a foray approach that called for the Section 936 affiliate to reimburse a portion of the U.S. parent corporation’s “product area R&D expenses” in connection with the development of manufacturing intangibles.36

It is difficult to see how the Section 936 exit strategy cases align with the IRS’s goal of increasing the strategic focus of transfer pricing litigation.37 In practice, these cases present fairly narrow fact patterns, which arise out of a non-arm’s-length regime. In short, while the statutory definition of intangible property, Section 936(h), was interpreted to give rise to several landmark Section 482 decisions in the 1980s, which addressed not only the arm’s-length return to intangible property but also the potential interaction between Section 482 and nonrecognition provisions of the Code.28


29 Regs. §1.6033B-1T(d)(1)(iii), (iv).

30 Regs. §1.6033B-1T(d)(1)(iv).

31 See General Motors (19 Transfer Pricing Report 1356, 4/21/11) paragraph 4, noting alternative IRS adjustments under Section 482 and Section 367(d).

32 In tax years after 1993, the credit available under Section 936 was subject to limitations intended to reduce the program’s overall cost to the U.S. fisc and to increase the economic benefits provided to the Puerto Rican economy.

33 Section 936(a) and (e). Although the Section 936 corporation was a domestic U.S. corporation, the shareholders of that corporation could be either domestic or foreign.

34 Section 936(h)(5)(C)(i). Also see Coca-Cola Co. v. Comr., 106 T.C. 1 (1996). Combined taxable income (CTI), a gross income concept, does not play any role in the specified methods under the Section 482 regulations. C.f., Section 925(a)(2) (repealed) (foreign sales corporation that qualifies for administration pricing methods may use the CTI approach to determine transfer prices from its related supplier).

35 Section 936(h)(5)(C)(ii). Section 936 cost sharing payments, unlike payments under a bona fide cost sharing agreement under Regs. $1.482-7(d)(4) (1986), did not give rise to any ownership interest in the intangible property on the part of the U.S. shareholder.

36 Section 936 was intended to give the Puerto Rican affiliate a reasonable return on manufacturing intangibles that it developed, or for which it made a cost sharing payment under Section 936(h)(5)(C)(ii).

37 The Section 936 exit cases present a “branch incorporation” paradigm, which is not especially common in modern tax practice. For that reason alone, judicial guidance in these cases may have limited application to other settings.
936(h)(3)(B), was a product of the Section 936 era, the answer to the present-day controversy might not be found in the Section 936 exit strategy cases.

**Cost Sharing Buy-in Cases Before 2007**

In contrast to the specialized setting of the Section 936 exit strategy cases, cost sharing arrangements are more widespread. Currently, most cases in this area likely arise under the regulations in effect before 2007 rather than the revised regulations.38 As in the Section 936 exit strategy cases, foreign goodwill and going concern value play an important role. The IRS’s 2007 CIP on cost sharing buy-in payments took a hard line concerning foreign goodwill and going concern value, suggesting that it was properly taken into account in evaluating the buy-in payment.39 The CIP may have limited relevance, as it was withdrawn in early 2012, two years after the IRS “de-coordinated” all such papers.40 In an analogous setting, the tax court warned the IRS against taking concepts from current regulations and applying them to earlier years subject to predecessor regulations.41

IRS examination teams have authority to resolve cases by applying the Code and regulations to the specific facts and circumstances of the cases before them. Recent experience suggests that, in the cost sharing area, exam teams may be willing to engage with taxpayers on the issue of foreign goodwill and going concern value, at least where that item can be reliably quantified. In practice, they may agree with the taxpayer that the cost sharing buy-in need not reflect value transferred to the foreign affiliate that relates to foreign goodwill. In some cases, this issue is part of a broader legal or factual inquiry regarding the exact nature of the items transferred to the foreign affiliate.42 In other cases, the analysis is more pragmatic, as the taxpayer and the IRS seek ways to bridge the gap between competing valuations of the buy-in amount.43 Whatever the motivation, any inclination on the IRS’s part to resolve these cases on a principled basis at the administrative level should be welcomed as a positive development.

**PCT Payment Cases**

Due to the natural lag in filing tax returns and initiating IRS examinations, it is too early to say how cases will fare under the 2009 temporary44 or 2011 final45 cost sharing regulations. Clearly, the amended regulations take a different approach than the pre-2007 regulations. Among other things, the new cost sharing regulations eliminate the facts and circumstances approach of the prior regulations in favor of using finance and valuation principles to evaluate the PCT payment. For their part, the IRS Examination Division and the Appeals Division have the expertise to apply this new quantitative framework, although disputes with taxpayers likely will persist concerning both interpretation of the facts and the quantitative inputs into the analysis (discount rates and terminal values, to name a few). Deseret shows that federal courts, when called upon to do so, can resolve valuation disputes that involve factual disputes and relatively sophisticated economic models.46 Still, it remains to be seen whether the largely quantitative approach of the revised cost sharing regulations will eliminate disputes concerning the scope of items subject to compensation under a cost sharing arrangement.

**Conclusion**

The role of goodwill in international transfer pricing and cross-border transfers of intangible property is evolving. The IRS’s full-value methods put increased pressure on the notion that foreign goodwill and going concern value is an item of intangible property under Section 936(h)(3)(B). It is understandable why the Obama administration proposed amendments to the Code in this area, and why similar changes to the multilateral rules are being considered.

The Deseret case showed some of the challenges associated with isolating goodwill, a residual amount, from a group of other business assets. As in most valuation cases, the outcome there turned on analysis of the facts and, equally important, on a few key inputs into the financial model. It is worth noting that Deseret involved fairly simple facts, at least in comparison to the

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38 Two cost sharing cases currently are docketed in the Tax Court: *Amazon.com Inc. v. Comr.*, No. 31197-12 (petition available at 21 Transfer Pricing Report 925, 1/24/13), and *Altera Corp. v. Comr.*, Nos. 9963-12 and 6253-12 (petitions and IRS answers available at 21 Transfer Pricing Report 381, 8/9/12). The main issue in *Altera* pertains to the amount of the cost sharing payments rather than the buy-in—specifically, whether stock-based compensation was properly included in the cost base. Both *Amazon* and *Altera* involve the pre-2007 version of Regs. §1.482-7.

39 The September 2007 CIP is available at 16 *Transfer Pricing Report* 386, 10/4/07. See section 2E of the paper.

40 21 *Transfer Pricing Report* 352, 8/9/12.

41 *Veritas Software Corp. v. Comr.*, 133 T.C. 297 (2009) (available at 18 *Transfer Pricing Report* 890, 12/17/09). The IRS said it would not follow the ruling; its action on its decision in November 2010 took issue with the court’s finding that the IRS applied concepts from the 2006 temporary regulations, which did not apply to the tax years before the court. AOD 2010-005 at 4, n.6 (available at 19 *Transfer Pricing Report* 808, 11/18/10).

42 The regulations define foreign goodwill and going concern as “the residual value of a business conducted outside of the United States after all other tangible and intangible assets have been identified and valued.” Regs. §1.367(a)-1T(d)(5)(iii). Also see the February 2008 IRS directive on Section 936 at 16 *Transfer Pricing Report* 843, 3/27/08 (listing factors relevant to distinguishing between foreign and domestic goodwill and going concern value for purposes of Section 367(d)). The Section 936 exit strategy cases may pose challenging issues in terms of distinguishing between foreign and domestic goodwill.

43 In *Veritas*, 133. T.C. 297, the taxpayer valued the buy-in at $166 million; at trial, the IRS valued the buy-in at $1.675 billion. Gaps of similar magnitude are not uncommon in these cases.


45 T.D. 9568, 76 Fed. Reg. 80,082 (see note 1).

46 In another involved section 1060, the U.S. Tax Court noted that “determining an appropriate discount rate with mathematical precision is impossible” and “valuation is necessarily an approximation.” *Norwest Corp. v. Comr.*, 108 T.C. 265, 308 (1997) (citations omitted). The tax court also has observed that valuation of assets presents issues better suited for the give and take of the settlement process than adjudication.” *Buffalo Tool & Die Mfg. Co. v. Comr.*, 74 T.C. 441, 451 (1980), acq. 1982-2 C.B.1.
typical cross-border transfer pricing case. Determining how much goodwill a local radio station holds is less challenging than evaluating the goodwill in a transfer to the foreign affiliate of a U.S. multinational. A cross-border transfer of the type considered problematic by the IRS likely will involve multiple categories of intangible property, including technology, marketing, and customer-based intangibles. Each of those intangibles may in turn be at a different stage of development, and its development expenses may have been borne by different parties and in varying proportions. If one factors in distinct national markets and cultural and business environments, the ability to perform a reliable DCF analysis, much less to isolate any residual goodwill amount by entity or by region, poses real challenges.

The final chapter in the story of goodwill in cross-border transfers is yet to be written. The Section 936 exit strategy cases squarely present the foreign goodwill issue, albeit in a setting with limited application to the broader universe of multinational taxpayers.

In cost sharing buy-in cases under the pre-2007 regulations, the IRS takes the position that all goodwill, foreign and domestic, is properly included in determining the amount of the cost sharing buy-in payment. In that setting, foreign goodwill and going concern value can sometimes play a constructive role by providing a way to close the “valuation gap” between the IRS and the taxpayer other than in IRS Appeals or in litigation. That is, assuming that the foreign component of goodwill and going concern value can be reliably determined and segregated from other intangible property, it may provide a basis for agreement on an amount that better reflects the value of the underlying transfer.
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