

Tax in tech: Track transfer pricing

Transcript

CHRISTOPHER SUMMER: Hello, my name is Chris Summer. I'm a tax partner with Grant Thornton and I lead the technology initiative here for the Tax group. I'm joined today by Samit Shah, a Partner in our Transfer Pricing Group, and Steven Wrappe, the Leader of our Transfer Pricing Practice nationally. Thank you guys for joining today. So, to kick off, I'm just going to throw this out to you: Steve, can you talk a little bit about the current IRS focus on the transfer pricing area?

STEVEN WRAPPE: The current focus has been kind of heading in this direction for a long time. About 12 years ago, the IRS switched from a district office centric development of cases for transfer pricing to a nationally led development of cases — and it's taken a long time, but it's begun to make a difference. The IRS is having more wins and partial wins than they've had in a very long time in transfer pricing. And that's informing, a little bit, their hiring and pursuing additional transfer pricing examinations. And the area that they have particularly shown a great deal of interest is in the area of intangibles — brand intangibles, yes, but also technology intangibles, and so that's why it would be, I think, relevant to this group.

SAMIT SHAH: When we think about it at a field level — what we're seeing from our clients — we've seen a number of cases recently come out. Microsoft is the biggest one that likely came out where they've gotten adjustment in the billions for really a finite period of time. When you look at what Microsoft had done, and you look at the issues that are laid out for taxpayers, the issues tend to be circling around IP migration/cost-sharing arrangements and again, as Steve mentioned, because it's a 12-year-old centralization in the process, it takes time to win these cases and to formulate the arguments. In the tech clients that I serve, these issues especially tend to be in the inbound space where IP is owned offshore and US is — yeah, they might be a distributor, but the question is: In their a customer relationship that they're relying upon, is there IP that they're developing themselves? And there has been a number of cases that I know my clients were dealing with around that inbound issue.

STEVEN WRAPPE: With their new funding that they received recently, the IRS extended what they call compliance alerts to US distributors that are foreign owned, that have losses or, you know, low profits and they use the period 2017 through 21. They use one of two letters, one was a little bit less directed than the other and would say your profits are low or you have losses and that's not what we expect generally for a distributor of limited function. Therefore you

should reconsider your transfer pricing. The other letter, which is a little more directed, basically said we are considering opening an examination. So, both of these letters are relatively measured in their approach. They're just kind of laying out facts and then encouraging taxpayers to basically self-initiate adjustments, and a lot of clients, they're considering just that right now. IRS is definitely more comfortable with their ability to proceed with examinations than they were before. It doesn't mean that they're necessarily getting hyperbolic, but they are basically saying you might face an examination on this.

CHRISTOPHER SUMMER: So, with all this more empowered taxing authority, what tools do taxpayers have as they're working through these things?

STEVEN WRAPPE: It's basically the basic blocking and tackling: You have to have your documentation in place, it has to be reasonable. The IRS has made very clear recently that if you have insufficient documentation then it will not stop them from imposing a penalty. That just means you've got to take a hard look and make sure that your documents are updated and that they are a reasonable position and that you're following it. And then, yeah, it may cause some concern, but if you can get to that point, then I don't think it's any different than it's been before. It's just that the IRS is of the impression that a lot of taxpayers have let their documentation slip in quality, and they basically would like to call it out.

SAMIT SHAH: Yeah, and to add on to that, IRS has actually issued an FAQ specifically talking about what they deem to be quality documentation and what's included in that documentation itself. Again, like Steve said, right: Blocking and tackling is sort of the best foot forward for any taxpayer, especially if they're trying to convey how their business operates instead of letting the IRS infer that on them for themselves.

STEVEN WRAPPE: Initially, that's really all you can do. But you know, at some point it may make sense to approach the advanced pricing agreement if what you've done isn't exactly up to snuff and you want to do something about it today.

CHRISTOPHER SUMMER: Excellent. Well, thank you guys so much for joining. Thank you guys for giving us some quick hits on the current transfer pricing environment. We appreciate your time and I look forward to continuing to help taxpayers as they work through IRS and other taxing authorities through these transfer pricing exams. Thank you for your time.

STEVEN WRAPPE: Thanks for having us, Chris.

SAMIT SHAH: Thank you.