Insights: Transfer Pricing

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Recent updates in transfer pricing

In this *Insights: Transfer Pricing*, we provide an update on the most recent developments on BEPS Action 1: Addressing the Tax Challenges of the Digital Economy as well as the ongoing Altera case (*Altera Corp. v. Commissioner*).

"Programme of Work" to develop a tax solution to digital economy

On May 31, 2019, the Organisation for Economic Co-operation and Development (OECD) released its "Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy**."** The Programme of Work sets a highly ambitious January 2020 target to reach agreement among the OECD member countries on the new 'architecture' of international tax rules. This timeline was endorsed by the 129 members of the Inclusive Framework on BEPS (IF) at their Paris meeting on May 28 and 29, 2019 and by G20 Finance Ministers at their Fukuoka meeting on June 8 and 9, 2019.

CRA was a sponsor of the 2019 OECD International Tax Conference held in in Washington, DC on June 3 and 4, 2019. At this conference, key representatives, including Pascal Saint-Amans, Director of the OECD Centre for Tax Policy and Administration (CTPA), shared their views of the tax challenges of digitalization. While initially, the tax challenges arising from the digitalization of the economy were predominantly related to large technology companies, the new guidelines will affect most, if not all, multinational companies. The current plan for the taxation of the digital economy, as outlined in the Programme of Work, relies on a two-pillar approach. The first pillar seeks to allocate MNE profits based on where goods and/or services are sold, even if it does not have a physical presence in that country. The second pillar moves beyond the concept of nexus and looks to apply a global minimum tax rate for all MNEs.

As was made clear in the Fukuoka meetings, OECD-member countries and tax practitioners see various hurdles to reaching agreement as the challenges of digitalization go well beyond the existing BEPS guidelines and explores fundamental changes to the international tax architecture. Each tax authority must examine the implications of the new guideline on its taxable profit, involving political engagement. In order to agree on the long-term solution, it must be a unified, consensus-based solution among the member countries. This process will also require the right balance between precision and administrability for each tax jurisdiction.

Although skepticism about the rather ambitious deadline of January 2020 remains, it is clear that the OECD has had great success changing the international tax landscape through the BEPS project back in 2013; therefore the OECD's ability to reach a consensus-based solution for digital economy cannot be dismissed.

Ninth Circuit again ruled for the IRS over Altera Corp.

On June 7, 2019, the US Court of Appeals for the Ninth Circuit upheld its previously withdrawn decision regarding the treatment of employee stock option expenses in the pool of costs that must be shared in qualifying cost-sharing arrangements (the June 2019 decision).

This new ruling reverses the 2015 US Tax Court ruling, which found that the Treasury Regulation's requirement that related entities include the cost of employee stock compensation in their cost-sharing arrangements, was invalid (Altera Rulings).[1] This decision was appealed by the IRS and on July 2018 the Ninth Circuit reversed the Altera Rulings (the July 2018 decision). Then, in August 2018, the Ninth Circuit announced the withdrawal of the July 2018 decision due to the death of Judge Reinhardt. With the June 2019 decision, the Ninth Circuit re-issued its ruling on the case, with a decision that is generally in line with the July 2018 decision. Altera Corp., now a subsidiary of Intel, has the rights to seek an appeal of the June 2019 decision by the full Ninth Circuit, which would need to be filed by July 17, 2019. The question regarding Altera Corp. and Intel's appetite to seek a rehearing remains unanswered.

Our view on how these new rulings impact US taxpayers

Since Intel has not publicly announced its decision on whether or not to appeal, taxpayers should not make any immediate changes. That said, if Intel does not file an appeal, taxpayers should revisit their cost-share agreement to confirm the treatment of employee stock option expense with regards to the calculation of the cost-sharing pool. Where cost-sharing agreements do not explicitly address this issue, further research into the calculation of the cost-sharing pool may be needed. Taxpayers who have historically excluded the cost of employee stock options from the cost sharing pool may need to change their cost-sharing structures as they won't be able to deduct the full cost of stock compensation from their US taxable income. Additionally, tax reserves may need to be put into place for past years that can still be subject to IRS audit.

About CRA's Transfer Pricing Practice

Our consultants help clients navigate every phase of implementing and supporting international tax structures including: intellectual property (IP) and acquisition planning, documentation, and audit defense. We also provide litigation support and expert testimony services in tax and transfer pricing litigation.

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[1] *Altera Corporation and Subsidiaries, Petitioner vs. Commissioner of Internal Revenue*, Respondent. (Nos. 6253-12, 0063-12) Filed July 27, 2015.