



Insights: Transfer Pricing

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In this year-end edition of *Insights: Transfer Pricing*, we highlight the work of our Transfer Pricing Practice in 2019. Additionally, we provide a recap of the 2019 transfer pricing landscape and focus on transfer pricing hot topics: taxation of the digital economy, the Organisation for Economic Co-operation and Development's (OECD's) Unified Approach, and what lies ahead in 2020.

Our consulting work: a year in review

Our consultants help clients navigate every phase of implementing and supporting international tax structures including: intellectual property (IP) and acquisition planning, documentation, and audit defense. We also provide litigation support and expert testimony services in tax and transfer pricing litigation. We highlight some of our 2019 projects below.

Planning

While the OECD continued to work on BEPS 2.0 and countries updated their transfer pricing regulations, we conducted IP restructuring work for our clients in various jurisdictions including those onshoring their IP to Ireland due to changes in the Irish tax law. These engagements involved the valuation of complex IP for clients in a variety of industries. The methodologies our transfer pricing consultants used were specifically tailored to each respective client, the industry issues they faced, and the specific facts and circumstances of each transaction. We are keeping apprised of the ongoing OECD Unified Approach and its implications on future transfer pricing.

Documentation

With our strong and up-to-date knowledge of global regulatory requirements, we have helped our clients meet their global transfer pricing documentation obligations. We migrated clients to different forms of documentation to meet the changing compliance landscape, assisted with Country-by-Country Reporting (CbCR) compliance, Local File and Master File development, as well as regional form submissions.

Audit defense

CRA's transfer pricing consultants successfully defended IP valuations or IP migrations and international tax structures under audit by the IRS and tax authorities around the world. In 2019, we assisted clients with transfer pricing audits for cases in Australia, Canada, Denmark, France, Germany, Italy, the UK, and the US, as well as with state and local tax (SALT) matters.

Litigation consulting

CRA consultants assisted counsel and their clients facing litigation involving tax and transfer pricing disputes. Our 2019 work on high profile cases involved understanding complex industries and complicated issues related to tax reporting, cost sharing, IP valuations, and other transfer pricing matters.

A recap of regulations/guidance and litigation

With BEPS 1.0 in place, many countries have already adopted country-by-country reporting, master file / local file, or revised transfer pricing documentation standards. Taxpayers continue to restructure their operations, especially since Ireland implemented its new transfer pricing regulations. 2019 also saw continued discussions and developments related to the taxation of the digital economy, with some governments pre-emptively implementing their own digital taxation policies.

Additionally, new transfer pricing regulations and guidance continued to be issued in 2019. CRA maintains an up-to-date reference guide of global TP regulations which is found at here:

<http://www.crai.com/service/transfer-pricing/beps-action-13-implementation-and-global-transfer-pricing-documentation>.

Key IRS news and regulation

US – IRS	
February 2019	IRS Advance Pricing and Mutual Agreement program developed a “functional cost diagnostic model” to facilitate its review of advance pricing agreement requests. Section 59A states that services eligible for the services cost method (SCM) are exempted from base erosion and anti-abuse tax (BEAT).
March 2019	IRS released Advance Pricing Agreements (APA) statistics of 2018.
April 2019	IRS added three campaigns related to: (1) Captive services providers; (2) Offshore private banking; and (3) Loose-filed Forms 5471.
June 2019	IRS issued an updated directive on Reasonably Anticipated Benefits (RAB) in cost-sharing arrangements (i.e., that stock based compensation (SBC) should be included in cost-sharing arrangements). This directive replaced one issued in 2018.
December 2019	The US Treasury Secretary issued a letter to the OECD that opposed digital services tax initiatives proposed by the OECD, but showed support for Pillar One.

Key OECD projects/transfer pricing guidelines

OECD	
January 2019	Release of Policy Note to address tax challenges of the digitalization of the economy
February 2019	Public consultation document to address tax challenges of the digitalization of the economy
May 2019	Programme of Work adopted by the Inclusive Framework on BEPS.
July 2019	OECD and Brazil share outcomes of project to align Brazil's transfer pricing rules to OECD standard.
October 2019	OECD invites public input on the Secretariat Proposal for a "Unified Approach" under Pillar One.
September 2019	Platform for Collaboration on Tax invites comments on a draft tool kit designed to help developing countries with the implementation of transfer pricing documentation requirements.
November 2019	OECD releases further guidance for tax administrations and MNE Groups on Country-by-Country reporting. Public consultation meeting on the Secretariat Proposal for a "Unified Approach" under Pillar One
December 2019	Transfer Pricing in Brazil: Towards Convergence with the OECD Standard Public consultation meeting on the Global Anti-Base Erosion (GloBE) Proposal - Pillar Two

Litigation

Transfer pricing litigation in 2019 involved issues such as the use of transactional net margin method (TNMM), the degree of comparability needed for the comparable uncontrolled price (CUP) method, intercompany financing, and state aid, among other issues. We highlight notable cases below.

North America

Case	Issue	Status
United States		
SIH Partners LLLP (US Court of Appeals Third Circuit)	SIH Partners LLLP disputed that its US subsidiary, a shareholder of two controlled foreign corporations (CFCs), did not need to include the CFCs' income in its taxable income. The two CFCs made guaranteed loans (and received income from these loans). SIH Partners LLLP attempted to invalidate the applicable regulation, Section 956.	On March 8, 2019, the Court of Appeals confirmed the Tax Court's ruling that foreign corporation guarantees of margin loans are taxable.
Altera Corp (US Court of Appeals Ninth Circuit)	Altera excluded stock-based compensation expenses in the costs shared under its cost-sharing agreement (CSA). The IRS asserted that stock option compensation costs should be shared under a CSA.	On June 7, 2019, the Court of Appeals determined that stock option costs should have been included in CSAs. On November 11, 2019, the taxpayer's motion for an additional hearing was denied.
Amazon (US Court of Appeals Ninth Circuit)	The IRS appealed a tax court decision related to a cost-sharing agreement that involved Amazon's transfer of IP to a European subsidiary.	On August 16, 2019, the Court of Appeals ruled in favor of Amazon and concluded that definition of an intangible does not include residual business assets (e.g., the culture of innovation, the value of workforce, etc.) and is limited to include only independently transferrable assets.

Europe

Case	Issue	Status
Denmark		
Microsoft Denmark (Danish Supreme Court)	The Danish tax authorities considered that Microsoft Denmark's remuneration for marketing activities was too low, as Microsoft excluded sales made from OEM licenses from its commissions. The Danish tax authorities argued that all sales, including OEM sales, should be included. The Danish tax authorities also made a discretionary assessment based on lack of timely transfer pricing documentation.	On January 31, 2019, the Danish Supreme Court ruled in favor of Microsoft and found that the Danish tax authority had not satisfied its burden of proof and no adjustment was necessary.
European Commission		
The Netherlands and Starbucks (General Court of the European Union)	The European Commission asserted that the APA between The Netherlands and Starbucks Manufacturing EMEA BV was incompatible with an internal market and asked for the recovery of the state aid provided by the EU.	On September 24, 2019, the General Court annulled the European Commission's decision.
Luxembourg and Fiat Chrysler Finance Europe (General Court of the European Union)	European Commission argued that Fiat Chrysler Finance Europe had intercompany financing arrangements that were not arm's-length and amounted to Luxembourg providing state aid to Chrysler Finance Europe.	On September 24, 2019, The General Court ruled in favor of the European Commission.
France		
Google (Administrative Court of Appeals)	The French tax administration argued that Google had a permanent establishment in France because of its ad sales to customers in France.	On April 25, 2019, the Administrative Court ruled that Google France did not have the capability to carry out the advertising activities on its own and thus Google did not have a permanent establishment in France.
Google (Supreme Court)	The French tax authority asserted that Google Ireland had a permanent establishment in France and had under-reported its revenue in France.	On September 12, 2019, Google settled the case by paying a EUR 1 billion in fines and taxes.
Norway		
Normet Norway AS (Borgarting Lagmannsrett)	Normet Norway AS appealed a decision that its valuation of transferred IP was too low, resulting in an IP valuation adjustment from NOK 3.6 million (~\$409k USD) to NOK 58.2 million (~\$6.5m USD). Normet initially used a relief from royalty calculation, while the Norwegian tax office relied on the CUP method for its assessment.	On March 19, 2019, the Court of Appeals ruled in favor of the Norwegian tax office that the taxpayer's IP valuation was underestimated.
Spain		
Ikea (Audiencia Nacional (TEAC))	The Spanish tax authorities argued that the profits in 2007, 2008, and 2009 of IKEA Spain, an IKEA wholesale distributor, were not in accordance with arm's-length principle. The taxpayer applied the TNMM as the most appropriate method and argued that the three-year average return earned by IKEA Spain was in the interquartile range while the single year 2007 return was below the range.	On March 6, 2019, the Spanish Court determined that IKEA Spain's 2007 profits should be adjusted to the lower quartile and also determined that since the 2008 and 2009 profits were within the arm's-length range, no further adjustment was required.

Asia Pacific

Case	Issue	Status
Australia Glencore (Federal Court of Australia)	The Australian Tax Office argued that the amount paid by Glencore International AG (Swiss parent) to Glencore Australia for copper concentrate products under a “price sharing agreement” was not arm’s length. Glencore International AG paid resale price minus 23% to Glencore Australia.	On September 3, 2019, the Federal Court of Australia ruled in favor of Glencore; the Australian Tax Office is appealing the ruling.

Middle East and Africa

Case	Issue	Status
Israel Broadcom (Israel District Court)	Broadcom acquired an Israeli company. After acquisition, Broadcom converted the Israeli company into a routine service provider, and licensed the IP to other Broadcom affiliates. The Israeli tax authorities argued that the Israeli company’s functions, assets, and risks were transferred under the business restructuring and subject to additional tax.	On December 10, 2019, the Israel District Court ruled in favor of Broadcom and stated that converting an IP owner into a service provider does not trigger a tax event from the sale of an asset.
Zambia Nestlé Trading Ltd (Tax Appeals Tribunal)	Following a tax audit, the Zambia tax authority considered Nestlé Zambia a limited risk distributor and therefore proposed a tax adjustment plus penalties. Nestle argued that Nestlé Zambia was a full-fledged distributor and had incurred over five years of consecutive losses.	On March 28, 2019, the Tribunal ruled in favor of Nestlé, accepting that Nestlé Zambia was a full-fledged distributor.

Hot topics in transfer pricing

Transfer pricing in the digital economy

In an effort to reach consensus on the taxation of the digital economy, the OECD Secretariat merged the three proposals on digital taxation by the EU, US, and G-24 into a Unified Approach. The Unified Approach was divided into two pillars:

- Pillar One aims to redefine the existing nexus concept, i.e., taxation occurs when a multinational enterprise (MNE) has a physical presence in a tax jurisdiction. The new nexus attempts to tax sales in countries where the taxpayer does not have a physical presence. To achieve this, the OECD Secretariat proposed a formulaic approach of redefining market-related profits into three amounts. However, there is still ambiguity on which taxpayers this applies to and how taxable profits are derived. The OECD received a number of public comments on Pillar One, which indicates that there is still significant work left to clarify how to implement Pillar One directives.

- Pillar Two, also referred to as the Global Anti-Base Erosion Proposal (GloBE), focuses on developing a minimum global tax “where other jurisdictions have not exercised their primary taxing rights or the payment is otherwise subject to low levels of effective taxation.”¹ The OECD aims to reduce the risk of unilateral measures by proposing four rules that would amend tax treaties to prevent double taxation. Similar to Pillar One, there remains significant questions on the design and mechanics of the minimum tax.

While the OECD has been working on the Unified Approach, certain tax authorities have begun implementing their own digital taxation policies, as shown below:

Country	Effective Date	Tax Rate	Tax Base	Global Revenue Threshold	Domestic Revenue Threshold
Austria	1/1/2020	5.0%	Revenue derived from online advertising	Euro 750M	Euro 25M online advertising services
France	1/1/2019	3.0%	Revenue derived from online advertising	Euro 750M	Euro 25M in taxable services supplied in France
Turkey	3/1/2020	7.5%	Revenue from online services including advertisements, sales of content, and paid services on social media websites	Euro 750M	TRY 20M digital services revenue

In addition, other countries have announced their intentions to enact digital services taxes, such as the UK, Canada, Russia, Israel, South Korea, Spain, and Sweden.

What lies ahead in 2020

The OECD will be hard at work on further developing the Unified Approach to the taxation of the digital economy in 2020. We expect to hear comments from tax payers and policymakers throughout the year. In addition, countries will continue to add guidance to their regulations, for example, Ireland implemented its transfer pricing regulations, effective January 1, 2020. The new Irish transfer pricing regulations incorporate the 2017 OECD Transfer Pricing Guidelines and new transfer pricing documentation requirements.

Given the continued scrutiny from tax authorities worldwide, we recommend that taxpayers continue adhering to transfer pricing regulations and guidance and ensure that they prepare and maintain clear records and documentation detailing how their intercompany transactions adhere to pertinent regulations and guidance. In particular, we advise that:

- Companies with digital sales should be aware of the developments in the OECD’s Unified Approach as well as country-specific digital taxation policies. It will be important for companies to assess the potential tax implications from these policies.

¹ OECD, OECD secretariat invites public input on the Global Anti-Base Erosion (GloBE) Proposal under Pillar Two,” <https://www.oecd.org/tax/oecd-secretariat-invites-public-input-on-the-global-anti-base-erosion-proposal-pillar-two.htm>.

In addition, recent cases show us that:

- Companies should check that the interest rates on their intercompany loans are supported by substantial analysis and documentation.
- Companies should know how stock option compensation costs are treated in their current cost-sharing arrangements and follow future case rulings on the matter.
- Companies should be aware of the courts' preference for the CUP method (even with adjustments) over other transfer pricing methods in certain situations.

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