



International Tax Update

International Tax Developments Audits and Appeals 2018

David Fischer, Crowell & Moring

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Agenda

- IRS International Organization
- Tax Cuts & Jobs Act: Early Issues
- Case Developments
- New Transfer Pricing Audit Guidelines
- iCAP
- International discovery

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U.S. International Tax

U.S. Treasury Department	IRS Office of Chief Counsel	IRS Large Business & International
Deputy Assistant Secretary (International Tax Affairs) LG Chip Harter	Chief Counsel, IRS William M. Paul (Acting)	LB&I Commissioner Douglas O'Donnell
Deputy Assistant Secretary (Tax Policy) (Vacant)	Associate Chief Counsel (International) Marjorie Rollinson	LB&I Deputy Commissioner Nikole Flax
International Tax Counsel Tom West	Deputy Associate Chief Counsel (International) Daniel M. McCall	Director, Treaty & Transfer Pricing Operations Jennifer Best
Deputy International Tax Counsel Brian Jenn	LB&I Deputy Division Counsel (International) Kathryn Patterson (Acting)	Director of Field Operations Transfer Pricing Practice John Hinman

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Tax Cuts and Jobs Act of 2017

Early possible Exam Issues

- Repatriation on Transition to Participation Exemption System (Section 965)
 - Frequently Asked Questions / Proposed Regulations (August 8, 2018)
 - IRS Campaign: “alert potentially impacted taxpayers about new filing and payment obligations”
 - Rev. Proc. 2018-17, limit CFC elections of November 30 tax years
- Foreign Derived Intangibles Income deduction / Global Intangibles Low-Taxed Income inclusion
 - GILTI Proposed Regulations (September 13, 2018)
 - Lack of guidance on Foreign Tax Credit issues
- Base Erosion and Anti-Avoidance Tax
 - COGS (payments for goods) are not base-erosion; are software payments COG or royalties? embedded royalties? sales commissions v resales?

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Tax Cuts and Jobs Act of 2017

Early possible Exam Issues

- Withholding on Transfers of Partnership Interests
 - Notice 2018-08, “PTP” Notice, publicly traded partnerships excepted
 - Notice 2018-29, use FIRPTA procedures to withhold
- Gain on Sale of Partnership interest
 - Overruled *Grecian Magnesite*

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Does Tax Reform Conflict with Treaties?

- Savings clause: can tax domestic residents as if Treaty does not exist
- Non-discrimination: not impose taxes on foreign entities more burdensome tax than on domestic entities
 - Savings clause not applicable to non-discrimination
- Do BEAT, GILTI, FDII violate non-discrimination?
- Treaty override
 - Last in time (no new U.S. treaties ratified since 2010)
 - Specifically provide that override
- Potential for challenge prior to tax being applied (*US Chamber of Commerce*)

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Transfer Pricing Examination Process (TPEP)

- Publication 5300, June 29, 2018, updated August 2018
 - Replaces Transfer Pricing Audit Roadmap, follows Publication 5125, LB&I Examination Process
 - Similar Phases: Planning, Execution, Resolution
- Incorporates review of Country by Country Report in Planning
- Working hypothesis in planning phase, with caution that need to review
- Request Transfer Pricing Documentation in Execution Phase
 - Mandatory Transfer Pricing Documentation IDR no longer mandatory (Jan. 12, 2018 Memorandum)
 - Applies if Transfer Pricing Operations or Cross-Border Activities assigned, or instructed in Campaign
- Ratio analysis as part of Execution
- Incorporates Acknowledgment of Facts

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Transfer Pricing: Selection of Methods

- In LB&I cases, Treaty and Transfer Pricing Review Panel (in Transfer Pricing Operations) to review decisions by Exam to change transfer pricing method from method used by taxpayer
 - Consists of TPPO Director, or APMA Director, a Senior Advisor, and the income-shifting practice network manager
- Conditions
 - Taxpayer timely provides Transfer Pricing Documentation
 - Includes best method analysis
 - Applies specified method
- Standard: facts and circumstances - reliability
 - Consider whether adjustments to Taxpayer method can be made to make it more reliable
- Degree of Taxpayer participation unclear

(Directive LB&I 04-0118-002)

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ICAP

International Compliance Assurance Programme

- Joint review of transfer pricing risks by several jurisdictions cooperatively
- Pilot program launched in January, 2018: US / Canada lead
 - Arises out of APA , BEPS, CAP, CbC
 - Participation by 8 OECD countries: Australia, Canada, Italy, Japan, the Netherlands, Spain, the UK, the US
- Handbook: “risk assessment process”
 - Transfer pricing documentation, country-by-country reports
 - Kickoff meeting, share information with all countries
 - Participating countries each assess risks
 - Each country prepares “CAP outcome letter”
- Assessment of “high risk” will result in examination in country
- Concern: is this the first step to global formulary apportionment? Safe harbor?

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Altera

Arm’s Length Standard Concerns under Ninth Circuit reversal, now withdrawn

- Commensurate with income means can allocate under Section 482 without regard to comparable transactions or arm’s length methods
- Acceptable for Treasury to ignore evidence of arm’s length transactions when issuing Regulations under Section 482
- Reminiscent of *Xilinx*, issued and withdrawn after uproar re Treaty obligations requiring arm’s length standard

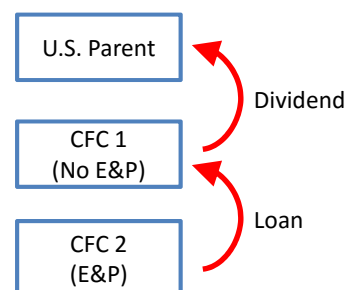


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Illinois Tool Works (T.C. Memo 2018-121)

Repatriation Strategy Upheld

- Loan from lower tier CFC to upper tier was *bona fide* debt
- Debt / equity factor analysis: intent to repay, control, dividend history, presence of indicia of debt (form), treatment in corporate records, ability to pay/size of advance, record of repayment, use of funds, “thinness”
 - Found heavily favor debt treatment
- Avoidance of Subpart F:
 - Leave to Congress to “repair shortfall”
 - Fix had been proposed, not adopted



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Medtronic (8th Circuit Reversing and Remanding to Tax Court)

“The Jig Is Up” (anonymous)

- Medtronic develops and sells medical devices (Cardiac), manufactured by Puerto Rico subsidiary
- Taxpayer and Tax Court adopted comparable uncontrolled transactions (CUT) based on settlement of lawsuit with Pacesetter
- Eighth Circuit:
 - Tax Court factual findings insufficient to evaluate use of CUT (remand)
 - Hostility toward CUT
 - Settlement circumstances; not “ordinary course”
 - Comparability of contractual terms (Cross license)
 - Presence and coverage of other intangibles
 - Risk/product liability expense\
- Prediction of result on remand?

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Coca-Cola (Tax Court)

- Coke's transfer pricing was based on a 1996 Closing Agreement, resolving prior years
 - 10% routine return, 50/50 profit split
- Coke had relied on Closing Agreement from 1987 through 2004, accepted by the IRS
- \$3 billion Transfer pricing case for 2007-2009, trial completed (Judge Lauber)
- Coke won summary judgment re Foreign Tax Credits for Mexican taxes
 - Compulsory payment requires "reasonable determination" and "exhaustion of remedies"
 - Not need to wait until Tax Court litigation over
 - Coke sought Competent Authority assistance and was denied by IRS
 - Adjustments and deficiency claim if Mexican taxes end up less

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Questions?

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