

## Transfer Pricing -- a Seamless Web

It's been more than a century since Frederic Maitland first characterized the law (or, more accurately, legal history) as a seamless web.<sup>1</sup> The metaphor seems particularly appropriate in the context of IRS Chief Counsel's exploration of the APA Program and its proper role in sound tax administration.

Section 482 of the Internal Revenue Code, along with the OECD Transfer Pricing Guidelines for Multinational Enterprises, attempts to give meaning to the "arm's-length standard." This effort necessarily involves a complex matrix of legal, economic and factual/financial analysis. There are few things known to a metaphysical certainty about transfer pricing. And that undeniable fact is both a blessing and a curse. For those among us who are rules-driven, the notion that transfer pricing resolution "depends on the particular facts and circumstances" is intellectually unsatisfying. However, the alternative, trying to fit all transfer pricing matters into a Procrustean bed of ironclad truths, is by far the greater danger.

I prefer to look at the glass half-full. I **like** the notion that the world of "transfer pricing" is a world of ambiguity. With each new matter, I feel like Forrest Gump opening a new box of chocolates. I particularly enjoyed my stint as a Team Leader in the APA Program because there seemed to be a clear recognition (both within the Service and in the tax community) of the APA Program's role in the seamless web of transfer pricing law. Over time, it was possible to develop and refine by the iterative process a body of guiding principles that could serve to inform decision-making (and thereby reduce the time needed to fairly resolve difficult transfer pricing controversies). The operative rule then, it seemed to me, was entirely appropriate:

*The IRS APA Program was bound by controlling case law, and by IRS National Office litigation directives, binding Rulings, and other formal declarations of IRS policy or APA Program practice. But, in the absence of such definitive guidance, the APA Team Leader, working closely with senior APA Program management, was permitted to "operate."*

This approach gave meaning to the role of the APA Program as "*incubator*" for the development of IRS positions on unsettled legal/economic issues embedded in the Section 482 web. Taxpayers most often came to the APA Program because the law was unsettled -- if the answer was so obvious, they might not incur the considerable time and expense attendant to the APA process. The willingness of taxpayers to come to the IRS with "open palms" in a proactive non-adversarial co-development setting is something to be actively encouraged— not discouraged.

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<sup>1</sup> Frederic William Maitland, **A Prologue to a History of English Law**, 14 L. QUARTERLY REV. 13 (1898); see also 1 Frederick Pollock & Frederic W. Maitland, **THE HISTORY OF ENGLISH LAW** 1 (2d ed. 1899).

In recent years, the APA Program Office has veered from its historical role. There are numerous contributing factors; however, that I prefer to focus not on the symptoms but rather on the effects of this transformation. The highest and best use of the APA Program is as a forum for resolution of the most difficult transfer pricing issues. But the Program has evolved to the point where it is predisposed to act in only the most certain of situations. We are aware that public scrutiny of the APA Program has intensified. The Senate Finance Committee inquiry is certainly testament to this heightened scrutiny. However, the APA Program Office must remain undeterred from its mission, or it risks being perceived as “business as usual.” Given the front-loaded costs for taxpayers of seeking an APA, that will be the Program’s death knell.

There is another balancing act to bring your attention. No doubt cross-pollenization within the IRS (*i.e.*, between the APA Program and other Branches of Chief Counsel and ACCI) produces invaluable synergies. The APA Program Office is contributing extensively to some of the most critical transfer pricing thinking undertaken by any tax authority anywhere. I think I speak for everyone in commending the considerable effort of an already overburdened APA Program Staff in development of technical guidance. However, cross-pollenization has its downside-- it can give rise to “*group think*.” It seems to me that some of APA’s independence has been sacrificed at the altar of ongoing guidance projects. Taxpayers and the government will benefit most from an APA Program focused on balancing consistency with the equally important objectives of intellectual independence and case currency.

It concerns me (and should concern all of us) that a reviewing Congressional Committee, with limited visibility into the dynamics of an APA (or Competent Authority) negotiation, might come in as a super-reviewing body and reach ill-conceived conclusions about the merits of a particular result (or, even worse, chill the process itself). Is the APA Program perfect? No, but neither are other alternative dispute forums. Not by a long shot.

The APA Program works for both the IRS and tax community. It can continue to serve its intended role: (i) if the APA Program Office is given the resources to allow it to function properly (see my BNA *Commentary* [annexed hereto]), and (ii) if checks and balances are put in place to ensure that APA determinations are suitably vetted (but not micromanaged). Constraining the APA Program’s jurisdiction and independence is most definitely not the right answer.

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*Note:* This paper reflects the personal opinions of the author and is not intended to reflect the views of Baker & McKenzie LLP. The author wishes to thank his colleague, Daniel S. Karen, for his substantial insights.