Transfer Pricing Country Summary
United States

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Legislation

Existence of Transfer Pricing Laws/Guidelines

Under Section 482 of the Internal Revenue Code (IRC) of the U.S. Treasury, the Internal Revenue Service (IRS) has the authority to adjust the allocation of gross income, deductions, credits or allowances among or between businesses that are owned or controlled directly or indirectly by the same interests if such adjustments are necessary to prevent the evasion of tax or clearly to reflect the income of such businesses. The corresponding Section 1.482 of the U.S. Treasury Regulations (Section 1.482) sets forth the general principles and guidelines to be followed under Section 482 of the IRC, and establishes the arm's length principle as the standard for determining the true taxable income of a taxpayer.

On July 31, 2009, the Treasury issued Final Service Regulations (§1.482 -9), providing greater guidance under circumstances in which a controlled party makes contributions to an intangible owned by another party. In December 2011, the U.S. Treasury released final cost- sharing regulations, which were intended to provide further guidance to taxpayers choosing to enter into qualified cost - sharing arrangements (CSAs).

Documentation requirements

The Internal Revenue Service ("IRS") requires disclosure of detailed information on controlled transaction with foreign entities with the filing of the tax return (i.e., Form 5471 or 5472).

In addition, the IRS requires documentation to be prepared by taxpayers supporting their intercompany transactions to protect against penalties arising from a potential transfer pricing adjustment. Transfer pricing documentation should present the arm's length consideration of transactions between the related parties.

A taxpayer must demonstrate with "contemporaneous" documentation that it has made a reasonable effort to evaluate the intercompany transactions. The requirements for the documentation to be "contemporaneous" include that the documentation is prepared prior to the filing of the tax return. Furthermore, Section 482 provides a detailed list of the principal documents to be included in a contemporaneous documentation.

In the current law there is no exemption from documentation obligation and limited transfer pricing documentation.

Definition of Related Party

Related parties are entities under common control, direct or indirect, whether legally enforceable or not, by the same interests. Related parties include taxpayers that have ownership or control of other taxpayers. Control is only generally defined in the IRC, however, common examples include voting power, the right to appoint the majority of the members of management, and control on the basis of contractual arrangements.

Treasury Regulations Section 1.482-1(i)(4) specifies that "controlled" includes any kind of control, direct or indirect, whether legally enforceable or not, and however exercisable or exercised, including control resulting from the actions of two or more taxpayers acting in concert or with a common goal or purpose. It is the reality of the control that is decisive, not its form or the mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted.

Transfer Pricing Scrutiny

The level of transfer pricing scrutiny is high and the IRS has significant experience in dealing with transfer pricing audits. The focus is on large corporations and the audits can be random or risk-selected. The IRS has recently issued *Transfer Pricing Examination Process* (Publication 5300 (6-2018)), a guide to best practices and processes to assist with the planning, execution and resolution of transfer pricing examinations. The publication is intended to be consistent with the Large Business & International (LB&I) *Examination Process* (LEP) (Publication 5125). The *Transfer Pricing Examination Process* (TPEP) replaces the *Transfer Pricing Audit Roadmap* (Roadmap), a 2014 toolkit designed to provide IRS examiners with audit techniques, advice, links and reference materials. The TPEP is similar in many respects to the Roadmap and also includes new materials related to country-by-country reporting, exhibits related to newly developed Practice Units, and new guidance on the Initial Transfer Pricing Documentation IDR.

The IRS conducts audits for both taxpayers that are suspected to have not complied with the arm's length standard as well as taxpayers that should affirmatively demonstrate their transfer pricing policies. The IRS requests supporting transfer pricing documentation within 30 days of providing an Information Document Request ("IDR").

Transfer Pricing Penalties

Under Section 1.6662 of the IRC, the IRS may impose penalties on the underpayment of taxes resulting from improper intercompany transfer prices. These penalties are 20% (of the underpaid taxes) for substantial valuation misstatements, and 40% for gross valuation misstatements. Taxpayers may avoid transfer pricing penalties by having transfer pricing documentation at the time it files the tax return that includes intercompany transactions that are the subject of an adjustment if the documentation establishes that the taxpayer determined the transfer pricing in accordance with a specified method under Section 482 that is reasonably applied.

Transfer pricing penalties are triggered under two criteria (1) transactional penalties and (2) net-adjustment penalties.

A substantial valuation misstatement penalty can be assessed when the IRS determines that the transfer price for any property or services claimed on an income tax return is 200% more or 50% less than the arm's length price (as determine by the IRS). The IRS may assess a gross valuation misstatement penalty if the transfer price claimed is 400% more or 25% less than the arm's length price.

A net-adjustment penalty can be assessed when the IRS determines that a net adjustment exceeds the lesser of $5 million or 10% of taxpayer gross receipts for the taxable year. The IRS may assess a gross net-adjustment penalty if the net adjustments exceed the lesser of $20 million or 20% of the tax payers' gross receipts for the taxable year.

Advance Pricing Agreements

The US Advanced Pricing Agreement ("APA") Program is a voluntary process wherein the IRS and taxpayers can resolve transfer pricing issues under Section 482 of the IRC, the regulations thereunder, and relevant income tax treaties.

The APA Program is intended to proactively resolve actual or potential transfer pricing disputes in a cooperative manner by encouraging taxpayers to present to the IRS all the facts relevant to a proper transfer pricing analysis and to work towards a mutual agreement. APAs provide taxpayers with greater certainty regarding their transfer pricing methods.

An APA is a binding contract between the IRS and a taxpayer by which the IRS agrees not to seek a transfer pricing adjustment under Rev. Proc. 2015-41 for a covered transaction if the taxpayer files its tax return for a covered year consistent with the agreed transfer pricing method.

Taxpayers can pursue unilateral, bilateral or multilateral APAs through this program and, generally, they apply for a period of five years.

In 2012, the APA Program merged with the Office of the US Competent Authority to form the Advance Pricing and Mutual Agreement (APMA) Program.

The filing fee is $60,000 U.S. Dollars ("USD") for large taxpayers, $35,000 USD for renewals, $22,500 USD for smaller taxpayers in certain circumstances, and $12,500 for an amendment to an existing APA. Small taxpayers are defined as having sales revenues for the controlled group of less than $500 million in each of its most recent three back years, or small transactions not greater than $50 million USD annually, or intangible transactions not greater than $10 million USD.

Implementation of BEPS-related documentation requirements

The U.S. released proposed regulations based on the OECD action plan in December of 2015. The regulations were finalized in June 2016. The country-by-country reporting obligation is the new filing requirement of Form 8975 for tax years beginning on or after July 1st 2016. The IRS will also allow voluntary filing for tax years beginning on or after January 1st 2016. The contemporaneous documentation report remains as the documentation required in addition to the country-by-country reporting requirement.

Documentation and Disclosure Requirements

Tax Return Disclosures

Transactions between US entities and foreign entities need to be reported on Form 5471, Information Return of U.S. Persons with Respect to Certain Foreign Corporations (Schedule M) for US-owned foreign entities, or Form 5472, Information Return of a 25% Foreign-Owned US Corporation or Foreign Corporation Engaged in a US Trade or Business (Part IV) for US entities owned by foreign corporations or foreign corporations engaged in a US trade or business. Also, the Schedule UTP (Uncertain Tax Position), which is part of Form 1120, should be attached when submitting the US tax return. For entities that contribute in a cost sharing arrangement for development of intangibles, they need to file a Cost Sharing Statement upon the first occurrence of intangible development cost. Preparers that file returns for taxpayers that take a contrary position to an IRS regulation may need to file a disclosure Form 8275-R to protect against preparer penalties.

Level of Documentation

The main requirements for complete contemporaneous transfer pricing documentation under §1.6662 - 6(d)(2)(iii)(B) are :

- Overview of the taxpayer's business, including an analysis of the economic and legal factors that affect the pricing of its property or services;
- Description of the taxpayer's organizational structure (including an organization chart) covering all related parties engaged in transactions potentially relevant under section 482;
- Documentation explicitly required by the regulations under section 482, including any inter - company contracts, documentation (if applicable) of: a bona fide cost sharing arrangement, a market share strategy, correlative adjustments resulting from proposed setoffs;
- Description of the transfer pricing method selected and an explanation of why that method was selected;
- Description of the alternative methods that were considered and an explanation of why they were not selected;
- Description of the controlled transactions (including the terms of sale) and any internal data used to analyze those transactions;
- Description of the comparables that were used, how comparability was evaluated, and what (if any) adjustments were made;
- Explanation of the economic analysis and projections relied upon in developing the method;
- Description or summary of any relevant data that the taxpayer obtains after the end of the tax year and before filing a tax return which would help determine if a taxpayer selected an applied a specified method in a reasonable manner;
- A general index of the principal and background documents and a description of the recordkeeping system used for cataloging and accessing those documents. For intra-group services, documentation should include the following: intercompany agreement, group

ownership/organizational structure and a detailed description of functions and expenses incurred in providing services.
- Supporting documentation in the form of an appendix used in preparation of the analysis included in the report.

For country-by-country reporting obligation, taxpayers are required to file Form 8975 for tax years beginning on or after 1 July 2016. The IRS will also allow voluntary filing for tax years beginning on or after 1 January 2016.

Record Keeping

There is no statutory requirement to keep transfer pricing documentation. However, having transfer pricing documentation is potentially helpful in avoiding penalties stemming from transfer pricing adjustments, and must be submitted within 30 days of being requested to serve this purpose. Therefore, at a minimum it is prudent to retain the transfer pricing documentation for all years that are still open under audit.

Language for Documentation

The relevant documentation needs to be filed and submitted in English.

Small and Medium Sized Enterprises (SMEs)

An SME is not exempt from compliance with Section 482 of the IRC; however, if the volume of transactions is sufficiently low, penalties under Section 6662 of the IRC will not apply.

Deadline to Prepare Documentation

Documentation must be in place at the time the taxpayer files its tax return. Failure to provide contemporaneous documentation does not trigger a penalty in and of itself.

Deadline to Submit Documentation

The taxpayer must be able to provide documentation of its inter- company transactions within 30 days of a request from the IRS for such documentation in order for the documentation to protect it from potential penalties related to an adjustment (and, as stated, the documentation must have been completed prior to filing its tax return). Failure to provide contemporaneous documentation does not trigger a penalty in and of itself.

Statute of Limitations

As a general rule, the IRS must assess tax, or file suit against the taxpayer to collect the tax, within three years after the return is filed [IRC Sec. 6501(a)]. The three-year period of limitation on assessment also applies to penalties.

An extended six-year statute of limitations on assessment applies to returns that omit a substantial amount of gross income [IRC Sec. 6501(e)]. The extended statute gives the IRS extra time to identify and assess a deficiency in situations where the taxpayer's return gives no clue to the existence of the omitted income.

For non-filing, false returns or fraud, the statute of limitation is unlimited.

Transfer Pricing Methods

Section 1.482 specifies methods for documenting transactions that largely parallel those specified in the OECD Transfer Pricing Guidelines.

For tangible goods transactions, taxpayers can use one of five specified methods: the CUP method, the resale price method, the cost plus method (CPM), the profit split method and the comparable profits method (similar to the transactional net margin method under the OECD Guidelines).

For intangibles, taxpayers can use of three specified methods: the CUT method (comparable uncontrolled transaction, similar to the CUP), CPM, the profit split method and the comparable profits method. In certain circumstances, methods for platform contribution transactions (“PCT”) in a Cost Sharing Arrangement (“CSA”).

For service transactions, taxpayers can use one of six specified methods: the service cost method, the comparable uncontrolled service price method, the gross services margin method, the cost of services plus method, the comparable profits method, and the profit split method. Other unspecified methods may also be applied, and should be applied if they lead to a more reliable arm’s length result.

Taxpayers are required to choose the “best method,” defined as the method that leads to the most reliable arm’s length result.

Treasury Regulations Section 482 also establishes methodologies for other intercompany transactions which include:

- Loan and advances, for which methods are based on an arm’s length rate or a safe harbor (See Safe Harbor section); and
- CSA transactions, for which the methodology is based on a Reasonably Anticipated Benefit share. The CSA buy-ins, or PCT, are determined based on the following methods:
- CUT;
- CUSP;

- Income method;
- Acquisition price;
- Market capitalization; and
- Residual profit split

Comparables

The IRS will typically prefer U.S. comparables for analysis of a tested party that is a U.S. taxpayer. Canadian comparables will also be accepted. However, in the absence of local comparables, comparables from another market may be accepted if there is a compelling reason to do so.

According to Treasury Regulations Section 1.482-1(d)(4)(ii), uncontrolled comparables ordinarily should be derived from the geographic market in which the controlled taxpayer operates, because there may be significant differences in economic conditions in different markets. If information from the same market is not available, an uncontrolled comparable derived from a different geographic market may be considered if adjustments are made to account for differences between the two markets. If information permitting adjustments for such differences is not available, then information derived from uncontrolled comparables in the most similar market for which reliable data is available may be used.

Tax treaty and competent authority

The U.S. has established an extensive income tax treaty network with other countries, approximately 60 income tax treaties are currently in place. According to statistic published by the IRS, double tax relief is almost always provided to taxpayers.

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