

LB&I International Practice Service Transaction Unit

IPS Level	Number	Title	UIL Code	Number
Shelf	N/A	Business Inbound	–	–
Volume	6	Inbound Income Shifting	Level 1 UIL	9422
Part	6.7	Sales or Leases of Tangible Property/Goods	Level 2 UIL	9422.07
Chapter	N/A	N/A	Level 3 UIL	N/A
Sub-Chapter	N/A	N/A	–	–

Unit Name	Inbound Resale Price Method Routine Distributor
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Issue and Transaction Overview

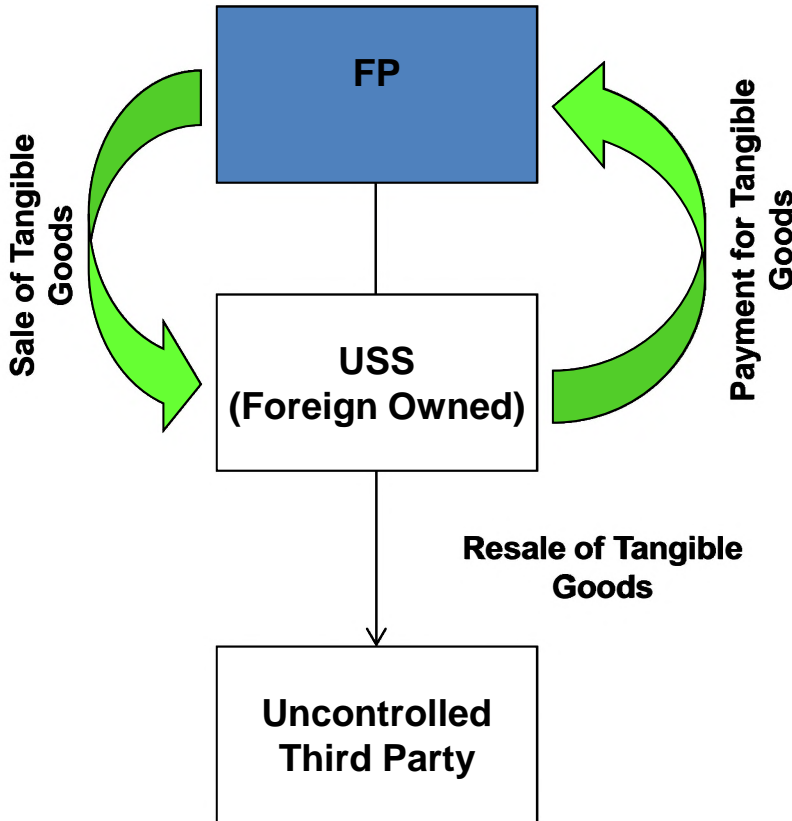
Inbound Resale Price Method Routine Distributor

- The Resale Price Method (“RPM”) is a specified transfer pricing method under Treas. Reg. 1.482-3(c). RPM evaluates whether a transfer price charged in a controlled transaction is arm’s length by comparing the gross profit margin realized in a controlled transaction to gross profit margins observed in uncontrolled transactions. Gross profit margin is the ratio of gross profit to net sales revenue. Gross profit is net sales revenue less cost of goods sold (“COGS”).
- RPM may be used in conjunction with internal comparables or external comparables. Internal comparables are transactions involving the taxpayer and uncontrolled parties, whereas external comparables are transactions in which neither party to the transaction is part of the taxpayer’s controlled group.
- Other specified methods include the Comparable Uncontrolled Price Method (“CUP”) which evaluates transfer prices by directly comparing prices rather than profits and the Comparable Profits Method (“CPM”) which evaluates transfer prices by comparing profits net of operating expenses rather than profits that are gross of operating expenses. As such, RPM is a less direct method than the CUP method, but a more direct method than the CPM. The more direct a method is, the stricter the comparability requirements. If the stricter comparability requirements are satisfied, then a more direct method will generally be more reliable than a less direct method.
- Sometimes the use of the RPM may be inappropriate when the comparables are better suited for the CPM because they do not meet the comparability requirements under RPM. This may be the case when external comparables are employed. While the approach and underlying principles are the same when analyzing internal and external comparables, this unit focuses on external comparables.
- When employed, RPM is ordinarily used in cases involving subsidiaries that are wholesale or resale distributors.



CONSULTATION: If a pricing or valuation adjustment is pursued and gives rise to double taxation, the Taxpayer may have access to double tax relief under Article 25 and the Mutual Agreement Process. Make sure you consult with the Advance Pricing and Mutual Agreement Program (“APMA”).

Transaction and Fact Pattern

Diagram of Transaction	Facts
 <p>The diagram illustrates the transaction flow between three entities: FP (Foreign Parent), USS (Foreign Owned), and an Uncontrolled Third Party. FP is represented by a blue box at the top, USS (Foreign Owned) by a white box in the middle, and the Uncontrolled Third Party by a white box at the bottom. A vertical line connects FP and USS. A green curved arrow on the left points from FP to USS, labeled 'Sale of Tangible Goods'. A green curved arrow on the right points from USS to FP, labeled 'Payment for Tangible Goods'. A vertical arrow points from USS to the Uncontrolled Third Party, labeled 'Resale of Tangible Goods'.</p>	<ul style="list-style-type: none">▪ Foreign Parent (“FP”) wholly owns United States Subsidiary (“USS”), a US corporation.▪ USS is a US Corporation for US tax purposes.▪ FP is located in foreign country and is engaged in research, design and manufacturing of tangible goods.▪ USS operates as a distributor of tangible goods in the United States.

Summary of Potential Issues

Inbound Resale Price Method Routine Distributor

Issue 1

Did the taxpayer select the appropriate comparable companies and make appropriate adjustments to achieve comparability?

Issue 2

Are consistent accounting practices used for computing gross profit margins for the controlled transaction and uncontrolled comparables?

All Issues, Step 1: Initial Factual Development

Inbound Resale Price Method Routine Distributor

RPM evaluates whether a transfer price charged in a controlled transaction is arm's length by comparing the gross profit margin realized in a controlled transaction to gross profit margins observed in uncontrolled transactions

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Does Form 5472 represent that purchases are being made? 	<ul style="list-style-type: none"> ▪ Form 5472, Purchases of Stock in Trade 	
<ul style="list-style-type: none"> ▪ Obtain and review the transfer pricing documentation. ▪ Obtain and review the organizational charts. The team will want to obtain the tax, legal, functional and/or departmental organization charts. ▪ Ask the Taxpayer to provide a presentation on the organization and the transactions under examination. ▪ Request the Taxpayer's functional analysis if it was not attached to the transfer pricing study. ▪ If RPM is utilized, determine if this is the best method. 	<ul style="list-style-type: none"> ▪ Transfer Pricing Documentation ▪ Organizational Chart- Functional and/or Departmental ▪ Contracts ▪ Intercompany Agreements ▪ Invoices ▪ Functional Analysis ▪ Practice Unit, "Best Method Determination for an Inbound Distributor," DCN: ISI/9422.09_05 (2013) 	

All Issues, Step 1: Initial Factual Development (cont'd)

Inbound Resale Price Method Routine Distributor

RPM evaluates whether a transfer price charged in a controlled transaction is arm's length by comparing the gross profit margin realized in a controlled transaction to gross profit margins observed in uncontrolled transactions

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none">Review the financial statements and correlate the statements to the tax return.	<ul style="list-style-type: none">Taxpayer's Financial StatementsSecurity and Exchange Commission ("SEC") Filings: 10K and 20FTransfer Pricing Roadmap	

Issue 1, Step 2: Review Potential Issues

Inbound Resale Price Method Routine Distributor

Issue 1

Did the Taxpayer select the appropriate comparable companies and make appropriate adjustments to achieve comparability?


Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ RPM evaluates whether a transfer price charged in a controlled transaction is arm's length by comparing the gross profit margin realized in a controlled transaction to gross profit margins observed in uncontrolled transactions. In order to determine if the transaction is arm's length, the Taxpayer must select transactions or companies that are sufficiently comparable to the controlled transaction. Some of the key elements of comparability are functions performed, assets employed, contractual terms, risks, economic conditions, and property and/or services. ▪ While the CUP method requires close physical similarity between the products involved in the controlled and uncontrolled transactions, the RPM may be reliable if the products involved in the controlled and uncontrolled transactions are of the same general type (e.g., consumer electronics). However, if there are significant functional differences associated with the controlled and uncontrolled transactions, then the reliability of the RPM will be compromised. ▪ The comparability factors under the RPM are more stringent when compared to the application of the CPM. Therefore, if the potential comparables are not sufficiently comparable for purposes of RPM, the comparables may still be suited for the CPM. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-1(d) – <i>Comparability</i> ▪ Treas. Reg. 1.482-3(c)(3) – Comparability and reliability for resale price method ▪ Transfer Pricing Functional Analysis Questionnaire

Issue 1, Step 2: Review Potential Issues (cont'd)

Inbound Resale Price Method Routine Distributor

Issue 1

Did the Taxpayer select the appropriate comparable companies and make appropriate adjustments to achieve comparability?

Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ Adjustments may have to be made to the gross profit margin if the controlled and uncontrolled transactions differ with respect to the comparability factors mentioned previously. The more adjustments that are made will generally cause the results to be less reliable. The less reliable the results means the less likely that the RPM is the best method. ▪ In general, the most common adjustment for an inbound routine distributor case is a working capital adjustment. However, adjustments for contractual terms, sales, marketing, advertising programs and services, the level of market, and/or foreign currency risks may also exist. 	<ul style="list-style-type: none"> ▪ Treas. Reg. Sec. 1.482-1(d) – <i>Comparability</i> ▪ Treas. Reg. 1.482-3(c)(3) – Comparability and reliability for resale price method ▪ Transfer Pricing Functional Analysis Questionnaire ▪ Treas. Reg. 1.482-3(c)(3)(ii)(C) – Adjustments ▪ Adjustments for Changes in Exchange Rates During an APA Term (May 2002)
 <p>CONSULTATION: Please consult with an economist if you need assistance regarding comparability adjustments that were made by the Taxpayer, or comparability adjustments you think should be made.</p>	

Issue 1, Step 3: Additional Factual Development

Inbound Resale Price Method Routine Distributor

Issue 1

Did the Taxpayer select the appropriate comparable companies and make appropriate adjustments to achieve comparability?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Compare the controlled and uncontrolled transactions with respect to all factors that could affect prices or profits, including the following: <ul style="list-style-type: none"> – Functions performed; – Contractual terms; – Risks borne; – Economic conditions; – Property or services. 	<ul style="list-style-type: none"> ▪ Transfer Pricing Documentation ▪ Contracts ▪ Intercompany Agreements ▪ Key Employee Interviews ▪ Functional Analysis Questionnaire ▪ Transfer Pricing Roadmap ▪ SEC Filings: 10K and 20F for the Taxpayer and comparables ▪ Company Websites ▪ Standard Industry Codes (SIC) and National American Industry Classification System (NAICS) Codes SIC–NAICS Bridge 	

Issue 1, Step 3: Additional Factual Development (cont'd)

Inbound Resale Price Method Routine Distributor

Issue 1

Did the Taxpayer select the appropriate comparable companies and make appropriate adjustments to achieve comparability?

Fact Element	Resources	6103 Protected Resources
	<ul style="list-style-type: none">▪ Capital IQ and Standard & Poor's ("S&P") Industry Survey reports▪ Practice Unit, "Comparability Analysis for Tangible Goods Transactions Inbound," DCN: ISI/PUO/V_6_01(2013)	

Issue 1, Step 3: Additional Factual Development (cont'd)

Inbound Resale Price Method Routine Distributor

Issue 1

Did the Taxpayer select the appropriate comparable companies and make appropriate adjustments to achieve comparability?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ Determine whether adjustments should be made to account for any material differences identified between the controlled and uncontrolled transactions.	<ul style="list-style-type: none">▪ Transfer Pricing Documentation will generally discuss if adjustments have been made▪ Contracts▪ Intercompany Agreements▪ Request Taxpayer's adjustment workpaper's	

Issue 1, Step 4: Develop Arguments

Inbound Resale Price Method Routine Distributor

Issue 1

Did the Taxpayer select the appropriate comparable companies and make appropriate adjustments to achieve comparability?


Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ RPM requires close comparability between the controlled and uncontrolled transactions. When external comparables are employed, it is often difficult to determine whether the stringent comparability factors have been met. ▪ Comparability under this method must be analyzed both in terms of types of functions, assets and risks, and in terms of the intensity of those functions, assets and risks. For instance, both the reseller in the controlled transaction and the reseller in the uncontrolled transactions may perform a selling function. However, the controlled reseller may be required to incur greater selling expense per dollar of sales than the uncontrolled resellers. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-1(d) – <i>Comparability</i> ▪ Treas. Reg. 1.482-3(c)(3)(ii) – Comparability under resale price method 	

Issue 1, Step 4: Develop Arguments (cont'd)

Inbound Resale Price Method Routine Distributor

Issue 1

Did the Taxpayer select the appropriate comparable companies and make appropriate adjustments to achieve comparability?

Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ One should compare the ratio of operating expenses to net sales and the ratio of operating assets to net sales between that of the controlled and uncontrolled transactions. If there are material differences, then one should endeavor to understand what gives rise to those differences. ▪ If the comparables do not meet the comparability standards under RPM, then consider whether the comparables can be used under CPM. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-1(d) – <i>Comparability</i> ▪ Treas. Reg. 1.482-3(c)(3)(ii) – <i>Comparability under resale price method</i> 	
 <p>DECISION POINT: Can the Taxpayer use RPM? Did the Taxpayer select the appropriate comparables? Did the Taxpayer make the appropriate adjustments?</p>		

Issue 2, Step 2: Review Potential Issues

Inbound Resale Price Method Routine Distributor

Issue 2

Are consistent accounting practices used for computing gross profit margins for the controlled transaction and uncontrolled comparables?

Explanation of Issue	Resources
<ul style="list-style-type: none">▪ RPM analyzes the transfer price charged for a controlled transaction by comparing it to the gross profit margin of uncontrolled comparables. The consistency in accounting reporting and financial data classification between the controlled transaction and the uncontrolled comparables is critical under the RPM.▪ Typically, COGS and operating expenses are not classified uniformly across the uncontrolled comparables and the controlled transaction. Thus, the gross profit margin of the controlled transaction may not be comparable to the gross profit margins earned by uncontrolled comparables. This lack of uniformity would affect the comparability of gross profit calculations and the overall reliability of the RPM. As such, RPM is hard to implement in practice due to accounting classification differences between the controlled transaction and the comparables because it is often hard to identify and quantify the accounting inconsistencies.	<ul style="list-style-type: none">▪ Treas. Reg. 1.482-3:<ul style="list-style-type: none">- Treas. Reg. 1.482-3(c) – <i>Resale price method</i>- Treas. Reg. 1.482-3(c)(3)(iii)(B) – <i>Consistency in accounting</i>▪ Taxpayer’s Financial Statements▪ SEC Filings: 10K and 20F▪ Company Websites

Issue 2, Step 3: Additional Factual Development

Inbound Resale Price Method Routine Distributor

Issue 2

Are consistent accounting practices used for computing gross profit margins for the controlled transaction and uncontrolled comparables?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Is there consistency in classification between the controlled transaction and uncontrolled comparables for COGS and operating expenses? For example: <ul style="list-style-type: none"> – Depreciation; – Returns and allowances; – Rebates; – Transportation costs; – Insurance; and – Packaging. ▪ Is there consistency in inventory valuation methods between the controlled transaction and uncontrolled comparables (e.g., LIFO and FIFO)? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Documentation ▪ Contracts ▪ Financial Statements to see classification between COGS and operating expenses ▪ Trial Balance to see classification between COGS and operating expenses ▪ General Ledger to see classification between COGS and operating expenses ▪ Invoices ▪ Intercompany Agreements ▪ SIC - NAICS (codes) SIC-NAICS Bridge ▪ Capital IQ – Including Market Studies ▪ Transfer Pricing Roadmap 	

Issue 2, Step 4: Develop Arguments

Inbound Resale Price Method Routine Distributor

Issue 2

Are consistent accounting practices used for computing gross profit margins for the controlled transaction and uncontrolled comparables?


Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ It is important to determine whether the accounting practices between the controlled transaction and uncontrolled comparables are reliable in determining an arm's length result. There should be consistency in how the Taxpayer and uncontrolled comparables report items in COGS and operating expenses. For example, the Taxpayer and uncontrolled comparables should report items such as discounts, returns and allowances, rebates, transportation costs, insurance and packaging in the same manner, in order for you to ascertain whether the financial data is reliable. ▪ The degree of consistency in accounting practices between the controlled transaction and the uncontrolled comparables affects the reliability of the transfer pricing result under RPM. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-3(c)(3)(iii)(B) – <i>Consistency in accounting</i> 	

Issue 2, Step 4: Develop Arguments (cont'd)

Inbound Resale Price Method Routine Distributor

Issue 2

Are consistent accounting practices used for computing gross profit margins for the controlled transaction and uncontrolled comparables?

Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ If the accounting practices are consistent, proceed applying the resale price method with appropriate adjustments. Additionally, a second method can be used as confirmation of the arm's length price, generally the Comparable Profits Method. ▪ If the accounting practices are not consistent, then the use of resale price method is likely not the Best Method. If not consistent, consider using the Comparable Profits Method with the same comparables 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-3(c)(3)(iii)(B) – <i>Consistency in accounting</i> ▪ Practice Unit, “Best Method Determination for an Inbound Distributor,” DCN: ISI/9422.09_04 (2013) 	
 <p>DECISION POINT: Determine if there are consistent accounting practices between the Taxpayer and uncontrolled comparables.</p>		

Training and Additional Resources

Chapter 6.7.1 Sales or Leases of Tangible Property/Goods

Type of Resource	Description(s) and/or Instructions for Accessing	References
CENTRA sessions	<ul style="list-style-type: none"> ▪ 2012 Centra Introduction to Transfer Pricing ▪ 2012 Centra Overview and Introduction to IRC 482 ▪ 2011 (TPO) CPE CENTRA – Income Shifting Overview (Day 1) 	
Issue Toolkits	<ul style="list-style-type: none"> ▪ IRM Exhibit 4.61.3-4 Functional Analysis Questionnaire ▪ IRM 4.61.3 Development of IRC section 482 Cases 	
Treatises	<ul style="list-style-type: none"> ▪ <i>Bittker & Lokken – Fed. Tax'n Inc. Est and Gift</i> Part 10, Chapter 79 Reallocation of Income and Deductions ▪ OECD Transfer Pricing Guidelines 	
White Papers / Guidance	<ul style="list-style-type: none"> ▪ Adjustments for Changes in Exchange Rates During an APA Term (May 2002). 	
Other Training Materials	<ul style="list-style-type: none"> ▪ APA Study Guide Lesson One: Major Elements 	

Glossary of Terms and Acronyms

Term/Acronym	Definition
APA	Advance Pricing Agreement
APMA	Advance Pricing and Mutual Agreement Program
COGS	Cost of Goods Sold
CPM	Comparable Profits Method
CUP	Comparable Uncontrolled Price Method
FP	Foreign Parent
FIFO	First In First Out
IBC	International Business Compliance
IPN	International Practice Network
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
ISI	Income Shifting Inbound
LB&I	Large Business & International
LIFO	Last In First Out
NAICS	North American Industry Classification System

Glossary of Terms and Acronyms (cont'd)

Term/Acronym	Definition
OECD	Organisation for Economic Co-operation and Development
RPM	Resale Price Method
S&P	Standard & Poor's
SEC	Securities and Exchange Commission
SIC	Standard Industry Classification
TPO	Transfer Pricing Operations
USS	A foreign-owned United States Subsidiary

Index of Related Issues

Issue	Associated UIL(s)	References
CPM Simple Distributor	<ul style="list-style-type: none"> ▪ 9422.07 	<ul style="list-style-type: none"> ▪ Practice Unit, “CPM Simple Distributor Inbound,” DCN: ISI/9422.07_07(2013)
Comparability	<ul style="list-style-type: none"> ▪ 9422.07 	<ul style="list-style-type: none"> ▪ Practice Unit, “Comparability Analysis for Tangible Goods Transactions - Inbound,” DCN: ISI/PUO/V_6_01(2014)
Functional Analysis	<ul style="list-style-type: none"> ▪ 9422.07 	<ul style="list-style-type: none"> ▪ Practice Unit, “Comparability Analysis for Tangible Goods Transactions - Inbound,” DCN: ISI/PUO/V_6_01(2014)
Tangible Goods-Inbound CUP	<ul style="list-style-type: none"> ▪ 9422.07 	<ul style="list-style-type: none"> ▪ Practice Unit, “Purchase of Tangible Goods from a Foreign Parent CUP Method,” DCN: ISI/9422.07_05(2013)
Rev. Proc. 99-32	<ul style="list-style-type: none"> ▪ 9422.09 	<ul style="list-style-type: none"> ▪ Practice Unit, “Revenue Procedure 99-32 Inbound Guidance,” DCN: ISI/9422.09_08 (2014)
Best Method Determination for an Inbound Distributor	<ul style="list-style-type: none"> ▪ 9422.09 	<ul style="list-style-type: none"> ▪ Practice Unit, “Best Method Determination for an Inbound Distributor,” DCN: ISI/9422.09_04(2013)
Three Requirements of IRC 482	<ul style="list-style-type: none"> ▪ 9422.09 	<ul style="list-style-type: none"> ▪ Practice Unit, “Three Requirements of IRC 482,” DCN: ISI/9422.09_02(2013)
Arm’s Length Standard	<ul style="list-style-type: none"> ▪ 9422.09 	<ul style="list-style-type: none"> ▪ Practice Unit, “Arms Length Standard,” DCN: ISI/9422.09_06(2013)