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# *Exam*

## *Continued Emphasis on Transfer Pricing Issues in Examinations and How to Resolve Transfer Pricing Disputes*

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## I. Introduction

Transfer pricing, or the practice of pricing transactions between related parties, has increasingly become an enforcement priority for many tax authorities. Transfer pricing can result in the allocation of profits of large multinational enterprises ("MNEs") between two or more countries (and, hence, determine the tax revenue for those countries), so it is a high priority for many tax authorities. Fortunately, taxpayers in the United States have bilateral opportunities to avoid and resolve transfer pricing disputes as a result of bilateral income tax treaties, in addition to domestic avenues. This column will discuss the challenges facing U.S. taxpayers engaging in cross-border transactions with related parties and how they can navigate through a bilateral resolution when transfer pricing disputes arise.

## II. The Transfer Pricing Landscape

Transfer pricing in the United States is governed by Code Sec. 482 and the underlying regulations (Reg. §1.482-1 *et seq.*), which require U.S. taxpayers to report profits or results from transactions with related parties consistent with those that would have been achieved in arm's-length transactions between unrelated parties. Where taxpayers fail to price their intercompany transactions in such a manner, the Internal Revenue Service ("IRS") may apportion or allocate gross income, deductions, credits, or allowances among related parties as necessary to prevent the evasion of taxes or to clearly reflect income of the U.S. taxpayer. Code Sec. 482 further directs that income from the transfer or license of intangible property be "commensurate with the income attributable to the intangible."

As the complexity and prevalence of intercompany cross-border transactions increase, so does transfer pricing enforcement by tax authorities. In the United States, transfer pricing regulations date back to the 1930s, but beginning in the 1960s, the IRS has issued extensive regulations on how to determine an arm's-length price for a variety of intercompany transactions. Following a major rehaul in the 1990s (and with subsequent revisions), these regulations have served as the foundation for IRS enforcement efforts focused on transfer pricing compliance. Many foreign countries have developed transfer pricing rules similar to those in the United States with a long history of enforcement activities.

Global efforts have also impacted the landscape of transfer pricing and compliance efforts. Much of this work has been led by the Organisation for Economic Co-operation and Development ("OECD"). The OECD's model tax convention, first published in 1963, serves as the template for many international bilateral tax treaties. The OECD's Transfer Pricing Guidelines ("TPG"), first published in 1995, provide a common basis for resolving transfer pricing disputes in accordance with the arm's-length principle under income tax treaties between OECD member countries or other countries that have adopted the TPG. In 2013, the OECD started work on an international tax framework to combat tax avoidance by MNEs using base erosion and profit shifting ("BEPS"). The resulting reports published in 2015 included changes to the TPG and other proposals, many of which have been enacted into law, aimed at enhancing compliance and aligning the taxation of MNEs with the locations where they earn profits.[1]

This work led to the OECD's guidance on country-by-country ("CbC") reporting in 2015, now adopted in some form by many countries, including the United States.[2] CbC reporting requires large MNEs to reconcile financial statement data and allocate income, profit, taxes paid, and economic activity to each jurisdiction in which they operate. These reports are shared with tax administrations to assess risks associated with transfer pricing and BEPS activities. As of January 1, 2025, in the European Union ("EU"), portions of the CbC reports filed by MNEs with consolidated group revenues greater than EUR 750 million are made public.

The OECD has also worked with a group of countries known as the "Inclusive Framework" to address the tax challenges posed by the digitalization of the economy. In 2017, a two-part framework called "BEPS 2.0" was proposed: Pillar One would reallocate certain amounts of taxable income for large MNEs to market jurisdictions, meaning tax would be imposed on MNEs that provide digital services in jurisdictions where they do not have a physical presence and that, under prior law, would not have been subject to tax. Pillar Two would ensure that income is taxed at a certain rate under the Model Global Anti-Base Erosion ("GloBE") rules, currently set at 15 percent for MNEs with revenues over EUR 750 million.[3] Pillar Two has been enacted into domestic law by most EU member states and many other countries. Adoption of Pillar One would require a multilateral convention; while a draft convention was published in 2023, it is not clear when (or whether) there might be sufficient consensus among participating countries to issue a final convention that is open to signature.

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The future of the OECD's work on BEPS and its interactions with the U.S. tax system is uncertain. Historically, the United States has generally supported the OECD's work on BEPS and implemented guidance that aligns with some of its recommendations. In 2021, the Biden administration joined a political agreement with respect to Pillar Two, including a commitment to respect the application of Pillar Two by countries that adopted it. But the Biden Administration was unable to garner sufficient support in Congress to revise existing U.S. law (notably the global intangible low-taxed income ("GILTI") and base erosion and anti-abuse tax ("BEAT") rules) to more closely align with the OECD framework. As of January 2025, the new Trump administration issued a memorandum that voided any prior political commitments made with respect to the BEPS project that have not been enacted by Congress.

## III. IRS Audits of Transfer Pricing Arrangements

Disputes over transfer pricing arrangements generally arise from an audit by a tax authority of one or more members of an MNE. In the United States, such audits are managed by treaty and transfer pricing operations ("TTPO") within the Large Business and International ("LB&I") division of the IRS. TPPO includes national transfer pricing specialists who develop and coordinate transfer pricing strategy, training, and operational approaches. Examinations by TPPO are guided in part by the transfer pricing examination process ("TPEP") publication.[4] TPEP is intended to help facilitate an understanding between the IRS and taxpayers regarding the transfer pricing audit process and to improve communications and efficiency, and is worth review by taxpayers faced with a transfer pricing audit.

While transfer pricing audits generally proceed similarly to those on non-transfer pricing issues, they do have a tendency to become protracted due to the uncertainties inherent in questions of valuation and the factual nature of intercompany transactions. These issues drive one of the primary challenges of transfer pricing audits and disputes: the potential resource drain. Taxpayers subjected to a transfer pricing audit may have to undertake the time-intensive tasks of identifying and providing documentation (not just on the tax positions taken, but also on the core functions, assets, and risks involved in the intercompany transactions), valuation and financial records, and possibly making company personnel available for interviews. Taxpayers may find it beneficial to preemptively review (and potentially revise as appropriate) their documentation on the related-party transactions, intercompany agreements, and the company's transfer pricing policies. Written agreements can be a particularly powerful tool in a transfer pricing audit, as regulations require the IRS to respect written contractual terms, including the allocation of risk, that align with the economic substance of the related-party transaction.[5]

Taxpayers should also review their transfer pricing analysis (and supporting contemporaneous documentation) to ensure that it reflects any relevant changes, such as in the operations of the business. Since 2018, the IRS has increasingly asserted penalties under Code Sec. 6662 for inadequate or incomplete contemporaneous transfer pricing documentation. Code Sec. 6662 imposes a 20- or 40-percent nondeductible penalty for Code Sec. 482 adjustments that increase U.S. tax.[6] Penalties can be avoided if the taxpayer demonstrates that it determined the intercompany price using a transfer pricing method in a reasonable manner and maintains (and produces upon request) contemporaneous documentation.[7] The IRS' 2020 frequently asked questions ("FAQs") on transfer pricing documentation elaborate on areas where documentation may be deficient and how it can be reinforced.

## IV. Resolution of Disputes Resulting from Transfer Pricing Adjustments

If an IRS audit results in an adjustment to the profits of a U.S. taxpayer from an intercompany transaction, the U.S. taxpayer has a number of avenues to resolve the dispute. The U.S. taxpayer can take advantage of the routes traditionally available to challenge an IRS adjustment, such as through the IRS Independent Office of Appeals ("Appeals"), various alternative dispute resolution ("ADR") procedures, and litigation. The U.S. taxpayer is also equipped with one additional and very powerful tool: the mutual agreement procedure ("MAP") process provided in bilateral tax treaties. MAP provides a mechanism for the competent authorities in two jurisdictions to discuss and reach a compromise regarding a transfer pricing adjustment initiated in one jurisdiction that impacts the tax results in the second jurisdiction. However, if a taxpayer wishes to dispute a U.S.-initiated adjustment, they must choose between either Appeals or MAP. More details about when this decision must be made are set forth below.

### A. U.S. Tax Treaties

The United States has bilateral tax treaties with more than 60 countries, most modeled after the U.S. Model Income Tax Convention (the "U.S. Model Treaty," most recently revised in 2016[8]), though there are material differences in many treaties as a result of negotiations with treaty partners and when the treaties were negotiated. Bilateral tax treaties provide a framework to resolve a number of issues, including transfer pricing disputes as well as withholding tax, residency, permanent establishment, and limitations on benefits. Because the provisions of each bilateral tax treaty vary, this column discusses primarily the provisions of the U.S. Model Treaty.

Two articles of the U.S. Model Treaty are central to the resolution of transfer pricing disputes: the Associated Enterprises article and the MAP article. The Associated Enterprise article (Article 9) generally provides that where related parties engage in "commercial or financial relations" that are different than those that would have existed between unrelated parties, each contracting state may tax the profits that would have resulted had such conditions not existed. Article 9 further provides that when one contracting state makes an allocation and taxes the resulting profits, the other contracting state shall make an appropriate adjustment to the tax imposed on those profits (*i.e.*, provide correlative relief). In this regard, the Associated Enterprise article instructs that the competent authorities of the contracting states shall consult, as necessary.

The MAP article (Article 25) allows taxpayers who are subject to "taxation not in accordance with the provisions of [the tax treaty]" to seek relief through the competent authority of one or both contracting states. The competent authority of one contracting state may provide unilateral relief or "shall endeavor" to resolve the issue through a mutual agreement with the other contracting state. It is important to note that relief from taxation in contravention of the treaty (*e.g.*, double taxation) is not guaranteed.

Tax treaties commonly provide that agreements reached through MAP may be implemented notwithstanding any domestic procedural barriers, and such a provision is included in the U.S. Model Treaty ("Any agreement reached shall be implemented notwithstanding any time limits or other procedural limitations in the domestic law of the Contracting States.").[9] Thus, refunds of taxes can generally be made even if the statute of limitations has expired. However, treaties may contain time limits on when MAP requests must be made. For example, the U.S.–U.K. tax treaty requires the case be presented within the later of three years from the first notification resulting in taxation in contravention of the treaty or six years from the end of the taxable year in which the tax is imposed or proposed.[10] The U.S.–Japan tax treaty includes only the three-year period from the date of first notification.[11] And the U.S.–Korea tax treaty has no specified period of limitations.[12] Again, it is important to check the relevant treaties, as the specific provisions may vary significantly. In addition, each country may prescribe specific procedural rules for requesting MAP. The rules pertaining to MAP in the United States are discussed below.

A few tax treaties provide for arbitration if an agreement cannot be reached through the regular MAP procedures. For example, the U.S.–Canada treaty generally requires arbitration proceedings to begin two years after the commencement of the MAP, unless the competent authorities agree to a different date.[13] However, this treaty and many others exclude from arbitration cases that are not "suitable" for resolution through arbitration.[14] To date, it seems that arbitration in MAP cases remains uncommon. This is at least in part because the possibility of arbitration encourages the competent authorities to resolve the dispute before arbitration arises.

## B. U.S. Competent Authority

Within the United States, the authority to act as the competent authority is delegated to the Deputy Commissioner (International) of LB&I, and further to the Advance Pricing and Mutual Agreement Program ("APMA") within TTPO. Procedures and guidance on the U.S. MAP process are provided in Rev. Proc. 2015-40.[15] This revenue procedure sets out both the pre-filing and filing requirements and the information that must be contained in the submissions. Additionally, and of significant importance, it also discusses when MAP consideration is permitted or barred.

With respect to U.S.-initiated adjustments, MAP is effectively foreclosed if the case has been considered by Appeals.[16] Issues for which Appeals consideration has been requested pursuant to a protest can be transferred to the competent authority by severing the issues within 60 days after the opening conference with Appeals.[17] A taxpayer may also seek MAP after receiving a Notice of Proposed Adjustment from IRS Examination. Where taxpayers have reached a resolution regarding a U.S.-initiated adjustment, either administratively by executing a Form 870-AD or other similar agreement with IRS Examination, MAP may be requested, but the U.S. competent authority will only seek correlative relief from the foreign competent authority; the U.S. competent authority will not deviate from the terms of the prior settlement. The same is true if the taxpayer obtains a judicial determination or reaches a settlement in litigation.[18]

For foreign-initiated adjustments, the U.S. competent authority wants to ensure that the foreign competent authority will be able to fully negotiate the issue, including having the ability to make concessions. Thus, Rev. Proc. 2015-40 cautions taxpayers against taking any action that could be prejudicial to the process, including agreeing to or acquiescing in a foreign-initiated adjustment.[19] The U.S. competent authority has broad discretion to decline assistance in many circumstances.[20]

## C. U.S. MAP Practice and Procedure

Perhaps one of the most unique aspects of the MAP process is that the taxpayer is not involved in the actual negotiations. The U.S. competent authority has periodic meetings with its foreign counterparts. For counterparts with a high volume of cases, the meetings may be frequent (perhaps four times a year). For counterparts with low volumes, the timing of the meetings may be more episodic. These meetings are government-to-government negotiations covering multiple cases. The role of the taxpayer is to help the competent authorities prepare for such meetings.

Rev. Proc. 2015-40 sets forth the detailed information that is required to be included in the MAP submission, including:

> a thorough, informative explanation of the competent authority issues for which assistance is requested,

> including but not limited to descriptions or discussions of: a. The relevant transactions, activities, or other circumstances surrounding the competent authority issues for which assistance is requested; b. The taxpayer's understanding of the legal basis for each U.S.-initiated action, foreign-initiated action, or taxpayer-initiated position giving rise to the competent authority issues; c. The taxpayer's view on the justification for assistance under the applicable U.S. tax treaty(ies); and d. The content of any related requests for assistance submitted to the foreign competent authority, together with an explanation of any material differences between the competent authority request filed under the revenue procedure and the request filed with the foreign competent authority.[21]

It is common that as the U.S. competent authority considers the case, it will issue a number of requests for information, with the expectation that the taxpayer responds fully and cooperatively. Indeed, a hallmark to the MAP process is that the taxpayer will keep both sides fully informed of the relevant facts and legal positions, and a best practice is to ensure that information submitted to one competent authority is also submitted to the other competent authority. A taxpayer may be requested (or may initiate the request) to make a presentation to the competent authorities and, in certain circumstances (such as an unusual or complex case), the presentation may be made jointly to both competent authorities.[22]

Often, the competent authorities will meet several times in the course of negotiating a resolution of a complicated case. The potential need for multiple meetings, along with the time required for the competent authorities to review the initial request and develop a position, means that it is not uncommon for a case to last two to three years (or possibly longer). Where a resolution is reached, it may involve the full or partial withdrawal of the initial adjustment by the competent authority in the country that made the initial adjustment, the granting of full or partial correlative relief (*e.g.*, the reduction of profits) by the competent authority of the second country, or a combination of these remedies. The agreement may relieve all double taxation or a portion of the double taxation, or an agreement may not be reached resulting in no relief at all.

The U.S. competent authority has been very successful in resolving transfer pricing disputes over the years. In the five-year period between 2017 and 2021, the U.S. reported that only one to two percent of transfer pricing cases resulted in no relief.[23] However, this figure rose significantly in 2022 and 2023, with 18 percent and 13 percent of transfer pricing cases, respectively, resulting in no relief. It is unclear why this spike occurred.[24] One theory is that it may be the result of the U.S. competent authority clearing out inventories of old cases that could not be resolved. Another theory is that it reflects that transfer pricing cases are becoming increasingly complex. And yet another theory is that the mix of cases is changing; previously, the counter parties in a large percentage of U.S. transfer pricing cases were from a small number of countries, but, more recently, the counter parties come from a larger number of countries. The data for 2024 has not yet been released, but it may shed more light on this potentially evolving issue.

Once the competent authorities reach a basis for agreement, the terms will be presented to the taxpayer for acceptance or rejection. If the taxpayer rejects the resolution, the competent authorities may continue to negotiate or may close the case as unagreed. In the latter situation, the taxpayer is generally free to pursue any other domestic remedies that are available.[25]

Prior to a tentative competent authority resolution being reached, a taxpayer may request that the resolution be extended to cover subsequent tax years for which federal income tax returns have been filed.[26] For years for which the returns are not yet due, a competent authority resolution can serve as the basis for negotiating an advance pricing agreement ("APA") that resolves transfer pricing issues on a prospective basis in these years. Likewise, the U.S. competent authority may request that a taxpayer expand its MAP request to include subsequent years for which returns have been filed or issues that are interrelated to those covered by the MAP request. The U.S. competent authority may also request that a taxpayer file an APA request to cover subsequent years. The U.S. competent authority will not require that the taxpayer expand the MAP request or request an APA, but the U.S. competent authority will take a taxpayer's refusal into account in determining the extent of relief provided on the issues covered by the taxpayer's MAP request.[27]

## V. Transfer Pricing Litigation

While some transfer pricing disputes can be resolved *via* MAP (or avoided by an APA), there are cases that cannot be resolved without litigation. Until relatively recently, the IRS had a poor track record in litigating transfer pricing matters. A notable win for the IRS during this era dated back to 1979 in *E.I. DuPont de Nemours & Co*.[28] This trend changed in 2019, however, when the U.S. Court of Appeals for the Ninth Circuit sided with the IRS in *Altera Corporation*[29] regarding the validity of the regulations on the inclusion of costs associated with stock-based compensation in cost-sharing arrangements.[30] Since then, the IRS has had a number of cases dealing with high-profile taxpayers and large amounts of taxes, penalties, and interest. It seems likely that transfer pricing litigation will continue and potentially increase.

Transfer pricing cases currently in litigation cover a wide range of transfer pricing issues. For instance, taxpayers and the IRS dispute the extent to which the commensurate with income language in Code Sec. 482 authorizes the IRS to look at ex post data to adjust a transfer price, even though such data would not be used by unrelated parties, or to disregard foreign law limitations on income that can be returned to the United States.[31] Another area of IRS focus is the selection of the best method to price the intercompany transfers of intellectual property, and the proper application of those methods.[32] Litigation also abounds regarding the valuation of pre-existing intangibles that are made available to related parties in cost-sharing arrangements.[33] Finally, taxpayers have disputed the IRS' effort to lower interest rates on intercompany loans based on the "implicit support" of the parent (*e.g.*, the possibility that the parent would provide support for a subsidiary's loan obligation even if not formally required to do so).[34] These cases indicate the areas that the IRS has identified for enforcement, and taxpayers with similar issues can glean insight from the litigation positions advanced by the government. Taxpayers should monitor these cases for future developments, such as court opinions, that could have an immediate impact on the landscape of transfer pricing enforcement.

## ENDNOTES

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1 *See, e.g., www.oecd.org/en/topics/base-erosion-and-profit-shifting-beps.html#beps-actions*.
2 *See* Reg. §1.6038-4.
3 *See, e.g., www.oecd.org/en/topics/policy-issues/base-erosion-and-profit-shifting-beps.html*.
4 IRS Publication No. 5300 (Rev. 9-2020).
5 Reg. §1.482-1(d)(3)(ii)(B).
6 Code Secs. 6662(a), (e)(1)(B)(ii), (e)(3), and (h)(1).
7 Code Sec. 6662(e)(3)(B)(i).
8 *home.treasury.gov/system/files/131/Treaty-US-Model-2016_1.pdf*.
9 U.S. Model Treaty, art. 25 ¶ 2 (2016).
10 U.S.–U.K. tax treaty, art. 26 ¶ 1, *home.treasury.gov/system/files/131/Treaty-UK-7-24-2001.pdf*.
11 U.S.–Japan tax treaty, art. 25 ¶ 1, *home.treasury.gov/system/files/131/Treaty-Japan-11-6-2003.pdf*.
12 U.S.–Korea tax treaty, *www.irs.gov/pub/irs-trty/korea.pdf*.
13 U.S.–Canada tax treaty, art. 26 ¶ 6, *www.irs.gov/pub/irs-trty/canada.pdf* (Income Tax Treaty and Protocols 1, 2, 3, and 4 from 1980); *home.treasury.gov/system/files/131/Treaty-Canada-Pr2-9-21-2007.pdf* (Protocol from 2007 amending art. 26).
14 *E.g.*, U.S.–Canada tax treaty, art. 26.6(b)(1)(B).
15 IRB 2015-35.
16 Appeals can have limited involvement in the MAP process (referred to as the "simultaneous appeals process"); however, the procedure is intended only for Appeals to assist in the process and Appeals does not have settlement authority. Rev. Proc. 2015-40, IRB 2015-35, 236, §6.04(2).
17 *Id.*
18 *Id.*
19 *Id.*
20 As noted above, each country may prescribe procedural rules for requesting MAP. It is important to check these rules before taking a material action with respect to U.S.-initiated or foreign-initiated adjustments.
21 Rev. Proc. 2015-40, IRB 2015-35, 236, Appendix §2.01(2) (describing Part 2.1 of the MAP submission).
22 Rev. Proc. 2015-40, IRB 2015-35, 236, §2.07(2).
23 OECD, Mutual Agreement Procedure Statistics per jurisdiction, United States, 27, 36, 45, 54, 63 (2023 APA Statistics), *www.oecd.org/content/dam/oecd/en/topics/policy-issue-focus/map-statistics/map-statistics-united-states.pdf* (last accessed May 27, 2025).
24 *Id.* at 4, 18.
25 Rev. Proc. 2015-40, IRB 2015-35, 236, §9.02-03.
26 *Id.*
27 *Id.*
28 CtCls, 79-2 USTC ¶9633, 608 F2d 445, 221 CtCls 333, *cert. denied*, SCt, 445 US 962, 100 SCt 1648 (1980).
29 CA-9, 2019-2 USTC ¶50,276, 926 F3d 1061, *cert. denied*, 141 SCt 131 (2020).
30 Reg. §1.482-7A(d)(2).
31 *E.g., Perrigo Co.*, No. 1:17-cv-00737 (W.D. Mich.); *3M Company & Subsidiaries*, No. 23-3772 (8th Cir.).
32 *E.g., Medtronic, Inc.*, Nos. 23-3063 and 23-3281 (8th Cir.); *Amgen, Inc. & Subs.*, Nos. 16017-21 and 15631-22, Dec. 62,445(M), TC Memo. 2024-38.
33 *E.g., Microsemi Corp. & Subs.*, No. 36721-21 (Tax Court); *Airbnb Inc.*, No. 12423-24 (Tax Court); *Facebook Inc.*, No. 21959-16, 164 TC No. 9, Dec. 62,663 (opinion issued May 22, 2025).
34 *E.g., Eaton Corp.*, Nos. 2607-23 and No. 2608-23 (Tax Court); *see also* GLAM 2023-008.