Part II

Transfer Pricing and Valuation Regulations in Practice

Part II of this book is composed of ten case studies and a concluding chapter containing policy recommendations. I construct composite transfer pricing cases with a view to representing all of the methods explicitly sanctioned by Section 482—both 1968 and 1993 temporary versions—for establishing and evaluating intra-company transfer prices. Additionally, one of the transfer pricing cases is based on the capital employed method contained in the 1993 proposed regulations. The three valuation case studies included in Part II are similarly representative of a range of recurring methodological issues.

My overarching objective in reviewing these composite case studies is to consider:

- Why Section 482 transfer pricing regulations (both 1968 and 1993 temporary versions) will often fail to produce arm's length results, and may in fact produce results that are inconsistent across similarly situated firms;
- How these problems are compounded by the institutional context in which transfer pricing disputes are resolved;
- What insights the history of Section 338 issues provides as to the relative merits of different approaches to valuing intangible property, and the potential sources of controversy over such issues in connection with intra-company pricing; and,
- How statutory legislation and administrative practice can be made more consistent.

Hence, in the final chapter of Part II (Chapter 8), I pull together the method-specific critiques developed in the preceding case studies, and argue that intra-company pricing disputes arise as frequently as they do, and administrative practice diverges from statutory tax legislation as much as it does in this area, largely for two reasons: Section 482 regulations are highly ambiguous on a number of key points,[139] and disputed issues are resolved via administrative procedures that are extremely ad hoc. This state of affairs lends itself to

[139] This statement applies with very nearly equal force to both 1968 regulations and 1993 temporary regulations.

the unequal tax treatment of similarly situated firms, and to corporate tax liabilities that are often less, and occasionally more, than existing statutes mandate. Chapter 8 summarizes a number of policy recommendations that would narrow the gap between statutory legislation and administrative practice.

As noted in the introduction to this book, I assume, for purposes of discussion, that existing tax legislation remains in place. The arm's length standard is embodied in an extensive network of bilateral tax treaties to which the United States is a party, and it is unambiguously the international norm. Consequently, the U.S. Congress will probably not deviate from it unilaterally. For this reason, my policy recommendations go to how both regulations and dispute resolution procedures should be modified so that they are applied more uniformly and conform more closely to the statutory arm's length standard. However, in principle, the direction of change could also be reversed: Congress could modify tax laws to accord more closely with actual practice.

Stated differently, I do not advocate higher or lower corporate tax burdens per se, as an end in itself.[140] However, similarly situated firms should be treated uniformly for tax purposes. Tax burdens should be predictable. The distortions introduced into economic decision-making by virtue of the existing lacunae between tax legislation and administrative practice should be reduced. On a more ideological level, administrative practice should be subordinate to, and consistent with, statutory legislation in a democracy. To bring these salutory changes about, either laws or regulations and dispute resolution processes need to be changed. At present, the latter appear more malleable than the former.

[140] In this connection, it should be noted that, on purely economic grounds, one can make a compelling case that corporations should not be taxed.