

## LB&I International Practice Service Transaction Unit

IPS Level	Number	Title	UIL Code	Number
Shelf	N/A	Business Inbound	–	–
Volume	6	Income Shifting	<b>Level 1 UIL</b>	9422
Part	6.9	Other Transfer Pricing Issues	<b>Level 2 UIL</b>	9422.09
Chapter	6.9.1	Other Transfer Pricing Issues	<b>Level 3 UIL</b>	N/A
Sub-Chapter	N/A	N/A	–	–

<b>Unit Name</b>	Three Requirements of IRC 482
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# Issue and Transaction Overview


## Three Requirements of IRC 482

IRC 482 allows the IRS to make allocations to ensure that taxpayers clearly reflect income attributable to controlled transactions and to prevent the evasion of taxes.

Found in the statutory language of IRC 482 , there are three basic prerequisites before this code section can be applied:

- 1) There must be two or more organizations, trades or businesses; AND
- 2) There must be common ownership or control, either directly or indirectly of such entities; AND
- 3) The IRS must determine that an allocation is necessary either to prevent evasion of taxes, or to clearly reflect the income of any of those entities.

All three prerequisites must be found in order to apply IRC 482 .

 **CONSULTATION:** You should consult with the appropriate legal counsel, Transfer Pricing Practice (TPP), Technical Specialists (TS) or Issue Practice Network (IPN) reference and resource materials if you are having any difficulty applying these prerequisites.

# Issue and Transaction Overview (cont'd)

## Three Requirements of IRC 482

### Two or More Organizations

The first prerequisite to apply IRC 482 is “two or more organizations, trades, or businesses.”

Per Treas. Reg. 1.482-1(i)(1) an “organization” is defined as one of any kind including:

- Sole proprietorship; partnership; trust; estate; association; corporation.

NOTE: IRC 482 applies to domestic transactions as well as international transactions.

Per Treas. Reg. 1.482-1(i)(2) a “trade or business” means:

A trade or business activity of any kind regardless of:

- Place of organization; formal organization; type of ownership (individual or otherwise); place of operation.

Thus, the definition of “organization, trade, or business” under IRC 482 is very broad. In addition, at least two such broadly defined parties must be involved for IRC 482 to apply.

# Issue and Transaction Overview (cont'd)

## Three Requirements of IRC 482

### Ownership or Control

The second prerequisite to apply IRC 482 is “ownership or control.” Specifically, Treas. Reg. 1.482-1(i)(4) includes a broad definition of what constitutes control:

- any kind of control
- direct
- indirect
- legally enforceable or not
- two or more taxpayers:
  - acting in concert, or
  - with a common goal or purpose
- reality of the control is decisive
- form of the control is not decisive

This regulation further states, “A presumption of control arises if income or deductions have been arbitrarily shifted.”

# Issue and Transaction Overview (cont'd)

## Three Requirements of IRC 482

### Reallocation to Clearly Reflect Income

The third prerequisite to apply IRC 482 is that the allocation must be necessary to:

- prevent evasion of taxes, or
- clearly reflect income

Remember, allocations affecting taxable income can be made to:

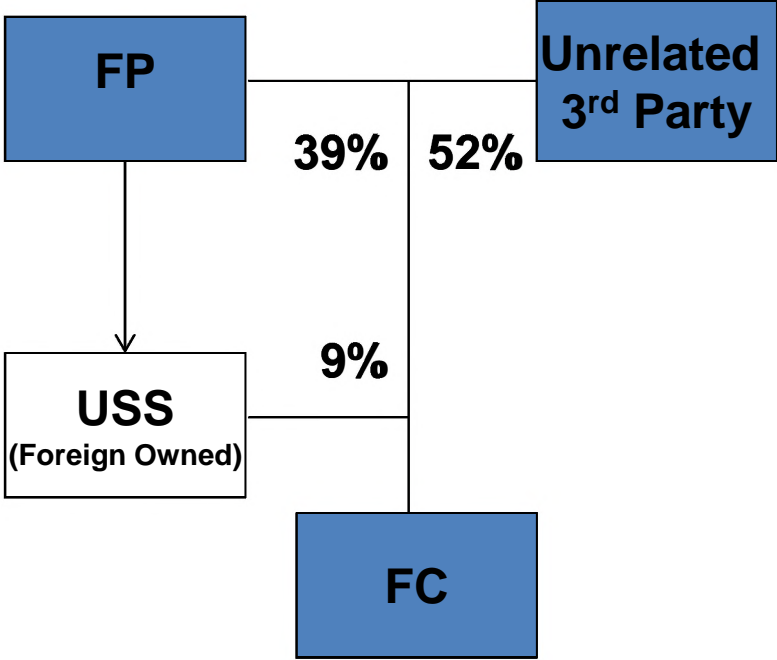
- Income
- Deductions
- Credits
- Allowances

The courts have decided on numerous occasions that an IRS allocation will be upheld unless the taxpayer can prove the IRS determination was arbitrary and capricious.

- *Liberty Loan Corp v. US*, 498 F.2d 225, 229 (8<sup>th</sup> Cir. 1974)
- *H Group Holding, Inc. v. C.I.R.*, T.C. Memo. 1999-334,21
- *Kenco Restaurants Inc. v. C.I.R.*, 206 F3d 588, 593-94 (6<sup>th</sup> Cir. 2000)

# Transaction and Fact Pattern

## Three Requirements of IRC 482

Diagram of Transaction	Facts
 <p>The diagram illustrates the ownership structure of the Foreign Company (FC). At the top, a blue box labeled 'FP' (Foreign Parent) has a downward arrow pointing to a white box labeled 'USS (Foreign Owned)'. To the right of 'FP' is a blue box labeled 'Unrelated 3rd Party'. A vertical line descends from the space between 'FP' and 'Unrelated 3rd Party', with '39%' on the left side and '52%' on the right side. This vertical line connects to a horizontal line that branches to the left, connecting to the top of the 'USS' box, and to the right, connecting to the top of a blue box labeled 'FC'. The '9%' ownership stake is indicated between the 'USS' box and the 'FC' box.</p>	<p>Two or more organizations could be shown as follows:</p> <ul style="list-style-type: none"><li>▪ Foreign Parent (“FP”) owns 100% of United States Subsidiary (“USS”).</li><li>▪ FP makes all managerial decisions for Foreign Company (FC).</li><li>▪ FC is owned by FP 39%, USS 9% and Unrelated 3<sup>rd</sup> Party 52%.</li><li>▪ FC manufactures and sells tangible goods to USS.</li><li>▪ FP, FC and USS are all corporations for US tax purposes.</li></ul>

# Summary of Potential Issues

Three Requirements of IRC 482	
<a href="#"><u>Issue 1</u></a>	Does FP, USS, and FC qualify as two or more organizations, trades or businesses?
<a href="#"><u>Issue 2</u></a>	Does USS have ownership or control over FC?
<a href="#"><u>Issue 3</u></a>	Does the USS allocation under IRC 482 clearly reflect income?



# All Issues, Step 1: Initial Factual Development

## Three Requirements of IRC 482

Taxpayers and foreign affiliates may use non arm's length prices for the sale of tangible goods to inappropriately shift income outside of the United States. It is important to establish the facts and review the supporting documentation to substantiate that intercompany prices are charged at an arm's length price.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"><li>▪ Are USS and FP and FC separate entities?</li><li>▪ Can you identify the ownership of all the entities?</li><li>▪ Does Form 5472 indicate any transactions between USS and FC?</li></ul>	<ul style="list-style-type: none"><li>▪ Worldwide Organizational Chart</li><li>▪ Tax Structure Organizational Chart</li><li>▪ Transfer Pricing Documentation</li><li>▪ Taxpayer's Financial Statements</li><li>▪ Form 5472, Part III (Rev 2012)</li><li>▪ Form 5472, Part IV, Line 14 &amp; 15 (Rev 2012)</li><li>▪ Transfer Pricing Roadmap</li></ul>	

# Issue 1, Step 2: Review Potential Issues

## Three Requirements of IRC 482

### Issue 1

Does FP, USS and FC qualify as two or more organizations, trades or businesses?

Explanation of Issue	Resources
<ul style="list-style-type: none"><li>▪ Based on the information provided – Could you conclude two or more organizations, trades or businesses exist?</li><li>▪ Are there two separate organizations?</li><li>▪ Are there two trades or businesses?</li></ul> <p>Remember, at least two parties are needed for IRC 482 to apply.</p> <p>Keep in mind - Two or more organizations, trades or businesses under IRC 482 applies whether or not incorporated, whether or not organized in the US and whether or not affiliated with each other.</p>	<ul style="list-style-type: none"><li>▪ Treas. Reg. 1.482-1(i)(2)</li><li>▪ <i>Sun Capital Partners III v. New England Teamsters &amp; Trucking Industry Pension Fund</i>, 724 F.3<sup>rd</sup> 129 (1<sup>st</sup> Cir. 2013)</li></ul>

# Issue 1, Step 3: Additional Factual Development

## Three Requirements of IRC 482

### Issue 1

Does FP, USS, and FC qualify as two or more organizations, trades or businesses?



Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ Which of the entities (FP, USS or FC) qualify as organizations, trades or businesses?</li> <li>▪ What functions does FP perform? What functions does USS perform? What functions does FC perform?</li> <li>▪ What risks are assumed by FP, USS or FC?</li> </ul>	<ul style="list-style-type: none"> <li>▪ Contracts or intercompany agreements between FP, USS and FC pertaining to the Organization, Management, Services, Sales, Purchases or other applicable Functions.</li> <li>▪ Invoices</li> <li>▪ Organizational Chart</li> <li>▪ Functional (Personnel) Chart</li> <li>▪ Transfer Pricing Documents</li> <li>▪ Transfer Pricing Roadmap</li> </ul>	

# Issue 1, Step 4: Develop Arguments

## Three Requirements of IRC 482

### Issue 1

Does FP, USS, and FC qualify as two or more organizations, trades or businesses?

Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ If based on the facts developed there are two or more organizations, trades or business, then you should proceed to Issue 2 to determine if they are under common control.</li> <li>▪ When challenging whether two or more organizations, etc. exist, look to current judicial doctrine such as <i>Sun Capital Partners v. New England Teamsters &amp; Trucking Industry Pension Fund</i></li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.482-1(i)(2)</li> <li>▪ <i>Sun Capital Partners III v. New England Teamsters &amp; Trucking Industry Pension Fund</i>, 724 F.3<sup>rd</sup> 129 (1<sup>st</sup> Cir. 2013)</li> </ul>	
 <p><b>DECISION POINT:</b> If there are not two or more organizations, trades or business, then the requirements of IRC 482 are not applicable.</p>		
 <p><b>CONSULTATION:</b> You should consult with the appropriate legal counsel, Transfer Pricing Practice, Technical Specialists or Issue Practice Network (IPN) reference and resource materials if you are having any difficulty applying these prerequisites.</p>		

# Issue 2, Step 2: Review Potential Issues

## Three Requirements of IRC 482

### Issue 2

Does USS have ownership or control over FC?


Explanation of Issue	Resources
<p>Remember in the facts previously stated – USS makes all managerial decisions for FC.</p> <ul style="list-style-type: none"><li>▪ In your situation - Do you have actual or practical control rather than any particular percentage of stock ownership in the other party to the transaction?</li><li>▪ Do you have two independently owned companies acting in concert with each other?</li><li>▪ Do you have income or deductions that have been arbitrarily shifted?</li></ul>	<ul style="list-style-type: none"><li>▪ Treas. Reg. 1.482-1(i)(4)</li><li>▪ Treas. Reg. 1.482-1(i)(5)</li> <li>▪ <i>DHL Corp. v. Commissioner</i>, TC Memo 1998-461, aff'd in part, rev'd in part, 285 F.3d 1210 (9th Cir. 2002).</li><li>▪ <i>B. Forman Co. Inc v Commissioner</i>, 453 F.2d 1144 (2nd Cir. 1972).</li></ul>

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

## Three Requirements of IRC 482

### Issue 2

Does USS have ownership or control over FC?

Explanation of Issue	Resources
<ul style="list-style-type: none"> <li>▪ Ownership or control includes a broad definition of what constitutes control:</li> <li>▪ Any kind of control</li> <li>▪ Direct</li> <li>▪ Indirect</li> <li>▪ Legally enforceable or not</li> <li>▪ Two or more taxpayers:               <ul style="list-style-type: none"> <li>- acting in concert, or</li> <li>- with a common goal or purpose</li> </ul> </li> <li>▪ Reality of the control <u>is</u> decisive</li> <li>▪ Form of the control is <u>not</u> decisive</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.482-1(i)(4)</li> <li>▪ <i>Charles Town Inc. v. Commissioner</i>, 372 F.2d 415 (4<sup>th</sup> Cir. 1967)</li> </ul>
 <p><b>CONSULTATION:</b> You should consult with the appropriate legal counsel, Transfer Pricing Practice, Technical Specialists or Issue Practice Network (IPN) reference and resource materials if you are having any difficulty applying these prerequisites.</p>	

# Issue 2, Step 3: Additional Factual Development

## Three Requirements of IRC 482

### Issue 2

Does USS have ownership or control over FC?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ Control is one of “actual, practical control rather than any particular percentage of stock ownership.”</li> <li>▪ Ask yourself – Does one individual or party have enough control, not because of stock ownership, to move or influence the party or parties in question to act as instructed?</li> <li>▪ Remember, you must obtain sufficient information on how the parties relate to each other to determine if there is actual or practical control that influences the business policies and direction of the parties.</li> <li>▪ Keep in mind – When two separate interests in distinctly different parties come together <u>in concert</u> to effect a joint business relationship, it constitutes the same interests under IRC 482.</li> </ul>	<ul style="list-style-type: none"> <li>▪ <i>DHL Corp. v. Commissioner</i>, TC Memo 1998-461, aff'd in part, rev'd in part, 285 F.3d 1210 (9th Cir. 2002).</li> <li>▪ <i>B. Forman &amp; Co. v. Commissioner</i>, 54 T.C. 912, 921 (1970).</li> </ul>	

# Issue 2, Step 3: Additional Factual Development (cont'd)

## Three Requirements of IRC 482

### Issue 2

Does USS have ownership or control over FC?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ Does FP and/or USS hold sufficient shares in FC to influence management decisions of FC?</li> <li>▪ Is either FP or USS the “single “ largest shareholder of FC?</li> <li>▪ Does FP and/or USS have the same board of directors?</li> <li>▪ Does FP and/or USS have significant authority under a management agreement with respect to FC?</li> <li>▪ Are the unrelated 3<sup>rd</sup> party active or passive participants in relation to FC?</li> </ul>	<ul style="list-style-type: none"> <li>▪ SEC Filings (Form 20F/Form 10K)</li> <li>▪ Financial Statements</li> <li>▪ Organizational Charts</li> <li>▪ Form 5471, Sch. A (Rev. December 2012).</li> <li>▪ Form 5472, Part II (Rev. December 2012)</li> <li>▪ Board Minutes</li> <li>▪ Operating/Management Agreements</li> <li>▪ Online Databases</li> <li>▪ YK1</li> </ul>	



# Issue 2, Step 4: Develop Arguments

## Three Requirements of IRC 482

### Issue 2

Does USS have ownership or control over FC?

Explanation of Adjustment	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ If based on the facts developed, there is common control of FP, FC and USS, then proceed to Issue 3 to determine if the reported income of USS clearly reflects an arm's length transaction.</li> <li>▪ Indirect ownership, while not defined in IRC 482, presumes ownership through a corporation, partnership, trust or estate.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.482-1</li> <li>▪ <i>DHL Corp. v. Commissioner</i>, TC Memo 1998-461, aff'd in part, rev'd in part, 285 F.3d 1210 (9th Cir. 2002).</li> <li>▪ <i>B. Forman Co. Inc v Commissioner</i>, 453 F.2d 1144 (2nd Cir. 1972).</li> <li>▪ IRC 267</li> </ul>	



**DECISION POINT:** Determine if there is common control. If common control does not exist then the requirements of IRC 482 are not applicable



**CONSULTATION:** You should consult with the appropriate legal counsel, Transfer Pricing Practice, Technical Specialists or Issue Practice Network (IPN) reference and resource materials if you are having any difficulty applying these prerequisites.

# Issue 3, Step 2: Review Potential Issues

## Three Requirements of IRC 482

### Issue 3

Does the USS allocation under IRC 482 clearly reflect income?

Explanation of Issue	Resources
<ul style="list-style-type: none"> <li>▪ Identify the items affecting taxable income resulting from the controlled transaction. The price paid by USS to FC for goods and service can affect USS' taxable income. For instance, If the price paid to FC is high, this may result in the reduction of taxable income to the US.</li> <li>▪ Allocations affecting taxable income items can be made to:               <ul style="list-style-type: none"> <li>- Income</li> <li>- Deductions</li> <li>- Credits</li> <li>- Allowances</li> </ul> </li> </ul>	<p>Request and/or Review the following:</p> <ul style="list-style-type: none"> <li>▪ Transfer Pricing Documents</li> <li>▪ Treas. Reg. 1.482-1</li> <li>▪ <i>Liberty Loan Corp. v. United States</i>, 498 F.2d 225, 229 (8th Cir. 1974)</li> <li>▪ <i>Ballentine Motor Co. v. Commissioner</i>, 321 F.2d 796 (4th Cir. 1963)</li> <li>▪ <i>Grenada Industries, Inc. v. Commissioner</i>, 17 T.C. 231 (1951)</li> <li>▪ <i>Grenada Industries v. C.I.R, aff'd</i>, 202 F.2d 873 (5th Cir.1953, acq., 1972-2 C.B. 2)</li> <li>▪ Transfer Pricing Roadmap</li> </ul>

# Issue 3, Step 3: Additional Factual Development

## Three Requirements of IRC 482

### Issue 3

Does the USS allocation under IRC 482 clearly reflect income?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> <li>▪ What is the tax rate being paid in the US? When compared to the sales income reported by USS, is the US tax rate low?</li> <li>▪ Are there indications that USS is reducing its net income by paying FC too much for the goods and services?</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.482-1</li> <li>▪ Transfer Pricing Documentation</li> <li>▪ IRS Economist Report</li> </ul>	
<ul style="list-style-type: none"> <li>▪ Is the net income reported by FC or FP high compared to the net income reported by USS? Is the price paid to FC for the goods and services purchased by USS a factor in the lower net income reported by USS?</li> </ul>	<ul style="list-style-type: none"> <li>▪ Financial statements</li> <li>▪ Tax Returns</li> <li>▪ SEC Filings</li> </ul>	
<ul style="list-style-type: none"> <li>▪ Is the price paid for the goods and services purchased from FC higher than expected for this type of product?</li> </ul>	<ul style="list-style-type: none"> <li>▪ Industry Publications</li> <li>▪ Websites</li> <li>▪ Competitor Annual Reports</li> <li>▪ Transfer Pricing Documentation</li> </ul>	

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

## Three Requirements of IRC 482

### Issue 3

Does the USS allocation under IRC 482 clearly reflect income?



Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"><li>Does the USS have adequate books and records to identify the controlled transaction?</li></ul>	<ul style="list-style-type: none"><li>Trial Balance</li><li>Journal Entries</li><li>Invoices</li><li>Wire Transfers</li><li>Trial Balance with cost broken down by type</li></ul>	

# Issue 3, Step 4: Develop Arguments

## Three Requirements of IRC 482

### Issue 3

Does the USS allocation under IRC 482 clearly reflect income?

Explanation of Adjustment	Resources	6103 Protected Resources
<p>Your legal analysis should always reflect on whether or not the income or deductions are appropriate for the facts and circumstances.</p> <ul style="list-style-type: none"> <li>▪ Does the income or deductions coincide with the functions performed by the parties?</li> <li>▪ Does one party have a special function that the other does not perform, thereby indicating a potentially larger share of the income?</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.482-1</li> <li>▪ <i>Liberty Loan Corp. v. United States</i>, 498 F.2d 225, 229 (8th Cir. 1974)</li> </ul>	
<p> <b>DECISION POINT:</b> Considering the Three Requirements of IRC 482, an adjustments should be considered to clearly reflect income when warranted.</p>		
<p> <b>CONSULTATION:</b> You should consult with the appropriate legal counsel, Transfer Pricing Practice (TPP), Technical Specialists (TS) or Issue Practice Network (IPN) reference and resource materials in drafting Form 5701 – Notice of Proposed Adjustment (NOPA), if necessary.</p>		

# Training and Additional Resources

## Chapter 6.9.1 Other Transfer Pricing Issues

Type of Resource	Description(s) and/or Instructions for Accessing	References
SABA (Centra) session	<ul style="list-style-type: none"><li>▪ 2012 (TPO) SABA – Overview and Introduction to 482</li></ul>	
Issue Toolkits	<ul style="list-style-type: none"><li>▪ IRM 4.61.3 Development of IRC section 482 Cases</li></ul>	
Issue Toolkits	<ul style="list-style-type: none"><li>▪ IRM 4.61.3-4 Functional Analysis Questionnaire</li></ul>	
Issue Toolkits	<ul style="list-style-type: none"><li>▪ Audit Tool – Checklist and Audit Tool for Developing Transfer Pricing Issues</li></ul>	

# Training and Additional Resources (cont'd)

Chapter 6.9.1 Other Transfer Pricing Issues		
Type of Resource	Description(s) and/or Instructions for Accessing	References
Other Training Materials	<ul style="list-style-type: none"><li>▪ <i>Bittker and Lokken Fed. Tax'n Inc. Est and Gift, Chapter 79: Reallocation of Income and Deductions</i></li></ul>	
Other Training Materials	<ul style="list-style-type: none"><li>▪ Organisation for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines</li></ul>	

# Glossary of Terms and Acronyms

Term/Acronym	Definition
FP	Foreign Parent
FC	Foreign Corporation
IBC	International Business Compliance
IPN	International Practice Network
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
LB&I	Large Business & International
OECD	The Organisation for Economic Co-operation & Development
TPO	Transfer Pricing Operations
TPP	Transfer Pricing Practice
TS	Technical Specialist
UIL	Uniform Issue List
NOPA	Notice of Proposed Adjustment
USS	United States Subsidiary



# Index of Related Issues

Issue	Associated UIL(s)	References
Purchase of Tangible Goods - Inbound	9422.07	Practice Unit, "Purchase of Tangible Goods From a Foreign Parent – CUP Method", DCN: ISI/9422.07_05(2013)
Functional Analysis for Inbound Distributor	9422.07	Practice Unit, "Best Method Determination for an Inbound Distributor", DCN: ISI/9422.09_04(2013)
Comparable Profits Method (CPM) for a Simple Distributor – Inbound	9422.07	Practice Unit, "CPM Simple Distributor Inbound", DCN: ISI/9422.07_07(2013)
Taxpayer's Affirmative Use of IRC 482 - Inbound	9422.09	Practice Unit, "Taxpayers Affirmative Use of IRC 482", DCN: ISI/9422.09_03(2013)
Arm's Length Standard - Inbound	9422.09	Practice Unit, "Arm's Length Standard", DCN: ISI/9422.09_06(2013)
Rev. Proc. 99-32 - Inbound	9422.09	Practice Unit, "Revenue Procedure 99-32 Inbound Guidance", DCN: ISI/9422.09_08(2014)