

# **Mitigating Risk Inherent in the Shifting Sands of Transfer Pricing**

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# Agenda

- Sources of transfer pricing risks, including divergence between supranational guidance and local law
- Dealing with OECD Base Erosion and Profit Shifting (BEPS) project's 'Amount B'
- Transfer pricing dispute resolution developments
  - New EU transfer pricing directive
  - Changes in OECD, US, and other countries' Advance Pricing Agreement (APA) procedures and guidance
- Use of AI and data analytics in transfer pricing enforcement

# **Sources of Transfer Pricing Risks, Including Divergence between Supranational Guidance and Local Law**

# Sources of Transfer Pricing Risks

- Transfer pricing risks can emanate from multiple sources, including for example:
  - Inadequate analysis of functions, assets, and risks
  - Mergers, acquisitions, restructurings, and other business transactions
  - New business models
  - New transfer pricing rules
  - Gaps between supranational transfer pricing guidance and local transfer pricing laws

# “Mind the GAPS” that Create Transfer Pricing Risks

- Examples of transfer pricing risks arising from gaps between supranational transfer pricing guidance and local or regional transfer pricing laws
  - United States
  - European Union
  - Switzerland
  - Others?

# Transfer Pricing Rules in (versus?) Domestic Context

- Transfer pricing rules
  - International transfer pricing rules vs. domestic transfer pricing legislation
  - Cross-border transactions vs. domestic transactions
  - "Transaction-based view"
  - Facts-driven - "value creation"

# Transfer Pricing Rules in (versus?) Domestic Context

- Allocation of tax liabilities in general
  - Jurisdictions
  - Entities
  - Taxation systems
- Transfer pricing view vs. broader domestic tax / legal system
- What constitutes or identifies...
  - "Law"
  - Tax liability
  - Taxpayer
  - Realization vs. "deemed" realization
  - "Income" vs. "deemed" income

# US Judicial Review of Global Tax Coordination Efforts

- US law creates three potential layers of judicial review affecting US transfer pricing rules and global tax proposals
  - Constitutional limitations—what can Congress do by statute
  - Delegation limitations—what Congress can allow the administration to do by regulation
  - Regulatory limitations—how much latitude does the administration have in interpreting and implementing statutes
- Recent case law reflects a more stringent application of all of these doctrines, reducing the ability of administration to implement political agreements
- All of these types of review can impact international efforts to coordinate transfer pricing and other tax rules



# US Constitutional Limitations

- Early US case law suggests that “realization” of income is a constitutional requirement for “non-apportioned” taxes
  - *Eisner v. Macomber*: stock dividend does not give rise to income
  - Debate: whether case implies a constitutional requirement, and, if so, whether it is still good law
- *Moore v. United States*
  - Challenge to 2017’s “mandatory repatriation tax” imposed as part of tax reform; challenge is based on shareholder not realizing income from holding stock in foreign corporation
  - Ninth Circuit held that tax was constitutional, saying that realization is *not* required
  - Argued in US Supreme Court in December 2023 - much of argument focused on attribution of realized income to shareholders, not realization
- Potential implications
  - Deviations from arm’s length transfer pricing (deemed, but unrealized, income)
  - US GILTI (and potential IIR, if adopted)
  - UTPR
  - Deemed inclusions from Amount A

# US Delegation Limitations

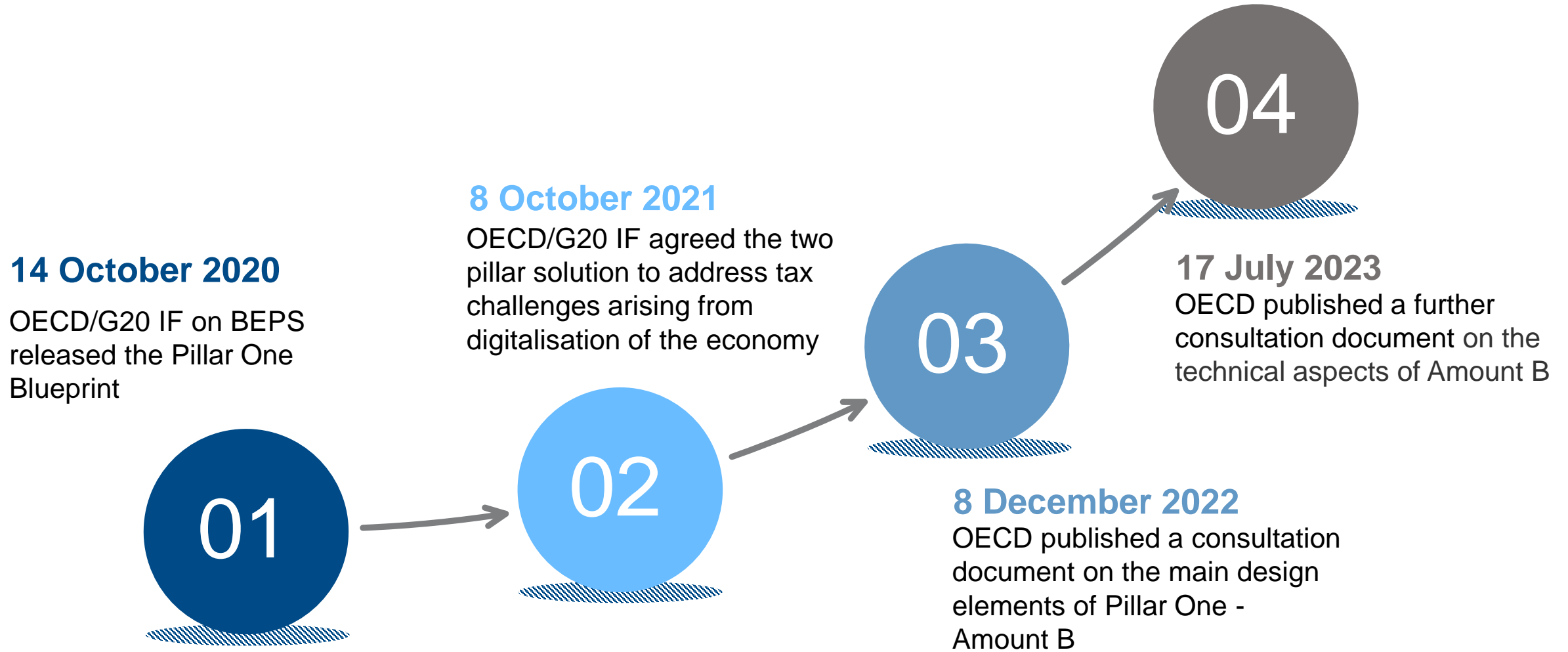
- US case law limits Congress's ability to permit administration to write laws
  - *Gundy v. United States* (2022): Supreme Court reiterates principle
  - Statute must have an “intelligible principle” from which agency acts, or Congress must answer “important questions”
- Private nondelegation
  - Limits also exist on Congress's ability to delegate to a nongovernmental entity
  - Court of Appeals (5<sup>th</sup> Cir.) in *National Horsemen's Benevolent and Protective Association v. Black*, which limited Congress's ability to let a private entity create rules for thoroughbred horseracing
- Potential implications
  - Delegation of transfer pricing rulemaking to OECD (e.g., Amount B)
  - Ability to adapt to new OECD administrative guidance (Pillar Two)
  - Determination of tax base by financial accounting oversight authorities, not administrative regulators (Pillars One and Two)

# US Regulatory Limitations

- US case law: judicial review of regulatory rulemaking for consistency with statutes
  - *Chevron* (1984) has governed the standard under which regulations are reviewed
  - *Chevron* examines (1) whether underlying statute is ambiguous and (2) whether agency rule is a reasonable interpretation of the statute
- *Loper Bright*: this year, the Supreme Court will reconsider *Chevron*
  - Case concerns the payment of expenses for on-board fishery monitoring, but provides the Court with an opportunity to modify or overrule *Chevron* generally
  - May potentially limit agency rulemaking with respect to “controversial powers”
- Potential implications
  - Complex US transfer pricing regulatory regime creates extensive and highly prescriptive rules based on very simple statute
  - Internationally coordinated transfer pricing rules (e.g., Amount B) are even more extensive and prescriptive provisions
  - US statutory authorization for Pillars One and Two may need to be very detailed, complicating US implementation

# **Dealing with OECD Base Erosion and Profit Shifting (BEPS) Project's 'Amount B'**

# Amount B – Evolution to Date



# Purpose of Amount B



To streamline the approach for pricing baseline marketing and distribution activities **in accordance with the arm's length principle** (ALP)



Enhance tax certainty and reduce resource-intensive disputes between taxpayers and tax administrations



Address the needs of low capacity jurisdictions

# Overview

## Who will it affect?

- Multinationals selling tangible goods on a wholesale basis operating through routine or limited risk distributors
- Activities need to be “baseline” to fall within scope of Amount B

## How?

- Amount B aims to simplify pricing of these routine activities by providing for fixed returns for in-scope baseline marketing and distribution activities
- Pricing is based principally on application of the TNMM using an agreed benchmarking approach
- The appropriate arm’s length return for in scope transactions is determined by reference to a pricing matrix which sets out a grid of arm’s length returns expressed as a return on sales (with some exceptions)

# Qualifying Transactions

## **Buy-sell marketing and distribution transactions**

Distributor purchases goods from associated enterprises for wholesale distribution to unrelated parties

## **Sales agency and commissionaire transactions**

Sales agent / commissionaire contributes to wholesale distribution of goods by associated enterprises to unrelated parties



# Scope: Baseline Marketing & Distribution Activities

- Natural tension between achieving simplification and respecting the ALP
- Two alternatives outlined in consultation document
  - **Alternative A** - prioritises simplification and tax certainty objectives
  - **Alternative B** – favours the inclusion of an additional qualitative scoping criterion to determine if distribution activities are “baseline”

# Alternative A – Scope Criteria



**One-Sided Method** – Transaction can be reliably priced using a one-sided transfer pricing method with distributor as tested party



**Quantitative Filter** – operating expenses to sales ratio to identify functional variations



**Services & Commodities Exclusion** – distribution of services excluded together with marketing, trading or distribution of commodities



**Non-Distribution Activities** – Distributor will be excluded if it carries out non-distribution activities, unless they can be evaluated and reliably priced on a separate basis and meet a specific administrative guardrail

# Alternative B



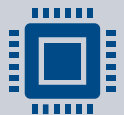
Removes transactions from scope of simplified approach where distributor makes “non-baseline contributions” to the transaction



Non-baseline contributions:

Functions and assets that represent **a key source of actual or potential economic benefits** in the transaction; &

Contributions whose benefits are expected to exceed the actual or potential economic benefits typically derived from core distribution functions.



Examples include:

Technical or specialized support activities including customization or modification of the products distributed.  
Specific contributions that enable market access for highly regulated products.

# Pricing Framework



TNMM is regarded as the appropriate method to price in-scope transactions except in limited circumstances where internal comparable uncontrolled prices (CUPs) are available



Transactions are priced by reference to a pricing matrix compiled by the OECD based on a global dataset of companies involved in baseline marketing and distribution activities



Return on sales is applied as net profit indicator



The pricing matrix provides a grid of arm's length returns expressed as a return on sales



The applicable arm's length return will depend on the distributor's specific features taking the following factors into account:

Industry grouping

Level of operating assets – operating asset to sales intensity

Level operating expense – operating expense to sales intensity

# Pricing Framework

## Further modifications to address:

### Geographic Differences

Modified pricing matrix to address:

1. **High / Low Profit Jurisdictions** – where there are identified differences in profitability between qualifying jurisdictions and the global dataset
2. **High Risk Jurisdictions** – where country risk may affect arm's length returns attributable to baseline marketing and distribution activities (based on sovereign credit rating)
3. **Local variations** – where local tax administration produces a local dataset which is translated into a local pricing matrix for that country and verified by the IF

### Low and High Functionality

Berry ratio cap and collar approach as corroborative test and guardrail where return on sales NPI produces a result that is not in line with the ALP

# Next Steps & Implementation

Work is ongoing to address open items and reach consensus among IF member

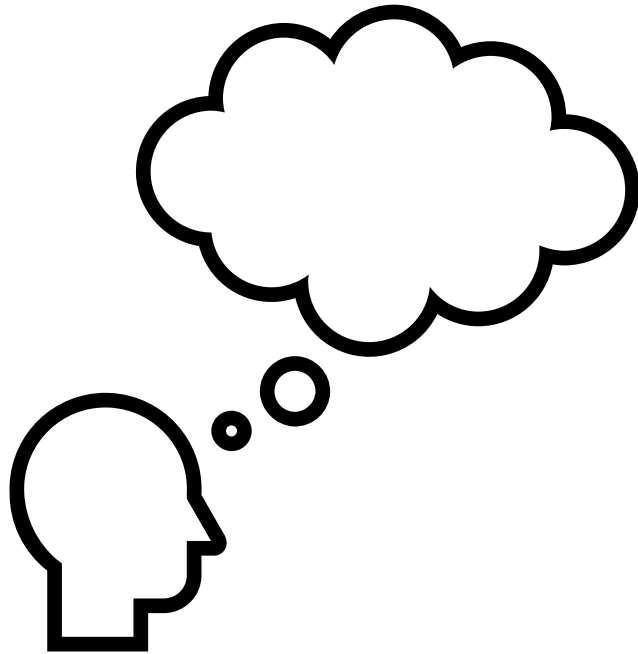
## Key open items:

- **Scope** – quantitative v qualitative approach
- **Pricing Framework** including geographic differences
- Application to **digital goods**

Final Amount B Report to be published and incorporated into OECD Transfer Pricing Guidelines by January 2024

Domestic implementation will depend on local law procedures in relation to adoption of revisions to existing TPGs

# Key Questions



## Will it achieve the stated aims of

- ? Simplification
- ? Enhancing tax certainty
- ? Reducing disputes between taxpayers and tax administrations
- ? Addressing the needs of low capacity jurisdictions
- ? Respecting the ALP

## Implications for taxpayers?

- Compliance challenges
- Transparency with respect to underlying data
- Timing of implementation and potential impact on existing TP policies
- Safe harbour v prescriptive approach
- Potential complexity of scoping criteria and range of adjustments
  - Potential for manipulation
  - Risk that it ultimately just changes the nature of the dispute

# Amount B and US Transfer Pricing Law

- As a general matter, US transfer pricing principles do not permit broad-based, formulaic approaches except as safe harbors
  - 1994 regulations expressly state that “[u]nadjusted industry average returns themselves cannot establish arm's length results.”
  - Preamble reflects particular concern with CPM/TNMM
  - More recently, US foreign tax credit regulations require foreign country to use arm’s length principles to permit underlying tax to be creditable
- Amount B formulas appear inconsistent with this principle
- Practical impact unclear
  - Amount B qualitative threshold determination (“baseline activities”) likely results in an analysis similar to the US CPM comparability factors
  - Additionally, US comparables used in CPM/TNMM analysis may produce an arm’s length range compatible with Amount B formulaic results
  - Current administration seems amenable to adapting foreign tax credit rules to OECD initiatives



# **Transfer Pricing Dispute Resolution Developments**

# **New EU Transfer Pricing Directive**

# EU Transfer Pricing Proposal

The EU Commission **Transfer Pricing Proposal** of September 12, 2023 (COM(2023) 529 final) is part of the **BEFIT** package, which has two objectives:

Creating a set of common rules for the taxable base determination of Large European Groups

Integrating the transfer pricing key principles in the EU law system



At present, the lack of coordination and harmonization of transfer pricing regulations at EU level grants wide discretion in the interpretation and application of the OECD Transfer Pricing Guidelines ("**OECD TPG**"), creating breeding ground for disputes.

# Current State of Transfer Pricing in the EU

**No definition of arm's length principle ("ALP") in the EU legislation**

**23 of 27 Member States ("MSs") are OECD members (excluding Malta, Cipro, Romania and Bulgaria)**

**Even among MSs which are OECD members, there are differences in relation to:  
the transfer pricing application and  
the status and the role of the OECD TPG**

# EU Transfer Pricing Proposal - Approach

## How to harmonize the ALP within the EU?

Inclusion in the EU law of the OECD ALP and of the OECD TPG

**Option 1**



Inclusion in the EU law of the OECD ALP and of the OECD TPG, with a mechanism for coordinating a common interpretation and application at Union level

**Option 2**

Introduction and development of an autonomous definition of the ALP and, consequently, of the guidelines

**Option 3**



Inclusion in the EU law of the ALP without any reference to the OECD TPG

**Option 4**



Introduction in the EU law of the ALP based on the UN Model

**Option 5**



# EU Transfer Pricing Proposal - Approach

The Proposal aims at obtaining a reduction of disputes, double taxation and double non-taxation at EU level.  
This objective is pursued through Option 2, which provides :

- Incorporation of the ALP in the EU law;
- Harmonization of the *transfer pricing* **key rules**;
- Clarification of the role and status of the OECD TPG;
- Introduction of the possibility to establish binding common rules on specific subjects and safe harbours;
- Creation of an EU experts group ensuring a common interpretation of the ALP and of the OECD TPG.

# EU Transfer Pricing Proposal - Structure

## Chapter I General provisions

- **Scope of the Directive**
- **Definitions**

## Chapter II Transfer pricing rules

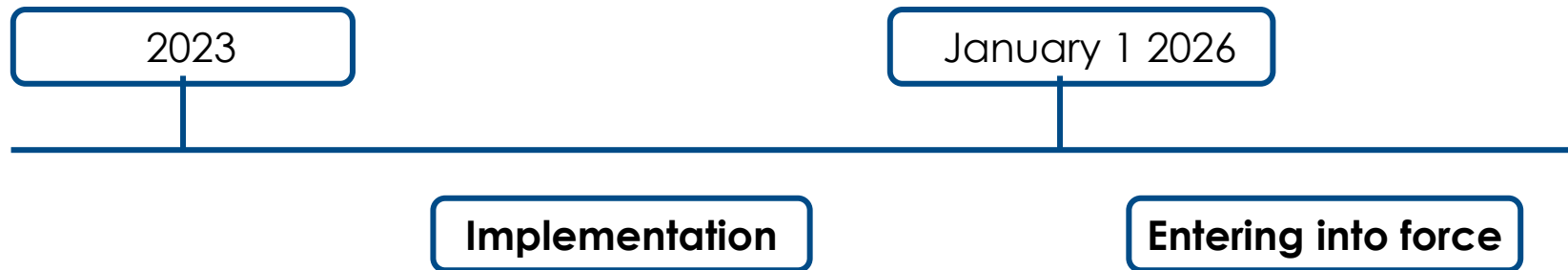
- **General rule on the application of ALP**
- **Definition of associated enterprises**
- **Corresponding adjustment**
- **Compensating adjustment**
- **Identification of the commercial and financial relations**
- **TP Methods**
- **Most appropriate method**
- **Comparability analysis**
- **Determination of the arm's length range**
- **Transfer pricing documentation**

## Chapter III - IV Organization/ Final provisions

- **Application of the ALP**
- **Evaluation of the Directive impact**
- **Exercise of delegation**
- **Implementation and entering into force**

# EU Transfer Pricing Proposal - Transposition

*Transposition - Art. 20*





# EU Transfer Pricing Proposal - Scope

## Scope (art. 2)

Taxpayers that are registered in, or subject to, tax in one or more MSs, including permanent establishments in one or more Member States

# EU Transfer Pricing Proposal: Selected Issues

- Associated enterprise
- Compensating adjustment (see Appendix)
- Corresponding adjustment (see Appendix)
- Transfer pricing methods, comparability analysis and arm's length range (see Appendix)
- Transfer pricing documentation (see Appendix)
- Application of arm's length principle (see Appendix)
- Competence of the EU Court of Justice

# EU Transfer Pricing Proposal: Associated Enterprises

Art. 5 - Purpose of the provision

## Transfer Pricing Proposal, Explanatory Memorandum

[...] domestic legislation of Member States shows **differences in the definition of associated enterprises** and, in particular, on the notion of “control” which is normally the precondition to apply transfer pricing. Certain Member States apply a threshold of 25% while others apply a threshold of 50% shareholding when it comes to determining whether the control criterion is met. It translates into businesses facing tax uncertainty, high compliance costs as well as frequent, time-consuming legal disputes [...]

## Transfer Pricing Proposal, Recital (5)

To ensure that the arm’s length principle is applied in a uniform way across the Union, Member States should apply a **common definition of associated enterprises**. In order to ensure equal treatment, a permanent establishment should be treated, for the purpose of this Directive, as an associated enterprise and thus the internal dealings between head office and permanent establishment should be determined in accordance with the arm’s length principle

# EU Transfer Pricing Proposal: Associated Enterprises

Art. 5, § 1

## **Associated enterprise**

means a person who is related to another person (both legal and natural) by participating in the control of another entity through

a. a holding that **exceeds 25% of the voting rights**, or

b. a participation **in the capital through a holding that directly or indirectly exceeds 25%**, or

c. entitlement **to 25% of the profits**, or

d. participation in the management with **a position to exercise significant influence** over the other person.

# EU Transfer Pricing Proposal: Associated Enterprises

*Art. 5, § 2-5*

- If **more than one person** participates in the management, control, capital or profits **of the same person**, as referred to in paragraph 1, **all persons** concerned shall be regarded as associated enterprises.
- If the **same persons** participate in the management, control, capital or profits of **more than one person**, as referred to in paragraph 1, **all persons** concerned shall be regarded as associated enterprises.
- A person who **acts together with another person** in respect of the voting rights or capital ownership of an entity shall be treated as holding a participation in all of the voting rights or capital ownership of that entity that are held by the other person.
- In indirect participations, the fulfilment of the criteria shall be determined by **multiplying the rates of holding through the successive tiers**. A person holding more than 50 % of the voting rights shall be deemed to hold 100 % of the voting rights.

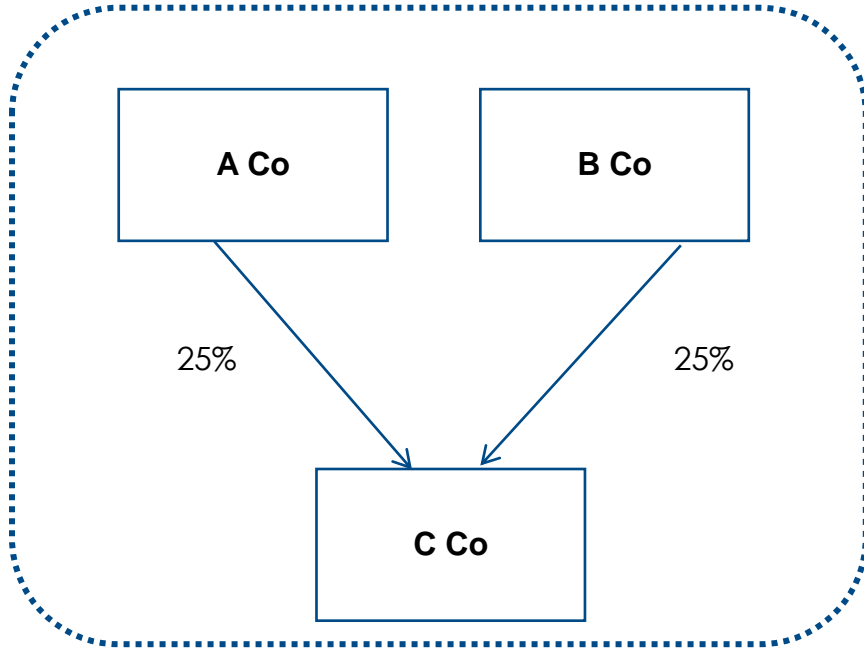
# EU Transfer Pricing Proposal: Associated Enterprises

Art. 5, § 6-7

- **Individual:** *"An individual, his or her spouse or recognised partner, in accordance with the applicable national law, and his or her lineal ascendants or descendants and his or her siblings shall be treated as a single person"*.
- **Permanent establishment** shall be considered an associated enterprise of the enterprise of which it is a part of.

# EU Transfer Pricing Proposal: Associated Enterprises

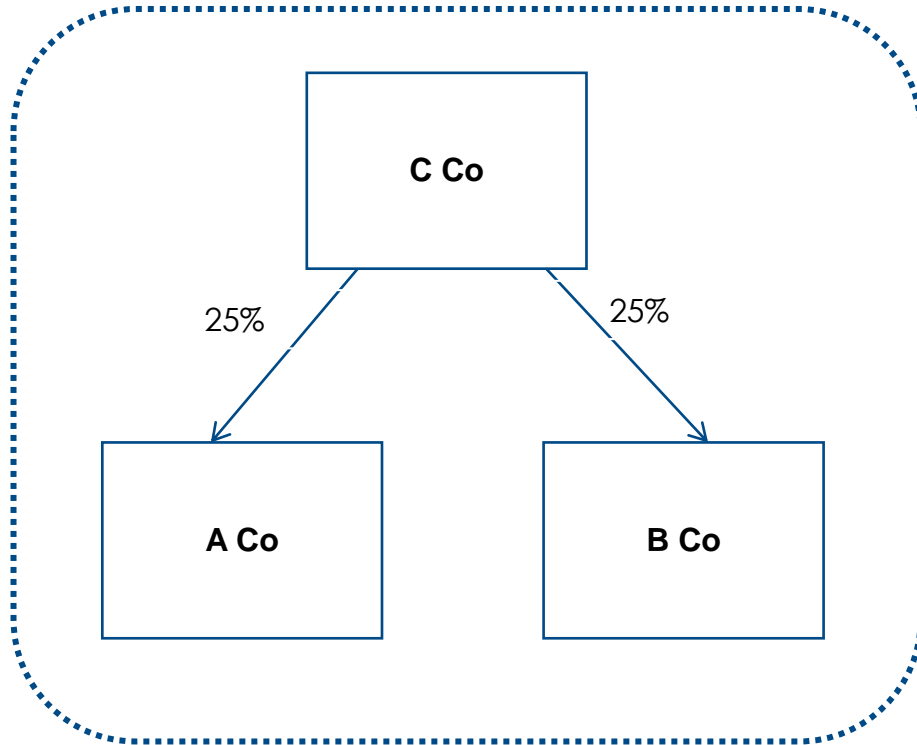
Possible scenario: Art. 5, § 2



If **more than one person** participates in the management, control, capital or profits of the same person, as referred to in paragraph 1 (see previous slide), **all persons** concerned shall be regarded as **associated enterprises**.

# EU Transfer Pricing Proposal: Associated Enterprises

Possible scenario: Art. 5, § 3

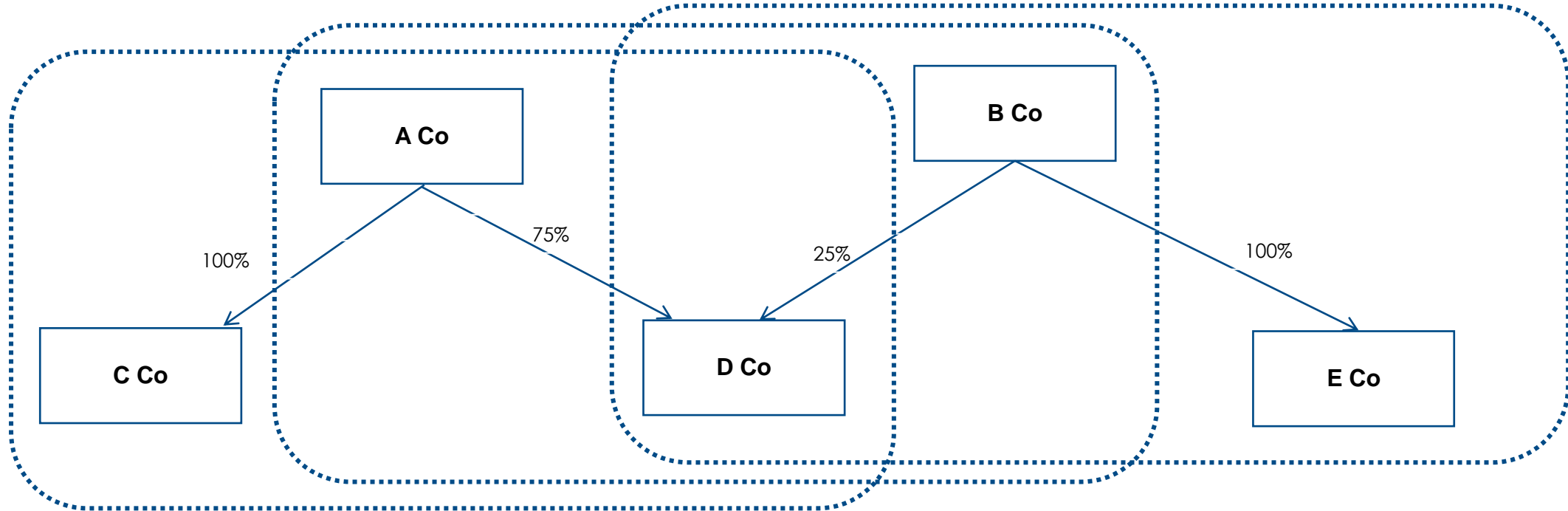


If the **same persons** participate in the management, control, capital or profits **of more than one person**, as referred to in paragraph 1 (see previous slide), **all persons** concerned shall be regarded as **associated enterprises**.



# EU Transfer Pricing Proposal: Associated Enterprises

Possible scenario: Art. 5, § 2-3



- If **more than one person** participates in the management, control, capital or profits of the same person, as referred to in paragraph 1 (see previous slide), **all persons** concerned shall be regarded as associated enterprises.
- If the **same persons** participate in the management, control, capital or profits **of more than one person**, as referred to in paragraph 1 (see previous slide), **all persons** concerned shall be regarded as associated enterprises.

# EU Transfer Pricing Proposal: Comparison with OECD

## Art. 9, par. 1 OECD Model Convention

*“a) an enterprise of a Contracting State **participates directly or indirectly in the management, control or capital** of an enterprise of the other Contracting State,*

*or*

*b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State”*

## Commentary to Art. 9, par. 1, OECD Model Convention (§ 1)

*“parent and subsidiary companies and companies under common control”*

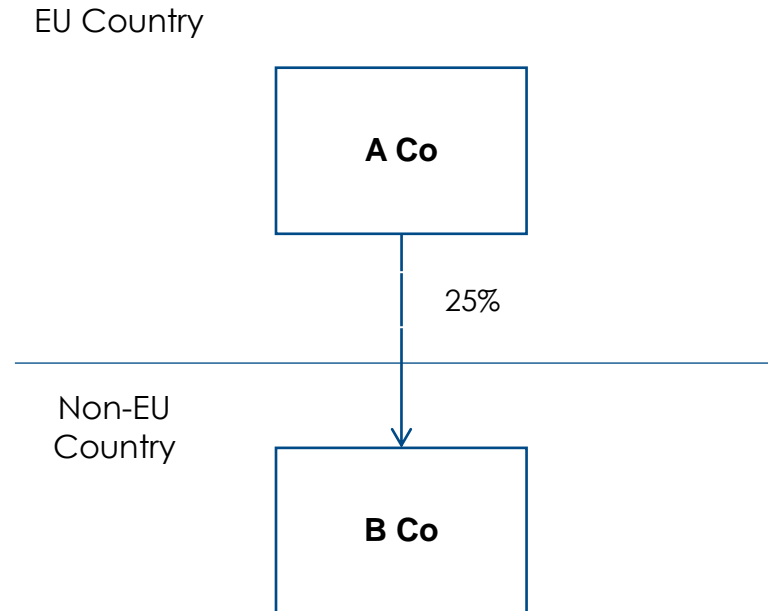
## OECD TPG

### **No definition**

*(The 1979 OECD Report states that it was not thought to be necessary to define expressions such as ‘associated enterprises’ and ‘under common control’ as a **broad basis of common understanding** of what was meant was assumed to exist).*

# EU Transfer Pricing Proposal: Associated Enterprises

## Qualification conflicts



- EU Country domestic law provides for a **participation threshold of 25%**
- Non-EU Country domestic law provides for a **participation threshold of 50%**
- In case of a transfer pricing adjustment of the EU Country Tax Authorities, would the competent tax authorities open a MAP?



**AUTONOMOUS CONCEPT OF ASSOCIATED ENTERPRISES  
UNDER THE TAX TREATY**

# EU Transfer Pricing Proposal

*Competence of the EU Court of Justice*

The entering into force of the Proposal will imply  
**the competence of the EU Court of Justice**  
in transfer pricing cases among MSs?



***Alternative procedure for dispute  
resolution?***

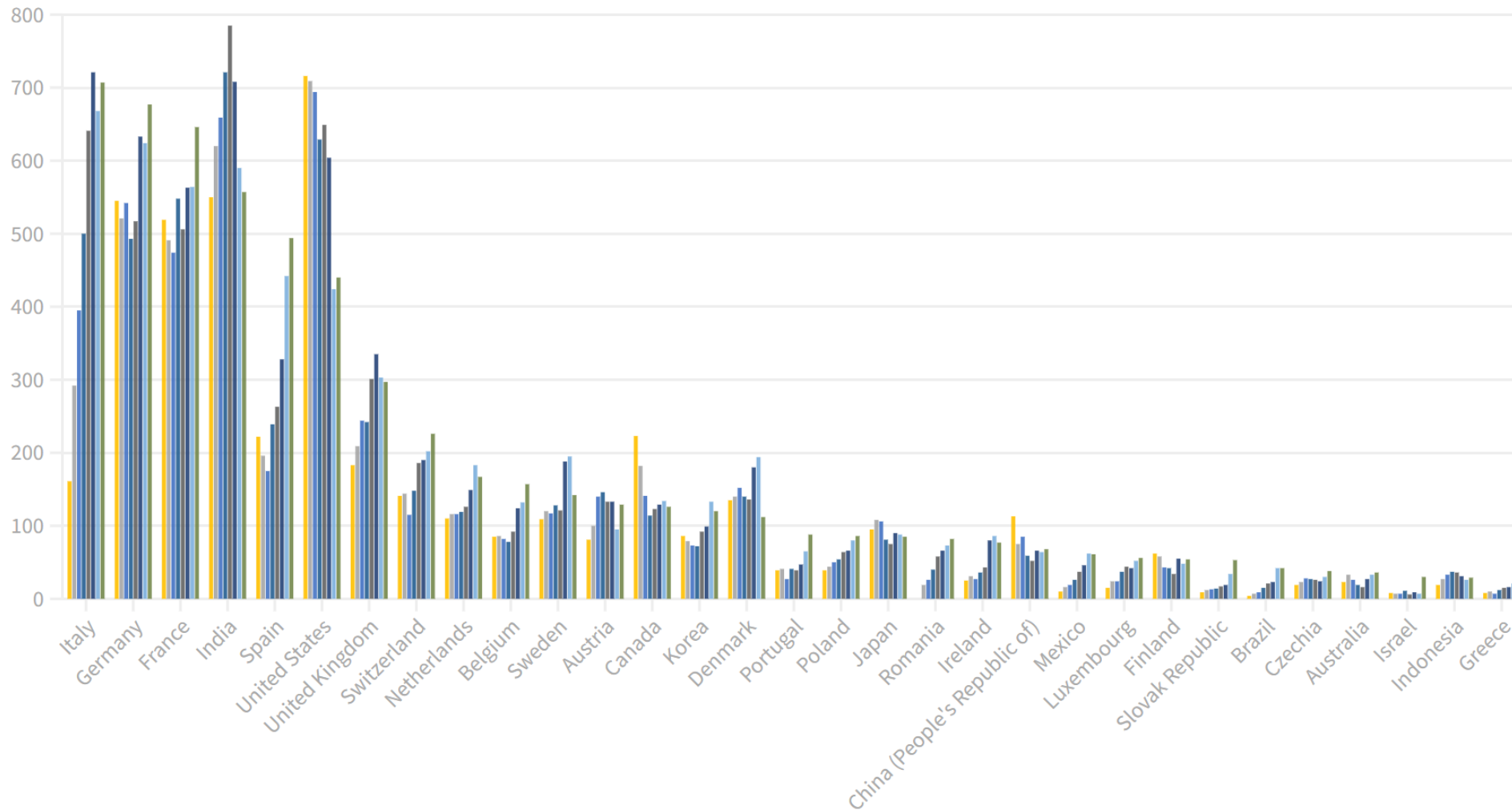
# **Changes in OECD, US, and other countries' Advance Pricing Agreement (APA) procedures and guidance**

# OECD Changes

- Manuals:
  - Manual on the Handling of Multilateral Mutual Agreement Procedures and Advance Pricing Arrangements (2023)
  - Bilateral Advance Pricing Arrangement Manual (2022)
- 2022 OECD MAP Statistics
  - More new MAP cases opened in 2022 (3% increase); 11% increase in transfer pricing cases
  - Fewer MAP cases closed in 2022 (4% decrease); 6% increase in transfer pricing cases
  - Outcomes are generally positive (73% of MAP cases resulted in full resolution); same for transfer pricing cases
  - Average case times closer to 24-month target (29 months for transfer pricing cases)
- ICAP – exploring how to make ICAP more appealing to companies (as compared with European Trust and Cooperation Approach (ETACA))

# OECD Changes

**MAP inventory in number of cases (transfer pricing cases)**  
Jurisdictions with at least 25 transfer pricing cases in 2022 end inventory



## “Top 10 Takeaway”

- More transfer pricing cases in Italy, Germany, France, Spain, Switzerland, Belgium
- Fewer transfer pricing cases in India, USA, UK, Netherlands

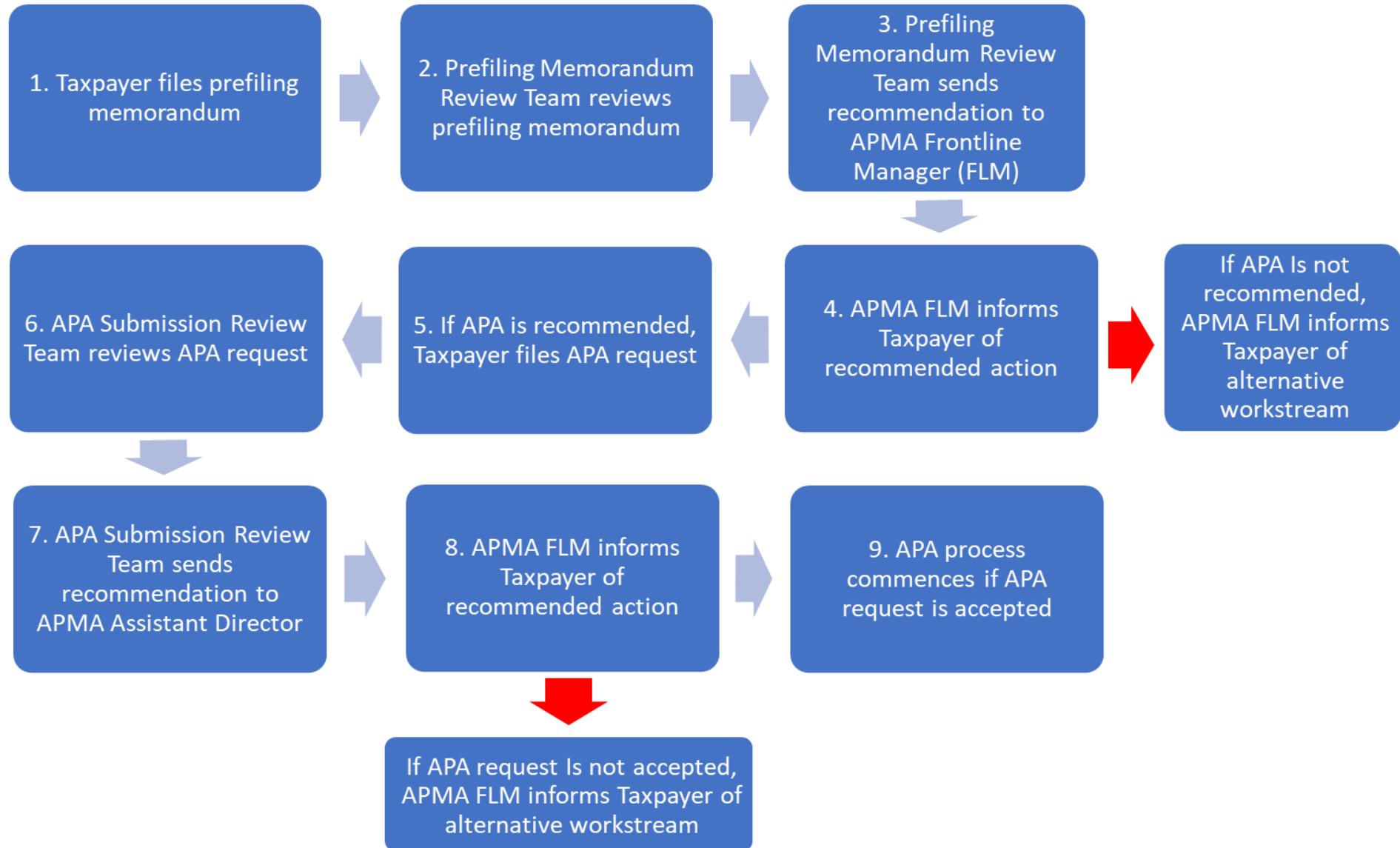
Source: OECD

# Brief Comparison of APA, MAP & ICAP

	<b>Advance Pricing Agreement (APA)</b>	<b>Mutual Agreement Procedure (MAP)</b>	<b>Int’l Compliance Assurance Program (ICAP)</b>
<b>Objective</b>	Prevent future disputes	Resolve actual disputes	Prevent future disputes
<b>Outcome</b>	Binding agreement	Binding resolution of dispute	Outcome letters providing comfort and possible resolution of specific issues
<b>Years Covered</b>	5+ years, some prospective, potential rollback	Past years subject to audit and assessment	1-2+ completed years plus 2 roll forward years
<b>Right of Access</b>	Discretionary but routinely granted	Matter of right for eligible taxpayers and issues	Discretionary and selective
<b>Number of Tax Administrations</b>	1 (unilateral), 2 (bilateral), 3+ (multilateral)	2 or more	3 or more
<b>Information Required</b>	Extensive	Issue specific, but usually moderate	Limited; prescribed documentation packages
<b>User Fee</b>	Yes, in US and many countries	No	No
<b>Typical Time to Complete</b>	~2-4 years	~1.5-2.5 years	~1 year
<b>Taxpayer Participation</b>	Significant interaction with tax authority(ies) but not during government-government negotiations	Modest interaction with tax authorities and not during government-government negotiations	Significant interaction with tax authorities to inform tax authorities of taxpayer’s operations and transfer pricing

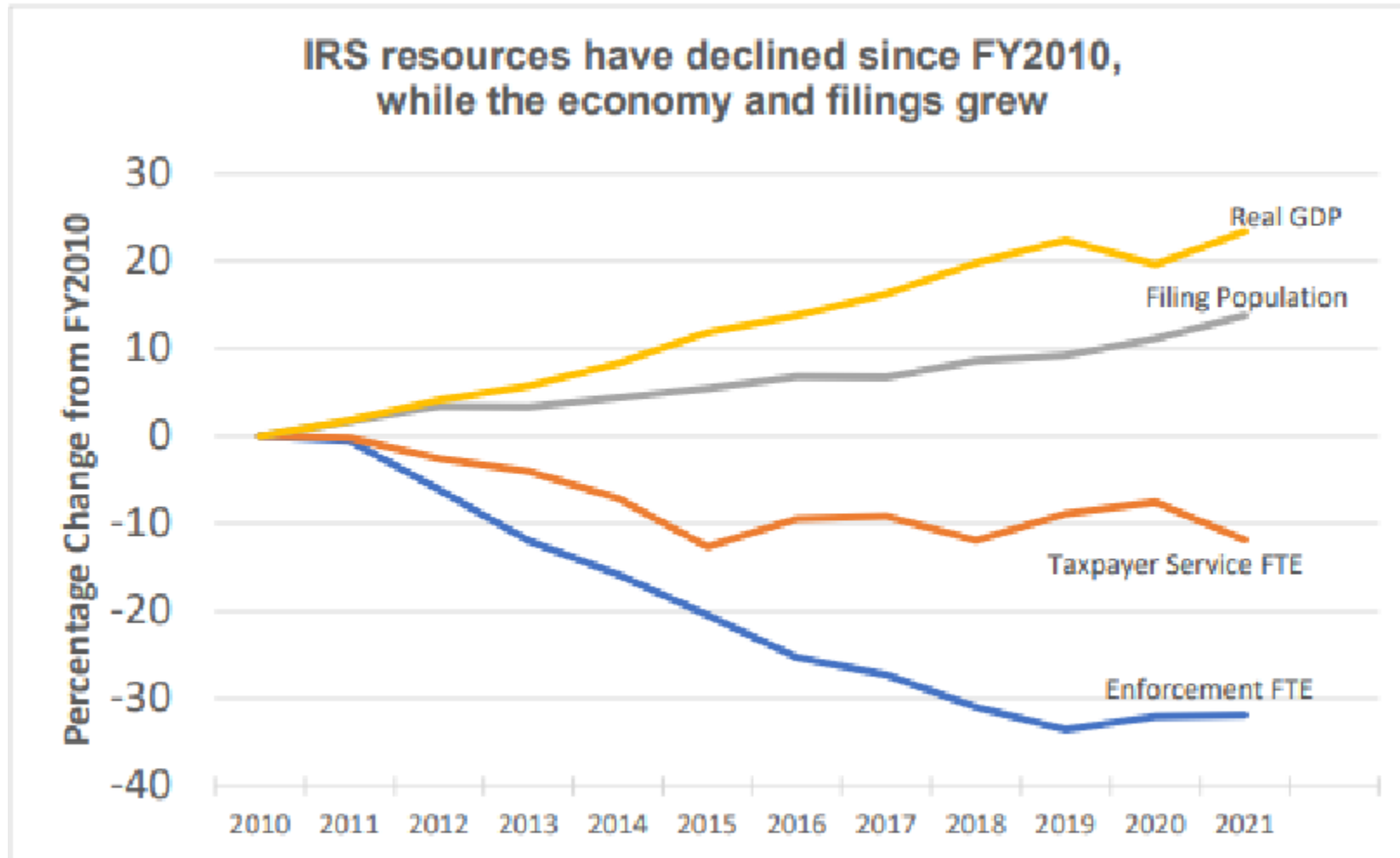


# Flowchart for IRS APMA Guidance (2023)

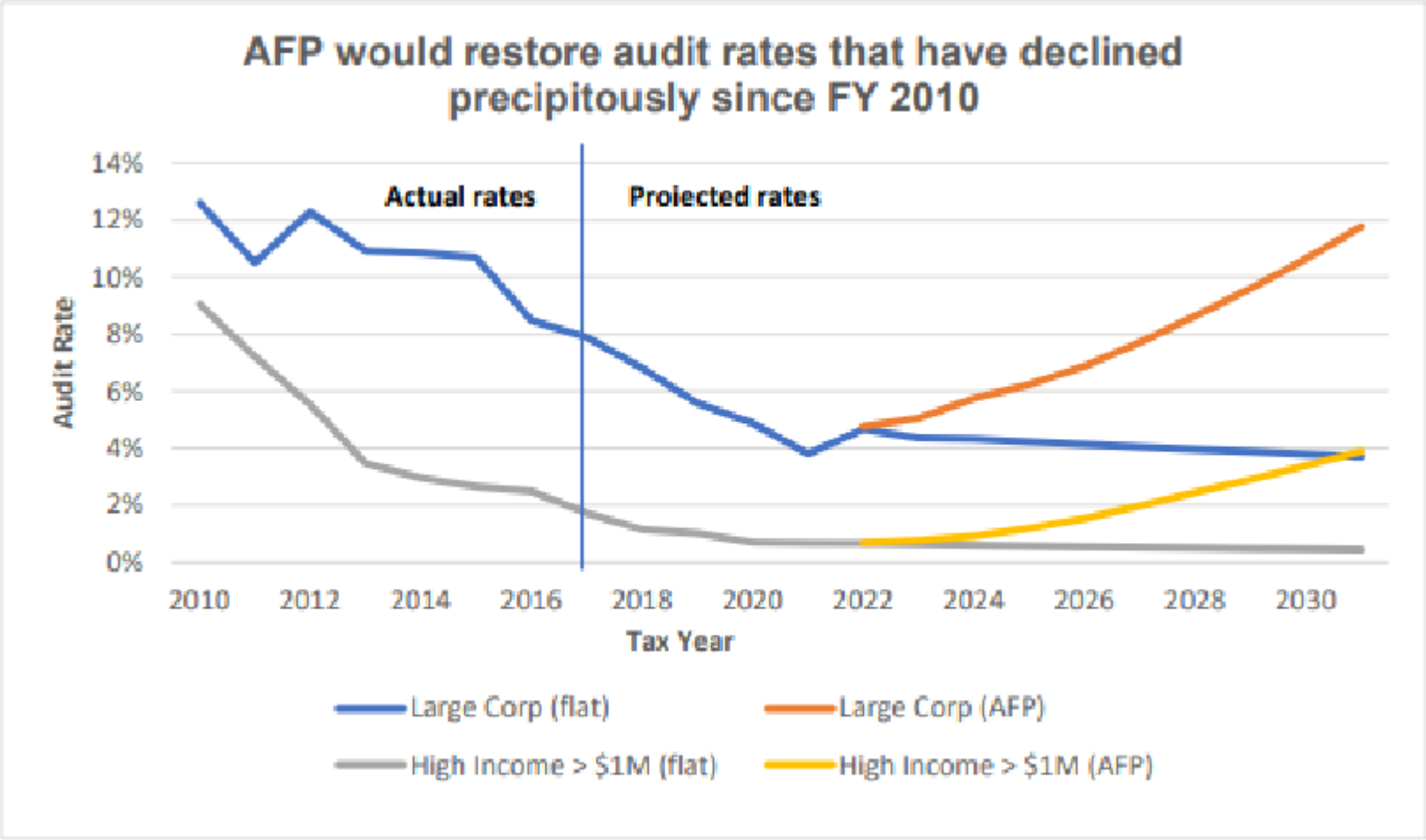


# **AI and Data Analytics in Transfer Pricing Enforcement**

# IRS Resources v. Economy Growth



# Historical v. Projected Audit Rates



# Inflation Reduction Act Funding Package

- Enacted in 2021
- \$80 billion in increased IRS funding over the next 10 years
- \$45.6 billion earmarked for enforcement
  - Examinations, collections, criminal investigations, legal and litigation support, and digital asset monitoring
- This is over and above the annual IRS operating budget
- Reduced by \$20 billion in 2023 as part of budget compromise

# IRS Strategic Operating Plan (2023)

- Detailed proposals for how the IRS will spend its \$80B IRA windfall
- Strong emphasis on enforcement against large corporations
  - Prioritizing hiring of subject matter experts (not just accountants and lawyers)
  - Centralized planning – the field will have even less discretion than today
  - Data analytics is a priority – the term “analytics” appears 149 times
    - Statistical outliers at higher risk
    - Enforcement priorities will emanate from “black box” algorithms; IRS explanations will be ex post rationalizations
- Planning phase will continue through FY24; implementation will likely take place in FY26 and beyond
- Transfer pricing is a top enforcement priority in the plan

# IRS & Data Analytics: A Brief History

- Discriminant Function System (DIF) score
- IRS Office of Compliance Analytics (2011-16): mainly identify theft and refund fraud
- IRS Office of Research Applied Analytics & Statistics (2016)
- IRS \$99 million contract with Palantir (2017): Lead Case Analytics software
- LB&I Campaigns: compliance targets identified in part by data analytics
- International Compliance Assurance Program (ICAP)
  - Multinational group of tax authorities
  - Pooling CbC and other data to perform risk analysis of TP issues
  - IRS able to piggy-back on more advanced tax authorities' tools
- Additional examples in Appendix

# IRS Access to Comprehensive IP Database

- Effective in 2022, IRS procured access to comprehensive database of IP transactions and service agreements dating back to at least 2000
- “At a minimum, the database should contain all publicly available IP transactions and Service Agreements gathered from sources including company filings, regulatory filings, Freedom of Information Act (FOIA) requests and FOIA-like requests.”
- “The database should provide analytical tools used in standard transfer pricing analyses. Ideally, the database should provide a numerical summary of the search results, including an interquartile range based on IRC Section 482 definitions.”
- “A primary consideration is the effectiveness of the search engine that would enable IRS tax practitioners to meet LB&I’s regulatory needs (i.e., the arm’s length standard). The IRS transfer pricing analyst must be able to search on key characteristics of the transaction under examination to derive an appropriate pool of potential comparable transactions. The interface should be user-friendly and laid out in an intuitive manner. If needed, the IRS will assemble a panel of transfer pricing analysts to demo the database products to determine the efficacy of the product.”



# Example: Social Media Trawling

- IRS Request for Information Regarding Social Media Research (Dec. 18, 2018, modified Jan. 30, 2019 and Feb. 19, 2019): trawling social media accounts to “assist with previously identified tax compliance cases”
- Recent IRS contract with data broker, Digital Envoy, which tracks real-time location data for over 25% of the adult US population, including data from popular dating apps
- Why is the IRS so interested in the intimate personal details of US taxpayers?
- Classic case: Instagram posts showing lavish lifestyle
- Relevant to transfer pricing audits as well
  - LinkedIn – are key employees still identifying US as their home?
  - Corporate social media accounts – do descriptions of transactions, offices or functions match transfer pricing position?

# IRS And Data Analytics: Coming Attractions

- Commissioner Werfel has made increased use of data analytics/AI a management priority
- Large multinational businesses are explicit targets of enforcement push
  - Announcement of 60 new audits of the largest corporate taxpayers
- IRS LB&I enforcement priority against inbound taxpayers
  - 150 US subsidiaries of foreign corporations will receive “compliance notices” on their transfer pricing
  - IRS promises “swift and aggressive action” against these taxpayers
- Data analytics will be key to IRS audit targeting for this population

# Use of AI and Data Analytics in Europe

- Which tax authorities are leveraging AI and data analytics in Europe?
- Some tax authorities view ICAP as a mechanism to “piggy back” on more advanced data analytics of other jurisdictions
- How do those efforts appear to compare with IRS efforts?
- What takeaway points are relevant for MNCs?

**Q&A**

**Thank you!**

# Appendix

# **New EU Transfer Pricing Directive**

# EU Transfer Pricing Proposal - Structure

## Chapter I General provisions

- **Scope of the Directive**
- **Definitions**

## Chapter II Transfer pricing rules

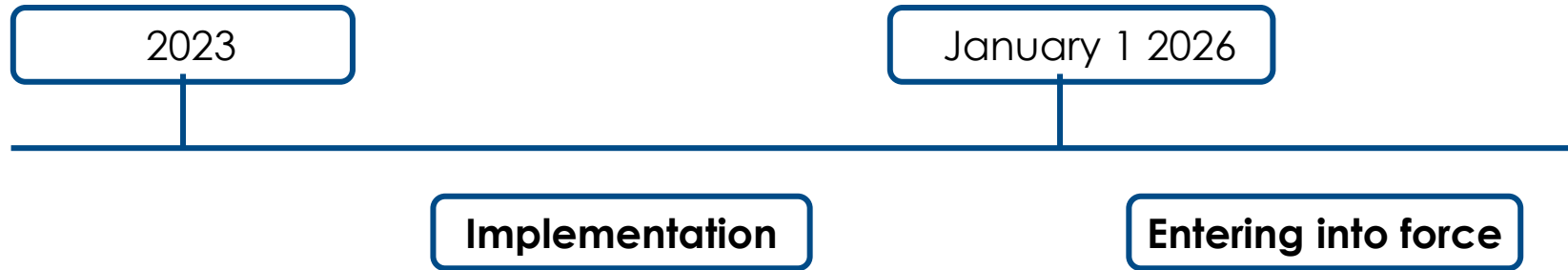
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- **Compensating adjustment**
- **Identification of the commercial and financial relations**
- **TP Methods**
- **Most appropriate method**
- **Comparability analysis**
- **Determination of the arm's length range**
- **Transfer pricing documentation**

## Chapter III - IV Organization/ Final provisions

- **Application of the ALP**
- **Evaluation of the Directive impact**
- **Exercise of delegation**
- **Implementation and entering into force**

# EU Transfer Pricing Proposal - Transposition

*Transposition - Art. 20*





# EU Transfer Pricing Proposal

## *Corresponding adjustment - Art. 6, § 1*

In case of a *primary adjustment* in a MS, the State of the counterparty shall guarantee that a **unilateral corresponding adjustment** will be put in place in order to eliminate the double taxation within **180 days if specific conditions are met**

If the MS to which the corresponding adjustment has been asked agrees that the primary adjustment is in line with the ALP both in principle and in relation to the amount (lett. a)

If the primary adjustment determines the taxation of profits already taxed by the MS to which the corresponding adjustment has been asked (lett. b)

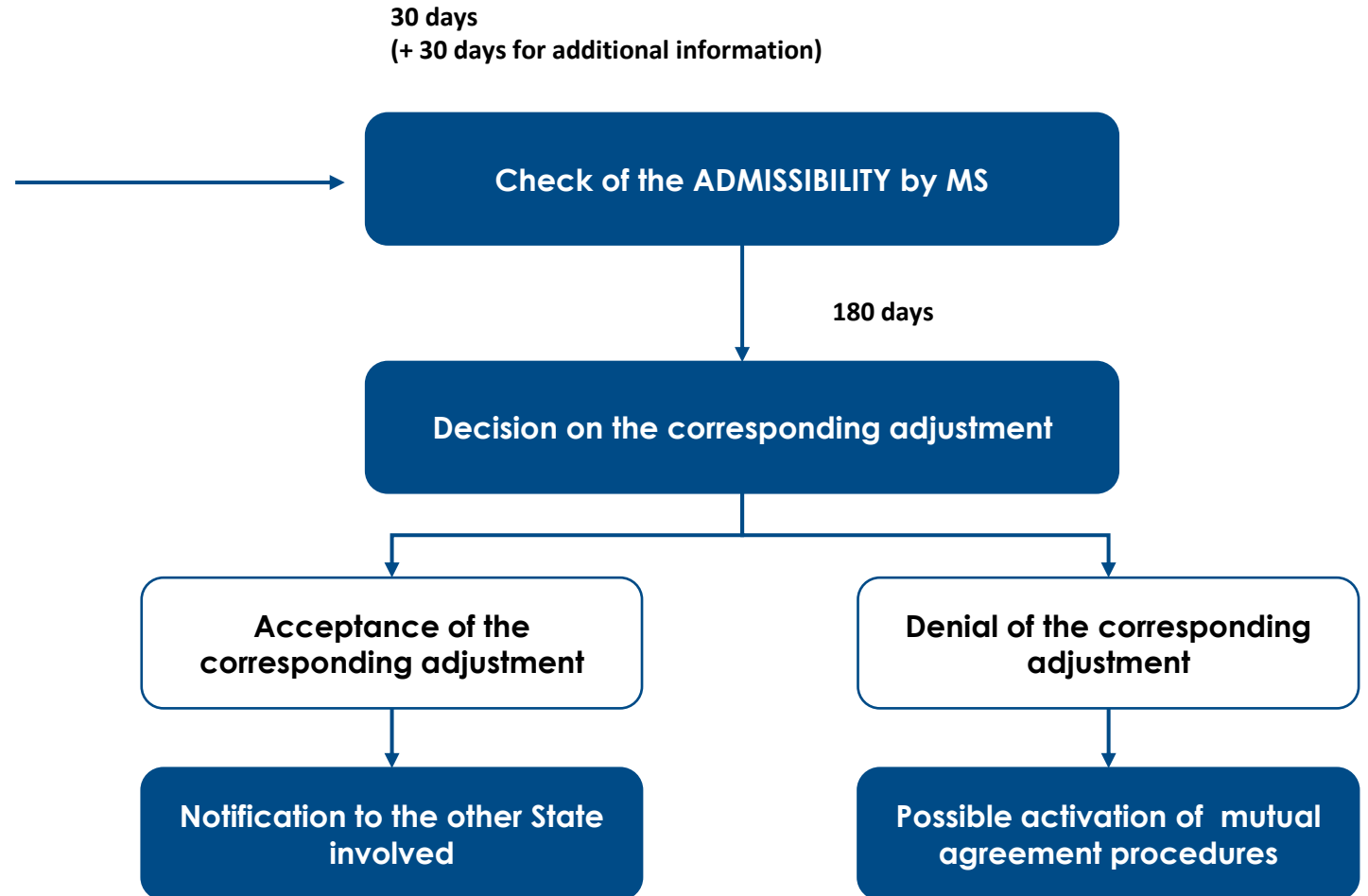
In the presence of a DTC if a third jurisdiction is involved (lett. c)

# EU Transfer Pricing Proposal

Corresponding adjustment - Art. 6, § 3

## Taxpayer shall submit the request:

- Indicating the **factual and legal circumstances** based on which the primary adjustment is deemed in line with the ALP
- Providing a **certificate** (or an equivalent document) **attesting the definitive nature of the primary adjustment**. If it is still not definitive on the date of the submission of the request: (i) this is to be indicated in the request and (ii) the corresponding adj could be recognized only when the primary adjustment is final



# EU Transfer Pricing Proposal

*Corresponding adjustment - Art. 6, § 3, lett. e)*

If the unilateral corresponding adjustment is denied it will be possible to activate

*DTC's MAP*

*Arbitration Convention*

*Directive EU 2017/1852*

# EU Transfer Pricing Proposal

*Corresponding adjustment - Art. 6, § 4 Joint Audit*

The corresponding adjustment shall be recognized **in case of joint audit** if

**The Tax Authorities involved agree  
on the determination of the  
audited transfer prices (lett. a)**



**The primary and the  
corresponding adjustment are  
symmetrically recognized (lett. b)**

# EU Transfer Pricing Proposal

*Corresponding adjustment - Art. 6, § 5, Downward adjustment*

The MS could recognize a **downward adjustment** in the absence of a *primary adjustment* if

The downward adjustment is in line with the ALP (both in principle and on its amount)  
(lett. a)

a corresponding amount is included in the profits of the associated enterprise  
(lett. b)

the intent to recognize a downward adjustment has been communicated to the other jurisdiction\*  
(lett. c)

**This mechanism allows the State recognizing the downward adjustment to assess that there is not a double non-taxation**

\* Explanatory memorandum and Recital (7) provide that this provision is aimed at ensuring that MSs can preserve their national tax sovereignty and the right to assess [...] that there is neither double taxation nor double non-taxation.

# EU Transfer Pricing Proposal

## Compensating adjustment - Art. 7

Means an adjustment in which the taxpayer reports a transfer price for tax purposes that is, in the **taxpayer's opinion**, an arm's length price for a controlled transaction, **even though this price differs from the amount actually charged between the associated enterprises**

(in line with the OECD TPG)



**Accepted by each MS in the form of a year-end adjustment initiated by the taxpayers when five conditions are met:**

1. before recording the relevant transaction, or series of transactions, the taxpayer made reasonable efforts to achieve an arm's length outcome;
2. the taxpayer makes the adjustment symmetrically in the accounts in all MSs involved;
3. the taxpayer applies the same approach consistently over time;
4. the taxpayer makes the adjustment before filing the tax return;
5. the taxpayer is able to explain why its forecast did not match the result achieved.

# EU Transfer Pricing Proposal

*Transfer pricing methods, comparability analysis and AL range - Arts. 9-12*

The proposal is substantially in line with the OECD *TPG*  
Some differences concern:

## **Selection of the method (Art. 11)**

no explicit reference to a natural hierarchy of the methods. On the contrary, the OECD *TPG* (§ 2.3) state that the traditional transaction method is preferable to the transactional profit method and that the CUP method, if applicable, is to be preferred.

## **Arm's length (AL) range (Art. 12)**

interquartile range vs full range (§ 3.62)  
median vs any point (§ 3.61)

# EU Transfer Pricing Proposal

## *Transfer pricing documentation - Art. 13*

- The taxpayer shall have sufficient sufficient information and analysis available to verify that the conditions of its transactions with associated enterprises are in accordance with Article 4(1) and should at least encompass the elements referred to in articles 8, 9, 10, 11 and 12.
- The Commission shall be empowered to adopt **delegated acts**, in accordance with **Article 18**, by laying down common templates, setting linguistic requirements, defining the type of taxpayer to abide by these templates and the timeframes to be covered.



### **Article 18 – Exercise of delegation**

- The delegation of power referred to in Article 13 may be revoked at any time by the Council. A decision to revoke shall put an end to the delegation of the power specified in that decision. It shall take effect the day following the publication of the decision in the Official Journal of the European Union or at a later date specified therein. It shall not affect the validity of the delegated act if already in force.
- **Before adopting the delegated act, the Commission shall consult experts designated by each Member State [...].**
- As soon as it adopts the delegated act, the Commission shall notify it to the Council.
- The delegated act shall enter into force without delay and shall apply as long as no objection is expressed by the Council. The Council may object to the delegated act within two months of the notification of that act. That period shall be extended by two months at the initiative of the Council. In such a case, the Commission shall repeal the act immediately following the notification of the decision to object by the Council.



# EU Transfer Pricing Proposal

## *Application of the ALP - Art. 14*

- Member States shall ensure that transfer pricing rules are applied in a manner **consistent with the OECD TPG**.
- The Council may lay down further rules, consistent with the OECD TPG, on how the arm's length principle is to be applied in **specific transactions** (transfer of intangibles, provision of services, cost contribution arrangements, transactions in the context of business restructurings, financial transactions, dealings between the head office and its permanent establishments).
- The said further rules be taken by means of Council **implementing acts** based on a proposal from the Commission.



### **Reference to the OECD TPG**

- The last version of the OECD TPG is binding for MS in applying the ALP.
- *The Explanatory Memorandum* recognizes that, in order to grant the homogeneous application of the ALP, the last version of the OECD TPG shall apply.
- The Proposal makes reference to the 2022 version of the OECD TPG and to possible amendments approved by the European Union via the OECD Committee on fiscal affairs through the adoption of EU acts pursuant to art. 218, par. 9, TFUE.
- Moreover, the Commission can propose future amendments to the Directive.

# **AI and Data Analytics in Transfer Pricing Enforcement**

# Example: Taxpayer Information Gateway Contents

AIMS 1120 Summary.xls	Law Enforcement Privilege; Non-responsive/relevant materials redacted
BRTF 945 Withheld Federal Income Tax.xls	Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF 1120 Income Tax Reserve Change.xls	Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF 1120 Bardahl Formula for Manufacturing Industry.xls	Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF 1120 M3 Other Income_Loss and Other Expense_Deduction.xls	Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF 1120 Other Line Items.xls	Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF M-3 8916-A .xls	Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS 1120 Sch M3 Part III Expense_Deduction Items.xls	Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS 1120 Effective Tax Rate Percentage.xls	Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS 1120 Sch M3 Part I and II.xls	Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS 5471 2007 Comprehensive Analysis.xls	Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS 5471 2007 WorldProfitAnalysis.xls	Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS 5471 2008 Comprehensive Analysis.xls	Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS 5471 2008 WorldProfitAnalysis.xls	Deliberative Process Privilege; Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS 5471 2009 Comprehensive Analysis.xls	Deliberative Process Privilege; Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS 5471 2009 WorldProfitAnalysis.xls	Deliberative Process Privilege; Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS 5471 2010 Comprehensive Analysis.xls	Deliberative Process Privilege; Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS 5471 2010 WorldProfitAnalysis.xls	Deliberative Process Privilege; Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS 5471 2011 Comprehensive Analysis.xls	Deliberative Process Privilege; Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS 5471 2011 WorldProfitAnalysis.xls	Deliberative Process Privilege; Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS 5471 2012 Comprehensive Analysis.xls	Deliberative Process Privilege; Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS 5471 2012 WorldProfitAnalysis.xls	Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS_BRTF 1120 Expenses to Total Income Percentages.xls	Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS_BRTF 1120 Income Statement Book Tax Differences.xls	Deliberative Process Privilege; Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS_BRTF 1120 Income_Balance Sheet Year to Year Percentage Change.xls	Deliberative Process Privilege; Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS_BRTF 1120 Line Items to Gross Profit Percentages.xls	Deliberative Process Privilege; Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS_BRTF 1120 Ratios.xls	Deliberative Process Privilege; Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS_BRTF 1120 Summary and Details.xls	Deliberative Process Privilege; Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS_BRTF 1120 Tax Computation.xls	Deliberative Process Privilege; Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS_PSC 5471 Analysis.xls	Deliberative Process Privilege; Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_DCS_PSC 5472 Analysis.xls	Deliberative Process Privilege; Law Enforcement Privilege; Non-responsive/relevant materials redacted
MeF_PSC_DCS 851 Affiliations.xls	Deliberative Process Privilege; Law Enforcement Privilege; Non-responsive/relevant materials redacted

As of 2014

# IRS “Special Projects Sandbox”

Contract awarded to Eastport Analytics in 2019:

To improve the [redacted] it is essential for IRS to maximize its ability to identify non-compliant taxpayers while reducing the inconvenience to many compliant taxpayers.

[redacted] Research, Applied Analytics, & Statistics (RAAS) delivers rapid analytical results for, and operational insights into, some of the most difficult and pressing non-compliance issues facing IRS mission areas. The Large Business & International (LB&I) organization through its role in administering treaties and managing compliance relationships with other countries collects a significant amount of data. Moreover, Treaty and International Individual Compliance program office analysts need to effectively organize the collected data to supply compliance teams across the IRS with useable and actionable international data.

[redacted] When new international data comes in, the (b)(4) [redacted] allows the analysts involved to determine how to best make use of the information. Search tools, analytic techniques, and classification systems are often deployed on top of these International datasets. Some examples of these international datasets include [redacted]

[redacted] and many others.