

## LB&I International Practice Service Process Unit – Overview

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Volume	6	Income Shifting	UIL Code	9422
Part	N/A	N/A	Level 2 UIL	N/A
Chapter	N/A	N/A	Level 3 UIL	N/A
Sub-Chapter	N/A	N/A		

<b>Unit Name</b>	Review of Transfer Pricing Documentation by Inbound Taxpayers
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# Introduction

## Review of Transfer Pricing Documentation by Inbound Taxpayers

Multinational taxpayers oftentimes enter into a wide variety of related-party, controlled transactions involving the transfer of tangible goods, intangibles and/or services. Taxpayers are required to document the efforts undertaken to price these transactions at arm's length. This documentation is referred to as the taxpayer's transfer pricing documentation, contemporaneous documentation, or Transfer Pricing Study. The contemporaneous documentation must be in existence at the time taxpayer filed its tax return and also be provided to the IRS within 30 days of being requested if taxpayer is seeking to avoid the IRC section 6662(e) and (h) penalties.

The purpose of this Process Overview Unit is to serve as an introduction to the review of a taxpayer's transfer pricing documentation ("TPD"). Review of the TPD serves a couple of important purposes. First, the Transfer Pricing Audit Roadmap uses the TPD in the Planning Phase (Pre-Examination Analysis) to note areas that require further development, confirmation or inquiry. The review of the TPD is then used in the initial transfer price risk analysis and development of a preliminary working hypothesis. Second, the review of the TPD is essential to determine if it meets the requirements of section 6662(e) penalty avoidance.

If, as the statute permits, the taxpayer has not prepared section 6662(e) documentation, exam would issue a written information document request at the beginning of the audit for relevant information regarding the taxpayer's transfer pricing practices. Such non-contemporaneous documentation may establish that the taxpayer's controlled party transactions meet the arm's length standard but it will not prevent imposition of the IRC section 6662(e) or (h) penalties if the IRS determines the transactions are not at arm's length.

If a taxpayer does not have contemporaneous documentation or the TPD is deemed deficient and the Service concludes that a transfer pricing adjustment is appropriate, the taxpayer may be subject to transactional or net adjustment penalties under IRC section 6662(e) and (h). The regulations contain reasonable cause and good faith requirements in order for taxpayers not be subjected to such penalty provisions. To meet the reasonable cause and good-faith requirements (if taxpayer is subject to the transactional penalty) or to have amounts excluded from the calculation of the net section 482 adjustment (if taxpayer is subject to the net adjustment penalty), the taxpayer must maintain and provide the IRS with documentation sufficient to establish that the taxpayer reasonably concluded that the chosen pricing method was the best method and its application provided the most reliable measure of an arm's-length result, given the available data. Additionally, if the taxpayer chose an unspecified method but a specified method was potentially applicable, the taxpayer must establish that none of the specified methods was likely to be the best method and provide a more reliable measure of an arm's length result.

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### Review of Transfer Pricing Documentation by Inbound Taxpayers

The following documentation should be provided to the IRS via the mandatory transfer pricing information document request (IDR):

- Overview of business;
- Organizational structure;
- Documentation specifically required by IRC 482 and the regulations thereunder;
- Description of method chosen;
- Explanation of methods not chosen;
- Description of controlled transactions;
- Description of the comparables;
- Explanation of economic analysis;
- Relevant year-end data, and
- Index.



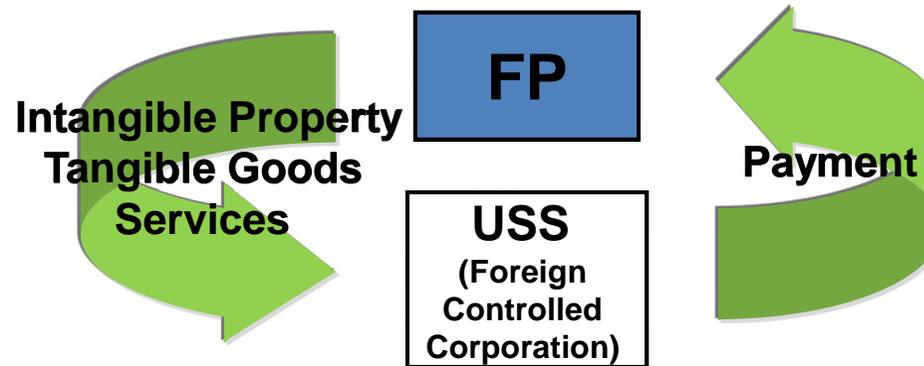
**CAUTION:** Background documents are not specifically required under the mandatory transfer pricing IDR. However, background documents should be requested as needed.

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## Process Overview

### Review of Transfer Pricing Documentation by Inbound Taxpayers

This Process Unit focuses on the documentation provided when there is an inbound transaction of tangible goods, intangibles, and services. However, similar documentation is also required for outbound transactions. During the Pre Examination Analysis of the tax return, the International Examiner (IE) will request (via Mandatory Transfer Pricing IDR), review, and analyze the taxpayers IRC section 6662(e) transfer pricing documentation in order to gain a better understanding of the taxpayers transfer pricing transactions. Areas requiring further development, confirmation or inquiry should be noted (as outlined in the Transfer Pricing Roadmap). This analysis of the TPD is critical in the overall assessment and hypothesis developed by the IE and Economist when formulating the audit plan. The analysis may be accomplished in a series of steps as further defined in this IPS Unit. These steps are focused around the 10 principal documentation requirements contained in Treas. Reg. 1.6662-6(d)(2)(iii)(B). The exam team should consider whether the documentation meets the requirements under the regulations or is deficient and thus potentially subjecting the taxpayer to penalties under IRC 6662(e) and (h). It is important to remember that the overall objective of IRC 6662(e) is to improve compliance with the transfer pricing rules and regulations prescribed in IRC 482 and the regulations thereunder. Pursuant to IRC 6662(e), taxpayers are required to document their transfer pricing transactions and to provide such documentation to the IRS in a timely manner..



- Foreign Parent (FP) owns 100% of US Subsidiary (USS).
- FP sells tangible goods to USS. Additionally, FP licenses intangible property and provides services to USS.
- USS has TPD prepared by an outside consultant.

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## Detailed Explanation of the Process

### Review of Transfer Pricing Documentation by Inbound Taxpayers

#### Analysis

The purpose of a taxpayer's transfer pricing documentation is to show that its transactions with related parties are priced in accordance with the arm's length standard. There are various pricing methods, discussed in the regulations promulgated under IRC Section 482, from which the taxpayer may choose for purposes of demonstrating transactions are performed at arm's length. These methods include Comparable Uncontrolled Price Method, Resale Price Method, Cost Plus Method, Comparable Profits Method, Profit Split Method, and Unspecified Methods. There is no hierarchy for these methods. However, the Taxpayer must select the method that provides the most reliable measure of an arm's length result, taking into consideration all the data available. This is known as the "best method rule." To be the best method, the method selected must not only produce the most reliable measure of an arm's length result, but also be the most reliable application of the method. For example, if there are two or more applications of the same method but one such application is more accurate in terms of certain key factors (comparability, data, and assumptions), resulting in a more reliable application of the method, the more reliable application is considered the "best method."

The documentation should show that the taxpayer reasonably concluded that the transfer pricing methodology chosen and applied met the best method rule (i.e., it provides the most reliable measure of an arm's length result). In addition, taxpayers should document how they selected their method, why it's the best method, and the reasons they rejected other possible methods (specified and unspecified).

This Process Unit Overview does not cover how to select the "best method." For selecting the best method see the IPS unit entitled Best Method Determination of an Inbound Distributor ISI/9422.09\_04 (2013). Additionally, this process unit does not cover "comparability." For information on how to do a comparability analysis (including functional analysis) see IPS Process Unit Overview (PUO) entitled Comparability Analysis for Tangible Goods Transactions-Inbound ISI/PUO/V\_6\_01 (2014).

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## Process Applicability

### Review of Transfer Pricing Documentation by Inbound Taxpayers

Review taxpayer's documents and public information to determine if there are significant controlled transactions.

Criteria	Resources	6103 Protected Resources
<p>Request taxpayers Transfer Pricing Documentation via issuance of the IRC 6662(e) Mandatory Transfer Pricing IDR.</p> <p>Prior to receipt of the TPD, the examiner should perform company history and background analysis in addition to reviewing the tax return and its attachments, including: mapping Forms 5472, 5471, 8858 and 8865 to the TPD (Are there transactions missing from the TPD?).</p> <p>Identify significant controlled transactions from review of the taxpayer's TPD. This review is part of the Pre-Planning Phase outlined in the Transfer Pricing Roadmap. The roadmap is a comprehensive toolkit outlining the audit steps all examiners should use during the Planning, Execution and Resolution phases of their transfer pricing examination. The roadmap is an audit tool, transfer pricing cases are unique, the exam team should exercise its judgment in performing their transfer pricing analysis.</p>	<ul style="list-style-type: none"> <li>▪ Transfer Pricing Roadmap</li> <li>▪ Mandatory Transfer Pricing Information Document Request (IDR)</li> <li>▪ Transfer Pricing Study</li> <li>▪ Form 5472 Part IV and confirm ownership</li> <li>▪ Form 5471 Schedule M</li> <li>▪ Form 8858</li> <li>▪ Form 8865</li> <li>▪ Form 1120 - Schedule M-3 and Uncertain Tax Positions (UTP) disclosures</li> <li>▪ Prior exam cycle files</li> <li>▪ Organizational Charts</li> <li>▪ Taxpayer website for discussions about its activities</li> </ul>	

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## Process Applicability (cont'd)

### Review of Transfer Pricing Documentation by Inbound Taxpayers

Review taxpayer's documents and public information to determine if there are significant controlled transactions.

Criteria	Resources	6103 Protected Resources
<p>Review the general ledger and financial statements for expenses relating to the production of goods, such as manufacturing costs, depreciation of plants, R&amp;D expense, warranty expenses etc.</p> <p>Perform ratio analysis based on the financial information.</p>	<ul style="list-style-type: none"> <li>▪ Annual Reports/Financial Statements for confirmation that the information matches the TPD</li> <li>▪ Income statement and balance sheet for expenses</li> </ul>	

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## Summary of Process Steps

Review of Transfer Pricing Documentation by Inbound Taxpayers	
Process Steps	
The Treasury Regulations provide a list of principal and background documents that need to accurately and completely describe the basic transfer pricing analysis conducted by USS.	
<a href="#">Step 1</a>	Review Overview of USS's Business.
<a href="#">Step 2</a>	Review USS's Organizational Structure.
<a href="#">Step 3</a>	Review any documentation explicitly required by the regulations under IRC 482.
<a href="#">Step 4</a>	Review the description of the method selected and explanation of why that method was selected. Also review the alternative methods along with reasons explaining why alternative methods were not chosen.

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## Summary of Process Steps (cont'd)

Review of Transfer Pricing Documentation by Inbound Taxpayers	
Process Steps	
The Treasury Regulations provide a list of principal and background documents that need to accurately and completely describe the basic transfer pricing analysis conducted by USS.	
<a href="#">Step 5</a>	Review the description of the controlled transactions and any internal data used to analyze the transactions.
<a href="#">Step 6</a>	Review the description of the comparables that were used, how comparability was evaluated, and what (if any) adjustments were made.
<a href="#">Step 7</a>	Review the explanation of the economic analysis and projections used for developing the method.
<a href="#">Step 8</a>	Review the general index and background documents along with the principal documentation.

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## Step 1: Overview of USS's Business

### Review of Transfer Pricing Documentation by Inbound Taxpayers

#### Step 1

An overview of USS's business is the first principal document. The overview should include an analysis of the economic and legal factors that affect the pricing of its property or services.

Considerations	Resources	6103 Protected Resources
<p>You may obtain the following documents to get an overview of USS's business:</p> <ul style="list-style-type: none"> <li>▪ Description of principal business segments, product lines, geographic markets, vendors, customers, and contractors.</li> <li>▪ Functional analysis identifying economically significant activities undertaken by the taxpayer. See IRM 4.61.3.5.1 - Functional Analysis</li> <li>▪ Description of contractual terms. See IRM 4.61.3.5.4 - Contractual Terms</li> </ul>	<p>Treas. Reg. 1.6662-6(d)(2)(iii)(B)(1), documentation requirement</p> <p>Treas. Reg. §1.482-1(d)(3)(i), functional analysis</p> <p>Treas. Reg. §1.482-1(d)(3)(ii), contractual terms</p> <ul style="list-style-type: none"> <li>▪ Transfer Pricing IDR</li> <li>▪ IRM 4.61.3 - Development of IRC 482 Issues</li> <li>▪ Transfer Pricing Roadmap</li> <li>▪ Transfer Pricing Functional Analysis Questionnaire</li> <li>▪ IPS Unit: Comparability Analysis for Tangible Goods Transactions Inbound DCN:ISI/9422.07_01 thru _06(2013)</li> <li>▪ Taxpayer Presentation</li> <li>▪ Intercompany and Third Party Agreements</li> </ul>	

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## Step 1: Overview of USS's Business (cont'd)

### Review of Transfer Pricing Documentation by Inbound Taxpayers

#### Step 1

An overview of USS's business is the first principal document. The overview should include an analysis of the economic and legal factors that affect the pricing of its property or services.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ Description of risks assumed which could affect the prices that would be charged or paid, or the profit that would be earned, such as, Market risks, Research and Development risks, Financial risks, Credit and collection risks, Product liability and Warranty risks, General business risks, Advertising and marketing risks, and/or Intangible risks. See IRM 4.61.3.5.3, Risk Analysis</li> <li>▪ Description of economic conditions that could affect prices or profits, including; Similarity of geographic markets, Size of each market, Level of the market (e.g. wholesale, retail, manufacture, etc.), Market share, Location-specific costs of the factors of production and distribution, Competition in each market, Economic condition of the industry (whether the market is in contraction or expansion), and Alternatives available to the buyer and seller. See IRM 4.61.3.5.5 - Economic Conditions</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6662-6(d)(2)(iii)(B)(1), documentation requirement</li> <li>▪ Treas. Reg. §1.482-1(d)(3)(iii), risk</li> <li>▪ Treas. Reg. §1.482-1(d)(3)(iv), economic conditions</li> <li>▪ Transfer Pricing Roadmap</li> <li>▪ IPS Unit: Comparability Analysis for Tangible Goods Transactions Inbound DCN:ISI/9422.07_01 thru _06(2013)</li> <li>▪ Intercompany and Third Party Agreements</li> </ul>	

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## Step 1: Overview of USS's Business (cont'd)

### Review of Transfer Pricing Documentation by Inbound Taxpayers

#### Step 1

An overview of USS's business is the first principal document. The overview should include an analysis of the economic and legal factors that affect the pricing of its property or services.

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ Identification of, development of, use of, and ownership of relevant intangible property (e.g., patents, trademarks, customers lists, trade secrets, copyrights, etc.)</li> <li>▪ Description of the relevant history of the taxpayer's (tested party's) operations including the business strategy employed by the taxpayer (tested party) throughout such history</li> <li>▪ Pre-existing economic analyses of the taxpayer's (tested party's) industry (either prepared internally or by industry associations, government agencies or securities analysts, etc.)</li> <li>▪ Description of how government involvement and the regulatory environment affect the taxpayer's (tested party's) business</li> <li>▪ Description of all financial summary reports used in budgeting and financial planning</li> </ul> <p> <b>DECISION POINT:</b> Do you have a good understanding of the taxpayer's business? Are the documents contained in the TPD reasonable and reliable?</p>	<p>Treas. Reg. 1.6662-6(d)(2)(iii)(B)(1), <i>documentation requirement</i></p> <ul style="list-style-type: none"> <li>▪ Annual report, Forms 10-K and 8K</li> <li>▪ Audited financial statements</li> <li>▪ Product line profit and loss statements</li> <li>▪ Domestic, export and foreign country price lists</li> <li>▪ Price lists for items purchased and items sold</li> <li>▪ Product catalogues, brochures, and pamphlets</li> <li>▪ Board of directors' minutes</li> <li>▪ Form 20-F filed with US Securities and Exchange Commission, if a foreign parent</li> <li>▪ Hart-Scott Rodino Forms filed with US Securities and Exchange Commission, if merger and acquisition for publicly held company involved</li> </ul>	

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## Step 2: Organizational Structure

### Review of Transfer Pricing Documentation by Inbound Taxpayers

#### Step 2

The second required document is a description of taxpayer's organizational structure which covers all related entities (domestic and foreign) engaged in transactions that are relevant (directly or indirectly) to the transfer pricing issues.

Considerations	Resources	6103 Protected Resources
<p>It is important to understand where USS fits into the organizational structure. The following information should be included within the TPD:</p> <ul style="list-style-type: none"> <li>▪ Complete legal entity organizational chart including ownership percentage and resident countries;</li> <li>▪ Complete tax entity organizational chart showing whether the entities are corporations, partnerships, or disregarded entities; and</li> <li>▪ Departmental organizational chart with names and positions. <ul style="list-style-type: none"> <li>– It is also a good idea to get position descriptions to help aide in determining what employees you may need to interview.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6662-6(d)(2)(iii)(B)(2), documentation requirement</li> </ul>	
 <p><b>CAUTION:</b> Map the tax return to the organizational chart. Do you have Forms / Returns for all the entities listed? Are there Forms / Returns missing or are there entities missing on the organizational chart?</p>	<ul style="list-style-type: none"> <li>▪ Attachments to the tax return; Form 5472, Form 5471 , Form 8858, and/or Form 8865</li> </ul>	

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## Step 3: Documentation Required by Regulations

### Review of Transfer Pricing Documentation by Inbound Taxpayers

#### Step 3

In some circumstances, the Regulations under IRC 482 will explicitly require certain documentation. When documentation is required by the Regulations, it should be included in the transfer pricing documentation.

Considerations	Resources	6103 Protected Resources
<p>Examples where documentation is specifically required by the regulations include when a market share strategy is used, when a taxpayer claims an exception to the Service's authority to make a commensurate-with-income (CWI) adjustment, and when a taxpayer utilizes a cost sharing arrangement (CSA).</p> <p><b><u>Market Share Strategy</u></b></p> <p>If USS adopts strategies to enter new markets or to increase a product's share in the existing market, it must provide documentation. The documentation must show that an uncontrolled taxpayer engaged in a comparable strategy under comparable circumstances for a comparable period of time and include substantiation of the following:</p> <ul style="list-style-type: none"> <li>▪ The costs incurred to implement the market share strategy are borne by the controlled taxpayer that would obtain the future profits that result from the strategy, and there is reasonable likelihood that the strategy will result in future profits that reflect an appropriate return in relation to the costs incurred;</li> <li>▪ Period of time is reasonable taking into account the industry and product in question; and</li> <li>▪ The market share strategy, related costs and expected returns, and any agreement to share costs was established before the strategy was implemented.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6662-6(d)(2)(iii)(B)(3), documentation requirement</li> <li>▪ Treas. Reg. §1.482-1(d)(4)(i)(A), (B) and (C), market share strategy</li> </ul>	

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## Step 3: Documentation Required by Regulations (cont'd)

### Review of Transfer Pricing Documentation by Inbound Taxpayers

#### Step 3

In some circumstances, the Regulations under IRC 482 will explicitly require certain documentation. When documentation is required by the Regulations, it should be included in the transfer pricing documentation.

Considerations	Resources	6103 Protected Resources
<p><b><u>USS Claims Exception to Commensurate-with-Income (CWI)</u></b></p> <p>If USS claims an exception to the Service's authority to make a commensurate-with-income adjustment, additional information should be included with the transfer pricing documentation. There are four separate exceptions described in Treas. Reg. 1.482-4 for each of the following types of scenarios: CUT involving the same intangible; CUT involving comparable intangible; methods other than CUT; and extraordinary events.</p> <p>If USS 's arm's length result is derived from the application of the CUT involving a comparable intangible or a method other than CUT, USS must provide the written contract with the defined terms and time period. Additionally, there may be no substantial changes in functions performed, and the actual profits or cost savings should fall within 80% to 120% of forecasts.</p> <p>If USS is claiming an extraordinary event, a description of the circumstances should be provided.</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. §1.482-4:</li> <li>▪ Treas. Reg. 1.482-4(f)(2)(ii), CWI Exceptions</li> <li>▪ Treas. Reg. 1.482-4(f)(2)(ii)(A), CUT-same intangible</li> <li>▪ Treas. Reg. 1.482-4(f)(2)(ii)(B), CUT-comparable intangible</li> <li>▪ Treas. Reg. 1.482-4(f)(2)(ii)(C), methods other than CUT</li> </ul>	

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## Step 3: Documentation Required by Regulations (cont'd)

Review of Transfer Pricing Documentation by Inbound Taxpayers		
Step 3		
In some circumstances, the Regulations under IRC 482 will explicitly require certain documentation. When documentation is required by the Regulations, it should be included in the transfer pricing documentation.		
Considerations	Resources	6103 Protected Resources
<p><b><u>Cost Sharing Arrangement (CSA)</u></b></p> <p>If USS is a party to a CSA, additional documentation is required. A controlled participant must substantially comply with certain administrative requirements (contractual, documentation, accounting and reporting) as follows:</p> <p><b><i>Contractual Provisions</i></b> -- The CSA must be recorded in writing in a contract that is contemporaneous with the formation (and any revision) of the CSA and include certain contractual terms and satisfy certain requirements.</p> <p><b><i>Maintenance and Updating of Documentation</i></b> -- The controlled participants must timely update, maintain, and produce certain sufficient documentation to establish that the participants have met the CSA contractual provisions as well as additional CSA documentation requirements.</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.482-7(b)(2) and (k), cost sharing</li> <li>▪ IPS Unit: Cost Sharing Arrangements vs Licensing Alternative ISO/9411.01_03(2013)</li> <li>▪ Treas. Reg. 1.482-7(k)(1), CSA contractual requirements</li> <li>▪ Treas. Reg. 1.482-7(k)(2) and Treas. Reg. 1.6662-6(d)(2)(iii)(D), documentation requirements</li> </ul>	

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## Step 3: Documentation Required by Regulations (cont'd)

Review of Transfer Pricing Documentation by Inbound Taxpayers		
Step 3		
In some circumstances, the Regulations under IRC 482 will explicitly require certain documentation. When documentation is required by the Regulations, it should be included in the transfer pricing documentation.		
Considerations	Resources	6103 Protected Resources
<p><b><u>Cost Sharing Arrangement (cont'd)</u></b></p> <p><b>CSA Accounting Requirements</b> -- The controlled participants must maintain sufficient accounting books and records (and underlying data and information) to establish that a consistent method of accounting to measure costs and benefits was chosen.</p> <p><b>CSA Reporting Requirements</b> -- Each controlled participant must timely file a "Statement of Controlled Participant to § 1.482-7 Cost Sharing Arrangement". The CSA Statement should include information as described in the regulations.</p>	<p>Treas. Reg. 1.482-7:</p> <ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.482-7(b)(2) and (k), <i>cost sharing</i></li> <li>▪ Treas. Reg. 1.482-7(k)(3), <i>CSA accounting requirements</i></li> <li>▪ Treas. Reg. 1.482-7(k)(4), <i>CSA reporting requirements</i></li> </ul>	
 <p><b>DECISION POINT:</b> If specific documents are required, are they included in the TPD? Does the documentation included comply with the applicable law?</p>		
 <p><b>CONSULTATION:</b> Consider consulting with Counsel and the Transfer Pricing Practice (TPP) Specialist if you have a issues involving market share strategy, CWI issues , and/or need assistance with the CSA.</p>		

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## Step 4: Method Selection

Review of Transfer Pricing Documentation by Inbound Taxpayers		
Step 4		
A description of the method selected should be included in the transfer pricing documentation (TPD).		
Considerations	Resources	6103 Protected Resources
<p>USS's TPD must contain a description of the method selected and an explanation of why the method was selected.</p> <ul style="list-style-type: none"> <li>▪ Review the description of the pricing method selected for each material intercompany transaction.</li> <li>▪ Identify the specific IRC Section 482 regulations governing the method selected. <ul style="list-style-type: none"> <li>– Transfer of Tangible Property (CUP, Resale Price, Cost Plus, CPM, Profit Split, Unspecified)</li> <li>– Transfer of Intangible Property (CUT, CPM, Profit Split, Unspecified)</li> <li>– Cost Sharing (CUT, Income Method, Acquisition Price Method, Market Capitalization Method, Residual Profit Split, Unspecified)</li> <li>– Controlled Service Transactions (Services Cost, CUSP, Gross Services Margin, Cost Plus, CPM, Profit Split, Unspecified)</li> </ul> </li> </ul> <p>The TPD must also contain a description of the alternative methods that were considered along with an explanation of why they were rejected (not selected).</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6662-6 (d)(2)(iii)(B)(4), documentation requirement</li> <li>▪ Treas. Reg. 1.482-3 – Methods for valuing transfers of tangible property</li> <li>▪ Treas. Reg. §1.482-4 – Methods for valuing transfers of intangibles</li> <li>▪ Treas. Reg. § 1.482-5, comparable profits method</li> <li>▪ Treas. Reg. 1.482-6, profit split methods</li> <li>▪ Treas. Reg. 1.482-7(g)(1)(i)-(vi), CSA methods—supplemental guidance</li> <li>▪ Treas. Reg. §1.482-9(a)(1)-(7), controlled services methods</li> </ul>	

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## Step 4: Method Selection (cont'd)

### Review of Transfer Pricing Documentation by Inbound Taxpayers

#### Step 4

A description of the method selected should be included in the transfer pricing documentation (TPD).

Considerations	Resources	6103 Protected Resources
<p>An analysis establishing the selected pricing method satisfies the best method rule should be included in the TPD. In determining which pricing method provides the most reliable measure of an arm's length result, the two primary factors to take into account are the degree of comparability between the controlled transactions and uncontrolled comparables, and the quality of the data and the assumptions used in the analysis.</p> <p>The reliability of a pricing method based on results of transactions between unrelated parties depends on the <b>degree of comparability</b> between the controlled transaction and uncontrolled comparables. Consideration should be given to:</p> <ul style="list-style-type: none"> <li>– Factors for determining comparability between transactions or taxpayers (Functions, Risk, Economic Conditions, Property or Services), and</li> <li>– Adjustments for Differences.</li> </ul> <p>If there are material differences between the controlled and uncontrolled transactions, adjustments must be made if the effect of such differences on prices or profits can be ascertained with sufficient accuracy to improve the reliability of the result under the method applied.</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. §1.482-1:</li> <li>▪ Treas. Reg. 1.482-1(c), best method</li> <li>▪ Treas. Reg. 1.482-1(c)(2)(i), comparability</li> <li>▪ Treas. Reg. 1.482-1(d)(2), standard of comparability</li> <li>▪ Treas. Reg. 1.482-1(d)(3)(i)-(iv), comparability factors</li> <li>▪ Treas. Reg. § 1.482-5(c)(2)(i)-(iii) and (iv), CPM comparability and CPM adjustments</li> <li>▪ IPS Unit: Comparability Analysis for Tangible Goods Transactions Inbound DCN: ISI/9422.07_01 thru _06(2013)</li> </ul>	

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Income Shifting	N/A	N/A	N/A

## Step 4: Method Selection (cont'd)

### Review of Transfer Pricing Documentation by Inbound Taxpayers

#### Step 4

A description of the method selected should be included in the transfer pricing documentation (TPD).

Considerations	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ Whether the method selected provides the most reliable measure of an arm's length result depends upon the following:               <ul style="list-style-type: none"> <li>– Completeness and accuracy of data;</li> <li>– Reliability of assumptions; and</li> <li>– Sensitivity of results to possible deficiencies in data and assumptions.</li> </ul> </li> </ul> <p>Confirmation of results by another method – If two or more methods produce inconsistent results, the best method rule will be applied to select the method that provides the most reliable measure of an arm's length result.</p> <p>Use of unspecified methods require consideration of realistic alternatives to the transaction. It is assumed that uncontrolled taxpayers dealing at arm's length would have evaluated the terms of the transaction and only entered into such transaction if no alternative is preferable.</p> <p> <b>DECISION POINT:</b> Has the best method been selected? If not, why?</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. §1.482-1:               <ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.482-1(c)(2)(i), comparability</li> <li>▪ Treas. Reg. 1.482-1(c)(2)(ii), data and assumptions</li> <li>▪ Treas. Reg. 1.482-1(d)(2), standard of comparability</li> <li>▪ Treas. Reg. 1.482-1(d)(3)(i)-(v), comparability factors</li> </ul> </li> <li>▪ Treas. Reg. § 1.482-5(c)(2)(i)-(iii) and (iv), CPM comparability and adjustments</li> <li>▪ IPS Unit: Comparability Analysis for Tangible Goods Transactions Inbound DCN: ISI/9422.07_01 thru _06(2013)</li> </ul>	

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Income Shifting	N/A	N/A	N/A

## Step 5: Controlled Transactions

### Review of Transfer Pricing Documentation by Inbound Taxpayers

#### Step 5

A detailed description of each controlled transaction should be in the transfer pricing documentation (TPD).

Considerations	Resources	6103 Protected Resources
<p>The TPD should include a detailed description of the controlled transactions (including the terms of sale) and any internal data used to analyze those transactions. TPD may include one study for all controlled transactions with all related parties, or a separate study for each controlled transaction with a related party. The TPD should also describe any other related party transaction(s) USS has with related entities (other than FP). For each controlled transaction, the TPD should describe functions performed, resources employed, and risks assumed by each entity in the controlled transaction.</p> <p>Items that should be included in TPD include:</p> <ul style="list-style-type: none"> <li>▪ Sources of information, clearly cited so information can be replicated.</li> <li>▪ Description of each controlled transaction, including background information on each related party.</li> </ul> <p>If there is TPD for each controlled transaction, would aggregation of similar transactions potentially be more reliable?</p> <p> <b>CONSULTATION:</b> Consult with an Economist, Counsel, or the TPP if you have questions regarding aggregation of transactions.</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6662-6(d)(2)(iii)(B)(6), documentation requirement</li> </ul> <p>Form 10K (Security and Exchange Commission (“SEC”) Filings) and Company website</p> <ul style="list-style-type: none"> <li>▪ Treas. Reg. §1.482-1(f)(2)(i), aggregation of transactions</li> </ul>	

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Income Shifting	N/A	N/A	N/A

## Step 5: Controlled Transactions (cont'd)

### Review of Transfer Pricing Documentation by Inbound Taxpayers

#### Step 5

A detailed description of each controlled transaction should be in the transfer pricing documentation (TPD).

Considerations	Resources	6103 Protected Resources
<p>Additional items that TPD should include:</p> <ul style="list-style-type: none"> <li>▪ Description of the products in each transaction.</li> <li>▪ Description of intangibles, and identification of ownership of intangibles.</li> <li>▪ A functional analysis.</li> <li>▪ A comparison of the transfer pricing results with the results from the application of the Best Method.</li> <li>▪ Relevant financial data for each controlled transaction.</li> </ul> <p>The TPD should clearly describe which entity performs each function, and which functions are considered routine or non-routine.</p> <p> <b>CONSULTATION:</b> Consult with an economist regarding the functional analysis and the best method.</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6662-6(d)(2)(iii)(B)(6), documentation requirement</li> <li>▪ Functional Analysis Questionnaire</li> </ul>	

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Income Shifting	N/A	N/A	N/A

## Step 6: Comparables

### Review of Transfer Pricing Documentation by Inbound Taxpayers

#### Step 6

A description of the comparables should be included in the transfer pricing documentation (TPD).

Considerations	Resources	6103 Protected Resources
<p>The TPD should include a description of the comparables selected, the process used to select the comparables, how comparability was evaluated, and what (if any) adjustments were made. Reliability of a method depends on the degree of comparability between controlled and uncontrolled transactions.</p> <p>Comparison between controlled (Tested Party) transactions and the comparables (uncontrolled) transactions is performed. The comparables are generally selected from a database or databases based upon selection criteria in efforts to identify similar companies with similar business activities performing under similar circumstances.</p> <p>From the controlled transaction, a Tested Party is chosen. The Tested Party operates in a similar business under similar circumstances as comparables and in most cases:</p> <ul style="list-style-type: none"> <li>▪ Is the least complex entity;</li> <li>▪ Performs fewest functions, and</li> <li>▪ Does not own intangible property or unique assets.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6662-6(d)(2)(iii)(B)(7), documentation requirement</li> <li>▪ Treas. Reg. §1.482-1(c)(2)(i), comparability</li> <li>▪ Treas. Reg. § 1.482-5(a) and (b), CPM tested party, arm’s length range and profit level indicators, and adjustments for tested party</li> <li>▪ IPS Unit: Comparability Analysis for Tangible Goods Transactions Inbound, ISI/9422.07_01 thru _06(2013)</li> <li>▪ IPS Unit – CPM Simple Distributor Inbound, ISI/9422.07_07(2013)</li> </ul>	

Volume	Part	Chapter	Sub-Chapter
Income Shifting	N/A	N/A	N/A

## Step 6: Comparables (cont'd)

### Review of Transfer Pricing Documentation by Inbound Taxpayers

#### Step 6

A description of the comparables should be included in the transfer pricing documentation (TPD).

Considerations	Resources	6103 Protected Resources
<p>The TPD should describe the comparables and the search process employed, to include:</p> <ul style="list-style-type: none"> <li>▪ Database(s) used and years searched;</li> <li>▪ Industry code(s), Standard Industry Code (SIC) or North American Industry Classification System (“NAICS”) Codes (NAICS) used in the search;</li> <li>▪ Comparables found in the search;</li> <li>▪ Criteria for selecting or excluding comparables, and</li> <li>▪ Any adjustments made to comparables.</li> </ul> <p> <b>DECISION POINT:</b> Did USS correctly select the tested party and the comparable companies? Are the comparables practical given the understanding of USS’s business? If there are any adjustments, are they reasonable?</p> <p> <b>CONSULTATION:</b> Consult an Economist for assistance regarding the selection of the tested party, comparables, and adjustments to comparables.</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. §1.482-1(d), comparability</li> <li>▪ Treas. Reg. § 1.482-5(c), comparability and reliability considerations</li> <li>▪ SIC Codes, used to find comparables</li> <li>▪ North American Industry Classification System (“NAICS”) Codes, used to find comparables</li> </ul>	

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Income Shifting	N/A	N/A	N/A

## Step 7: Economic Analysis

### Review of Transfer Pricing Documentation by Inbound Taxpayers

#### Step 7

An explanation of economic analysis and projections relied upon developing the method should be included in the transfer pricing documentation (TPD).

Considerations	Resources	6103 Protected Resources
<p>Description of any economic analyses undertaken to;</p> <ul style="list-style-type: none"> <li>explain the effect of potential differences (e.g., functions, risks, volume, geographic market, and/or level of market) upon the transfer price;</li> <li>determine the adjustments required to take into account material differences between the transactions (for example, Working Capital and Asset Intensity Adjustments); and</li> <li>develop internal or comparable financial data to account for differences in accounting treatment and the use of product or geographic segment data.</li> </ul> <p> <b>CAUTION:</b> Does the segmented data reconcile to the overall financial data and other segments? Does the segmented data tie to other segments and to the overall financials? If segment data is used, make sure the controlled transaction is included in the segmented financials.</p>	<ul style="list-style-type: none"> <li>Treas. Reg. 1.6662-6(d)(2)(iii)(B)(8), documentation requirement</li> <li>Transfer Pricing Functional Analysis Questionnaire</li> <li>Intercompany and Third Party Contracts</li> <li>Audited Financial Statements</li> </ul>	

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## Step 7: Economic Analysis (cont'd)

### Review of Transfer Pricing Documentation by Inbound Taxpayers

#### Step 7

An explanation of economic analysis and projections relied upon developing the method should be included in the TPD.

Considerations	Resources	6103 Protected Resources
<p>Economic analyses supporting a profit split method, if used:</p> <ul style="list-style-type: none"> <li>▪ Is the measure of routine profit appropriate?</li> <li>▪ Is the measure by which non-routine profits are split (i.e., R&amp;D expenses or marketing expenses) appropriate given the nature of the activities?</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.482-6, profit split methods</li> <li>▪ Treas. Reg. § 1.482-5, CPM</li> </ul>	
<p>Economic analyses supporting multiple year data, if used:</p> <ul style="list-style-type: none"> <li>▪ Is the use of multiple year data appropriate given the facts and circumstances?</li> <li>▪ Is the period used appropriate?</li> <li>▪ Is the period used consistently applied (same period used for both controlled and uncontrolled transactions)?</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. §1.482-1(f)(2)(iii), multiple year data</li> <li>▪ S&amp;P Industry Surveys</li> <li>▪ Industry Associations and Reports</li> </ul>	

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Income Shifting	N/A	N/A	N/A

## Step 7: Economic Analysis (cont'd)

Review of Transfer Pricing Documentation by Inbound Taxpayers		
Step 7		
An explanation of economic analysis and projections relied upon developing the method should be included in the TPD.		
Considerations	Resources	6103 Protected Resources
 <p><b>DECISION POINT:</b> Are there functions being performed that are not priced and should be? Are there services being performed that are not included as part of the covered transactions being evaluated? Do the assumptions reflect economic reality? Have the profit and loss statements been compared to the underlying financials for consistency in application and overall accuracy? Can the analysis and projections be corroborated? Is the explanation of the economic analysis and projections relied upon in developing the method substantially complete and accurate?</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. §1.482-1(c) and (d), data and assumptions, comparability</li> <li>▪ Treas. Reg. §1.482-4, intangibles</li> <li>▪ Treas. Reg. §1.482-9, controlled service transactions</li> <li>▪ Audited Financial Statements</li> <li>▪ IPS Unit: Comparability Analysis for Tangible Goods Transactions Inbound DCN: ISI/9422.07_01 thru _06(2013)</li> <li>▪ IPS Unit: Arms Length Standard, ISI/9422.09_06(2013)</li> </ul>	

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Income Shifting	N/A	N/A	N/A

## Step 8: General Index and Background Documents

### Review of Transfer Pricing Documentation by Inbound Taxpayers

#### Step 8

A description of the method selected should be included in the transfer pricing documentation (TPD).

Considerations	Resources	6103 Protected Resources
<p>A complete and accurate general index of the principal and background documents should be included in USS's TPD. Often a table of contents will satisfy this requirement. A description of the record keeping system used for cataloging and accessing those documents should also be included.</p> <p>The assumptions, conclusions and positions contained in the principal documents ordinarily will be based on, and supported by, additional background documents.</p> <p>Documents that support the principal documentation include documents listed in Treas. Reg. 1.6038A-3(c). The following documents must be maintained in order for a taxpayer to satisfy the record maintenance safe harbor (to the extent such documents may be relevant to determine the correct U.S. tax treatment of transactions between the reporting corporation and any foreign related party):</p> <ul style="list-style-type: none"> <li>▪ Original entry books and transaction records;</li> <li>▪ Profit and loss statements of the reporting corporation and all related parties;</li> <li>▪ Internal pricing documents;</li> <li>▪ Foreign country and third party filings; and</li> <li>▪ Ownership and capital structure.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6662-6(d)(2)(iii)(C), documentation requirement</li> </ul> <p>IRC § 6038A Information with respect to certain foreign-owned corporations</p> <ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.6038A-1(d), definitions of reporting corporation and related party</li> <li>▪ Treas. Reg. 1.6038A-3(c), specific records to be maintained for record maintenance safe harbor</li> </ul>	

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Income Shifting	N/A	N/A	N/A

## Definitions

### Review of Transfer Pricing Documentation by Inbound Taxpayers

#### Description

- **Arm's Length Standard** - A controlled transactions meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled/unrelated parties had engaged in the same transaction under the same circumstances (arm's length result).
  
- **Controlled Parties** - Two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests. Controlled entities are often referred to as "related" parties.

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## Training and Additional Resources

Review of Transfer Pricing Documentation by Inbound Taxpayers		
Type of Resource	Description(s) and/or Instructions for Accessing	References
CENTRA sessions	<ul style="list-style-type: none"> <li>▪ 10-22-12- Performing Functional Analysis by Engineering International Issues Team (HHR344383).</li> <li>▪ FY2012 Transfer Pricing Introduction to 482.</li> <li>▪ FY2013 IRC 482 Overview.</li> <li>▪ FY2012 Comparable Profits Method – High Value.</li> <li>▪ FY2012 PLIs in a CPM World.</li> </ul>	
Issue Toolkits	<ul style="list-style-type: none"> <li>▪ Transfer Pricing Road Map</li> <li>▪ Functional Analysis Questionnaire</li> <li>▪ Transfer Pricing IDR</li> </ul>	<p>Transfer Pricing Roadmap</p> <p>Transfer Pricing Functional Analysis Questionnaire</p> <p>Mandatory Transfer Pricing (IDR)</p>

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## Training and Additional Resources (cont'd)

Review of Transfer Pricing Documentation by Inbound Taxpayers		
Type of Resource	Description(s) and/or Instructions for Accessing	References
Issue Toolkits (continued)	<ul style="list-style-type: none"> <li>▪ Transfer Pricing Checklist</li> <li>▪ IRM 4.61.3 Development of IRC 482 Issues</li> </ul>	Checklist – IRC § 482 (Transfer Pricing)  IRM 4.61.3 - Development of IRC 482 Issues
OECD Transfer Pricing Guidelines	<ul style="list-style-type: none"> <li>▪ Article 9</li> </ul>	OECD Transfer Pricing Guidelines
Databases / Research Tools	<ul style="list-style-type: none"> <li>▪ BNA Tax Management Int'l Portfolio 886-2nd s II - Transfer Pricing - The Regulations</li> <li>▪ BNA Tax Management Int'l Portfolio 890 - Transfer Pricing</li> </ul>	BNA 886-2nd TMFEDPORT No 886 s II  BNA Portfolio #890, WS 1

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## Glossary of Terms and Acronyms

Acronym	Definition
COGS	Cost of Goods Sold
CPM	Comparable Profits Method
CUP	Comparable Uncontrolled Price
CUSP	Comparable Uncontrolled Services Price
CUT	Comparable Uncontrolled Transaction
FP	Foreign Parent
IDR	Information Document Request
IP	Intangible Property
IPN	International Practice Network
IPS	International Practice Service
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
ISI	Income Shifting Inbound
ISO	Income Shifting Outbound
MNE	Multinational Enterprise

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## Index of Related Issues

Issue	Associated UIL(s)	References
Provision of Services	▪ 9422.05	IPS Unit: Services Cost Method Inbound Services, ISI/9422.09_04
Sale of Tangible Goods	▪ 9411.05	IPS Unit: Sale of Tangible Goods from a CFC to a USP CUP Method, ISO/9411.05_01 (2013)
Overview of IRC Section 482	▪ 9411.07	IPS Unit: Overview of IRC Section 482, ISI/9411.07_01(2013)
Comparability	▪ 9422	IPS Unit: Comparability Analysis for Tangible Goods Transactions Inbound, ISI/9422.07_01 thru _06(2013) ISI/PUO/V_6_01 (2014)
Comparable Profits Method	▪ 9422.07	IPS Unit: CPM Simple Distributor Inbound, ISI/9422.07_07(2013)
Resale Price Method	▪ 9422.07	IPS Unit: Inbound Resale Price Method Routine Distributor, ISI/9422.07_04(2013)
Purchases of Tangible Goods	▪ 9422.07	IPS Unit: Purchase of Tangible Goods from a Foreign Parent CUP Method, ISI/9422.07_09(2013)
Best Method	▪ 9422.09	IPS Unit: Best Method Determination for an Inbound Distributor, ISI/9422.09_05 (2013)
Arm's Length Standard	▪ 9422.09	IPS Unit: Arms Length Standard, ISI/9422.09_06(2013)