



Overview

Alvarez & Marsal Tax, LLC, Taxand USA

Taxand USA provides a full suite of transfer pricing advisory services, that includes such diverse activities as intellectual property valuations, supply chain planning, compliance documentation, benchmarking of core functions, and debt capacity and interest rate analyses. Taxand USA's transfer pricing advisory engagements highlight a broad spectrum of analysis, such as:

- ❖ Merger integration planning and documentation to combine the global transfer pricing policies of the combined entities,
- ❖ Assisting MNEs in tax controversy matters with the U.S. Internal Revenue Service ("IRS"), including to obtain unilateral and bilateral APAs and MAP agreements,
- ❖ Conducting planning and valuation analyses for the future development and exploitation of intellectual property,
- ❖ Preparing global compliance documentation,
- ❖ Providing buy-side and sell-side due diligence services and assessment of risks in anticipation of a company's life-event, and
- ❖ Establishing global intercompany financial arrangements and support for debt instruments.

General: Transfer Pricing Framework

Transfer pricing legislation is governed by Section 482 of the US Internal Revenue Code of 1986 ("IRC"), as amended, and the US Treasury Regulations issued thereunder (the "482 Regulations"). Consistent with the 482 Regulations, transactions between related parties must take place on an arm's-length basis. The phrase related party refers to any two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the US, and whether or not affiliated) owned or controlled directly or indirectly by the same interests. Although most commonly applied to transactions with foreign affiliates, Section 482 also applies to U.S. domestic transactions among entities under common control.

Accepted Transfer Pricing Methodologies

The OECD Guidelines are not incorporated into U.S. legislation, however the transfer pricing methods described in the 482 Regulations are substantially similar and, notably, center on the arm's length principle. There is also no explicit hierarchy of transfer pricing methods, as the "best method" rule requires that a transfer pricing method is selected that provides for most reliable assessment of the arm's length dealing.

In applying the best method rule, the taxpayer is allowed to apply any other method as long as it can be demonstrated that it leads to an arm's length outcome. The most frequently used method is the Comparable Profits Method ("CPM"), which is commonly applied as a functional equivalent to the TNMM under the OECD Guidelines.

The 482 Regulations provide for specific methods to be applied under certain circumstances, including:

- ❖ Use of the Services Cost Method ("SCM") when pricing routine services transactions at cost (see Treas. Reg. 1.482-9);
- ❖ For valuation of platform contributions and implementation of a Cost Sharing Arrangement ("CSA") (see Treas. Reg. 1.482-7); and
- ❖ With respect to financial transactions (see Treas. Reg. 1.482-2).

Transfer Pricing Documentation Requirements

Transfer pricing documentation guidelines are issued under U.S. Treasury Regulation Section 1.6662-6(d) ("6662 Regulations"). Taxpayers are not specifically required to prepare annual documentation and are not required to file this with the local tax authority. Taxpayers that maintain contemporaneous documentation, that is transfer pricing documentation prepared in advance of the corporate income tax filing deadline for the relevant financial period, are eligible for penalty relief in the event of a net transfer pricing adjustment. These regulations also set out the information requirements for the documentation.

Although the OECD Guidelines are not directly adopted by the 482 Regulations, the documentation requirements are substantially similar. Accordingly, there is no specific requirement to prepare a Master File, but this is commonly done by U.S. headquartered companies to align with the requirements in countries that do more directly follow the OECD Guidelines.

There are no specific thresholds for Section 482 or the 6662 Regulations to apply.

Filing of a country-by-country report on Form 8975 is required for MNE's that exceed the \$850 million annual revenue threshold. Filing of a country-by-country report is only required if the ultimate parent entity or the surrogate parent entity is tax-resident in the U.S.

Local Jurisdiction Benchmarks

The 482 Regulations establish comparability criteria to be followed, whether applying the CPM, CUP or another method. When the CPM is selected as the best method, a benchmark is expected in most cases to demonstrate that related party transactions are at arm's length. The IRS prefers North American benchmarks when evaluating a tested party based in the U.S. As the data used must be publicly available and replicable by the IRS, in practice it is most common to use exchange-listed companies for benchmarks. The 482 Regulations allow for use of multiple year data and the interquartile range in terms of benchmarking.

Although a financial refresh is to be conducted every year for full compliance with the documentation requirements to test the results of the intercompany transactions against the comparable data for the tested period, in practice most



taxpayers do not undertake a full update of their benchmark searches on an annual basis. In cases when a business activity does not undergo significant changes, a search can be updated in full every few years.

Advance Pricing Agreement “APA”/Bilateral Advance Pricing Agreement “BAPA” Overview

The U.S. has a long history of resolving transfer pricing matters through APA, whether as a unilateral or as a BAPA, and MAP cases. The IRS does have a preference for BAPA, as this generally provides for a stronger case file to have another treaty partner involved with the matter and to remove at least some possibility that the terms of the APA will be challenged by a foreign tax authority in the future. The IRS publishes and regularly updates the Revenue Procedures applicable to APA and MAP cases. The Revenue Procedures set out the requirement to request such a ruling, the procedures by which the cases will be handled, and the amount of user fees to be paid for seeking the respective form of relief.

The typical APA/BAPA has a term of five (5) years and may under certain circumstances be “rolled back” to previous tax years where the statute of limitations remains open. The IRS is also typically open to a longer total APA term, seeking to have a few years of prospective application once the APA is fully negotiated and finalized.

Transfer Pricing Audits

The IRS conducts audit examinations at random and all companies are subject to audit for any open period. The ordinary statute of limitations period is three years. Under current guidance, when an MNE is audited, the transfer pricing reports are to be requested under the first Information Document Request (“IDR”). The transfer pricing documentation is then to be presented within thirty (30) days, and thus also why in practice it is important to maintain regular documentation.

Transfer Pricing Penalties

There is no specific penalty for the non-preparation of transfer pricing documentation, but rather the existence of contemporaneous documentation serves to abate general tax penalties that may result from a transfer pricing adjustment upon an audit by the IRS. The actual computation of any tax penalty is complex and largely depends upon the quantum of the adjustment.

Local Hot Topics and Recent Updates

The IRS continues to actively audit and litigate cases involving intangible property transactions. These tend to focus quite heavily on CSAs and in particular the valuation ascribed to any Platform Contribution Transaction that may be required upon making existing intellectual property available to the CSA for further development (the “PCT” payment). There are a number of recent or pending court cases involving some of the largest U.S. companies and intercompany transactions entered into by them for the development and exploitation of intangible property.

Another area for multinational enterprises to be aware of is the potential for transfer pricing audits at the individual state level. Although tax audits undertaken by the IRS at the federal level garner the most attention, transfer pricing rules are also generally applicable for establishing arm’s length profits reported in the U.S. states where a company does business. The U.S. states have been engaging third-party vendors to enhance their technology capabilities to better identify potential audit candidates and to support with benchmarking analyses to support adjustments. This continues to be a developing area of interest for states, as they seek to collect the appropriate taxes in their jurisdiction attributable to the activities undertaken there.

UNITED STATES



Documentation threshold

| | |
|-------------|-------------------|
| Master file | N/A |
| Local file | N/A |
| CbCR | USD \$850 million |

Submission deadline

| | |
|-------------|--|
| Master file | N/A – there is no requirement to submit transfer pricing documentation in the ordinary course. |
| Local file | N/A |
| CbCR | Included with the corporate income tax filing for the relevant tax year. |

Penalty Provisions

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|---|---|
| Documentation – late filing provision | N/A |
| Tax return disclosure – late/incomplete/no filing | Late or non-filing of Form 5471/5472, the international informational return submitted with the CIT, is subject to a fine of \$25,000 per Form 5472 (one form to be submitted for each foreign affiliate) and \$10,000 per Form 5471. |
| CbCR – late/incomplete/no filing | This follows the general tax records penalty regime. |



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