

Pricing Knowledge Network

Focusing on the impact of major intercompany pricing issues

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PKN/TCDR Alert United States - Recent developments within the IRS LB&I transfer pricing program

A Transfer Pricing Publication

At a Tax Executives Institute conference on October 13, 2011, Mike Danilack, Internal Revenue Service ("IRS") Deputy Commissioner (International), discussed his concern with the disproportionately large number of cases in the U.S. Competent Authority Program involving transfer pricing adjustments made by foreign governments on inbound transactions involving U.S. taxpayers. He acknowledged that the IRS has placed a much greater focus on transfer pricing cases involving outbound transactions and needs to increase its focus on transfer pricing cases involving inbound transactions.

Mr. Danilack also expressed his concern that some foreign governments may be making aggressive and unprincipled transfer pricing adjustments. He encouraged taxpayers to involve the U.S. Competent Authority in these cases, especially considering that some foreign governments might be encouraging taxpayers to waive their right to competent authority assistance as a condition for entering into a settlement. Mr. Danilack reminded the audience that not involving competent authority could result in the IRS denying foreign tax credits claimed on the foreign tax paid, in light of the requirement to exhaust administrative remedies prior to claiming a foreign tax credit.



Observations: The IRS' internal realignment has created a new transfer pricing practice with increased resources to devote to transfer pricing cases, and now the IRS has publicly stated that it has not given sufficient scrutiny to U.S. inbound transactions. As a result, it is reasonable to expect that there may be a significant increase in IRS transfer pricing audits of U.S. affiliates of foreign-based multinational corporations. See also recent public statements by Sam Maruca, IRS Transfer Pricing Director, regarding the disparity between U.S. versus foreign-initiated adjustments, which is discussed in our PKN Alert issued on September 20, 2011 ([click here](#) to view PKN Alert).

Although Mr. Danilack's comments do not point to any particular inbound transaction, PwC has observed increased attention from the IRS regarding intercompany debt arrangements. As recently discussed in our Washington National Tax Services publication issued September 29, 2011 ([click here](#) to view WNTS article), in addition to the issue of whether the amount of interest paid on intercompany debt is arm's length, the IRS is also scrutinizing more frequently whether intercompany debt should be recharacterized as equity with a particular emphasis on a company's ability to repay the intercompany debt in light of all other controlled transactions with the foreign parent company. To this end, the IRS has developed a standardized IDR that solicits an extensive amount of information regarding the particular intercompany debt arrangement.

Mr. Danilack's comments regarding settlements of foreign-initiated adjustments serves as a reminder to companies to consider carefully whether to enter into settlements with foreign tax authorities without first seeking competent authority assistance. In order to obtain a credit on the amount of income tax paid to a foreign country, Treasury Regulations under section 901 of the Internal Revenue Code require taxpayers to exhaust all effective and practical remedies to reduce the taxpayer's foreign tax liability, including invocation of competent authority procedures available under applicable treaties. The IRS' increased attention to this issue puts companies on notice that the IRS may deny foreign tax credits claimed on taxes paid to a foreign country where a taxpayer does not first seek competent authority assistance to reduce the amount of the foreign tax liability.

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