

**AICPA INTERNATIONAL ISSUES CONFERENCE- Session 3**

**Transfer Pricing: Current Developments –  
Structuring Cross-border Transactions**

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**Agenda**

- Cost Sharing Arrangements
- Section 367(d)
- Intercompany Services
- Business Restructurings
- Attribution of Profits to Permanent Establishments
- Global Dealing

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## **Cost Sharing Arrangements**

- CSA's used by related parties to jointly develop new intangibles, by sharing development costs in proportion to reasonably anticipated benefits
- Parties have separate exploitation rights in new intangibles, without royalty payments
- Treasury updating existing (1996) regs to improve compliance/administration, and provide more guidance on "buy-in" payments

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## **Cost Sharing Arrangements**

- Applicability of new methods in proposed -7 regs to valuation of in-process intangibles under -4
- Coordinated Issue Paper
  - Use of income method and acquisition price method from proposed regs to value buy-ins under current regs

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## Cost Sharing Arrangements

- Settlement guidelines for buy-in cases
- Division of rights in cost-shared intangibles
  - other than territorial basis?
- Discount rate determination under income method

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## Section 367(d)

- § 367(d):
  - US transferor of intangible property to a foreign corp in a § 351 or 361 transaction is treated as having made the transfer in exchange for annual payments contingent on the productivity, use, or disposition of the intangible over its useful life;
  - payments must be CWI from the intangible
- § 367(d) “intangible property” limited to § 936(h)(3)(B) intangibles
- Temporary regulations date back to 1986

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## **Section 367(d) – Possible Issues for Consideration in New Regulations**

- What happens when transferor goes out of existence?
- Is CWI standard same as in 482?
- Definition of intangibles subject to 367(d)
- 351 exchanges with boot, gain triggered - does that affect amount of annual contingent payments taken into account?

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## **Section 367(d) – Possible Issues for Consideration in New Regulations**

- Election to treat transfer as a sale - is that consistent with policy of 367(d)?
- Foreign transferee must reduce its E&P by the amount of the deemed payments - does the U.S. transferor get to add the payments to its basis in the shares of the transferee if actual payments have not been made?

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## **Intercompany Services**

- Existing final (1968) regs being updated to recognize:
  - transition from manufacturing to services-based economy,
  - increasing cross-border trade and globalization
  - discontinuities between transfer pricing for services vs. pricing for tangible and intangible property
- New methods for pricing services needed
- Need to revise cost safe harbor

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## **Intercompany Services**

- Application of business judgment rule to low-margin covered services
- Documentation issues/determination of comparables

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## **Intercompany Services**

- Specified covered services – activity-based/functional descriptions
- Determination of total services cost – treatment of stock-based compensation
- Adjustment of contract terms for economic substance

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## **Business Restructurings**

- “Cross-border redeployment by a multinational enterprise of entrepreneurial functions and/or risks”
  - Conversion to limited-risk distributors or contract manufacturers
  - Centralization of R&D/Intangibles
- Apply existing treaty/transfer pricing rules to common fact patterns

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## **Business Restructurings**

- Permanent Establishment Issues
- Synergy issues
- Exit tax issues
- Interaction with domestic anti-abuse rules

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## **Business Restructurings**

- Transfers of risks between related parties
- Transfers of “business opportunity” or “profit potential”
- “Disregarding” or “recharacterizing” transactions

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## **Attribution of Profits to Permanent Establishments**

- OECD Project – aimed at achieving greater consensus on attributing profits to Permanent Establishments under Article 7 (Business Profits) of OECD Model Tax Convention
- Primary goal is avoiding double taxation
- “Functionally separate entity” approach
  - apply Article 9 (Associated Enterprises) principles by analogy to determine arm’s length profits as if PE were a legally distinct and separate enterprise

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## **Attribution of Profits to Permanent Establishments**

- Implementation issues of PE Report – 3 possible approaches: under old Article 7, “half-way” implementation approach, and new Article 7 and commentary
- Symmetry requirement?; relationship of Articles 7 and 23

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## **Attribution of Profits to Permanent Establishments**

- U.S. implementation of PE Report in treaties
- Attribution of profits based on significant people functions
- Consistency requirement – use of code vs. treaty rules to determine business profits

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## **New Proposed Global Dealing Regulations**

- OECD PE Attribution Report Part III
  - Revised report published December 2006
- New Regulations Will:
  - Comport with emerging treaty principles in order to minimize double taxation
  - Reflect changes in global dealing in financial products since 1998 proposed regulations
  - Focus on the real economics of participation in a global dealing operation
- New Regulations Will Not:
  - Address PE determination, traditional banking

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## **New Proposed Global Dealing Regulations**

- Treatment of financial guarantees
  - Sourcing and Pricing
- Harmonization with Interest Allocation Rules