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GLOBAL TRANSFER PRICING SERVICES

Global Transfer Pricing Review

United States

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TAX



United States



KPMG observation

The United States (US) has one of the oldest and most mature transfer pricing regimes.

Over the past couple of years, the Internal Revenue Service (IRS) has reorganized its international division to focus resources on transfer pricing. In 2011, a new leadership transfer pricing position was created within the IRS. This position, Transfer Pricing Director, is responsible for setting transfer pricing policy in IRS audits and for working with the IRS Office of Chief Counsel to develop transfer pricing litigation strategy. A new Chief Economist position was also created to assist the Transfer Pricing Director in setting IRS-wide transfer pricing policy. Additionally, under the Transfer Pricing Director are three new teams of IRS transfer pricing specialists who are led by experienced managers and organized by region.

According to the IRS, the intent behind the creation of these new positions is to better coordinate transfer pricing matters within the IRS. Specifically, the goal is to deploy IRS resources more efficiently by identifying appropriate issues and taxpayers, and to allow taxpayers to achieve the same principled results regardless of venue.

The IRS' 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 further allowed for more expedited processing and resolution of transfer pricing disputes. The combined office is allowing the IRS to better align resources to complete APAs and to expedite the resolution of transfer pricing disputes.

In late 2013, the IRS released new draft guidance with respect to APAs and competent authority matters.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 in these processes. It is anticipated that there will be substantial changes made to the content of this proposed guidance before it is finalized.

The US Treasury Department is actively engaged in the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) project. Base shifting by US multinationals have received extensive press coverage as a result of a series of congressional hearings focusing on international tax structures.

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
- 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 3 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 6 years. The statute is unlimited if a false or fraudulent return is filed, if a wilful 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 prepared or 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 prepare or 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

Is preparation of a transfer pricing study required – i.e. can the taxpayer be penalized for mere failure to prepare a study?

No.

Other than complying with a requirement per the previous question, describe the benefits, if any, of preparing and maintaining a transfer pricing study?

The timely preparation of a transfer pricing study is the sole way to avoid penalties should a transfer pricing adjustment exceed certain penalty thresholds.

To satisfy the requirement and/or obtain the benefits, are there any requirements on when the transfer pricing study must be prepared and submitted?

Yes, the study must be prepared contemporaneously with the filing of the tax return for the year and must be submitted to the IRS within 30 days of an IRS request for review.

When a transfer pricing study is prepared, should its content follow Chapter V of the OECD Guidelines?

Yes, its contents should largely follow Chapter V of the OECD Guidelines.

There are 10 principal documents:

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

Are transfer pricing methods outlined in Chapter II of the OECD Guidelines acceptable?

Yes, although 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.

Is there a priority among the acceptable methods?

No.

If there is no priority of methods, is there a "best method" rule?

Yes.

Transfer pricing audit and penalties

When the tax authority requests a taxpayer's transfer pricing documentation, how long does the taxpayer have to submit its documentation?

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

If an adjustment is proposed by the tax authority, are dispute resolution options available to the taxpayer outside of competent authority?

Yes, 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 defences 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 has designated transfer pricing a key item in its international tax enforcement/compliance agenda, and, accordingly, as noted above, has appointed a new Transfer Pricing Director to coordinate this effort. In the past several years, also as part of this effort, the IRS has hired many experienced transfer pricing professionals: (i) to serve as a bridge between the IRS National Office and the field in transfer pricing audits and (ii) to improve the efficiencies in the APA and competent authority processes within APMA. The IRS goal is to create an integrated and coordinated transfer pricing practice.

The role of the transfer pricing specialists who work with the field agents will involve helping to develop cases for audit. These cases will be selected on the basis of several criteria, including size, but also whether the case is part of a pattern, represents an emerging issue, or is otherwise strategic for the IRS.

On 14 February 2014, the IRS released its long-awaited Transfer Pricing Audit Roadmap. The stated purpose of the Roadmap is to provide the IRS transfer pricing practitioner with audit techniques and tools to assist with the planning, execution and resolution of transfer pricing examinations.

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.

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

High.

Are management fees deductible?

Yes.

Are management fees subject to withholding?

No.

Are year-end transfer pricing adjustments permitted?

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.

Other recent developments

Some of the most significant recent developments are discussed previously. Other developments from the last couple of years include the introduction of Schedule UTP to report uncertain tax positions, effective 15 December 2009; the creation of the new Director of Transfer Pricing Operations position in the IRS during 2011; the merger of the IRS APA and MAP programs to create the new APMA program beginning in March 2012; the release of the proposed guidance for competent authority and APA matters; and the publication of the IRS' Transfer Pricing Audit Roadmap.

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?

Almost always. 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 the competent authority before paying tax?

Yes.

Advance pricing agreements

What APA options are available, if any?

Unilateral, bilateral and multilateral. Both named and anonymous pre-filing conferences are also available.

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. Visit the IRS' website for the latest information: www.irs.gov.

Please provide some information on how successful the APA program is and whether there are any known difficulties?

In recent years, the APA program had developed a sizable backlog of APAs and the expected time between receipt of a submission and the commencement of work by the APA program was approximately 1 year. The creation of the APMA program (which increases internal efficiencies in the processing of APAs by eliminating the historic hand-off from APA staff to competent authority personnel) and hiring of a significant number of experienced transfer pricing professionals should result in substantial decreases in the amount of time required to begin and to complete APAs. In 2012, 140 APAs were executed and in 2013, 145 APAs were executed, as compared with 42 for the 2011 year. The goal of the APMA program is to be able to finalize as many as 150 to 200 APAs a year.

Language

In which language or languages can documentation be filed?

English.

KPMG in the United States

Brian Trauman

Tel: +1 212 954 5871

Email: btrauman@kpmg.com

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