US IRS releases temporary regulations under Section 482 on coordinating transfer pricing rules with other code provisions

Overview

On 14 September 2015, the Treasury Department and IRS issued Treasury Decision 9738, which contained temporary regulations under Section 482 clarifying the application of the arm’s-length standard when multiple code sections (e.g., Sections 482 and 367) apply. The temporary regulations apply to tax years ending on or after 14 September 2015. The temporary regulations revise Reg. Section 1.482-1(f)(2)(i) and (ii)(B) are set forth in Reg. Section 1.482-1T(f)(2)(i)(A)-(E) and (j)(7).

The temporary regulations are primarily concerned with making the following points:

• Compensation for a Controlled Transaction under Section 482 is required regardless of whether another Code Section (e.g. Section 367) may also apply to the transfer.

• The arm’s-length values of assets determined under Section 482 should be the same whether or not Section 367 applies.

• The “best method” rule may require an analysis of the assets transferred in the aggregate even when some assets are transferred under the purview of Section 351 and other assets are transferred under other provisions of the Code.

Absent further action, the provisions of these temporary regulations will expire on 14 September 2018.
Specific provisions of Reg. Section 1.482-1T

Consistent with the existing regulations, the temporary regulations assert that the arm's-length standard of Section 482 applies to all controlled transactions. As such, the arm's-length amount must be consistent with the value transferred between the parties “without regard to the form or character of the transaction.” (See Reg. Section 1.482-1T(f)(2)(i)(A).) Consequently, a coordinated best method analysis and evaluation of the transaction or transactions may be necessary and such analysis “would include a consistent consideration of the facts and circumstances of the functions performed, resources employed, and risks assumed in the relevant transactions,” in order to achieve “a consistent measure of arm's-length results.” (See Reg. Section 1.482-1T(f)(2)(i)(C).) Further the Preamble to the temporary regulations specifically notes that the relative reliability of any measure of an arm's-length result “depends on the economics of the controlled transactions, not their formal character.”

The temporary regulations also require the taxpayer to consider the potential accretive effects of multiple transactions on the valuation of subject assets in order to determine if an aggregate analysis is appropriate (See Reg. Section 1.482-1T(f)(2)(i)(B)). Finally, the temporary regulations note that an allocation of some portion of the aggregate value among the transferred assets may be required as a result of the foregoing. Such an allocation “must be made using the method that, under the facts and circumstances, provides the most reliable measure of an arm's-length result for each allocated amount.” (See Reg. Section 1.482-1T(f)(2)(i)(D).)

Detailed examples

The temporary Section 482 regulations provide 11 examples, seven of which are new. The examples detail best method analyses that are consistent with the proposition that Section 482 requires arm's-length compensation regardless of the character (e.g., provision of services versus transfer of knowhow or other intangibles) or form of a Controlled Transaction (e.g., license versus sale versus contribution). The examples specifically address the issues of aggregative analysis of transactions, synergies among transactions and best method analysis under Section 482 (regardless of whether the transaction is also subject to Section 367. The examples indicate that aggregation is likely required when the sum of the transactions results in a higher value than if the transactions were analyzed separately. (See Reg. Section 1.482-1T(f)(2)(i)(E), Example 5.) Further, the examples indicate that an analysis of realistic alternatives is always potentially relevant under Reg. Section 1.482-4(d) or Section 1.482-7(g) (See Reg. Section 1.482-1T(f)(2)(i)(E) 8 and Reg. Section 1.482-1(f)(2)(ii)(B) example).

Coordination with proposed Section 367 regulations

The release of the temporary regulations in Treasury Decision 9738 coincides with the release of proposed regulations under Section 367 (Reg-139483-13, Fed. Reg. Doc. 2015-23279). The text of the temporary regulations was simultaneously issued as proposed regulations as part of this proposed regulation package under Section 367.

A separate Alert, Proposed regulations would subject outbound transfers of foreign goodwill or going concern value to tax under Section 367(a) or (d), dated 29 September, addresses the specific amendments to Section 367. The concurrent release of these temporary Section 482 and proposed Section 367 regulations is significant, however, because it highlights the interrelation between the activities and transactions covered under these two Code Sections and regulations, and signals an attempt by the IRS to “clarify the coordination of the application of the arm’s-length standard and the best method rule under Section 482 of the Internal Revenue Code (Code) in conjunction with other provisions of the Code.” (See Preamble to Reg-139483-13.)

Other IRS actions and guidance

In addition to the release of these temporary Section 482 and proposed Section 367 regulations, the IRS has also recently issued Notice 2015-54, which announced forthcoming regulations under Section 721(c) that will
create an exception to the general nonrecognition rule for property contributions to a partnership under Section 721(a). (See Tax Alert, US regulations forthcoming on partnership nonrecognition of property contributions, dated 19 August 2015, for more detail on this Notice.)

The IRS and Treasury intend that the regulations will ensure that a US Transferor of Section 721(c) property to a Section 721(a) partnership takes into account (either immediately or periodically) the built-in gain attributable to the Section 721(c) property. The IRS and Treasury also announced their intent to issue modified regulations specific to partnerships under Sections 482 and 6662 to address controlled transactions involving partnerships and the appropriate transfer pricing methods, valuation approaches, periodic adjustment provisions and documentation of those transactions.

Taken together, these recent actions by the IRS and Treasury constitute a concerted effort to clarify the application of Section 482 to controlled transactions that occur within regulatory schemes of special application within the Internal Revenue Code, particularly to the extent that those controlled transactions might involve tax-favored transfers of appreciated assets outside the US. These actions also apparently seek to establish the primacy of the Section 482 regulations (particularly the arm’s-length standard and best-method analysis) in determining the value of the assets conveyed in such transactions.
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