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Global Tax Alert

News from Transfer Pricing

US Treasury to consider reviving expired transfer pricing aggregation regulations

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According to a Tax Analysts article dated 3 February 2021, the United States (US) Department of the Treasury (Treasury) may soon open a project to revive transfer pricing aggregation regulations under Internal Revenue Code¹ Section 482 that were issued in temporary form in 2015 but expired in 2018 without being finalized.

Background

In July 1994, the Treasury published final transfer pricing regulations under Treas. Reg. Section 1.482-1, which included a set of rules on the aggregation of interrelated transactions in determining arm's-length transfer pricing. The relevant portion of the regulation states:

The combined effect of two or more separate transactions (whether before, during, or after the [tax] year under review) may be considered, if such transactions, taken as a whole, are so interrelated that consideration of multiple transactions is the most reliable means of determining the [arm's-length] consideration for the controlled transactions. Generally, transactions will be aggregated only when they involve related products or services, as defined in [Reg. Section] 1.6038A-3(c)(7)(vii) [groupings of products and types of services that reflect reasonable accounting, marketing, or other business practices within the industries in which the related party group operates].²

This regulation and its four subsequent examples provided guidance to taxpayers until it was replaced by new temporary Treas. Reg. Section 1.482-1T(f)(2)(i) in 2015. The 2015 temporary regulation was built on the foundation of its 1994 predecessor with modifications and clarification that the arm's-length standard must be satisfied when both Sections 482 and 367 apply. The result was a more rigid aggregation principle with less taxpayer flexibility in pricing intercompany transactions that are interrelated.

The Treasury initially planned to finalize the 2015 temporary regulation before it expired in 2018, but the project became less urgent after the *Tax Cuts and Jobs Act* (TCJA) amended the statutory text of Section 482 to explicitly allow aggregation for intangible transfers. Section 482 states:

For purposes of this section, the Secretary shall require the valuation of transfers of intangible property (including intangible property transferred with other property or services) on an aggregate basis or the valuation of such a transfer on the basis of the realistic alternatives to such a transfer, if the Secretary determines that such basis is the most reliable means of valuation of such transfers.

When the 2015 temporary regulation expired in September 2018, taxpayers were left with a statutory aggregation rule under Section 482 without further guidance for intangible property transfers occurring after 14 September 2018.

Implications

Although the Internal Revenue Service (IRS) has generally considered the aggregation principle to be the most reliable means of determining arm's-length consideration for controlled intangible property transactions,³ the lack of current regulations on the application of aggregation to intangibles transfers generally leaves taxpayers with greater transactional flexibility.

If the Treasury does revive the 2015 temporary regulations, it is unknown how the new regulations will be issued. While it may be possible for the Treasury to use the prior proposed regulations to directly promulgate final regulations, it is more likely that the new regulations would be issued as part of a larger regulation package so that Treasury can solicit comments, and respond to those comments in the Preamble to the final regulations to avoid an *Administrative Procedures Act* challenge (similar to the *Altera* case⁴). It is also possible that, given the comprehensive international tax overhaul from the TCJA, Treasury will start from scratch and draft a more comprehensive overhaul of the transfer pricing regulations to incorporate other statutory changes from the TCJA, such as the new statutory definition for intangible property contained in Section 367(d)(4).

Endnotes

1. All "Section" references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.
2. Treas. Reg. § 1.482-1(f)(2)(i) (1994).
3. Historically, the Tax Court has addressed aggregation arguments in *Medtronic, Inc. v. Commissioner*, T.C. Memo 2016-112 (holding that aggregation is not the most reliable means of determining arm's-length consideration for controlled transactions if such transactions are able to exist independently; however, the Tax Court opinion was vacated by 8th Circuit Court of Appeals); *Guidant v. Commissioner*, 146 T.C. No. 5 (2016) (upholding IRS authority, pursuant to Section 482 and the [2015] regulations thereunder, to aggregate one or more transactions when doing so provides the best means of determining true taxable income); *Amazon.com, Inc. & Subsidiaries v. Commissioner*, 148 T.C. No. 8 (23 March 2017) (holding the IRS valuation that aggregated the value of pre-existing intangibles with value of subsequently developed intangibles developed under a cost sharing arrangement was arbitrary, capricious and unreasonable); and *Veritas Software Corp. v. Commissioner*, 133 T.C. No. 297 (2009) (holding the IRS valuation aggregating the value of pre-existing intangibles with the value of subsequently developed intangibles developed under a cost sharing arrangement was arbitrary, capricious and unreasonable).
4. *Altera Corp v. Commissioner*, 145 T.C. No. 3 (27 July 2015) (holding the regulation at issue was invalid because the IRS ignored relevant comments to the proposed cost sharing regulations; however, the Tax Court opinion was reversed by the 9th Circuit Court of Appeals).

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