Peters Advisors
TRANSFER PRICING • TAX VALUATION

Developments in Transfer Pricing

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Richard Goldberg
RG Transfer Pricing Solutions

richard.goldberg@rgtps.com
(973) 224 4917
http://www.rgtps.com

Andrew Weaver
Peters Advisors

andrew.weaver@petersadvisors.com
(347) 501 2111
http://www.petersadvisors.com

Developments in Transfer Pricing - Agenda

I. Overview

II. Current Transfer Pricing Environment

III. Latest Developments in Transfer Pricing

IV. Identifying Risks Associated with Transfer Pricing Initiatives

V. Reducing Taxes and Avoiding Controversy

VI. Tax Planning Steps To Save Money Now and in the Future

I. Transfer Pricing – An Overview

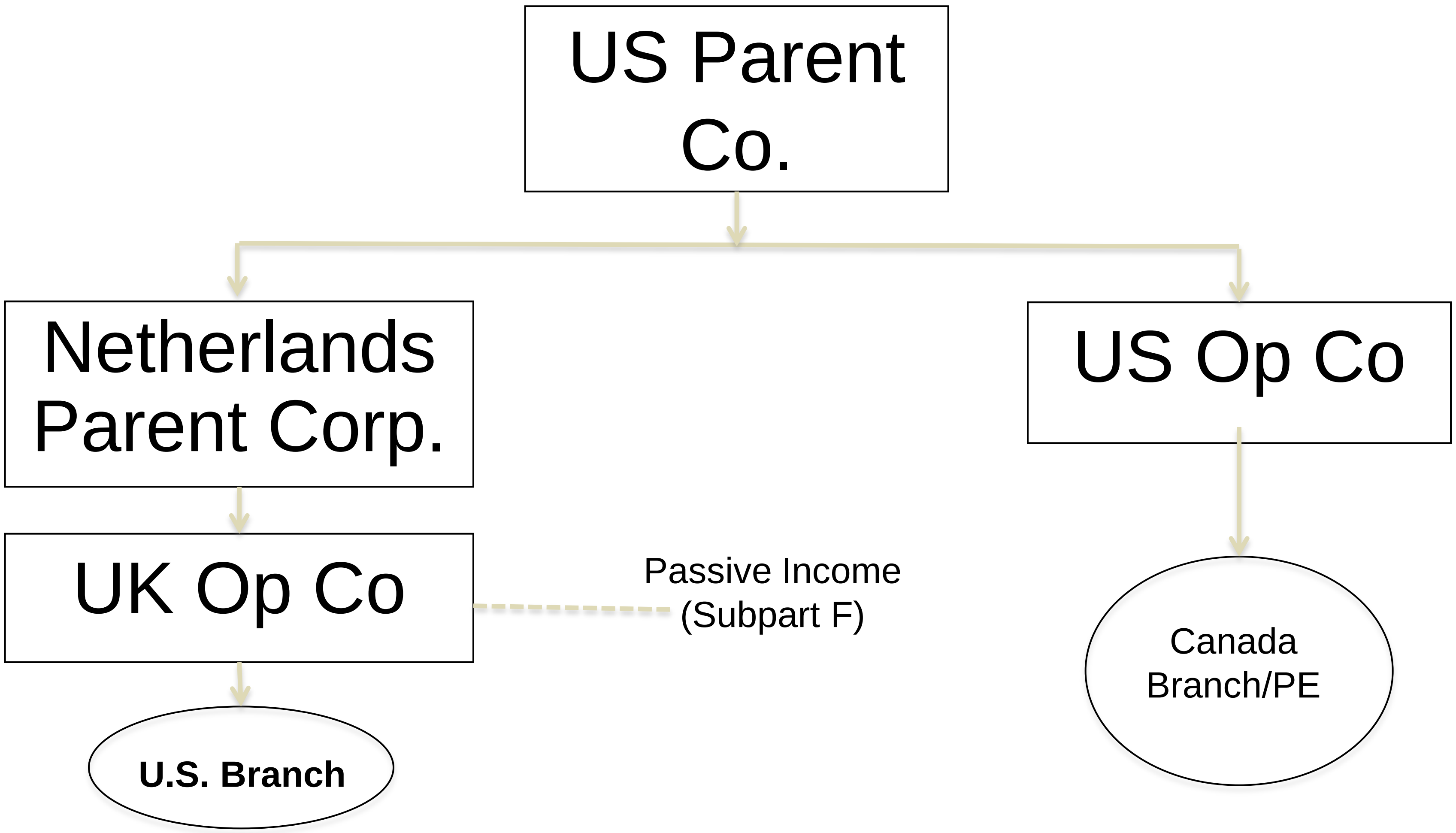
Multinational Corporations ("MNCs") are subject to income tax imposions based upon:

- Country of Residence
- Permanent Establishment ("PE") of a Non-Resident Company
- Withholding Remittances by Payer to Country of Source of Income (Interest, Dividends, Royalties, Technical Services)

- OR -

- Controlled Foreign Corporation ("CFC") Rules

I. Transfer Pricing – An Overview
Taxation Illustration



Components of a typical transfer pricing documentation study:

- Corporate and Business Overview
- Intercompany (Controlled) Transaction Review
- Functional/Risk Analysis
- Transfer Pricing Method Selection
- Economic Analysis

Permissable Transfer Pricing Methods

Traditional Transaction Methods:

A. Comparable Uncontrolled Transaction/Price (CUT/CUP) Method

B. Resale Price Method

C. Cost Plus Method

Transactional Profit Methods:

A. Comparable Profits Method/Transactional Net Margin Method (CPM/TNMM)

B. Transactional Profit Split Method

Illustration of Impact of Applying Different TP Methods

Fact Pattern:

- India Subsidiary provides customer support services on behalf of its Parent company, a US credit card issuer
- Transfer Price: Cost plus 10% (TNMM)
- India Tax Authority concludes on audit that Profit Split Method based on cost of services is more appropriate. Additional profit attribution of $74MM ((320MM * 200MM/680MM)-20).

	USD (in millions)
US CreditCard Business	
Revenue	1,000
Customer Svcs Costs	(220)
Other Costs	(480)
Profit	300
India Customer Svcs Center	
Revenue (Cost plus 10%)	220
Costs	(200)
Profit	20

II. Current Transfer Pricing Environment

Major Themes

- Increased Globalization of Business
- Disaggregation of Products and Services
- Focus on Tax Efficient Structuring and Planning
  - IP Migrations
  - Creative Use of Transfer Pricing Methodologies (“Transfer Mispricing”)
- Developing Countries Flexing Their Muscles
- Lag of Tax Law Modernization
  - Digital Economy Tax Loopholes
- Stakeholders (CFO, VP Tax) Face New Challenges
  - Transfer Pricing Exposures Pose Material Financial Statement Implications

Representative Financial Statement Disclosures:

Ingersoll-Rand

Ingersoll-Rand, an industrial company based in Dublin, reported in a June Form 8-K that it may owe between $400 million and $700 million in additional withholding and income taxes resulting from an IRS audit of the company's 2003-2006 tax years. The amount at issue concerns interest payments on intercompany debt issued in connection with Ingersoll-Rand's reincorporation in Bermuda. The company said it intends to continue to contest all proposed adjustments.

Jurisdiction(s): Bermuda, United States. Tax Analysts (July 29, 2013)

Dell Inc.

Dell Inc., a multinational computer technology corporation headquartered in Round Rock, Texas, reported in its June Form 10-Q that it is contesting proposed assessments issued by the IRS for tax years 2004-2006, primarily for transfer pricing matters. It said an unfavorable outcome could have a material effect on its operations, financial position, and cash flow.

Jurisdiction(s): United States. Tax Analysts (July 1, 2013)

Cardinal Health Cardinal Health, a healthcare services company, reported in its February 10-Q that it is contesting IRS-proposed additional taxes of $849 million regarding transfer pricing arrangements between foreign and domestic subsidiaries and the transfer of intellectual property among subsidiaries of an acquired entity that occurred before Cardinal Health's acquisition of that entity. The adjustment concerns fiscal years 2003 through 2007. The company states that CareFusion Corp., which was created in a spinoff from Cardinal Health in 2009, would be liable for $592 million of any tax paid under a tax matters agreement entered into in connection with the spinoff. Cardinal Health has accounted for the unrecognized tax benefits connected to the dispute.

Jurisdiction(s): United States, undisclosed. Tax Analysts (March 4, 2013)

III. Latest Developments in Transfer Pricing

Shifting Priorities

- MNC’s Focusing More Attention Beyond Effective Tax Rate (“ETR”) Optimization
- Transfer Pricing Risk Management Now a Top Priority
  - Good Corporate Governance (Agreements and Policies)
  - Intercompany Account Integrity and Data Granularity
  - “Permanent Establishment” Risk Mitigation
  - Timely and Cost Effective Resolution of Transfer Pricing Audit Issues
- The Organization for Economic Cooperation and Development’s (OECD’s) Base Erosion and Profit Shifting (BEPS) Initiative Poses Unprecedented Implications for Multinationals
- United Nations is now a Competing Player to OECD

OECD BEPs Action Plan

BASE EROSION AND PROFIT SHIFTING (BEPS) ACTION PLAN ITEM-BY-ITEM DESCRIPTION					
BEPS Action Description	**Targeted revisions to OECD Model Tax Convention**	**Targeted revisions to domestic tax rules**	**Targeted revisions to OECD Transfer Pricing Guidelines**	**Address VAT Avoidance in "Source" Country**	**Expected Output and Timing**
Jurisdiction to Tax:					
Digital Economy Issues (Action Item 1)	May expand scope of Permanent Establishment definition	Maybe	Maybe	Yes	Dedicated task force will issue a report identifying issues and possible actions to address (Sept. 2014)
Establish International Coherence of corporate income taxation					
Neutralize effects of hybrid instrument or entity mismatch arrangements (Action Item 2). More broadly, OECD will also make recommendations regarding model treaty provisions and the design of domestic tax rules to prevent the granting of treaty benefits in inappropriate circumstances. (Action Item 6).	Yes	Yes			Changes to OECD Model Treaty and recommendations regarding the design of domestic tax rules (Sept. 2014)
Strengthen CFC rules (Action Item 3)		Yes			Recommendations regarding the design of domestic rules (Sept. 2015)
Limit Base Erosion through the use of interest deductions and other financial payments (Action Item 4)		Yes (Recommendations by Sept. 2015)	Yes (Changes to be made by Dec. 2015)		Recommendations regarding best practices to eliminate BE through use of excessive interest deductions, pricing of related party financial transactions, including guarantees, internal derivatives used in internal bank dealings and captive and other insurance arrangements. (multiple dates)

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Establish International Coherence of corporate income taxation					
Revamp the work to counter harmful tax practices more effectively, improve transparency and substance (Action Item 5)	Yes	Yes			Finalize the review on member country regimes (Sept. 2014). Strategy to expand participation to non-OECD members (Sept. 2015). Revision of existing criteria (Dec. 2015)
Prevent the artificial avoidance of Permanent Establishment status through commissionaire arrangements and specific activity (e.g., preparatory and ancillary) exemptions. (Action Item 7)	Yes				Changes to the Model Tax Convention (Sept. 2015)
Develop rules to prevent BEPS by moving intangibles among group members by (i) broad and clear definition of "intangible", (ii) ensure intangible related profits allocated in accordance with "value creation"; (iii) develop TP rules or "special measures" for transfers of hard to value intangibles; and (iv) update guidance on cost contribution arrangements. (Action Item 8)	Maybe	Yes	Yes		Changes to TP Guidelines and possibly to Model Tax Convention (Sept. 2014, Sept. 2015).
Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or "special measures" to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. (Action Item 9)	Maybe		Yes		Changes to TP Guidelines and possibly to Model Tax Convention (Sept. 2015).

OECD BEPs Action Plan

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Establish International Coherence of corporate income taxation					
Develop rules to prevent BEPS by engaging in transactions not or rarely occurring between third parties. This will involve adopting TP or "special measures" to (i) clarify the circumstances in which transactions can be recharacterised; (ii) clarifying the application of TP methods; and (iii) provide protection against common types of base eroding payments, such as management fees and head office expenses. (Action Item 10)	Maybe		Yes		Changes to TP Guidelines and possibly to Model Tax Convention (Sept. 2015).
Ensuring Transparency While Promoting Increased Certainty and Predictability					
Establish methodologies to collect and analyse data on BEPS and the actions to address it. (Action Item 11)					Recommendations regarding data to be collected and methodologies to analyse them. (Sept. 2015)
Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures. (Action Item 12)		Yes			Recommendations regarding the design of domestic rules. (Sept. 2015)
Re-examine TP documentation by developing rules to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules will include a requirement that multinational enterprises provide all relevant governments with needed informaiton on their global allocation of income, economic activity and taxes paid among countries according to a "common template". (Action Item 13)		Yes	Yes		Changes to the TP Guidelines and recommendations regarding the design of domestic rules. (Sept. 2014)

OECD BEPs Action Plan

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Ensuring Transparency While Promoting Increased Certainty and Predictability					
Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under the Tax Treaty Mutual Agreement (aka. Competent Authority) Provision, including the arbitration provisions. (Action Item 14)	Yes				Changes to the Model Tax Convention (Sept. 2015)
From Agreed Policies to Tax Rules: The Need for a Swift Implementation of the Measures					
Develop an innovative way to implement the measures resulting from the work on the BEPS Action Plan by creating a multilateral instrument to amend specific provisions of Bi-Lateral Treaties currently in force. (Action Item 15)					Report identifying relevant public international law and tax issues. (Sept. 2014) Develop a multilateral instrument. (Dec. 2015)
IRS Circular 230 Disclaimer: To the extent that this document and/or attachment is considered as containing any U.S. federal tax advice, this communication is not intended or written to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to another party any transaction or matter addressed herein.					

III. Latest Developments in Transfer Pricing
United Nations

- Practical Manual on Transfer Pricing for Developing Countries (the "UN TP Manual") adopted by the UN Committee of Experts on International Cooperation in Tax Matters in October 2012
    - Written from a "Developing Country" perspective for Developing Country Tax Administrators;
    - Includes a Chapter on Transfer Pricing Country Practices in Brazil, China, India and South Africa written by representatives of these countries.
    - China's Chapter, for example, refers to Location Specific Advantages:
        - Profit split method as a possible solution to lack of local comparable transactions or Chinese market premium (unique qualities impacting on sale and demand for products and services in China);
        - Adjustment to mark up (but not to full cost) to reflect location cost savings in China;
        - Specifically ascribes a "global formulary apportionment approach for limited risk (toll or contract) electronics manufacturing in China.
- 25 Member UN Committee on Experts was reconstituted with a term expiring on June 30, 2017. Most members from developing countries. Met on Oct. 21-25, 2013 in Geneva.

III. Latest Developments in Transfer Pricing

Highlights of Recent Cases and Other Developments

- **3M vs. Commissioner:** Tax Court Petition filed March 2013. Issue in case: Is IRS permitted by Regulation to impose arm's length taxable income adjustment where foreign country (e.g., Brazil) prohibits payment of royalties from Brazilian subsidiary to U.S. parent company.

- **Altera vs. Commissioner**: Taxpayer challenging validity of IRS 2003 Cost Sharing Regulations explictly including cost of equity compensation in cost base.

- **2013 India Companies Act**. requires Directors of Indian companies to sign off in advance if "non-arm's length" pricing of related party transactions;

- **Proposed Mexican tax legislation**. Would prohibit deductions for cross-border payments to related parties taxed at effective rate less than 75% of Mexican tax rate.

News Coverage of Transfer Pricing Concepts

- Resulting from US Economic Environment
- Top Global Companies Paying Little US Tax
  - Avoidance vs Evasion
- Significant Financial Risks
- New Dimension of Reputational Risk

Identifying Risks

- Determining Likelihood of Audit/Scrutiny
- OECD Handbook for Risk Assessment
  - Risk Factors: Recurring transactions, Large/Complex one-time transactions, Transactions with related parties in low-tax jurisdictions, Substantial or disproportionate income in low-tax jurisdictions, Business restructurings, Commissionaires or limited-risk marketers, manufacturers, or researchers
- Country-specific Risk Assessment
  - Brazil, Russia, India, China
- Reputational / Franchise Risk

Best Practices to Consider

- Headquarter ("HQ") Expense Allocations:
  - Invest the time and effort to prepare robust qualitative descriptions establishing that either benefit test met or shareholder/non-beneficial criteria met;
  - Consider separate country-specific qualitative description supplements (Mexico, Korea, France, Germany, India)
  - Document countries with central bank exchange controls, regulatory restrictions or deductibility limitations
- Evaluate arm's length pricing of intercompany loans and internal guarantee transactions if material;
- Available Treaty Mutual Agreement Procedures; and
- Consider VAT Implications when Making Transfer Pricing Decisions.

V. Reducing Taxes and Avoiding Controversy

Best Practices to Consider (continued)

- Implement Permanent Establishment Guidelines (Services, Business Travellers, Subcontractors)(especially India, Italy, Germany, China, UK, Canada);
- Consider Preparing Contemporaneous Transfer Pricing Documentation for more aggressive countries even if not mandatory; and
- Ensure that financial data in tax return transfer pricing activity disclosure forms reconcile to source books and records.

Steps to Save the Organization Money Now and In the Future

- Participate in Industry Tax Associations (TEI, USCIB, SIFMA, etc.) and network with peers;
- Consider Advanced Pricing Agreements ("APA");
- Enhanced Engagement with tax authorities; and
- Monitor Country-by-Country Reporting, PE expansion, and Other BEPS initiatives to be ready to respond.

THANK YOU!

Richard Goldberg Biography

Richard Goldberg
Phone: +1 (973) 224-4917
Email: Richard.goldberg@rgtps.com
richard.goldberg@petersadvisors.com

www.rgtps.com
www.petersadvisors.com

Rich Goldberg is the owner and manager of RG Transfer Pricing Solutions LLC, an independent transfer pricing consulting firm dedicated to improving business' bottom lines through strategic tax planning and tax risk mitigation. Rich is also affiliated with Peters Advisors as a Senior Advisor. Rich has practiced transfer pricing since 1999.

During the immediately preceding twenty year period, Rich advised on various aspects of international, federal, and state & local income taxation as a member of the Corporate Tax Department of Citigroup Inc. and its legacy Salomon Smith Barney, Salomon Brothers and Phibro affiliates.

For the ten most recent years, Rich was the Director of Global Transfer Pricing of Citi. As such, Rich had global responsibility for transfer pricing matters across all Business Segments of Citi. Citi has approximately 200 million customer accounts and does business in more than 160 countries and jurisdictions. Outside the U.S., Citi typically operates through multiple entities in each jurisdiction, including both locally incorporated subsidiaries and foreign branches of Citibank, N.A., its primary bank affiliate.

Citi's cross-border activities include intercompany and inter-branch funding, administrative support, operations and technology services, and business unit specific activities (e.g., global trading, investment banking, product sales, relationship management, treasury and trade solutions services, consumer banking, and securities and fund services). Rich's responsibilities included transfer pricing governance, planning, documentation and audits/controversies.

Rich graduated an Honors Scholar in Accounting from the University of Connecticut and also earned a Juris Doctor there. Rich also received an LLM in Taxation from New York University. Rich is admitted as an Attorney and is a Certified Public Accountant.

Rich actively participates in various USCIB Tax Committee initiatives, including the work of the USCIB to influence tax policy issues that are before the Organization of Economic Cooperation and Development (OECD), most importantly the OECD's ongoing Base Erosion and Profit Shifting (BEPS) initiative.

Andrew Weaver Biography

Andrew Weaver
Phone: +1 (347) 501-2111
Email: andrew.weaver@petersadvisors.com
www.petersadvisors.com

Andrew Weaver has practiced transfer pricing since 2006. Andrew has spent the majority of his time as a consultant and advisor for Duff & Phelps and Thomson Reuters, providing transfer pricing services to clients in a wide range of industries, including pharmaceuticals, medical devices, household and personal care products, automotive, industrial products, and computer software and technology.

Andrew has managed transfer pricing engagements and produced results on a range of projects focusing primarily on implementing global transfer pricing policy, operational transfer pricing, optimizing strategic tax planning, and conducting intangible property valuations.

Andrew has developed an expertise in the global transfer pricing software and technology landscape, spending several years as a Product Manager for Thomson Reuters. In this role, Andrew lead data strategy initiatives and applied a market-driven approach to create industry-leading transfer pricing software products. With these experiences, Andrew also gained expertise in the global financial data environment from both a public and private data perspective. As a result of working closely with governments and tax authorities, accounting firms, and multinational corporations, Andrew has built a strong understanding the unique needs of each sector of the transfer pricing industry.

Andrew holds a BA from Rutgers University.