An Interview with Aydin Hayri of Deloitte, author of *Transfer Pricing in Action*

Deloitte Tax LLP Principal Aydin Hayri, together with Tax Senior Manager Althea Azeff, recently published Transfer Pricing in Action, a business novel that attempts "to bridge the abstract theory of transfer pricing and its everyday practice." Hayri recently sat down with Arm's Length Standard to discuss the book and transfer pricing trends.

Q: Aydin, your book, *Transfer Pricing in Action*, with Althea Azeff came out earlier this year from Kluwer Law. Can you please tell us what prompted you to write the book and why?

A: The simple answer is that I wanted to share my experiences in the practice of transfer pricing. I find transfer pricing to be an amazingly interesting and dynamic area. With the general acceptance of the "arm's length standard," we have witnessed extensive legislative activity and rulemaking around the world. Transfer pricing concepts that emerged from the interpretation of the arm's length principle, methods, and their applications show surprising uniformity across countries. Another interesting aspect of transfer pricing is that the points of disagreement are arbitrated with reference to economic theory in the areas of industrial organization, financial economics, and corporate finance, which conformed to my background.

Q: Tell us a little about your background in transfer pricing and as an economist.

A: I am a principal with Deloitte's global transfer pricing practice, based in the Washington D.C. National Tax Office. Before joining Deloitte, I was in academia, teaching at Charles University, Prague; the University of Warwick, England; and as a research fellow at Princeton University. Although I hold a Ph.D. from Princeton in economics – a science predicated on the pursuit of individual happiness – it took me a while to figure out that my own calling was in consulting, where you can get instant gratification and feedback on your work. It has been almost 16 years since I made the transition from academia to consulting.

Q: Did you find transfer pricing more rewarding than academia?

A: For me, yes. I've never had a dull moment since I started!

Q: What about new developments since the book was published mid-August 2013?

A: Most of the changes represent a continuing trend by tax administrations to get into the more complicated aspects of transfer pricing. Surprisingly, the underlying principles remain the same. Coming into transfer pricing with an economics background, I never took much comfort in what the legalistic language of local regulations may or may not have prescribed. For me it has always been about the underlying economics, or as some would say, the commercial feasibility of a transfer pricing arrangement. With Althea, we approached our book from this perspective, and also knowing what the emerging trends are. For example, in the book, we introduced the concept of "indicia of beneficial ownership of intangibles." It is a practical way to implement the new OECD draft on intangibles.

Q: What about the increasing OECD focus on control? Did you anticipate that as well?

A: Actually, the origins of our book go to the issue of control. As our understanding and application of the arm's length principle advanced, most of the nuances that were overlooked before became more important. So we began to analyze different shades of risk taking. First we had to deal with significant foreign exchange swings – that has now become almost standard in bilateral APA (advance pricing agreement) discussions. Second came the 2001 recession, followed by the 2008 Great Recession. We had to deal with the risks associated with that. Manufacturing and functional migrations now became the standard staple of business – it is routine for a multinational enterprise to move operations around, reroute its supply chain. All business changes involve upfront pain, followed by potential future gain or cost savings. In my practice, I have been running into the issue of who will take the pain and, of course, the gain. I decided to distill my experiences into an article on the risk allocation and control of risk.

Q: And there was just too much material, and you had to turn it into a book?

A: Well, I became uncomfortable with the abstract tone of the article that was taking shape. I wanted to make the discussion more practical – I began thinking of cases, similar to the examples the OECD included in the draft intangibles chapter. The challenge is that any transfer pricing analysis would rely on the current factual details, history, or course of conduct of the parties, and the availability of benchmarks. If you do not fully develop these three legs of the analysis, something will be amiss. Your conclusions or recommendations would become too simplistic, or abstract. Instead of setting up a case to make a point, I chose to build one detailed case and address many issues along the way.

Q: But would not one extended case study be limited, in terms of the industry and different factual scenarios?

A: You are right. As we got started with the book, we realized that we would be too limited if we stuck to our case only. That is where the business novel format helped. The characters of our fictitious company often reached out to their peers in different industries, who were facing similar issues. Their discussions presented opportunities for us to compare and contrast potentially different fact patterns.

Q: Usually this type of content is presented in a straightforward didactic manner. In *Transfer Pricing in Action*, the content is presented as a story that reads almost like an expanded case study, only with more flare and color. What prompted you to take that route?

A: We felt there is a need to explain transfer pricing from an everyday operational perspective. Existing literature is in the form of textbooks, or anthologies of professional articles, or annotated versions of regulations. This book is meant to fill this void and extend a bridge from the abstract theory of transfer pricing to real-life everyday practice. We wanted to propel the reader from start to finish with "action," hence the title. We went with a genre-bending method, marrying narrative form to straightforward textbook-like prose to bring to life the intricacies that come into play when a group of people interact throughout their company's lifecycle – in this case, from its birth in the United States through expansion abroad.

Q: What would you hope readers will walk away with having read *Transfer Pricing in Action*?

A: If nothing else, I'd want readers to appreciate that tax planning decisions are as real and mission-critical as any other business decisions, and that they require the same level of due diligence as any business investment.

Q: Any predictions as to what's coming in terms of transfer pricing developments for 2014?

A: First of all, there will be more focus on the issue of "control." I could see that a section on "control" will be the standard staple of every transfer pricing study. We will see taxpayers and tax administrations spend more time inquiring about how corporate decisions are made, and how the decision-making processes are documented. If you look at the current debate on base erosion, it is a debate about the primacy of functions versus risks. Large-country tax administrations would like to link risks to functions, while the general trend of global business, with the proliferation of contractual forms, collaboration and outsourcing deals, and financial engineering, presents an opposite trend. We see an increase in the packaging, repackaging, and sharing of business risks.

Q: And how do you expect this tension to be resolved? In the courts, in the local legislatures, or at the multinational level?

A: Well, I believe in the primacy of economic forces. If you think about it, taxation is like any other expense for corporations. In return for domiciling their people and assets in a certain jurisdiction, businesses expect to pay a price, which is the corporate tax. If this price is not right, meaning that there are competing jurisdictions where the price of locating people and assets is lower, corporations will ultimately move there. In a way, tax competition among governments will shape the landscape more than any legislative or policy initiatives.

Q: Does that mean governments' efforts to limit tax planning by multinational corporations may ultimately work against them?

A: I would think so. In economist-speak, relocation of functions and personnel is difficult in the short term. By increasing the tax burden on multinationals, however, the larger OECD countries are effectively forcing the MNEs domiciled in their territories to look elsewhere for the future growth of functions and personnel. In today's world, talent and facilities are increasingly mobile. Business culture is becoming more homogenized, and best practices are spreading faster than ever.

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