



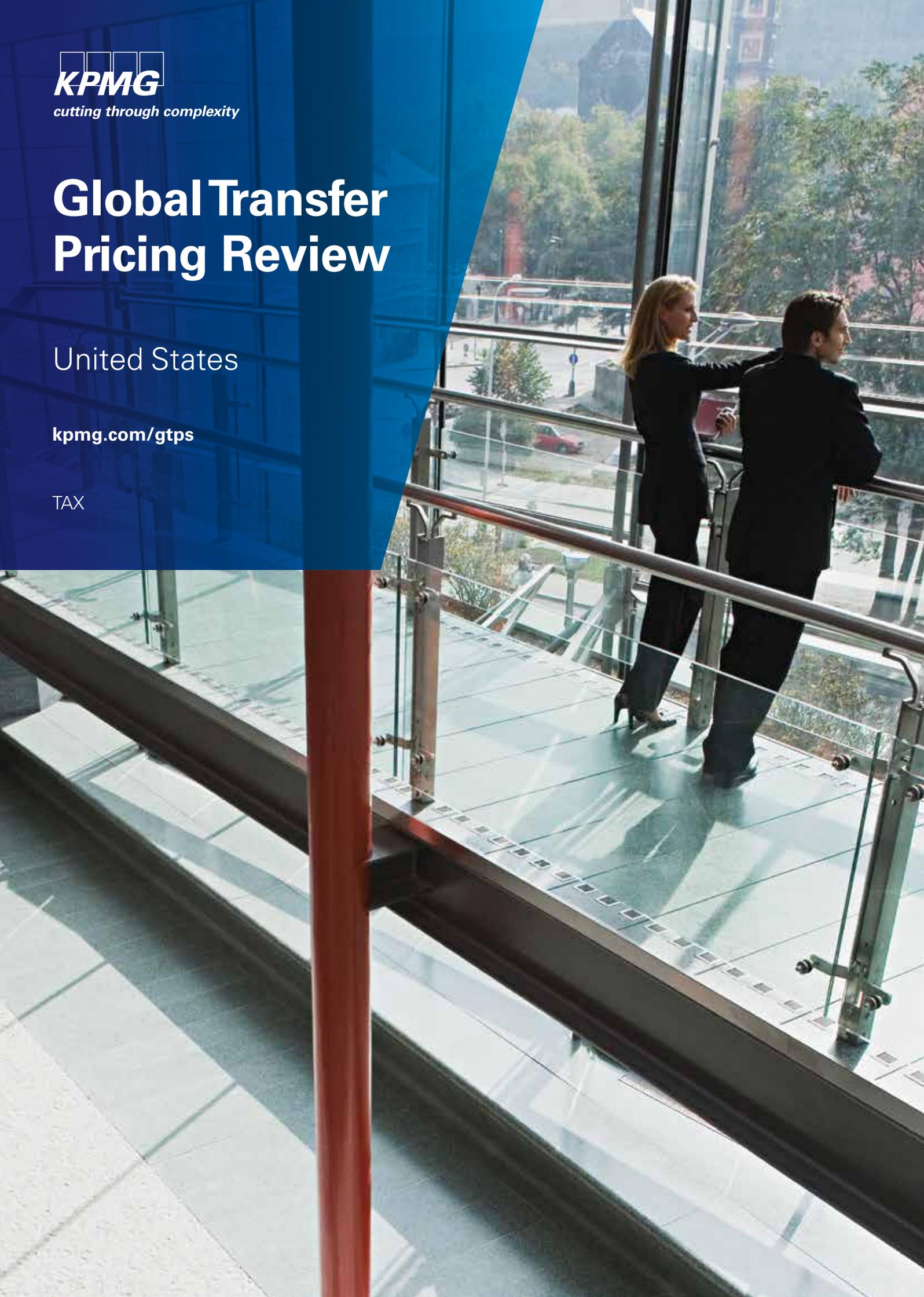
cutting through complexity

Global Transfer Pricing Review

United States

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TAX



United States

KPMG observation

The United States has one of the oldest and most mature transfer pricing regimes in the world.

Over the last year the US Treasury Department has been actively engaged in the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) project. As the OECD has made progress over the last year on Action Items relating to transfer pricing, the US has indicated that it agrees with the broad parameters of the OECD's proposals on country-by-country reporting, master file and local file rules under Action 13. The US plans to implement country-by-country reporting, but has not yet issued any related rules or guidance.

With respect to audits, the Internal Revenue Service (IRS) issued the Transfer Pricing Roadmap in February 2014, guiding Exam teams on how to focus on up-front planning and better factual development of transfer pricing issues. In addition, as part of the IRS's efforts toward greater knowledge sharing, issue-based analyses, and training of additional Examiners, the IRS published a number of training guides on international tax and transfer pricing topics (including, for example, exhaustion of remedies, review of transfer pricing documentation, and treatment of management fees). These guides are available within the IRS and to the public on the internet.

In the courts, the IRS is pursuing a number of different transfer pricing cases, more now than at any other point in history. The largest of these cases, of course, address the transfer of intangibles.

The IRS's combination of the Advance Pricing Agreement (APA) program and the competent authority program into a newly created group, the Advance Pricing & Mutual Agreement program (APMA), has allowed for more expedited processing and resolution of transfer pricing disputes.

In late 2013, the IRS released draft guidance with respect to APAs and competent authority matters. This proposed guidance represents substantial changes compared to the current procedures and is consistent with the objectives of APMA to enhance integration between competent authority matters and APAs, to improve allocation of resources, and to increase transparency and efficiency. The IRS has received comments on this draft guidance, and plans to release final guidance during 2015.

Transfer pricing study snapshot

The purpose of a transfer pricing study

	Applicable	Not applicable	Required to be contemporaneous	Submission to tax authority required	Thresholds apply/exist
Legal requirements		●			
Protection from penalties	●		●	●	●
Reduce risk of adjustment	●			●	
Shifts burden of proof		●			

Basic information

Tax authority name

Internal Revenue Service (IRS).

Citation for transfer pricing rules

Substantive rules: Internal Revenue Code (IRC) Section 482

- Treas. Reg. Section 1.482–1 through Section 1.482–9
- Penalty rules: IRC Section 6662(e) and Treas. Reg. Section 1.6662–6.

Effective date of transfer pricing rules

- Effective 6 October 1994 for Treas. Reg. Section 1.482–1 through Section 1.482–6, and Section 1.482–8
- 9 February 1996 for Section 1.6662–6
- 1 August 2009 for Section 1.482–9 and
- 19 December 2011 for Section 1.482–7.

What is the relationship threshold for transfer pricing rules to apply between parties?

The parties must be under common control. Control is based on a facts and circumstances test, and not on specific ownership thresholds.

What is the statute of limitations on assessment of transfer pricing adjustments?

Generally, the IRS has three years from the tax return filing date to make adjustments. However, if gross income in excess of 25 percent of the gross income stated in the return is omitted, the statute is extended to six years. The statute is unlimited if a false or fraudulent return is filed, if a willful attempt to evade taxes is made, or if no return is filed.

Transfer pricing disclosure overview

Are disclosures related to transfer pricing required to be submitted to the revenue authority on an annual basis (e.g. with the tax return)?

Yes.

What types of transfer pricing information must be disclosed?

IRS Forms 5471, (generally, US companies with foreign subsidiaries), 5472 (generally, US companies with

foreign parents), and Schedule UTP (Uncertain Tax Position), which is part of Form 1120, must be attached to the US tax return. In addition, participants in an intangible development cost sharing arrangement (CSA) must file a CSA statement upon formation of the arrangement and annually with their tax returns if they wish to ensure the arrangement will be governed by Treas. Reg. Section 1.482–7.

Forms 5471 and 5472, in general, require disclosure of related party transactions including loans, tangible goods, services, and intangibles. Schedule UTP requires certain taxpayers to report federal income tax positions (including positions relating to transfer pricing) for which an audited financial statement reserve is recorded or is not recorded due to an expectation to litigate.

What are the consequences of failure to submit disclosures?

A penalty of 10,000 US dollars (USD) is imposed for each Form 5471 or Form 5472 that is filed after the due date of the income tax return (including extensions) or does not include the complete and accurate information described in Section 6038(a). Currently, there are no penalties directly associated with Schedule UTP; the IRS is studying the issue. If a CSA statement is not filed (and other requirements not met), a taxpayer cannot rely on Treas. Reg. Section 1.482–7 to allow sharing of intangible development expenses at cost rather than value, the netting of royalty and cost sharing payments, or any other of its provisions.

Transfer pricing study overview

Can documentation be filed in a language other than the local language? If yes, which ones?

No.

When a transfer pricing study is prepared, should its content follow Chapter V of the Organisation for Economic Co-operation and Development (OECD) Guidelines?

Yes, for certain transactions. The US transfer pricing rules are similar to, but do not reference, the OECD Guidelines. Under the US transfer pricing rules, there are 10 principal documents required to be included in a transfer pricing study:

1. overview of the business
2. organization structure chart
3. documentation required by regulation, e.g. cost share participant names, market share strategy
4. description of transfer pricing methodology and reason for selection (best method analysis)
5. discussion of alternative methods not selected
6. description of controlled transactions
7. description and analysis of comparables
8. economic analysis
9. description of any relevant post year-end data, if applicable, and
10. an index of the principal and background documents relied on.

Does the tax authority require an advisor/tax practitioner to have specific designation in order to prepare or submit a transfer pricing study?

No.

Transfer pricing methods

Does your country follow the transfer pricing methods outlined in Chapter II of the OECD Guidelines? If exceptions apply, please describe.

Yes. There are some minor differences. The US allows for:

- tangible property transactions: comparable uncontrolled price (CUP) method resale price, cost plus, profit splits (comparable and residual), comparable profits method (CPM, equivalent to OECD transactional net margin method), and other unspecified methods
- intangible property transactions: CUT, profit splits, CPM, other unspecified methods, and, in certain circumstances, methods for platform contribution transactions (PCTs) under a cost sharing arrangement (CSA)
- services transactions: services cost (safe harbor), comparable uncontrolled services price (CUSP), gross services margin, cost of services plus, profit splits, CPM, and other unspecified methods
- loans or advances: arm's length, status of the borrower, and method

based on applicable federal rate (safe harbor)

- cost sharing transactions (balancing payments): reasonably anticipated benefit share
- PCTs (cost sharing buy-ins): CUT, CUSP, income method, acquisition price, market capitalization, residual profit split, and other unspecified methods.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? And if so, how many days?

Yes, 30 days.

When the tax authority requests a taxpayer's transfer pricing documentation, are there timing requirements for a taxpayer to submit its documentation? Please explain.

By regulation, the taxpayer has 30 days to submit documentation to avoid penalties.

If an adjustment is proposed by the tax authority, what dispute resolution options are available?

There are several administrative appeal routes including: regular appeals process, fast track appeals, early referral to appeals, Advance Pricing Agreements (APAs) with a 'rollback' to include the years under audit, and the simultaneous appeals and competent authority process.

If an adjustment is sustained, can penalties be assessed? If so, what rates are applied and under what conditions?

There are two types of penalties that can be assessed as an additional 20 percent or 40 percent of the tax underpayment. The Transactional Penalty applies at a 20 percent rate where the misstated transfer price for any property or service is 200 percent or more, or 50 percent or less, of the correct price. The Transactional Penalty applies at a 40 percent rate if the misstated transfer

price is 400 percent or more, or 25 percent or less, of the correct price.

The Net Adjustment Penalty applies at a 20 percent rate if the total net transfer pricing adjustment for the year is more than USD5 million or 10 percent of gross receipts. The Net Adjustment Penalty applies at a 40 percent rate if the adjustment is more than USD20 million or 20 percent of gross receipts.

To what extent are transfer pricing penalties enforced?

The Net Adjustment Penalty is nearly always enforced unless a valid defense applies (e.g. a reasonable basis). In practice, the IRS rarely, if ever, has asserted the Transactional Penalty.

What defenses are available with respect to penalties?

Submitting a reasonable transfer pricing study to the tax authority is the sole way to avoid the Net Adjustment Penalty. The Transactional Penalty can be avoided by demonstrating reasonable cause and good faith, which can be established through a transfer pricing study or in other ways.

What trends are being observed currently?

The IRS continues to treat transfer pricing as a key priority both from its own compliance and enforcement perspective and on the international stage. Not alone in this effort, the IRS is working closely with the OECD and G-20 member countries in the global trend toward tax transparency.

The IRS is also carefully scrutinizing concerns regarding the confidentiality of taxpayer information. Although consensus exists regarding country-by-country reporting, how information is exchanged among tax administrations—particularly given confidentiality concerns—remains to be negotiated. The IRS experienced a significant increase in requests for double tax relief from 2013 to 2014, and many expect the trend to continue as increased reporting requirements take hold around the world. More IRS resources will be needed to move cases efficiently to resolution.

Finally, IRS positions on the transfer of intangible assets will be affected by the

transfer pricing litigation cases currently in the pipeline.

Special considerations

Are secret comparables used by tax authorities?

No.

Is there a preference, or requirement, by the tax authorities for local comparables in a benchmarking set?

Yes, although it depends on the tested party. Because the US Securities and Exchange Commission has detailed reporting requirements for public corporations that are used by providers to create company databases and by practitioners to prepare transfer pricing reports, the IRS would expect US (and sometimes Canadian) comparables to be used to benchmark a US tested party, in the absence of a compelling reason to use a different set. For foreign tested parties, the IRS historically has been receptive to using any set (e.g. US comparables, global comparables, regional comparables or specific country comparables) that can be supported based upon the specific facts and circumstances and the reliability of available data.

Do tax authorities have requirements or preferences regarding databases for comparables?

Although there are no requirements to use a specific database, APMA and the IRS field generally use Standard and Poor's Compustat database to identify comparable companies worldwide. In some circumstances, particularly involving the competent authority, other databases (e.g. Disclosure Mergent, Orbis GlobalVantage, Worldscope OneSource, Osirus) may be used, including non-US databases that are used by its income tax treaty partners.

Does the tax authority generally focus on the interquartile range in a TNMM analysis?

Yes.

Does the tax authority have other preferences in benchmarking? If so, please describe.

The IRS makes public certain informal guidance, such as the format in which it prefers benchmarking data presented as well as certain adjustments to be used in comparable searches.

What level of interaction do tax authorities have with customs authorities?

High.

Are there limitations on deductibility of management fees beyond the arm's length principle?

Yes, some. While the arm's length principle is the primary vehicle for establishing the tax treatment of management fees, the IRS has other tools to challenge the deductibility of such fees under the Internal Revenue Code and based on case-law precedent. These situations are rare.

Are management fees subject to withholding?

No.

Are there limitations on the deductibility of royalties beyond the arm's length principle?

Yes. While the arm's length principle is the primary vehicle for establishing the tax treatment of royalties, the IRS has other tools to challenge the deductibility of such fees under the Internal Revenue Code and based on case-law precedent. These situations are rare.

Are royalties subject to withholding?

Yes.

Are taxpayers allowed to file tax return numbers that differ from book numbers?

Yes. When year-end financial results are not within an arm's length range, the US rules allow taxpayers to make post-year-end adjustments — to be reported on Schedule M of a timely filed original tax return — to bring the taxpayer within the arm's length range. Such adjustments may have US customs reporting implications. Additionally, there are rules prescribed (Revenue Procedure 99-32) for moving the cash accounts consistent with the post year-end adjustment.

Other unique attributes?

The US regulations permit comparison of controlled and uncontrolled transactions based upon results over an appropriate multiple-year period.

The US regulations also have safe harbors for interest rates and certain types of services.

Tax treaty/double tax resolution

What is the extent of the double tax treaty network?

Extensive. There are approximately 60 income tax treaties that the US currently has in force with other nations.

If extensive, is the competent authority effective in obtaining double tax relief?

Yes, generally. The IRS publishes annual statistics indicating that, overall, double tax relief is almost always provided. However, these statistics are not published on a country by country basis.

When may a taxpayer submit an adjustment to competent authority?

For a US-initiated adjustment, a written request for competent authority assistance may be submitted as soon as is practical after the proposed adjustment is communicated to the taxpayer in writing (generally, when the IRS Notice of Proposed Adjustment is issued). For a foreign-initiated adjustment, competent authority assistance may be requested as soon as the taxpayer believes such filing is warranted, based on the actions of the country proposing the adjustment. The income tax treaties of the US have varying provisions as to when notice must be provided of the action giving rise to the need for competent authority assistance.

May a taxpayer go to competent authority before paying tax?

Yes.

Advance pricing agreements

What APA options are available, if any?

Unilateral, bilateral, multilateral.

Is there a filing fee for APAs?

Yes. Currently, the filing fee is USD50,000 for large taxpayers (USD35,000 for renewals), and USD22,500 for smaller taxpayers in certain circumstances (i.e. gross worldwide income less than USD200 million or small transactions not greater than USD50 million annually and intangible transactions not greater than USD10 million).

Does the tax authority publish APA data either in the form of an annual report or through the disclosure of data in public forums?

Yes.

Are there any difficulties or limitations on the availability or effectiveness of APAs?

Yes. The creation of the APMA Program has improved efficiency in the processing of APAs by the IRS. The program completed 42 APAs in 2011 as compared with 140 in 2012 and 145 in 2013. However, over the past year the IRS has lost resources, resulting in a decline in APAs closed to 101 in 2014.

The IRS received 108 APA requests in 2014, an insignificant change from the 108 received in 2013. As such, APAs remain an important tool to achieve certainty and mitigate transfer pricing risk for many companies.

Cites: (Announcement 2014-14, 2014-16 I.R.B. 948, (14 April 2014)) and (Announcement 2015-11, 2015-15 I.R.B. 883, (30 March 2015)).

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