

A world map with a grid overlay, showing continents in dark blue and oceans in light blue. The grid consists of vertical and horizontal lines, with some lines highlighted in yellow and green. The map is centered on the Atlantic Ocean.

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Publisher

Tom Barnes

tom.barnes@lbresearch.com

Subscriptions

Claire Bagnall

claire.bagnall@lbresearch.com

Senior business development manager

Adam Sargent

adam.sargent@gettingthedealthrough.com

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Transfer Pricing 2022

Contributing editors**Wendy Abkin, Barton WS Bassett, Sanford W Stark
and Drew A Cummings****Morgan, Lewis & Bockius LLP**

Lexology Getting The Deal Through is delighted to publish the eighth edition of *Transfer Pricing*, which is available in print and online at www.lexology.com/gtdt.

Lexology Getting The Deal Through provides international expert analysis in key areas of law, practice and regulation for corporate counsel, cross-border legal practitioners, and company directors and officers.

Throughout this edition, and following the unique Lexology Getting The Deal Through format, the same key questions are answered by leading practitioners in each of the jurisdictions featured. Our coverage this year includes new chapters on Luxembourg and Taiwan.

Lexology Getting The Deal Through titles are published annually in print. Please ensure you are referring to the latest edition or to the online version at www.lexology.com/gtdt.

Every effort has been made to cover all matters of concern to readers. However, specific legal advice should always be sought from experienced local advisers.

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For further information please contact editorial@gettingthedealthrough.com

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United States

Wendy Abkin, Barton WS Bassett, Sanford W Stark and Drew A Cummings

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OVERVIEW

Principal legislation

1 | Identify the principal transfer pricing legislation.

Section 482 of the Internal Revenue Code provides that in the case of any organisations, trades or businesses that are owned or controlled directly or indirectly by the same interests, the US Secretary of the Treasury may distribute, apportion or allocate gross income, deductions, credits or allowances between or among these entities if the Secretary determines that the distribution is necessary to prevent the evasion of taxes or to clearly reflect income. Although section 482 contains only three sentences, the US Treasury has issued extensive regulations that provide detailed rules that govern the interpretation and application of this statutory provision.

Enforcement agency

2 | Which central government agency has primary responsibility for enforcing the transfer pricing rules?

The Internal Revenue Service (IRS) is organised to carry out the responsibilities of the Secretary of the Treasury. The IRS has the full authority to administer and enforce the internal revenue laws. The Treaty and Transfer Pricing Operations practice area of the Large Business and International division of the IRS is composed of transfer pricing professionals that focus on the examination and resolution of transfer pricing matters.

The respective state tax authorities throughout the United States also enforce transfer pricing rules. State enforcement efforts around transfer pricing are generally increasing in the United States and are likely to accelerate as state governments seek to address budget gaps resulting from the covid-19 pandemic.

OECD guidelines

3 | What is the role of the OECD Transfer Pricing Guidelines?

Outside the competent authority or advance pricing agreement (APA) context, the IRS applies and is bound by section 482 and the regulations issued thereunder. However, as part of the competent authority process, the IRS may consider the OECD Transfer Pricing Guidelines, which the United States considers to be generally consistent with its own regulations. Moreover, as part of a bilateral or multilateral APA, the IRS may also consider the OECD Transfer Pricing Guidelines. The Tax Court, in a transfer pricing case, has also cited the OECD Transfer Pricing Guidelines and various OECD published reports relating to transfer pricing as persuasive evidence.

Covered transactions

4 | To what types of transactions do the transfer pricing rules apply?

Section 482 applies to transactions between two or more organisations, trades or businesses (regardless of whether they are affiliated) that are owned or controlled directly or indirectly by the same interests. For purposes of section 482, 'control' is broadly defined to include any kind of control, whether legally enforceable and however exercisable or exercised, including two or more taxpayers acting in concert or with a common goal or purpose. In determining whether entities are commonly controlled, the courts have looked to the reality of control rather than any specific measure of stock ownership. A presumption of control arises if income or deductions have been arbitrarily shifted. For example, section 482 can apply in respect of a joint venture entity owned by unrelated parties.

Arm's-length principle

5 | Do the relevant transfer pricing rules adhere to the arm's-length principle?

Although section 482 does not require the application of the arm's-length principle, the regulations have for nearly 100 years required taxpayers to apply the arm's-length standard. The regulations provide that a controlled transaction meets the arm's-length standard if the results of the transaction are consistent with the results that would have been realised if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (the arm's-length result). The regulations note that because identical transactions can rarely be located, whether a transaction produces an arm's-length result will generally be determined by reference to the results of comparable transactions under comparable circumstances.

Base erosion and profit shifting

6 | How has the OECD's project on base erosion and profit shifting (BEPS) affected the applicable transfer pricing rules?

The OECD's BEPS project has not directly affected the applicable transfer pricing rules in the United States. However, some of the BEPS Project reports were addressed through provisions of the Tax Cuts and Jobs Act (TCJA) in 2017. For example, the TCJA includes provisions attempting to:

- neutralise the effects of hybrid mismatch arrangements (BEPS Action 2);
- design effective controlled foreign company rules (BEPS Action 3); and
- limit base erosion involving interest deductions (BEPS Action 4).

A number of other issues addressed by the BEPS project were established in US tax law prior to the launch of the OECD's efforts. For

example, the United States has a lengthy history of including limitation-of-benefits provisions in its bilateral tax treaties, as well as statutes and regulations addressing the application of treaty benefits in respect of hybrid structures.

PRICING METHODS

Accepted methods

7 | What transfer pricing methods are acceptable? What are the pros and cons of each method?

The regulations generally break down the acceptable transfer pricing methods into a number of categories, including transfer of tangible property, use or transfer of intangible property, and services. In all instances, method selection is subject to the best-method rule, which requires selection of the method that produces the most reliable measure of an arm's-length result.

The arm's-length amount charged in a controlled transfer of tangible property must be determined under one of the following six methods:

- the comparable uncontrolled price (CUP) method;
- the resale price method;
- the cost-plus method;
- the comparable profits method;
- the profit split method; and
- unspecified methods.

The arm's-length amount charged in a controlled transfer of intangible property must be determined under one of the following four methods:

- the comparable uncontrolled transaction (CUT) method;
- the comparable profits method;
- the profit split method; and
- unspecified methods.

The arm's-length amount charged in a controlled services transaction must be determined under one of the following seven methods:

- the services cost method;
- the comparable uncontrolled services price method;
- the gross services margin method;
- the cost of services plus method;
- the comparable profits method;
- the profit split method; and
- unspecified methods.

Loans and advances must be priced according to the arm's-length standard. The regulations contain safe harbours for certain loans with an interest rate at between 100 and 130 per cent of the applicable federal rate and certain intercompany transactions conducted in the ordinary course of business.

The transactional methods (the CUP and the CUT) are favoured by US federal courts but are not always available. Additionally, the Internal Revenue Service (IRS) typically challenges the use of the transactional methods on audit despite the fact that these methods will generally yield the most reliable measure of the arm's-length result. The comparable profits method is typically the easiest method to apply, but it can lead to some questionable results and may not always be appropriate given the controlling facts. The residual profit split method considers both parties to the transactions but can present issues around determining the correct data and assumptions to use.

Cost-sharing

8 | Are cost-sharing arrangements permitted? Describe the acceptable cost-sharing pricing methods.

The regulations permit cost-sharing arrangements that comply with specific structural and reporting requirements. A cost-sharing arrangement is an arrangement by which controlled participants share the costs and risks of developing cost-shared intangibles in proportion to their reasonably anticipated benefits (RAB shares). A controlled participant's RAB share is equal to its reasonably anticipated benefits divided by the sum of the reasonably anticipated benefits of all the controlled participants.

In addition, all controlled participants must make arm's-length payments to each controlled participant that provides a platform contribution, which includes any resource, capability or right that a controlled participant has developed, maintained or acquired externally to the cost-sharing arrangement that is reasonably anticipated to contribute to developing cost-shared intangibles. The appropriate methods for valuing a platform contribution, which must be applied in accordance with the best-method rule, include:

- the CUT method;
- the income method;
- the acquisition price method;
- the market capitalisation method;
- the residual profit split method; and
- unspecified methods.

Best method

9 | What are the rules for selecting a transfer pricing method?

The regulations provide that the arm's-length result of a controlled transaction must be determined under the method that, under the facts and circumstances, provides the most reliable measure of an arm's-length result (the best-method rule). There is no strict priority of methods, and no method will invariably be considered to be more reliable than others. However, the CUT method will generally yield the most reliable measure of the arm's-length result if an uncontrolled transaction involves the transfer of the same intangible under the same or substantially similar circumstances. If two or more methods provide inconsistent results, the arm's-length result must be determined under the method that, under the facts and circumstances, provides the most reliable measure of the arm's-length result.

Taxpayer-initiated adjustments

10 | Can a taxpayer make transfer pricing adjustments?

A taxpayer may generally make transfer pricing adjustments until the date its US income tax return is due. This includes reporting the results of its controlled transactions based upon prices different from those actually charged. However, the regulations provide that no untimely or amended returns will be permitted to decrease US taxable income based on allocations or other adjustments in respect of controlled transactions.

Safe harbours

11 | Are special 'safe harbour' methods available for certain types of related-party transactions? What are these methods and what types of transactions do they apply to?

The regulations provide a limited number of safe harbour provisions for certain related-party transactions. In relation to services, the services cost method evaluates whether the amount charged for services is arm's-length by reference to the total services costs with no markup.

If a taxpayer applies this method, then it will be considered the best method, and the IRS's allocations will be limited to adjusting the amount charged for those services to properly determine the amount of the total services costs. The services cost method only applies to certain enumerated services or low margin covered services for which the comparable markup on the total services costs is less than or equal to 7 per cent.

In relation to loans and advances, an interest rate of between 100 and 130 per cent of the applicable federal rate is considered an arm's-length rate of interest. The regulations also allow certain intercompany transactions in the ordinary course of business to be interest-free for a set amount of time.

In relation to all transactions, if the taxpayer has a written agreement in place before the transactions are entered into, the IRS will generally respect it if its terms are consistent with the economic substance of the underlying transaction.

DISCLOSURES AND DOCUMENTATION

Documentation

12 | Does the tax authority require taxpayers to submit transfer pricing documentation? Regardless of whether transfer pricing documentation is required, does preparing documentation confer any other benefits?

Although transfer pricing documentation is not required, the regulations provide a strong incentive for completing such documentation contemporaneously. To avoid penalties related to transfer pricing adjustments, which range from 20 to 40 per cent of the determined underpayment of tax, a taxpayer is required to provide 'contemporaneous' transfer pricing documentation to establish that the taxpayer reasonably concluded that the method selected provided the most reliable measure of an arm's-length result. The taxpayer must provide this documentation to the Internal Revenue Service (IRS) within 30 days of a request for it in connection with an examination of the taxable year to which the documentation relates.

Country-by-country reporting

13 | Has the tax authority proposed or adopted country-by-country reporting? What are the differences between the local country-by-country reporting rules and the consensus framework of Chapter 5 of the OECD Transfer Pricing Guidelines?

The regulations require the ultimate parent entity of a US multinational enterprise group with US\$850 million or more of revenue in the preceding annual reporting period to file its country-by-country reporting with its annual income tax return. When the IRS conducts international exchanges with partner jurisdictions under a treaty or tax information exchange agreement, the IRS will use the approved OECD Country-By-Country Reporting Schema.

Timing of documentation

14 | When must a taxpayer prepare and submit transfer pricing documentation?

A taxpayer seeking to avoid transfer pricing penalties must have documentation in place at the time its annual income tax return is filed. Upon request by the IRS during an examination, the taxpayer must provide its transfer pricing documentation within 30 days. During an examination, the IRS typically requests the taxpayer's transfer pricing documentation in one of its first information document requests.

Failure to document

15 | What are the consequences for failing to submit documentation?

Taxpayers that fail to timely create and maintain transfer pricing documentation may be subject to accuracy-related penalties of 20 to 40 per cent of the determined underpayment of tax.

ADJUSTMENTS AND SETTLEMENT

Limitation period for authority review

16 | How long does the tax authority have to review an income tax return?

The Internal Revenue Service (IRS) must generally propose any income tax adjustments within three years after an income tax return is filed. This time period is often extended by agreement between the taxpayer and the IRS. The three-year period also is subject to certain exceptions. For example, if a taxpayer omits over 25 per cent of its gross income, the IRS may propose an adjustment up to six years after an income tax return is filed. The IRS may also propose an adjustment at any time if the taxpayer fails to file a return, files a false or fraudulent return or wilfully attempts to evade taxes.

Rules and standards

17 | What rules, standards or procedures govern the tax authorities' review of companies' compliance with transfer pricing rules? Does the tax authority or the taxpayer have the burden of proof?

The IRS is governed by the Internal Revenue Code and the Treasury regulations, and is guided by many other IRS administrative materials, including revenue procedures, revenue rulings and the Internal Revenue Manual. The taxpayer has a heightened burden of proof to overcome a transfer pricing adjustment and must demonstrate that the IRS's determinations are arbitrary, capricious and unreasonable.

Disputing adjustments

18 | If the tax authority asserts a transfer pricing adjustment, what options does the taxpayer have to dispute the adjustment?

If the IRS asserts a transfer pricing adjustment, the taxpayer has a number of options for disputing it. First, the taxpayer may attempt to convince the examination team (or its management) that an adjustment is inappropriate. Next, the taxpayer is generally afforded an opportunity to attempt to resolve the case at the IRS Independent Office of Appeals, an independent administrative office. If applicable, the taxpayer may also seek competent authority relief, either in conjunction with or separate from appeals.

If the taxpayer is unable to resolve the dispute administratively, it has three main venues for seeking judicial review: the Tax Court (requiring a notice of deficiency but no prepayment), the district courts and the Court of Federal Claims (the latter two requiring payment of the adjustment and the assertion of a refund claim). Taxpayers typically pursue transfer pricing litigation in the Tax Court.

RELIEF FROM DOUBLE TAXATION**Tax-treaty network**

- 19 | Does the country have a comprehensive income tax treaty network? Do these treaties have effective mutual agreement procedures?

The United States has a comprehensive income tax treaty network with most European countries and many of its other major trading partners. There are some gaps in the US treaty network in Africa, Asia, the Middle East and South America. Brazil, Singapore and Taiwan are three examples of significant trading partners for which the United States does not have income tax treaties.

Requesting relief

- 20 | How can a taxpayer request relief from double taxation under the mutual agreement procedure of a tax treaty? Are there published procedures?

Procedures for competent authority assistance are set forth in Revenue Procedure 2015-40. These procedures become applicable when a taxpayer determines that the actions of the United States or a treaty country expose the taxpayer to potential double taxation. Taxpayers are encouraged to file a competent authority request promptly after a competent authority issue arises or is likely to arise.

When relief is available

- 21 | When may a taxpayer request assistance from the competent authority?

In the case of a US-initiated action, the US competent authority may be engaged as soon as the taxpayer receives a written communication of the amount of the adjustment (typically in a notice of proposed adjustment). Some US tax treaties contain specific timing requirements for competent authority requests.

Limits on relief

- 22 | Are there limitations on the type of relief that the competent authority will seek, both generally and in specific cases?

There are a number of limitations on the type of relief the competent authority will seek. If a taxpayer executes a closing agreement with the Internal Revenue Service on Form 870-AD, the US competent authority will only seek correlative relief from the applicable treaty country and will not undertake any actions that would change the determination of the US taxable income. Similarly, a taxpayer may file a competent authority request with respect to a US federal court's final determination of its tax liability, but only for the purpose of seeking correlative relief from the foreign competent authority.

Success rate

- 23 | How effective is the competent authority in obtaining relief from double taxation?

The US competent authority has a high success rate in obtaining relief from double taxation. According to data from the 2019 calendar year, the US competent authority resolved 81 per cent of transfer pricing cases by fully eliminating double taxation or fully resolving taxation not in accordance with a tax treaty and another 7 per cent of cases were granted unilateral relief. In 6 per cent of cases, the request was withdrawn by the taxpayer.

ADVANCE PRICING AGREEMENTS**Availability**

- 24 | Does the country have an advance pricing agreement (APA) programme? If so, is the programme widely used? Are unilateral, bilateral and multilateral APAs available?

The US APA programme allows for unilateral, bilateral and multilateral APAs. The Internal Revenue Service (IRS) prefers bilateral and multilateral APAs. If the taxpayer requests a unilateral APA, it must provide an explanation describing why a unilateral APA is appropriate.

According to data from the 2020 calendar year, taxpayers filed over 121 APAs that year (15 unilateral, 103 bilateral and three multilateral).

Process

- 25 | Describe the process for obtaining an APA, including a brief description of the submission requirements and any applicable user fees.

Taxpayers must initiate an APA request to include one or more covered issues that would apply to the proposed taxable years, including potential rollback years. All taxpayers that seek an APA with the IRS are required to file an APA request. The substantive requirements are outlined in Revenue Procedure 2015-41.

Typically, taxpayers are required to file a complete APA request, but in certain situations, a taxpayer may file an abbreviated APA request. Moreover, depending on the issues, some taxpayers are required to file a pre-filing memorandum and attend a pre-filing conference.

After receiving an APA request, the IRS will notify the taxpayer that the IRS has received the request and will typically hold an opening conference with the taxpayer. The IRS may also require the taxpayer to make presentations to the IRS and any foreign competent authorities, and it may require the taxpayer to provide additional information. If the IRS and the taxpayer agree that an APA should be approved, it will become effective when both the IRS and taxpayer sign it. Once executed, the APA is a binding agreement between the taxpayer and the IRS.

The user fee for an APA is US\$113,500. Small-case APAs are available to certain small businesses and have a lower user fee of US\$54,000.

Time frame

- 26 | How long does it typically take to obtain a unilateral and a bilateral APA?

According to data from the 2020 calendar year, new unilateral APAs were completed in an average of 36.2 months, and new bilateral APAs were completed in an average of 50.8 months.

Duration

- 27 | How many years can an APA cover prospectively? Are rollbacks available?

Although all cases are unique, typically, an APA will cover five or more years. At a minimum, the IRS will typically seek to set the APA term so there are at least three unexpired years remaining in the APA term upon the execution of the APA.

According to data from the 2020 calendar year, less than 10 per cent of APAs were approved for less than five years, while the longest APA approved that year had a term of 14 years. And while an APA is primarily a means to resolve prospective years, an APA may apply the covered methods to one or more earlier rollback years.

Scope

28 | What types of related-party transactions or issues can be covered by APAs?

The APA programme provides a voluntary process whereby the IRS and taxpayers may resolve transfer pricing issues, as well as issues for which transfer pricing principles may be relevant, in a principled and cooperative manner on a prospective basis. The transfer pricing issues can relate to intercompany transfers, the use of tangible or intangible property, intercompany services or loans/advances. The APA process is not available for addressing hypothetical or merely contemplated issues. The IRS may also require an APA to cover interrelated matters, especially when the taxpayer's proposed covered issues are most reliably evaluated together with other issues.

Independence

29 | Is the APA programme independent from the tax authority's examination function? Is it independent from the competent authority staff that handle other double tax cases?

The IRS operates the APA programme independent from its examination function. Thus, even though IRS examination personnel may participate during the APA process, the IRS APA team has ultimate authority to approve an APA. The same office of the IRS (the Advance Pricing and Mutual Agreement (APMA) office) handles both APAs and double tax cases.

Advantages and disadvantages

30 | What are the key advantages and disadvantages to obtaining an APA with the tax authority?

The main advantage of obtaining an APA is the certainty that it provides to the taxpayer and the IRS. An APA is a binding agreement and, absent fraud or similar malfeasance, for years covered in the APA term the IRS examination team will audit only to ensure the taxpayer's compliance with the APA's terms and conditions. An APA can, thus, alleviate issues that typically would require lengthy examinations and costly defence with both the IRS and foreign tax authorities.

The main disadvantage is the time and expense to obtain an APA, especially considering that the IRS may never examine or challenge the covered transaction in an examination.

SPECIAL TOPICS

Recharacterisation

31 | Is the tax authority generally required to respect the form of related-party transactions as actually structured? In what circumstances can the tax authority disregard or recharacterise related-party transactions?

The Internal Revenue Service (IRS) is generally required to respect the form of a related-party transaction as actually structured unless its structure lacks economic substance. Stated otherwise, even where a realistic alternative exists, the IRS generally will not restructure the transaction as if the alternative had been adopted by the taxpayer so long as the taxpayer's actual structure has economic substance.

If the taxpayer has a written agreement in place before the transactions are entered into, the IRS will generally respect it if its terms are consistent with the economic substance of the underlying transaction. If the taxpayer lacks contemporaneous written agreements, the IRS may impute a contractual agreement between the parties consistent with the economic substance of the transaction. US federal courts typically opt

to apply the more precise transfer pricing rules in lieu of disregarding transactions under the economic substance doctrine.

Selecting comparables

32 | What are some of the important factors that the tax authority takes into account in selecting and evaluating comparables? In particular, does the tax authority require the use of country-specific comparable companies, or are comparables from several jurisdictions acceptable?

The comparability of transactions and circumstances must be evaluated considering all factors that could affect prices or profits in arm's-length dealings. To be considered comparable to a controlled transaction, an uncontrolled transaction need not be identical to the controlled transaction, but it must be sufficiently similar that it provides a reliable measure of an arm's-length result.

The IRS typically conducts an analysis of the following factors to determine the comparability between the controlled and uncontrolled transactions:

- the functions performed, and associated resources employed, by the taxpayers in each transaction;
- significant contractual terms;
- significant risks that could affect the prices or profits;
- economic conditions that would affect the prices or profits; and
- comparison of the property or services transferred in the transactions.

The IRS typically requires the use of US-specific comparable companies, but it can include other North American companies.

Secret comparables

33 | What is the tax authority's position and practice with respect to secret comparables? If secret comparables are ever used, what procedures are in place to allow a taxpayer to defend its own transfer pricing position against the tax authority's position based on secret comparables?

Neither the IRS nor taxpayers may use secret comparables.

Secondary adjustments

34 | Are secondary transfer pricing adjustments required? What form do they take and what are their tax consequences? Are procedures available to obtain relief from the adverse tax consequences of certain secondary adjustments?

Secondary transfer pricing adjustments are required and may include correlative allocations and conforming adjustments. A correlative allocation is made in respect of other members of the group affected by the allocation. For example, if the IRS increases the income of one group member, it generally must decrease the income of another member.

Conforming adjustments must be made to conform a taxpayer's accounts to reflect transfer pricing allocations. The adjustments may include the treatment of an allocated amount as a dividend or a capital contribution. Those deemed dividend payments could be subject to withholding tax when paid. To avoid or mitigate those consequences, the IRS provided taxpayers relief in Revenue Procedure 99-32. Taxpayers may elect to treat the repatriation of cash as an interest-bearing account receivable or payable.

Non-deductible intercompany payments

35 | Are any categories of intercompany payments non-deductible?

The regulations do not make any intercompany payments non-deductible. However, a few provisions do potentially limit the deductibility of intercompany payments. One provision is section 163(j) of the Internal Revenue Code, which limits the deductibility of intercompany interest payments to 30 per cent of the adjusted taxable income.

As part of the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act), passed to address the covid-19 pandemic, Congress raised the limit on business interest deductions from 30 per cent to 50 per cent of adjusted taxable income for the tax years 2019 and 2020. Section 59A, the base erosion and anti-abuse tax (BEAT), may also potentially limit intercompany deductions. The BEAT is generally levied on certain large corporations that have deductions paid or accrued to foreign related parties that are greater than 3 per cent of their total deductions.

Anti-avoidance

36 | What legislative and regulatory initiatives (besides transfer pricing rules) have the government taken to combat tax avoidance with respect to related-party transactions? What are the penalties or other consequences for non-compliance with these anti-avoidance provisions?

As part of the Tax Cuts and Jobs Act, Congress enacted two initiatives to combat tax avoidance. The first, the BEAT, directly addresses related-party transactions. The BEAT is generally levied on certain large corporations that have deductions paid or accrued to foreign related parties that are greater than 3 per cent of their total deductions. Congress also enacted the global intangible low-taxed income regime, a global minimum tax. In general, US shareholders are taxed on extraordinary returns of most of a controlled foreign corporation's income. The regime sets a 10.5 per cent minimum tax rate on eligible taxpayers.

Location savings

37 | How are location savings and other location-specific attributes treated under the applicable transfer pricing rules? How are they treated by the tax authority in practice?

When conducting a comparability analysis between the uncontrolled and controlled transactions, location savings may need to be taken into account. If an uncontrolled taxpayer operates in a different geographic market than the controlled taxpayer, adjustments may be necessary to account for significant differences in costs attributable to the geographic markets. For example, the fact that the total costs of operating in a controlled manufacturer's geographic market are less than the total costs of operating in other markets ordinarily justifies higher profits to the manufacturer only if the cost differences would increase the profits of comparable uncontrolled manufacturers operating at arm's length, given the competitive positions of buyers and sellers in that market.

Further, the regulations permit taxpayers, in certain circumstances, to adopt temporary pricing strategies to enter new markets or increase a product's share of an existing market. However, even though the regulations allow for location savings, the IRS will typically closely scrutinise them.

Branches and permanent establishments

38 | How are profits attributed to a branch or permanent establishment (PE)? Does the tax authority treat the branch or PE as a functionally separate enterprise and apply arm's-length principles? If not, what other approach is applied?

Under the Model Income Tax Treaty, profits are attributed to a permanent establishment as if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account the functions performed, the assets used and the risks assumed by the enterprise through the permanent establishment and through the other parts of the enterprise.

Outside the treaty context, a foreign taxpayer is typically taxed on its income connected with the conduct of a trade or business in the United States. Whether a foreign taxpayer has a US trade or business requires a facts and circumstances analysis to determine whether the business activity in the United States is regular, continuous and considerable.

Exit charges

39 | Are any exit charges imposed on restructurings? How are they determined?

The regulations do not provide any exit charges on restructurings. However, if tangible or intangible property is transferred between related parties, or if services are provided, the regulations may apply, and the parties may be required to provide arm's-length compensation.

Outside transfer pricing, there are a number of other Internal Revenue Code provisions that prohibit tax-free exit transactions or that otherwise limit a taxpayer's ability to effectuate certain cross-border restructuring transactions. Individuals that exit the US tax system are subject to exit taxes.

Temporary exemptions and reductions

40 | Are temporary special tax exemptions or rate reductions provided through government bodies such as local industrial development boards?

The US government does not provide special tax exemptions or rate reductions. Numerous state and local governments offer tax exemptions and other tax incentives.

UPDATE AND TRENDS

Tax authority focus and BEPS

41 | What are the current issues of note and trends relating to transfer pricing in your country? Are there particular areas on which the taxing authority is focused? Have there been any notable legislative, administrative, enforcement or judicial developments? In particular, how is the OECD's project on base erosion and profit shifting affecting both policymakers and tax administrators?

In litigation, the Internal Revenue Service (IRS) continues to focus on the transfer of intangible property, with an emphasis on cost-sharing arrangements. In *Amazon.com, Inc v Commissioner*, the Ninth Circuit affirmed the Tax Court's opinion holding that the IRS abused its discretion in determining that the definition of 'intangibles' included certain non-enumerated items, such as goodwill and going-concern value. In *Altera Corp v Commissioner*, the IRS won its appeal regarding whether the IRS properly included stock-based compensation costs in the costs shared in a cost-sharing arrangement. In *Medtronic v Commissioner*, the Eighth Circuit reversed the Tax Court's decision and remanded for a decision; that remand trial commenced on 14 June 2021. In *The*

Coca-Cola Company v Commissioner, the Tax Court held that the IRS did not abuse its discretion by reallocating income using the comparable profits method. The IRS has also brought major transfer pricing cases relating to intangible assets against other major multinational enterprises (MNEs), such as Perrigo, Western Digital, Facebook and Microsoft.

On the regulatory front, the IRS has been busy issuing regulations related to the new Tax Cuts and Jobs Act (TCJA) provisions, such as the base erosion and anti-abuse tax (BEAT) and the global intangible low-taxed income (GILTI) regime.

The United States has also participated in the OECD's discussions on revamping the taxing rights of income generated from cross-border activities in the digital age. The OECD has developed two pillars to address the question of profit allocation and nexus rules and a global minimum tax rule. The United States has recently shown a willingness to participate in the negotiations for both pillars and the OECD is hoping to produce revised pillars for discussion in the next few months.

Coronavirus

42 | What emergency legislation, relief programmes and other initiatives specific to your practice area has your state implemented to address the pandemic? Have any existing government programmes, laws or regulations been amended to address these concerns? What best practices are advisable for clients?

On 27 March 2020, Congress overwhelmingly passed the Coronavirus Aid, Relief, and Economic Security Act (the CARES Act), which provides a US\$2 trillion economic stimulus and contains many major tax changes to help businesses and individuals. The CARES Act does not directly impact transfer pricing, but it has made a number of significant tax changes that impact most MNEs, including the following.

Temporary suspension of net operating loss limits and increased carry-back periods

The CARES Act temporarily repeals the 80 per cent of taxable income limitation on the utilisation of net operating loss (NOL) carry-overs imposed by the TCJA. In addition, taxpayers may now carry back NOLs arising in 2018, 2019 and 2020 to the taxpayer's five preceding taxable years. Taxpayers with losses generated during their 2018, 2019 and 2020 tax years, and taxable income in their preceding five tax years (carry-back years), can file amended income tax returns in the carry-back years to receive refunds. For carry-backs to pre-2018 tax years, corporations may obtain refunds of taxes paid at the pre-TCJA corporate rate of 35 per cent.

Increase of the limitation on deductible business interest

Under the CARES Act, for tax years beginning in 2019 and 2020, the limitation on deductible business interest expense under section 163(j) of the Internal Revenue Code is increased. Rather than using 30 per cent of the taxpayer's adjusted taxable income (ATI) for the year in the formula to compute allowable interest, the taxpayer may use 50 per cent of the ATI. Taxpayers may elect out of using this increased ATI limit for an eligible taxable year.

Reduction of the applicable recovery period for qualified improvement property

As enacted in 2017, the TCJA contained a drafting error that subjected qualified improvement property (such as interior improvements to retail stores and restaurants) to a 39-year recovery period instead of the 15-year recovery period intended by Congress. The CARES Act corrects this 'retail glitch' by shortening the recovery period for qualified improvement property to 15 years. These technical amendments

Morgan Lewis

Wendy Abkin

wendy.abkin@morganlewis.com

Barton W S Bassett

barton.bassett@morganlewis.com

Sanford W Stark

sanford.stark@morganlewis.com

Drew A Cummings

drew.cummings@morganlewis.com

1701 Market Street
Philadelphia, 19103
United States
Tel: +1 215 963 5000
www.morganlewis.com

make qualified improvement property eligible for bonus depreciation. Further, the technical amendments are permanent and take effect as if included in section 13204 of the TCJA.

The Consolidated Appropriations Act 2021

Another coronavirus relief bill – the Consolidated Appropriations Act 2021, which includes the Taxpayer Certainty and Disaster Tax Relief Act 2020 – was signed into law on 27 December 2020. The Act not only contains tax provisions to provide direct relief to individuals, but also includes tax benefits for various industries, including the green energy and technology industries.

The American Rescue Plan Act 2021

Finally, President Biden signed the American Rescue Plan Act 2021 on 11 March 2021, which provides \$1.9 trillion in relief funds across a broad spectrum of categories, including additional support for vaccine distribution, school reopenings, small business grants, tax credits, pension funds, unemployment support, health benefits and homeowner assistance. Broadly speaking, the bill includes multiple tax-relevant provisions, including but not limited to making the first \$10,200 in 2020 unemployment insurance benefits received by qualifying taxpayers non-taxable, a temporary expansion and increase of the child tax credit and an expansion of the employee retention credit to new small businesses.

The rules provided above related to the pandemic are subject to change, and we recommend reviewing the most recent guidance on the IRS's website and its 'Coronavirus Tax Relief and Economic Impact Payments' page.



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