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AN ALERT FROM THE BDO TRANSFER PRICING PRACTICE

BDO KNOWS: TRANSFER PRICING

SUBJECT

INTERNAL REVENUE SERVICE RELEASES GUIDANCE TO APPLY TRANSFER PRICING PRINCIPLES FOR DETERMINATION OF CREDITABLE FOREIGN TAXES FOR UNITED STATES CORPORATIONS WITH FOREIGN DISREGARDED ENTITIES OR BRANCHES

INTRODUCTION

On December 6, 2013, the Internal Revenue Service released Chief Counsel Advice ("CCA") Memorandum 201349015, dated September 16, 2013. The CCA addresses the determination of creditable foreign taxes of United States corporations with foreign disregarded entities or branches and notes that United States transfer pricing principles may be relevant in determining whether non-arm's length transfer prices result in noncompulsory payments of foreign taxes.

DISCUSSION

Regulations under section 901 provide that a foreign tax paid for credit purposes must be computed with a reasonable interpretation of foreign tax law, as modified by any treaties. Taxpayers have the burden to establish to the satisfaction of the Service that they have properly minimized their creditable foreign tax liability by exhausting all effective and practical remedies to reduce their liability for foreign tax (see Treas. Reg. § 1.902-2(e)5)). This burden includes the proper determination of foreign taxable income that is subject to foreign income tax.

United States transfer pricing principles under section 482 may be relevant in determining whether non-arm's length transfer prices result in noncompulsory payments of foreign tax, to the extent foreign tax law, as modified by tax treaties to which the foreign country is a part, includes similar arm's length principles.

CONTACT:

ROBERT PEDERSEN, New York
212-885-8398 / rpedersen@bdo.com

WILLIAM F. ROTH III, Grand Rapids
616-776-3761 / wfroth@bdo.com

VEENA PARRIKAR, San Jose
408-352-3534 / vparrikar@bdo.com

KIRK HESSER, Chicago
312-233-1802 / khesser@bdo.com

MICHIKO HAMADA HANEY, New York
212-885-8577 / mhamada@bdo.com

SEAN KIM, New York
212-885-7237 / skim@bdo.com

DONNA FRYE, Detroit
248-244-6528 / dfrye@bdo.com

HOLLY CARMICHAEL, San Jose
408-352-1985 / hcarmichael@bdo.com

BRAD RODE, Chicago
312-233-1869 / brode@bdo.com

JERRY SEADE, Houston
713-986-3108 / jseade@bdo.com

SCOTT HENDON, Dallas
214-665-0750 / shendon@bdo.com

CHIP MORGAN, Los Angeles
310-557-7517 / cmorgan@bdo.com

Transactions occurring between entities that are disregarded as separate entities from one another are usually disregarded for United States tax purposes. Similarly, in a consolidated group, adjustments to the transfer price of a transaction between a United States corporation and another consolidated group member's foreign branch or disregarded entity usually results in offsetting amounts of gross income and expense. In such cases, those transfer pricing adjustments do not change the total amount of worldwide taxable income recognized by the United States consolidated group. Those adjustments would also not affect the relative amounts or the ratio of the group's United States and foreign source income.

In cases where transactions between a United States corporation and a foreign branch or disregarded entity fail to use arm's length transfer pricing principles under section 482, resulting in an overstatement of profits subject to foreign tax, the Service may consider a portion of the foreign tax paid to be noncompulsory and therefore not eligible for a United States foreign tax credit.

CCA 201349015 may be accessed on the Service's Web site at www.irs.gov/pub/irs-wd/1349015.pdf.

RECOMMENDATION

All United States corporations with intercompany transactions between foreign branches or disregarded entities or foreign branches or disregarded entities of subsidiaries should examine their transfer pricing policies in light of the CCA, as appropriate. This CCA should also be considered when documenting and quantifying income tax exposures.