Transfer Pricing Specialists Urge A Return To Fundamentals

By Molly Moses

Law360, Washington (December 1, 2017, 2:22 PM EST) -- A panel of U.S. practitioners with decades of experience in transfer pricing suggested the level of detail in current rules has gone too far and advocated a return to more fundamental principles during a panel discussion Friday.

“Rules tend to lead to more rules,” said economist Barbara Rollinson of consulting firm Horst Frisch in Washington, D.C. “The reason more rules come along is there are outcomes that people don’t like in certain situations from the existing regulations, so we need a rule to fix that. And when we get a rule that fixes that, we go along with that for a while, and then we need to fix it again.”

Rollinson, along with Rocco Femia of Miller & Chevalier Chtd. and Samuel Maruca of Covington & Burling LLP, discussed the state of the current Organization for Economic Cooperation and Development transfer pricing rules during the annual Institute on Current Issues in International Taxation in Washington, presented by the Internal Revenue Service and George Washington University.

Rollinson, who worked for the U.S. Treasury in the 1980s and helped develop both the 1994 U.S. regulations and the 1995 OECD guidelines, held up the three latest revisions of the OECD rules, showing how the guidance in 2010 was twice as thick as the 1994 guidance, and the 2017 guidance, issued in July, was even thicker.

“We’ve gone way too far down the path of trying to have a different rule for each circumstance,” she said. “I don’t think that’s possible, and we need to step back to first principles.”

Femia agreed, saying lawyers as well as economists are to blame.

“We’re all part of the problem,” he said. “I think lawyers especially suffer from this urge to elaborate.”

Femia and Rollinson referred to the language setting forth the arm’s-length principle in § 1.482-1 of the regulations. It states that a transaction meets the principle if the results “are consistent with the results that would have been realized if unrelated parties had engaged in the same transaction under the same circumstances.”

Sometimes, however, parties in a controlled group “engage in transactions that you don’t observe third parties engaging in under similar circumstances,” Femia said. “The natural response to an observation like that is, let’s write down what we think might happen in that circumstance.”
But, he added, “Whatever it is we write down will raise more questions, and the urge is to answer those questions, and on and on.”

Maruca said specific rules have a place, but it’s important to remember that “there obviously are principles underlying these rules.” Courts, he said, often get caught up in narrow definitions — “whether you’re in the box or out of the box.”

Rollinson suggested courts would be less likely to do this “if there weren’t boxes in the regs.” In statistics, she said, there is the concept of a “type 2 error” — essentially when an analyst accepts something that should have been rejected.

“I would posit that when you have all these boxes ... you can end up with a lot of type 2 errors,” she said. “A lot of times when you follow the box, you wind up with the wrong answer. That means an answer that doesn’t fit with the goal of the outset, which was to price the way arm’s-length parties would price.”

Maruca, however, cautioned against overstating the case against specific rules.

“We don’t want to throw out the baby with the bathwater,” he said. “The OECD guidelines over the last 30 or 40 years have been a very effective basis for resolving issues in MAP, and they’re pretty highly articulated,” the attorney said, referring to the mutual agreement procedure for resolving cross-border tax disputes under treaties.

“There’s going to be a role for articulated rules for a while,” he said.

--Editing by Vincent Sherry.

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