



Transfer Pricing Memo

CRA The Ballentine
Barbera Group

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It is clear that transfer pricing legislation and enforcement have not evolved in sync with the globalization of the economy; a change in the level of tolerance among major trading partners is imminent given the spirited hearing conducted on July 22 by the Ways and Means Committee of the US House of Representatives. In his opening statement, the Chairman of the Committee, Senator Sander Levin (D-MI), characterized transfer pricing as “a serious issue that emerged over time to pose a challenge to the enforcement of US tax laws.” Chairman Levin cited various reports that demonstrate MNCs are “potentially gaming the current system to shift assets (to) foreign-based entities to avoid paying US taxes,” estimating the annual, adverse tax impact to be as great as \$60 billion. Such actions, according to Chairman Levin, may imply that US jobs are also moving overseas along with taxable income, further compounding the budgetary and employment challenges that the country currently faces.

The purpose of the hearing was twofold: to clarify the importance of the issue from the perspective of the federal government and to discuss proposed solutions for the problem. To calibrate the importance of transfer pricing relative to other tax reform efforts, the Joint Committee on Taxation (JCT) prepared a study focused on the mechanics used by MNCs to shift income within the framework of current international tax rules, including transfer pricing. The **JCT Report** includes six case studies using redacted and highly detailed data presenting actual fact patterns and financial data for the selected US-based MNCs, drawn from both industrial and consumer products industries. Based on this study, the JCT concluded that significant deficiencies exist in the ability of current transfer pricing rules to limit income shifted abroad to low-tax jurisdictions by US-based MNCs. While the economic impact of such transfer pricing “abuse,” coupled with weaknesses in the US legislation’s ability to mitigate the problem, comprise the overarching concerns, the discussions around potential solutions carried a common theme that challenged the conceptual foundation of transfer pricing: the arm’s-length standard. This debate was amplified by the fundamental problem that the United States will soon bear the highest corporate tax rate in the world.

The leadership of the Ways and Means Committee, as well as the vast majority of testifying experts and other members, clearly agreed with the JCT’s conclusions that income shifted by MNCs to low-tax foreign jurisdictions using existing transfer pricing rules constitutes a material problem for the US government. However, it is less clear what steps Congress will take and how they will be timed. One near-term solution available to the government is to address the lack of resources within the IRS to enforce compliance. With respect to the tax reform itself, the Obama administration has proposed several initiatives, including such items as the characterization of “excess returns” on transferred intangible property as Subpart F income.

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The Ballentine Barbera Group of Charles River Associates will be holding a WebEx presentation on Tuesday, September 21, during which we will present the views presented in this important hearing in more detail and discuss how they may impact MNCs operating in the US. Details around the WebEx presentation will be forthcoming. To RSVP, please contact Cathy Tucker at ctucker@crai.com.

Should you have any questions in the interim, please do not hesitate to contact your CRA [Transfer Pricing Advisor](#).

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