

International Tax Conference – 2011

Mumbai, India

Arm's Length Principle – Country Experiences United States

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Arm's Length Principle

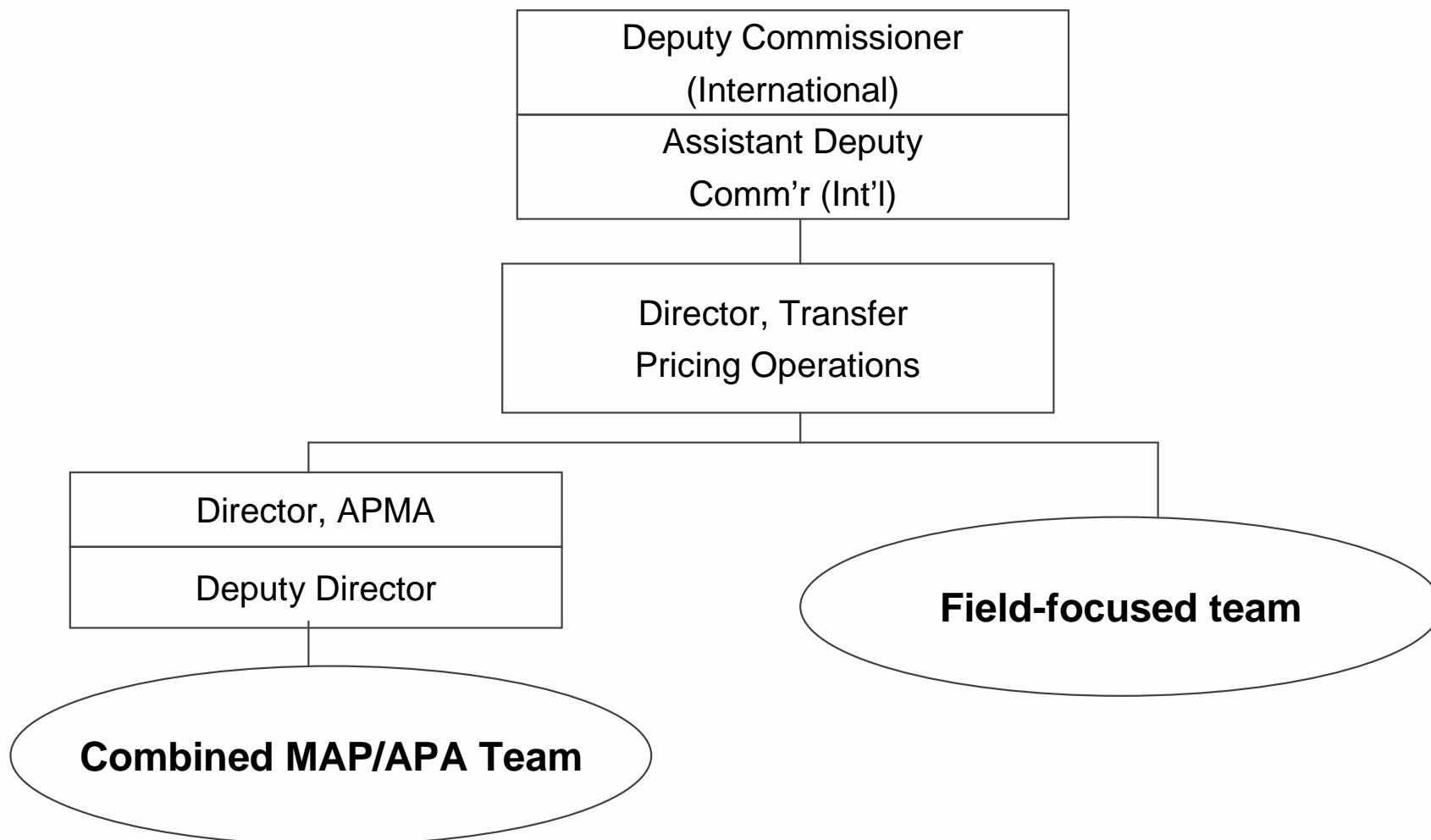
- The arm's length principle is alive and kicking
- The perennial issue is how to enforce it.
- US Tax Legislative seeks to circumvent it with changes to its anti-deferral regime and codification of the economic substance doctrine.
- Notwithstanding, the arm's length principle produces numerous tax controversies as well as financial statement incentives.

Arm's Length Principle

- The IRS is restructuring its international operations in order to effectively manage transfer pricing controversies
- To date, there is a serious imbalance between inbound and outbound adjustments, e.g. 90%
- The IRS wants to create
 - Consistency
 - Fairness
 - Efficiency

Arm's Length Principle

- The Large Business International function has been revised as follows:



Arm's Length Principle

- LB&I considers itself in a “knowledge business”
 - International tax is a vast specialty tax area that is most complex
 - International specialists must have a solid understanding of “the big picture” of the international tax issues
 - LB&I must develop, nurture, and leverage its collective expertise
- International provisions (e.g., FTC, subpart F, sourcing rules, treaty provisions) are not distinct technical areas and often operate on differing theories:
 - These provisions must be integrated as a whole
 - International specialists must understand how technical issues relate to one another to understand the cross-border planning undertaken by taxpayers.

Arm's Length Principle

- To succeed, LB&I states it must do three critical things:
 - Communicate
 - Collaborate
 - Train together and mentor our less experienced staff
- Training and knowledge management are critical
- LB&I must depend on strong and broad networks of experts

Arm's Length Principle

For realignment to accomplish its goal:

- LB&I's international specialists must operate as a single program.
- All international functions and operations must be integrated to the fullest extent possible.
- LB&I must operate off a strategic platform.
- LB&I must work as a team
- LB&I must identify the highest compliance risks
- LB&I must find appropriate ways to resolve cases in a practical matter

Arm's Length Principle

The LB&I Strategy is:

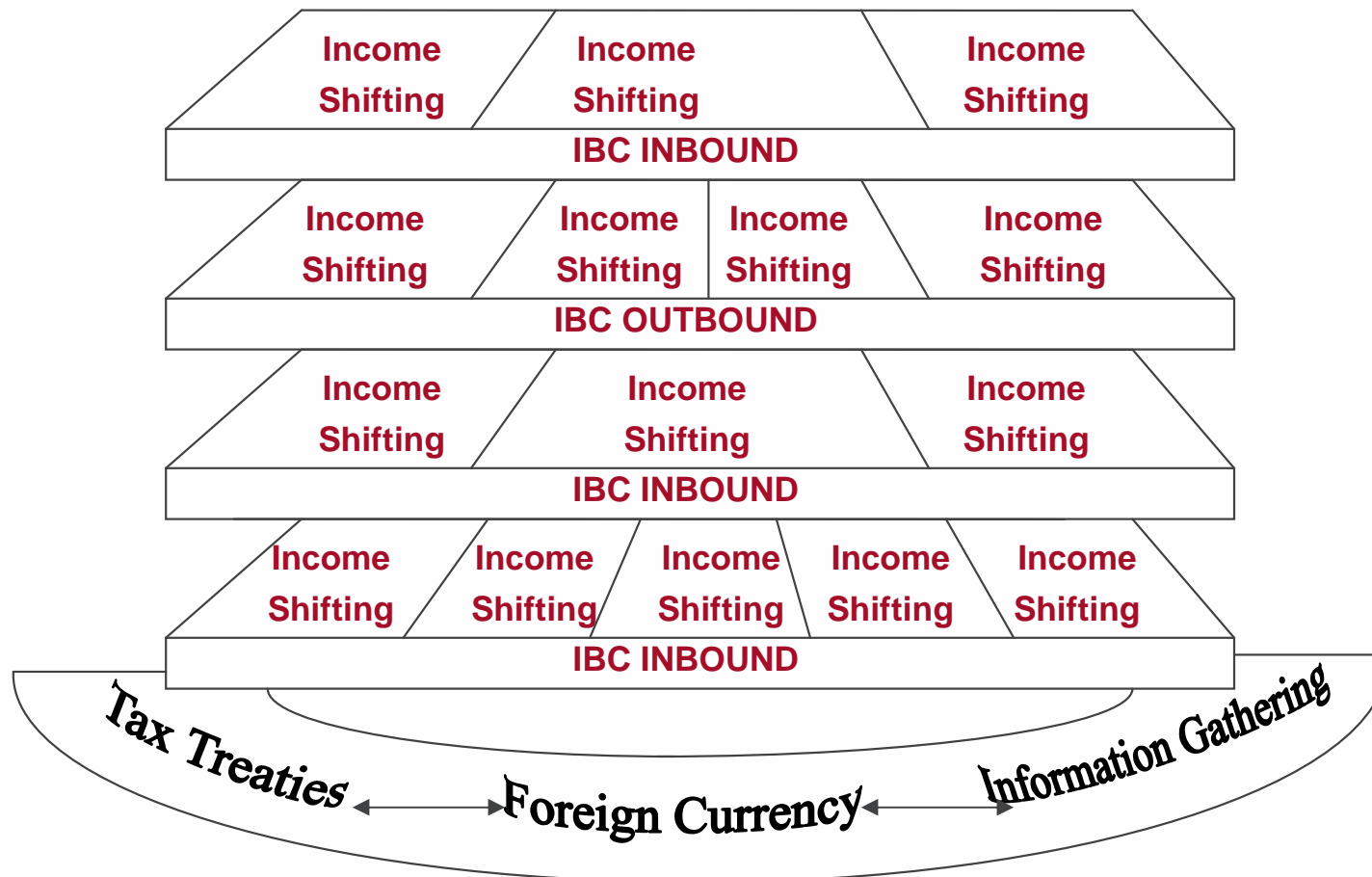
- Focus on cases/issue where taxpayers engage in aggressive planning
- Invest in high profile cases
- Focus on cases/issues where the planning can be replicated
- Move into high-risk areas not receiving sufficient attention
- Pursue strategy with discipline; be willing to let go of less important issues/cases
- Focus on training

Arm's Length Principle

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Arm's Length Principle

The "Four Faces" of the Matrix



Arm's Length Principle

Transfer Pricing Practice – APMA:

- The APA program and the Mutual Agreement Program will soon be fully integrated (target date is January 2012)
- Detailed design for the new “APMA” program is underway
- The restructuring will bring together the best practices of both offices
- The combination will seek to find new efficiencies in working transfer pricing cases (bilateral APAs and double-tax cases) and be more strategic in our interactions with treaty partners
- Adding new specialists and a new branch in San Francisco

Arm's Length Principle

Transfer Pricing Practice – Field:

- Detailed design of field support function is underway
 - Transfer pricing “technical” and economist focus
- Organization will serve as TP Director’s eyes and ears” and establish a clear line of sight.
- Facilitate communication and collaboration
- Drive strategic approach to handling transfer pricing cases
- Mode of operation will be modeled on the “transfer pricing pilot” cases

Arm's Length Principle

Areas of Emphasis:

- Cost sharing arrangements and other income shifting into PRI structures
- High-value services
- Inbound
- Country-specific considerations
- Financial services