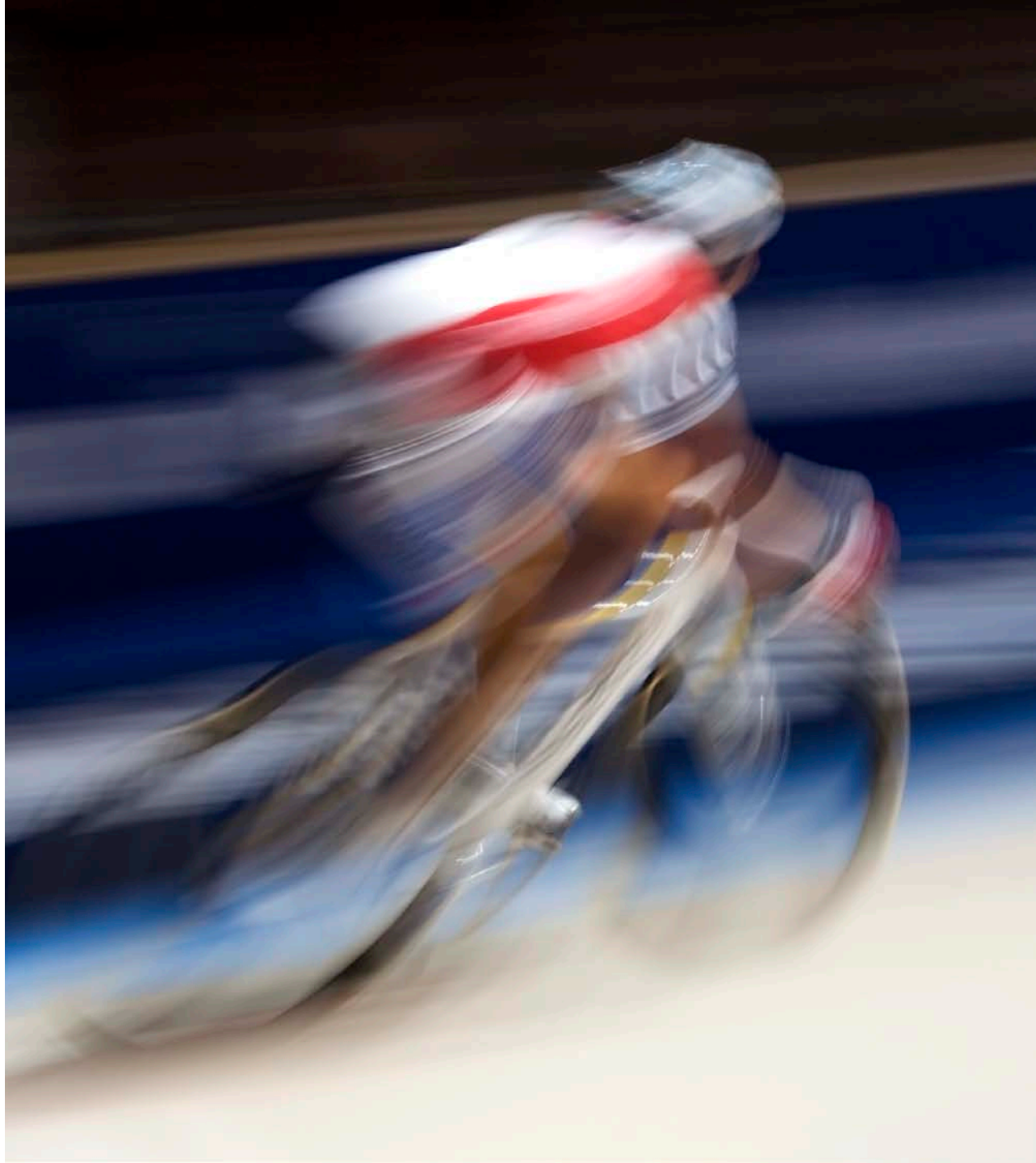




Practical Approach to Changing Landscape in Cross-Border Tax Controversies

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Agenda

- U.S. Tax issues
 - IDR requirements
 - Recent developments
- International Tax issues
 - 905(c)
 - Foreign currency issues
- Non-U.S. Tax issues
- Transfer Pricing issues

U.S. Tax issues

IDR requirements

New requirements for issuing IDRs

Discussions with taxpayer

- The underlying issue and how the requested information relates to the issue
- Review draft IDR with taxpayer
- Response time –guidance now allows for an extension, it allows a taxpayer and the agent to confer within five business days of the missed deadline

Drafting requirements

- One IDR per issue, except for requests at the commencement of examination related to general books, records and general business information
- Clearly states issue and requests only information related to that issue
- Commit to a review date for IDR production

New requirements for issuing IDRs (cont'd)

If information not received by response date, exam will follow IDR enforcement process

IRS discretion stops after a single 15-business day extension

- Determine what information is ultimately requested
- Agree with taxpayer on a response date
- Agent or specialist can extend response date by 15 business days

New IDR enforcement procedures

IDR directive and enforcement procedures

- New process triggered by incomplete response on due date, or extended due date
- Mandatory (no exceptions)

Three-step process

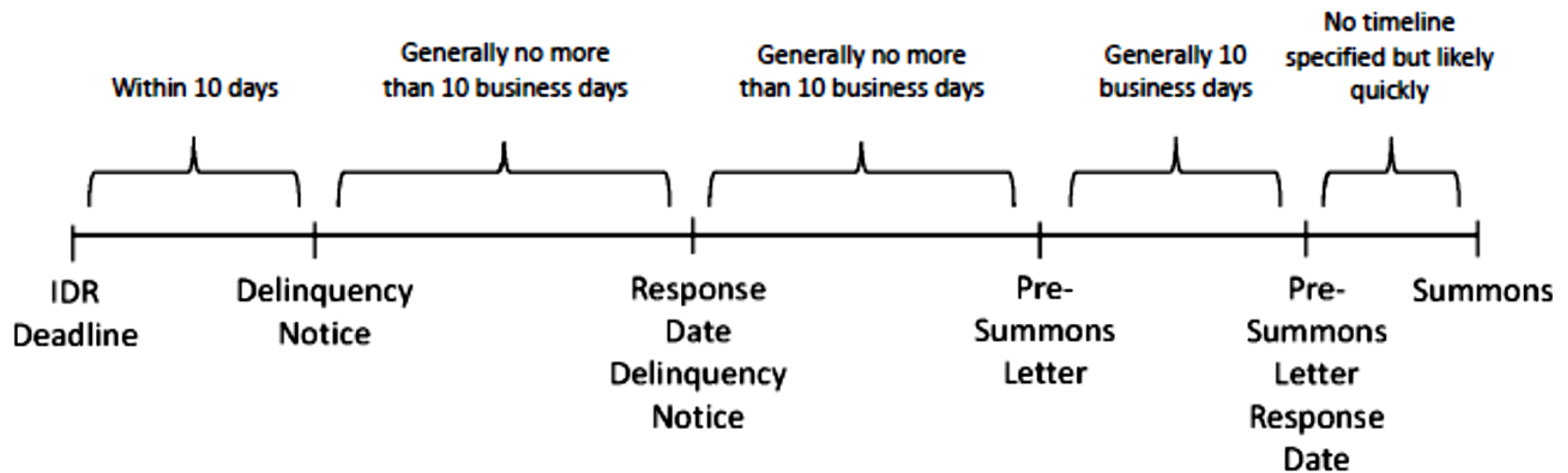
1. Delinquency Notice
2. Pre-Summons Letter
3. Summons

New IDR enforcement – implications

- Negotiations regarding deadlines must happen earlier than before
- Agents unable to change once IDR issued
- Must confirm you can meet the deadline, taking into account access to documents, availability of key employees, and potential privilege review
- IDR limited to one issue
- No longer allows for provision of some information quickly while providing other information later
- Extended deadlines
- Depending on request, press for extended deadlines
 - Where appropriate, consider discussions “up the chain of command”
- Elevating unreasonable timelines
- Maintain good working relationship
- Wisely utilize time while IDR in draft form

New IDR enforcement policy

Timeline



* IRS Agent has discretion to extend IDR deadline by 15 business days
Could be 55 or more business days from original IDR deadline until summons

Recent developments

What we are currently seeing...

Top audit issues include

- Bad debt deductions
 - Partial v. complete worthlessness
- Section 475 (mark to market) issues
- Research and development credit
- Section 199 deduction
- General accounting issues
- Chapter 3 withholding

What is on the horizon?

IRS transition to FATCA tax compliance

- Increase in IRS personnel
 - Field agents
 - Data analysts
- Historic emphasis on Financial Services
- Simultaneous Chapter 3 and FATCA exams

Notice 2014-33

Relief on Implementation of FATCA

That any enforcement actions for the calendar years 2014 and 2015 under FATCA and the temporary coordination regulations under Chapter 3, Chapter 61, and Section 3406 will take into consideration the good faith efforts of withholding agents

IRS return selection

- Form 5472 – information return of a 25% foreign-owned U.S. corporation or a foreign corporation engaged in a U.S. trade or business
- Form 5471 – information return of U.S. persons with respect to certain foreign corporations
- Form 1042-S – foreign person's U.S. source income subject to withholding

IRS Exam Policy

IRM 4.10.21

- Part 2 is general guidance for audits of U.S. non-financial entities
- Review withholding systems
- Review accounts payable file
- Review vendor records

Penalties

- 6721 – Failure to file correct information return
- 6722– Failure to furnish correct payee statements
- 6723 – Failure to comply with other information reporting requirements

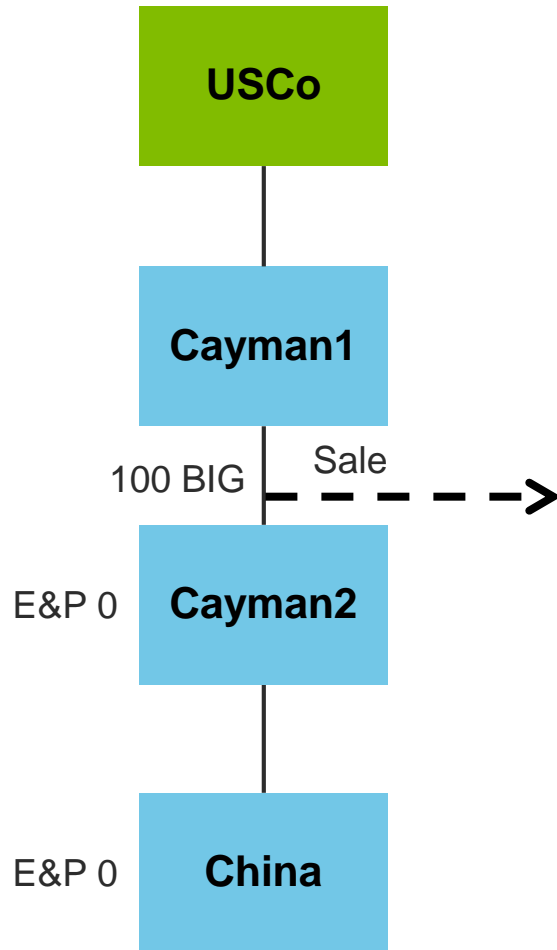
International Tax issues

905(c)

Translation rates for foreign taxes

- General rule: Accrual basis taxpayers translate taxes at average exchange rate for year to which taxes relate
- Exceptions, under which tax translated at spot rate on date of payment
 - Tax not paid within two years of close of year to which it relates
 - Tax pre-paid before year begins
 - Tax denominated in inflationary currency
 - By election, for taxes in nonfunctional currency
- Under 905(c), CFC treats taxes not paid within two years as added to the pool in the current year, converted at the spot rate
- For U.S. taxpayers, taxes not paid within two years relates back to the year in which the taxes relate, and is converted at the spot rate

Trapped Passive Basket Taxes – subsequent tax liability (e.g., Chinese Circular 698)



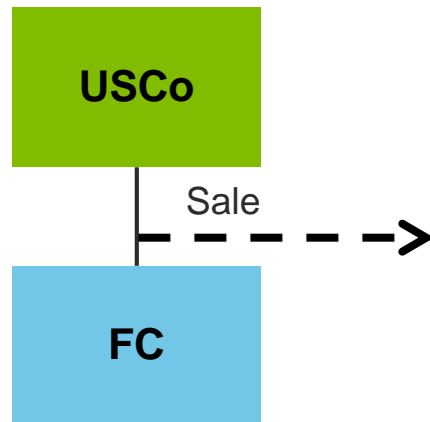
Facts

- In Year 1, Cayman1 sells Cayman2, recognizing 100 of passive subpart F gain and reports the gain to China pursuant to Circular 698
- Two years later, in Year 3, China imposes tax of 10 on Cayman1

Issue

- In Year 3, Cayman1 thus has a passive tax pool of 10 and a passive deficit of 10.
- How does USCo access the Chinese tax?
- What if Cayman1 CTB liquidates into USCo before the tax is paid? (See PLR 200127011)
- But what if that is impractical (e.g., Cayman1 has low-taxed E&P or foreign operations)?
 - Purchaser makes §338(g) elections?
 - Check Cayman2 and China before sale?

Foreign Tax redeterminations and Section 338



Facts

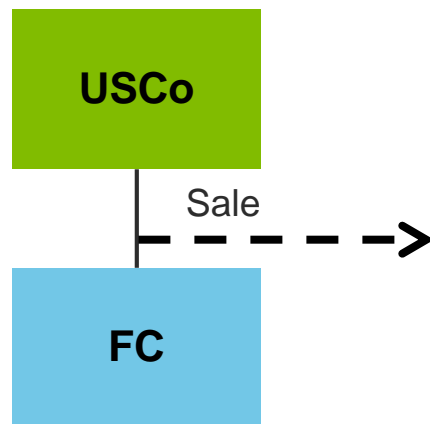
- FC earns income in Year 1 and accrues (but does not pay) 100 foreign tax
- USCo sells FC in Year 2 and purchaser makes §338(g) election
- In Year 3, “New” FC pays the Year 1 foreign tax

Issue

- “Old” FC did not pay the foreign tax within the section 905(c)(1)(B) two-year window, but new FC did
 - Must FC “unaccrue” the tax in Year 1? Is there a requirement that Old FC pay the tax?
 - What if the two years lapse and New FC pays the tax in Year 4?

Foreign Tax redeterminations and Section 338

(cont'd)



Facts

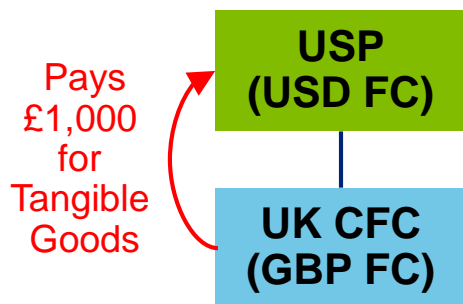
- FC earns income in Year 1 and contests the foreign tax on the income
- USCo sells FC in Year 2 and purchaser makes §338(g) election
- In Year 3, New FC concedes and pays the Year 1 foreign tax

Issue

- When does the Year 1 tax accrue?
 - Analogous to PLR 200127011 and Old FC retroactively accrues tax in Year 1?
 - Or does New FC accrue the tax in Year 3 (perhaps somehow subject to §901(m))?
 - Or none of the above?

Foreign currency issues

Foreign currency aspects of TP adjustments



Facts

- In Year 1, UK CFC purchases goods for £1,000 pursuant to the terms of its contract with USP
- In Year 5, a transfer pricing adjustment determines that UK CFC overpaid for the goods by £100

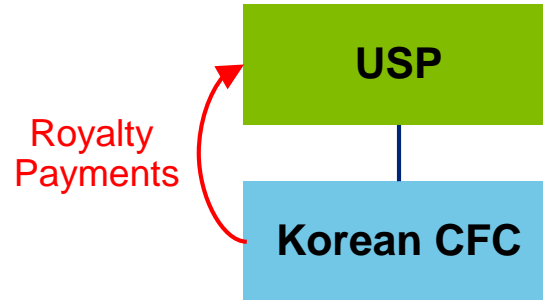
Issue

- Determine if the original overpayment will be treated as a dividend or if a payable/receivable will be booked pursuant to Rev. Proc. 99-32
- Note that the USD has appreciated over the period
 - Current translation of additional UK Tax currently due
 - Translation gain on USP's GBP denominated payable, if elected under 99-32
- Consider financial statement impact of additional tax paid
 - Was FIN 48 position originally booked?
 - CTA versus P&L
- What if the transfer pricing adjustment determined that UK CFC underpaid for the goods?
- What if the USD depreciated in value relative the GBP?
- What if the original transaction was conducted in USD rather than GBP?

Year	GBP:USD FX Rate
Year 1	1:2
Year 5	1:1.5

Non-U.S. Tax issues

Korea withholding tax issue



- Royalties (technology) from Korean payors to U.S. multinationals have sometimes been subject to withholding taxes on the basis that they are Korean source
- U.S. companies have challenged the withholding taxes in Korean courts and in MAP
- Recent Korean supreme court case held that royalties cannot be Korea source if the patents for which the royalties are paid are not registered in Korea
- U.S. competent authority working with taxpayers to recover previously withheld taxes

Transfer Pricing issues

Common TP Audit and related issues

- Transfer pricing between affiliates/associated enterprises
 - Character of related parties (entrepreneur vs. routine functions, conduct vs. contracts)
 - Recurring local losses treated as a service to the global group
 - Royalties (lack of benefit, value compared to local intangibles and local contributions)
 - Service charges (cost base, pass-through costs, stock-based comp, and markups)
 - Tangible goods (embedded royalties, bundle transactions)
- The price is right, but character isn't
 - Services categorized as royalties subject to withholding taxes
 - Services giving rise to a permanent establishment
 - Sourcing of royalty payments

Number of new MAP cases initiated by reporting period

OECD Member Countries

	2006	2007	2008	2009	2010	2011	2012
	Number of New Cases						
 Australia	9	13	8	19	21	10	10
 Austria	29	26	36	30	38	35	61
 Belgium	31	30	71	213	120	120	151
 Canada	76	70	85	103	101	94	87
 Chile	0	0	0	0	0	0	0
 Czech Republic	5	10	5	6	8	12	13
 Denmark	15	18	21	22	20	24	24
 Finland	1	11	8	5	11	13	14
 France	104	100	154	169	135	173	181
 Germany	212	186	177	177	150	306	277
 Greece	1	2	--	--	--	5	3
 Hungary	4	3	1	2	1	0	1
 Iceland	1	0	0	0	0	1	2
 Ireland	3	3	2	6	7	6	12
 Israel	--	--	--	--	4	9	5
 Italy	14	20	14	31	22	41	45

	2006	2007	2008	2009	2010	2011	2012
 Japan	37	49	40	44	34	22	31
 Korea	8	9	13	25	13	24	22
 Luxembourg	22	31	31	25	35	75	39
 Mexico	14	11	5	10	4	5	17
 Netherlands	80	57	--	64	51	34	83
 New Zealand	4	5	2	6	4	4	3
 Norway	15	21	30	21	16	7	10
 Poland	11	7	19	14	7	9	5
 Portugal	10	7	5	14	17	15	17
 Slovak Republic	0	--	1	1	3	4	1
 Slovenia	--	--	3	0	2	2	3
 Spain	18	67	24	24	24	18	36
 Sweden	72	61	104	64	104	111	100
 Switzerland	--	45	99	119	65	112	120
 Turkey	0	2	1	3	4	0	0
 United Kingdom	--	55	44	56	68	54	69
 United States	240	257	308	326	252	279	236
Total	1036	1176	1311	1599	1341	1624	1678

BEPS documentation/CBC impact

- New rules will increase the cost of compliance
- Will substantially increase transparency and global TP controversy
- The structure of the new rules will likely mean that more of the documentation work will be managed at the headquarters company
- Remember BEPs in the state context too

What is the Mutual Agreement Procedure (MAP)?

- Mutual Agreement Procedure (MAP)
 - Government-to-government negotiation pursuant to a tax treaty
 - Requested by taxpayer when the action of a tax authority results in taxation not in accordance with the tax treaty
 - Goal is for the two governments to reach a mutual agreement to avoid taxation that is not in accordance with the tax treaty
 - Success is not guaranteed, but several treaties, including the United States treaties with Germany and Canada, have binding arbitration
- Competent Authority (CA)
 - CA is the office or person responsible for implementing the terms of the tax treaty on behalf of the government
 - The U.S. CA is the IRS Deputy Commissioner (International)
 - Day-to-day operations by two IRS groups
 - Advance Pricing and Mutual Agreement (APMA) Program
 - Treaty Assistance and Interpretation Team (TAIT)

Why request MAP?

- Transfer Pricing matters – to resolve double taxation
 - Treas. Reg. § 1.482-1(a)(3) – taxpayers may not file an amended tax return to decrease taxable income – see also *Intersport Fashions West v. U.S.*, 103 Fed. Cl. 396 (2012)
 - The statute of limitations in most countries is longer than the United States, and MAP is the only procedure to reopen closed years and to obtain IRS approval to decrease taxable income
- Foreign tax credit matters
 - Treas. Reg. § 1.901-2(e)(5) – taxpayers must invoke their effective and practical remedies to avoid a foreign tax adjustment being treated as a voluntary tax
 - *Procter & Gamble Co. v. U.S.*, 106 AFTR2d 5311 (SD Ohio 2010) – Court held that the taxpayer was not entitled to section 901 foreign tax credits because it did not request competent authority assistance

What is an Advance Pricing Agreement (APA)?

- Binding contract with the tax authorities and taxpayers
 - Covers facts, pricing methods and results with respect to intercompany transactions
 - Generally five-year term (with rollback to open tax years)
 - Can be renewed
- “Critical Assumption” clauses allow renegotiation in the event of changed circumstances
 - Protects taxpayers from having to comply with a “bad deal” caused by material changes affecting their business
 - Taxpayers have input in drafting critical assumptions
- Voluntary process – Provides taxpayers with non-adversarial alternative to resolving transfer pricing disputes

Proactively managing TP risks: MAP cases for taxpayer-initiated foreign TP adjustments

- IRS likely to soon accept MAP cases based on a taxpayer-initiated foreign TP adjustment for tax years open in the foreign country
 - Notice 2013-78
 - May solve the Treas. Reg. § 1.482-1(a)(3)/Intersport Fashions West, Inc. v. U.S., 103 Fed. Cl. 396 (2012) issue for transactions with affiliates in treaty countries
 - May allow taxpayer to avoid penalties in the foreign jurisdiction (e.g. Canada)
 - Statutes of limitations can be longer in foreign countries than in the U.S.
- Examples
 - Foreign MNE failed to charge royalties or services to U.S. subsidiary
 - U.S. MNE with foreign distributor/manufacturer earning insufficient income
- IRS reserves the right to deny requests for assistance if the taxpayer-initiated positions
 - Evince after-the-fact tax planning or fiscal evasion, or
 - Are otherwise inconsistent with sound tax administration

Proactively managing TP risks: Global APA strategy

- Taxpayers are increasingly employing a global APA strategy to establish global acceptance of their TP policy and manage TP risk
- Negotiate APAs with a few countries in key regions to create persuasive authority in other jurisdictions
- Example: Negotiate APAs with the UK and France in EMEA and Japan and Australia in AsiaPac
- Tell the other countries/disclose on OECD BEPS documentation: “Other countries have agreed to the policy and so should you”

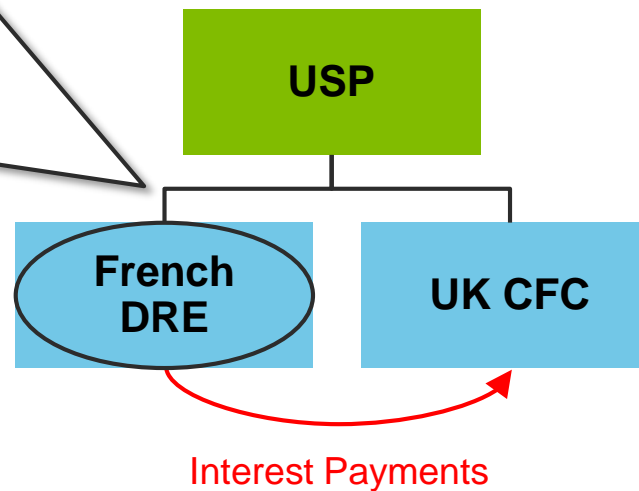
India MAP and APA developments

January 2015: India and U.S. reach agreement to solve backlog of MAP cases

- Framework relates to IT Enabled Services (ITES) and software development services
- Commitment to resolve both the appropriate cost plus markup as well as the related cost base on which the markup is applied
- Bilateral APAs to be allowed “soon” after backlog starts to clear

Competent authority and DREs

When requesting foreign-to-foreign competent authority assistance for transactions between a DRE and a CFC, consider filing a U.S. protective claim to preserve USP's right to implement the terms of the competent authority settlement between the two foreign competent authorities



Please remember
to complete your
evaluation

Speaker bios

Kerwin Chung is a Principal in Deloitte Tax LLP's Washington National Tax Office, and leader of the firm's National Advance Pricing Agreement (APA) and Competent Authority (CA) Group. He has more than 16 years of transfer pricing experience, specializing in APAs, CA, planning, examinations, and Customs matters. He has served as the taxpayer's lead negotiator for more than 70 APAs and has represented more than 80 taxpayers in the CA process. Kerwin's clients include U.S.- and foreign-based multinationals in numerous industries, including apparel, auto parts, chemicals, computers, computer peripherals, construction equipment, consumer electronics, electronic components, food and beverage, industrial machinery, insurance, logistics, office products, pharmaceuticals, photography, professional services, and publishing.

Kerwin has been recognized several times by inclusion in the Legal Media Group's Guide to the World's Leading Transfer Pricing Advisers. He is an active member of the ABA Tax Section Transfer Pricing Committee, and moderated a panel discussing transfer pricing in a down economy at the ABA Tax Section meeting in New Orleans in January 2009. He previously served as chairman of the ABA Intellectual Property Law Section Tax Committee and has chaired several subcommittees of the ABA Tax Section Transfer Pricing Committee.

Kerwin earned his B.B.A. (Accounting and Real Estate) from the University of Hawaii and his J.D. (Cum Laude), Harvard Law School.

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Daniel Dumezich is a Director at Deloitte Tax LLP and the leader of the firm's Federal Tax Controversy Service practice. Prior to joining Deloitte Tax, Dan was the head of the federal tax controversy practice and a partner at Winston & Strawn. Prior to joining Winston & Strawn, Dan was a partner at Mayer Brown, specializing in Tax Controversy. In his 26 years of practice at law firms, Dan established a strong history of successfully representing clients in both tax litigation and administrative matters before the IRS. Before becoming an attorney, Dan, a certified public accountant, was a tax specialist at a major accounting firm.

Dan has been involved in over 30 pieces of litigation, mostly in the U.S. Tax Court. Those cases involved a large variety of issues including, but not limited to, § 482 reallocations, Subpart F issues, deductibility of interest expense relating to a debt versus equity characterization, capitalization cost versus current deductibility of expenditures and valuation of assets.

In addition, Dan has had many a success in favorably settling cases for his clients prior to litigation, including professional firms, financial institutions, hedge funds, insurance companies, and individuals involved with tax advantaged transactions deemed abusive by the IRS.

Dan is currently a member of the Board of Directors for Community Foundation of Northwest Indiana, a non-profit healthcare group. From 1995 until 1999, Dan was a Judge for the Town of Schererville, Indiana and also served in the Indiana General Assembly as a State Representative from 1999 through 2002.

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Todd Izzo is an international tax partner and the global tax leader for the Consumer Business practice for Deloitte Touch Tohmatsu. He serves multinational corporations worldwide in a variety of industries, including manufacturing and consumer business. Todd has a focus on global tax planning, tax efficient supply chain planning, financial products and instruments, international mergers, acquisitions, reorganizations, tax treaties, foreign tax credit planning, income tax accounting and other areas of U.S. corporate and international taxation. Prior to joining Deloitte & Touche in 2000, Todd worked in the area of international and corporate tax for five years in the Washington, D.C. office of Dewey Ballantine and served as a law clerk for one year in the chambers of Judge Ed Becker of the U.S. Third Circuit Court of Appeals.

Todd received a B.S. degree with highest distinction in Accounting from Penn State University, a J.D. summa cum laude from the University of Pennsylvania Law School and a LL.M. in taxation summa cum laude from the Georgetown University Law Center. Todd was awarded the May 1991 Alexander E. Loeb Gold Medal award for the high score in Pennsylvania on the CPA exam and the Elijah Watt Sells Award for one of the top scores in the U.S. Todd is a frequent speaker on international tax matters and has served as an adjunct professor at both Duquesne and Robert Morris Universities. He is a member of the AICPA, PICPA, as well as both the Pennsylvania and District of Columbia Bars.

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