Panelists Try to Reconcile Tax Morality and Transfer Pricing

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The debate over whether multinational companies have a moral duty to pay their fair share of taxes can get more complicated in a transfer pricing context, in which the decision over how to allocate profits will likely result in some countries thinking that they got the short end of the stick, panelists said April 24.

During a session of the annual transfer pricing symposium hosted by the University of San Diego School of Law, practitioners and academics debated what it means to be a good corporate citizen in the transfer pricing area. They said the increasing pressure from antiavoidance activists and cash-strapped governments could put corporate advisers in the difficult position of choosing to pay more taxes as a cost of doing business but facing lawsuits from shareholders focused on the bottom line.

Steven Wrappe of KPMG LLP said he has struggled to reconcile the good corporate citizenship concept with the realities of transfer pricing. Wrappe said that while he’s sympathetic to the argument made by tax activists that some multinationals don’t pay their fair share of taxes, one has to recognize that most people who decide to practice tax aren’t scofflaws. “People go into tax because they like the way the logic works,” Wrappe said. “And there is a bit of a game to it, particularly for planners who are trying to pay an appropriate level of tax but no more.”

But in a transfer pricing environment, where value judgments must be made when deciding how and where to book profits, trying to abide by multiple countries’ transfer pricing laws — particularly when the interpretation and application of those laws may vary — and be a good corporate citizen is a challenge, said Wrappe. “There’s a balancing act,” he said. “Your transfer price isn’t going to change the amount of income you earn; it’s just going to change where you book it and who gets the revenue. If I change the transfer pricing up, I’m going to make one country happy and one less happy.”

John I. Forry, director of U.S. law programs for international legal professionals and a professor in residence at USD Law, said companies facing tax authorities’ inconsistent applications of transfer pricing rules have tough choices to make. They can decide they don’t want to fight the tax authority and pay the extra tax, but then they face a possible quarrel with their home country, which could argue that the company voluntarily paid the tax, he said. The company could be denied a foreign tax credit and competent authority relief and also be hit with a lawsuit by vigilant shareholders who see the double tax payment in the financial statements, Forry said.

Wrappe pointed out that a company’s decision to pay the extra tax will also be reflected in its transfer pricing documentation. “You’re going to have two governments thinking, ‘Gee, maybe we should’ve gotten more, particularly if the company is willing to pay double tax,’” he said. “You’re kind of documenting yourself into a corner. Many governments will take the position that if you documented your way into double tax, that’s not a government action, and therefore, you have no right to go to competent authority and get it worked out. So instead of giving you a marketable benefit, being a good corporate citizen might give you a real investor headache.”

Frank Rork, senior director of international tax at Edwards Lifesciences Corp., said the increasing transparency requirements that will result from the OECD’s base erosion and profit-shifting initiative, especially from country-by-country reporting, will be accompanied by more audits and deviation from the arm’s-length principle by some aggressive tax authorities. “I think we’re entering a world where there will be more controversy because data will be presented in such a way that more and more tax authorities will say, ‘We want a little piece of this profit,’” Rork said.

Companies will therefore have to ensure that they have good documentation and rely on tax treaty protection, Rork said, adding that if treaty relief isn’t available, they’ll have to decide whether to fight it out.