

At A Glance

# Transfer Pricing Litigation and Controversy Support

## Overview

Transfer pricing audits, controversy, and litigation have become primary ways in which tax authorities around the world pursue higher revenue from multinational companies. With the OECD questioning the reliability of the arm's length principle for almost all industries, the advent of unilateral digital taxes in Europe and Asia, COVID-19 recovery efforts, and a lack of clear and consistent global arbitration procedures, multinational companies, more than ever, need representation and support for their transfer pricing policies. NERA's transfer pricing economists offer a suite of sophisticated market-based pricing techniques—including DEMPE, value chain and industry structure analyses, benchmarking studies, and rigorous valuation methodologies—to help clients and their lawyers resolve tax disputes.

## Areas of Expertise

NERA's controversy support capabilities build on our long and established reputation as reliable independent expert witnesses and our ability to apply sound, market-oriented, case-specific economic theory in the resolution of tax disputes.

Our experts work closely with law firms and can assist with:

- Conducting fact-based investigations to assess the economic merits and demerits of tax authority positions and assisting in developing the overall case strategy based on these assessments;
- Assessing the purpose of IDRs issued by tax authorities and preparing strategic responses with appropriate supplemental explanations;
- Preparing objective, rigorous, and unbiased expert rebuttal testimony that communicates economic concepts, opinions, and conclusions in a clear, understandable, and persuasive manner; and

- Conducting risk assessments and “health checks” of legacy transfer pricing policies governing companies' financial, tangible, and intangible property and services transactions, and preparing APAs and other negotiated transfer pricing outcomes to mitigate clients' future audit risk.

## Case Summaries

### Financial Sector Litigation

NERA experts are frequently retained by tax attorneys to provide economic support and defend a range of complex cross-border financial transactions for hedge funds, brokerage houses, in-house insurance entities, and investment research and management companies. In several large litigation cases in the UK, France, and other EU countries, NERA has performed valuations of corporate financial guarantees, analyzed credit ratings and net risk exposures of related parties, and analyzed market instruments to prove *bona fide* debt status, among other services. In all cases, our strategic analysis was a critical part of the successful closure of the audit.

### **Transfer Pricing Audit of Multinational Automotive Supplier**

A US-headquartered manufacturer of R&D-intensive automotive systems with substantial European operations was targeted with significant IRS audit adjustments stemming from its cross-border royalties and related payments for intellectual property. NERA economists demonstrated through detailed source-and-destination value chain analyses that the relative contributions of European- and US-origin technologies to the geographic market areas reflected arm's length considerations for the market-specific applications of these technologies in the different regions and, therefore, no transfer pricing adjustments were indicated. The matter was settled at the IRS appeals level with no adjustments on either side.

### **Tax Audit Defense of a Distribution Company**

The IRS challenged the characterization of certain payments made to affiliated entities and disallowed their deduction for a leading US marketer and distributor of beverages. During the audit period, there were years when the company had significant losses even though, on a cumulative basis, it earned a profit that was within an arm's length range established by independent benchmarks. The NERA team investigated the reasons for the losses and developed supporting arguments based on management's contemporaneous financial projections to show that the results were nonetheless consistent with arm's length intercompany pricing.

The company's business results were adversely impacted by significant increases in cost that were outside of its control. Over time, management responded to these increases in product costs by modifying its US marketing and pricing strategies to increase volumes and margins. By developing supporting arguments using relevant data from contemporaneous business projections, NERA economists demonstrated that at all times during the audit period anticipated profits reflected an arm's length consideration for functions and risks, and thus no transfer pricing adjustment was indicated.

### **Tax Audit Defense of a Multi-Level Marketing Company**

A US multi-level marketing company faced income adjustments resulting from a transfer pricing audit of royalty

payments received from its affiliate in Mexico. The company tested the arm's length nature of the royalties based on the residual profit split method. Although the IRS agreed with the best method selection, it challenged various aspects of the application of the residual profit split method, including the scope of the analysis, valuation of routine benchmarks, and the identification and quantification of intangible expenditures. NERA economists prepared qualitative and quantitative support for all disputed aspects through evaluating the case and conducting DEMPE analysis and demonstrated that no income adjustment was warranted based on a scenario analysis. The case was resolved in favor of the taxpayer with no income adjustments.

### **MAP Case for a US OEM of Heavy Machinery and Equipment**

On a contentious matter regarding the double taxation of an adjustment initiated by a foreign tax authority, NERA assisted a large US OEM of heavy machinery in presenting a compelling and principled case to Competent Authority. At issue was the valuation of routine distribution and service profits, as well as justification of license fees paid for trademarks and relevant product and R&D intangibles. NERA experts developed and applied a series of unique economic adjustment to the PLI to account for the differences in product mix between the available benchmarks and the taxpayer.

## **About NERA**

NERA Economic Consulting ([www.nera.com](http://www.nera.com)) is a global firm of experts dedicated to applying economic, finance, and quantitative principles to complex business and legal challenges. For over half a century, NERA's economists have been creating strategies, studies, reports, expert testimony, and policy recommendations for government authorities and the world's leading law firms and corporations. With its main office in New York City, NERA serves clients from more than 25 offices across North America, Europe, and Asia Pacific.

## **Contact**

For more information or to contact our experts, please visit [www.nera.com/tp-controversy](http://www.nera.com/tp-controversy).