

LB&I International Practice Service Transaction Unit

Shelf		Business Outbound		
Volume	1	Outbound Income Shifting	UIL Code	9411
Part	1.5	Sales or Leases of Tangible Property/Goods	Level 2 UIL	9411.05
Chapter	1.5.1	Outbound Distributor – Sales or Lease of Tangible Property/Goods	Level 3 UIL	N/A
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Unit Name	CPM Simple Distributor Outbound
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Issue and Transaction Overview

CPM Simple Distributor Outbound

U.S. parent companies often sell tangible goods to other members of their controlled group for distribution in other countries or markets. Controlled Foreign Corporations (“CFC”) acting as distributors are sometimes the controlled purchasers of these tangible goods. The price at which the tangible goods are sold between these controlled parties is referred to as the transfer price. If the price charged in the controlled sale is less than an arm’s length price, then the resulting excess profits are effectively shifted to the CFC, at the expense of the U.S. Treasury.

The arm’s length standard governs controlled transactions, such as the sale of tangible goods between controlled parties. The Comparable Profits Method (“CPM”) is one of the specified profit-based transfer pricing methods that is used to determine whether a transaction between controlled parties is consistent with the arm’s length standard. The CPM is based on the notion that similarly situated business operations tend to earn similar returns over time. The CPM typically compares the Tested Party’s operating results over a range of years with those of uncontrolled taxpayers also known as comparables. The reliability of the results derived from the CPM is affected by the quality of the accounting data of both the Tested Party and the uncontrolled comparables.

The CPM evaluates whether the amount charged in a controlled sale of tangible goods is consistent with the arm’s length standard by referring to objective measures of profitability, known as profit level indicators (“PLIs”), derived from uncontrolled taxpayers that engage in similar business activities under similar circumstances. PLIs are financial ratios that objectively measure the relationship between profits, costs and resources. For a simple distributor of tangible goods, the most common PLIs used are the ratio of operating profit to sales (or Operating Margin), and the ratio of gross profit to operating expenses (commonly known as the “Berry Ratio”). If the Tested Party is a manufacturer of tangible goods, the PLI could be Return on Assets (“ROA”) or Return on Capital Employed (“ROCE”).

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Issue and Transaction Overview (cont'd)

CPM Simple Distributor Outbound

CPM does not price each transaction or product line separately, but rather determines if the transfer price is consistent with the arm's length standard by comparing the profitability of similar ("comparable") companies that have similar functions, assets and risks and that conduct business with unrelated ("uncontrolled") parties in free markets. The PLIs obtained from these comparable companies are then analyzed statistically to create an interquartile range of acceptable results that are generally considered arm's length. The selection of the appropriate comparable enterprises and the most reliable PLI is critical to getting to an arm's length result.

This unit assumes that CPM is the Best Method. For more information regarding the Best Method, please review the IPS Unit on Best Method Determination for an Inbound Distributor ISI/9422.09_04. Additionally, in order to fully understand the applicability of this IPS Unit, the reader should also review the Three Requirements of Section 482 ISI/9422.09_02, the Arm's Length Standard ISI/9422.09_06 and Comparability Analysis for Tangible Goods Transactions- Outbound ISO/PUO/V_1_01(2014).

Lastly, this unit focuses on reviewing the Taxpayer's Transfer Pricing Documentation ("TPD") to understand the basics of CPM. It is important to note that an independent analysis based on the Taxpayer's facts and circumstances should be performed by the exam team. For more information regarding reviewing a Taxpayer's TPD, please review the IPS Process Unit Overview on Review of Transfer Pricing Documentation for an Outbound Taxpayer ISO/PUO/P_1_07_02(2014).

-  **CONSULTATION / TREATY IMPLICATION:** If an adjustment is pursued and gives rise to double taxation, the Taxpayer may have access to double tax relief under the Mutual Agreement Procedures (MAP) of a relevant treaty. Providing the taxpayer information on competent authority (MAP under the relevant treaty) and keeping the statutes in both countries open is
-  **MANDATORY** (See IRM 4.60.2.1 discussing Pattern Letter 1853). If competent authority relief is sought by the taxpayer, make sure you consult with Advance Pricing Mutual Agreement (APMA).

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Transaction and Fact Pattern

CPM Simple Distributor Outbound

Diagram of Transaction	Facts
<p>The diagram illustrates the transaction between a US Parent and a CFC. A box labeled 'US Parent' is at the top, and a box labeled 'CFC' is at the bottom. A green arrow on the left points from the US Parent to the CFC, labeled 'Inventory'. A green arrow on the right points from the CFC to the US Parent, labeled 'Payment'. Below the CFC box is a callout box with the text 'CFC is a distributor'.</p>	<ul style="list-style-type: none"> ▪ US Parent (“USP” or “Taxpayer”) wholly owns CFC. ▪ USP manufactures the goods it sells to CFC. ▪ USP is the entrepreneurial entity and bears all business risks regarding its manufacturing activities. ▪ CFC functions as a distributor (does not have any embedded services or intangibles and acts as a true distributor), purchasing finished goods from USP and selling the finished goods to unrelated customers. ▪ CFC does not provide any advertising or promotion activities, and does not have other lines of business activity other than distribution of goods purchased from USP. ▪ CFC pays USP for the finished goods and is using the CPM method for evaluating whether the purchase price is consistent with the arm’s length standard. ▪ USP prepared and provided contemporaneous IRC 6662 documentation (Transfer Pricing Study) to the Exam Team.

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Effective Tax Rate Overview

CPM Simple Distributor Outbound

ETR of Company

When a U.S. taxpayer transfers tangible property outside of the U.S. to a CFC for an amount inconsistent with the arm's length standard, the taxpayer's worldwide effective tax rate may decrease substantially. This occurs when the income from the tangible property is deemed to be permanently reinvested offshore for U.S. Generally Accepted Accounting Principles ("GAAP") financial statement purposes. If accumulated offshore earnings were to be repatriated back to the U.S. as a dividend, the accumulated offshore earnings would be subject to U.S. taxation.

ETR Impact of Adjustment

- A U.S. company's overall ETR is the aggregate "rate of tax accrued on its worldwide income" as the U.S. GAAP calculation of ETR is based on tax accrual not cash payment.
- In this IPS Unit example, the overall ETR may be reduced since income may be shifted to the CFC from the U.S.
- ETR would increase if an adjustment is made to increase the payment due from the CFC to the USP.

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Summary of Potential Issues

CPM Simple Distributor Outbound

<u>Issue 1</u>	Did the Taxpayer choose the correct Tested Party?
<u>Issue 2</u>	Did the Taxpayer select the appropriate Profit Level Indicator, PLI?
<u>Issue 3</u>	Did the Taxpayer select the appropriate comparables and make the appropriate adjustments to achieve comparability?
<u>Issue 4</u>	Did the Taxpayer use the appropriate financial data and assumptions?

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All Issues, Step 1: Initial Factual Development

CPM Simple Distributor Outbound

The Comparable Profits Method (“CPM”) is a common method for establishing an amount charged in a controlled transaction based on objective measures of profitability. The CPM is a specified transfer pricing method that compares the Taxpayer’s operating results with those of uncontrolled taxpayers.

Fact Element	Resources
<ul style="list-style-type: none"> ▪ Does Form 5471 represent that purchases are being made by the CFC from the USP? 	<ul style="list-style-type: none"> ▪ Form 5471 Information Return of U.S. Persons With Respect to Certain Foreign Corporations, Sch M, Line 14 (Purchases of tangible property from related parties) ▪ Mandatory Transfer Pricing Information Document Request (IDR)
<ul style="list-style-type: none"> ▪ Which entity did the Taxpayer choose as the Tested Party? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study ▪ Organizational Chart
<ul style="list-style-type: none"> ▪ What PLI was used: <ul style="list-style-type: none"> – Operating Margin – Berry Ratio – ROA – ROCE – Other 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study ▪ Transfer Pricing Roadmap ▪ IRM 4.46.3-5 Exhibit - Transfer Pricing Compliance Processes ▪ Checklist – IRC § 482 (Transfer Pricing) ▪ IRM 4.61.3 - Development of IRC 482 Issues

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

CPM Simple Distributor Outbound

The Comparable Profits Method (“CPM”) is a common method for establishing the amount charged in a controlled transaction based on objective measures of profitability. The CPM is a specified transfer pricing method that compares the Taxpayer’s operating results with those of uncontrolled taxpayers.

Fact Element	Resources
<ul style="list-style-type: none"> ▪ What comparables did the Taxpayer choose? ▪ Did the Taxpayer make adjustments either to the Tested Party or the comparables? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study ▪ Transfer Pricing Roadmap ▪ Financial Statements ▪ Capital IQ (permission to access this online service is required) ▪ Security and Exchange Commission (“SEC”) Filings

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Issue 1, Step 2: Review Potential Issues

CPM Simple Distributor Outbound

Issue 1

Did the Taxpayer choose the correct Tested Party?

Explanation of Issue	Resources
<p>The Tested Party, between the controlled taxpayers, is the entity with the most reliable data and requires the fewest number of adjustments. Reliable data should be available for uncontrolled transactions comparable to the Tested Party.</p> <p>Generally, the Tested Party will not own valuable intangible property or unique assets that would distinguish it from potential uncontrolled comparables. Moreover, the Tested Party is usually the least complex of the controlled taxpayers.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. § 1.482-5(b)(2)(i), <i>Tested Party in general</i> ▪ Transfer Pricing Functional Analysis Questionnaire


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Issue 1, Step 3: Additional Factual Development

CPM Simple Distributor Outbound

Issue 1

Did the Taxpayer choose the correct Tested Party?

Fact Element	Resources
<ul style="list-style-type: none"> ▪ What functions do the Tested Party and the controlled entity perform? ▪ What risks do the Tested Party and controlled entity assume? ▪ Does the Tested Party own any intangibles? Are any intangibles being transferred in the transaction? <p> CAUTION: It is important to do a functional analysis to make sure all controlled transactions are being compensated consistent with the arm's length standard.</p>	<ul style="list-style-type: none"> ▪ Request and/or Review the following: <ul style="list-style-type: none"> ▪ Organizational Chart ▪ Transfer Pricing Study ▪ Transfer Pricing Roadmap ▪ Transfer Pricing Functional Analysis Questionnaire ▪ Contracts between Controlled Parties ▪ Intercompany Agreements ▪ Invoices (sample relating to transaction)
<ul style="list-style-type: none"> ▪ Does the Tested Party have reliable financial data? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study ▪ Financial Statement Data ▪ General Ledger ▪ Trial Balance


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Issue 1, Step 4: Develop Arguments

CPM Simple Distributor Outbound

Issue 1

Did the Taxpayer choose the correct Tested Party?

Explanation of Approach	Resources
<p>Whether the Taxpayer chose the correct Tested Party or not is based on which controlled entity has the most reliable data and requires the fewest and least complex adjustments. Additionally, there must be reliable data regarding the uncontrolled comparables. Also, the Tested Party generally will not own any valuable intangible property or unique assets.</p> <p>For purposes of this IPS Unit, the Tested Party is determined to be the CFC distributor since it does not own any valuable intangible property or unique assets.</p> <p> CONSULTATION: If uncertain as to the choice of the Tested Party, please consult with an Economist, Transfer Pricing Practice Specialist, or International Issue Specialist (“IIS”).</p>	<p>Treas. Reg. § 1.482-5:</p> <ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-5(b)(2)(i), <i>Tested Party in general</i> ▪ Treas. Reg. 1.482-5(b)(2)(ii), <i>Adjustments for Tested Party</i>



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Issue 2, Step 2: Review Potential Issues

CPM Simple Distributor Outbound

Issue 2

Did the Taxpayer select the appropriate PLI?

Explanation of Issue	Resources
<p>The selected PLI should appropriately measure relationships between profits and costs incurred or resources employed based on:</p> <ul style="list-style-type: none"> ▪ the nature of the activities of the Tested Party; ▪ the reliability of the available data with respect to the uncontrolled comparables; and ▪ the extent to which the PLI is likely to produce a reliable measure of the income that the Tested Party would have earned had it dealt with uncontrolled taxpayers at arm's length, given the facts and circumstances. <p>In general, the most commonly used PLIs for distributors are the operating margin (Operating Profit/Net Sales) and the Berry Ratio (Gross Profit/Operating Expenses)</p> <p> CAUTION: Please be aware that if the Berry Ratio is used, misallocation of costs between COGS and operating expenses could skew the results.</p> <p> CONSULTATION: Please consult with an Economist or a Transfer Pricing Practice (TPP) Specialist if you have questions about PLI selection</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. § 1.482-5(b)(4), <i>Profit Level Indicators</i> ▪ APA Study Guide ▪ Charles H. Berry, “Berry Ratios: Their Use and Misuse,” <i>Journal of Global Transfer Pricing</i>, April-May 1999, reprinted by CCH Inc. ▪ A Comprehensive Look at the Berry Ratio in <i>Transfer Pricing</i> by Martin Przysuski and Srinilal Lalapet

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Issue 2, Step 3: Additional Factual Development

CPM Simple Distributor Outbound

Issue 2

Did the Taxpayer select the appropriate PLI?

Fact Element	Resources
<ul style="list-style-type: none"> ▪ What is the nature of the activities of the Tested Party? ▪ What PLI did the Taxpayer select? <ul style="list-style-type: none"> – Did Taxpayer choose the Operating Margin, the Berry Ratio or another ratio? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study ▪ Contracts between Controlled Parties ▪ Intercompany Agreements ▪ Transfer Pricing Functional Analysis Questionnaire ▪ SEC Reports ▪ Taxpayer’s Internet Site
<ul style="list-style-type: none"> ▪ If Taxpayer selected the Berry Ratio: <ul style="list-style-type: none"> – Is the Tested Party’s ratio of COGS to operating expense consistent with the same ratio of the comparables? – Determine whether there may be cost allocation issues between COGS and operating expenses (for example, are operating expenses improperly included in COGS). 	<ul style="list-style-type: none"> ▪ Trial Balance ▪ General Ledger ▪ Financial Statements ▪ Workpapers with Supporting Computations ▪ Capital IQ for comparable party data

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

CPM Simple Distributor Outbound

Issue 2

Did the Taxpayer select the appropriate PLI?

Fact Element	Resources
<ul style="list-style-type: none"> ▪ Is the computation of the PLI consistent with and clearly reflect the behavior of a party operating at arm's length? <ul style="list-style-type: none"> – Taxpayer's computation of operating profit should be consistent with U.S. Generally Accepted Accounting Principles ("GAAP"). – Comparison of operating profit, not taxable income, is performed. – Foreign based companies may use International Financial Reporting Standards ("IFRS") for their financial statements which may require some adjustments to U.S. GAAP comparable companies in some cases. – GAAP allows certain expenses to be categorized as COGS or operating expenses. Determine if cost categorization is consistent between the Tested Party and the comparables. 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study ▪ Capital IQ for Industry Reports

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Issue 2, Step 4: Develop Arguments

CPM Simple Distributor Outbound

Issue 2

Did the Taxpayer select the appropriate PLI?

Explanation of Approach	Resources
<p>A variety of PLIs can be calculated for any given case. Whether the use of a particular PLI is appropriate depends upon:</p> <ul style="list-style-type: none"> ▪ The nature of the activities of the Tested Party; ▪ The reliability of the available data with respect to the uncontrolled comparables; and ▪ The extent to which the PLI produces a reliable measure of profitability that would have resulted if the Tested Party operated at arm's length. <p>The PLI should be derived from a sufficient number of years of data to reasonably measure returns that accrue to uncontrolled comparables. Generally, such a period should, at a minimum, encompass the taxable year under review and the preceding two taxable years.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. § 1.482-5(b)(4), <i>Profit Level Indicators</i>


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

CPM Simple Distributor Outbound

Issue 2

Did the Taxpayer select the appropriate PLI?

Explanation of Approach	Resources
<p>You may want to use a second PLI as a validation of the results from the PLI selected by the Taxpayer. In many instances, transfer pricing studies will actually use a back up second method to validate the results.</p> <p> CONSULTATION: Consult with an Economist, Engineer, or the TPP if you have questions about the PLI selection and/or a corroborating method. An economist or engineer report should be referenced and incorporated into the Facts, Law and Analysis sections of your Notice of Proposed Adjustment (“NOPA”). Do not simply state “see attached report” in the NOPA.</p>	<p>Treas. Reg. § 1.482-5:</p> <ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-5(b)(4), <i>Profit Level Indicators</i> ▪ Treas. Reg. 1.482-5(b)(4)(iii), <i>Other Profit Level Indicators</i>

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Issue 3, Step 2: Review Potential Issues

CPM Simple Distributor Outbound

Issue 3

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

Explanation of Issue	Resources
<p>The CPM tests the Taxpayer's operating results with those of comparable entities. In order for the uncontrolled entity to be a reliable comparable, there must be sufficient similarity in the functions performed, contractual terms, risks assumed, economic conditions and property or services of the Taxpayer and the uncontrolled comparable. Thus, when selecting the CPM as the best method, the Taxpayer must demonstrate there are uncontrolled comparable entities.</p> <p>The Taxpayer may make adjustments for material differences between the controlled and uncontrolled transactions. Sales and purchase adjustments (often known as asset intensity or working capital adjustments) and adjustments for differences in interest rates are commonly made. These adjustments may be needed to improve the reliability of the results derived when applying the CPM.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. § 1.482-5(c), <i>Comparability and reliability considerations</i> ▪ Treas. Reg. §1.482-1(d), <i>Comparability</i> ▪ Capital IQ can be used to search for comparables ▪ IPS Unit: Comparability Analysis for Tangible Goods Transactions Outbound IO/9411_01 (2014)

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Issue 3, Step 3: Additional Factual Development

CPM Simple Distributor Outbound

Issue 3

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

Fact Element	Resources
<ul style="list-style-type: none"> ▪ Did the Taxpayer select the appropriate comparables based on: <ul style="list-style-type: none"> – Product/Industry codes (typically measured by Standard Industry Codes (“SIC”)); – Operating geography of the Tested Party; – Company independence; – Adequacy and accuracy of comparable data; and/or – Other criteria, for example, size of the company, R&D and advertising? ▪ Does the selection/rejection of comparables seem logical and rational? ▪ Request “Rejection Matrix” and “Elimination Companies” from Taxpayer to determine potentially comparable companies and why these companies were not selected as comparables. 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study ▪ Capital IQ, used to find comparables and get industry reports ▪ SIC–NAICS Bridge used to find comparables <ul style="list-style-type: none"> SIC Codes North American Industry Classification System (“NAICS”) Codes ▪ Transfer Pricing Roadmap ▪ IPS Unit: Comparability Analysis for Tangible Goods Transactions Outbound IS/9411_01(2014)

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

CPM Simple Distributor Outbound

Issue 3

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

Fact Element	Resources
<ul style="list-style-type: none"> ▪ Did the Taxpayer take into consideration and make the following adjustments if necessary: <ul style="list-style-type: none"> – Terms of Sale and Purchase (known as working capital adjustments); – Inventory Levels; – Accounts Receivable and/or Accounts Payable (known as asset intensity adjustments); and – Stock Based Compensation. ▪ Are other adjustments necessary? ▪ What effect do the adjustments have on the adjusted arm's length range? ▪ Do the adjustments make the data more reliable? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study ▪ Financial Statements ▪ Security and Exchange Commission ("SEC") Filings ▪ Capital IQ ▪ Workpapers with Supporting Computation ▪ Transfer Pricing Roadmap ▪ IPS Unit: Comparability Analysis for Tangible Goods Transactions Outbound IS/9411_01(2014)


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

CPM Simple Distributor Outbound

Issue 3

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

Fact Element	Resources
<ul style="list-style-type: none"> Did the Taxpayer make its asset intensity adjustments for differences using the prime rate, Libor, T-bill rates or some other appropriate rate? 	<ul style="list-style-type: none"> Transfer Pricing Study Workpapers with Supporting Computation
 <p>CONSULTATION: Consult with an Economist or the TPP Specialist if you have questions about the selection of the comparable set and/or asset intensity adjustments. The Economist can also assist with reviewing or calculating adjustments necessary to make the comparable data more reliable</p>	

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Issue 3, Step 4: Develop Arguments

CPM Simple Distributor Outbound

Issue 3

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

Explanation of Approach	Resources
<p>Uncontrolled entities engaged in comparable transactions under comparable circumstances are considered appropriate comparables. The uncontrolled entity does not need to be identical to the Taxpayer’s Tested Party, but must be sufficiently similar in terms of functions, risk and resources.</p> <p>Adjustments can be made to account for differences between the Tested Party and the comparables. However, it is possible that more adjustments will produce less reliable data and the comparable will be less “sufficiently similar” to the Tested Party.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. § 1.482-5(c)(2) ▪ Treas. Reg. § 1.482-1(d) ▪ Treas. Reg. § 1.482-5(c)(2)(iv)


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Issue 4, Step 2: Review Potential Issues

CPM Simple Distributor Outbound

Issue 4

Did the Taxpayer use the appropriate financial data and assumptions?

Explanation of Issue	Resources
<p>The CPM evaluates whether the amount charged in a controlled transaction is arm's length based on objective measures of profitability or PLIs derived from uncontrolled taxpayers who engage in similar business activities under similar circumstances.</p> <p>The two major factors which directly affect the quality of data and assumptions used to determine the reliability of operating profits are:</p> <ul style="list-style-type: none"> ▪ Consistency in accounting principles and ▪ Allocation of costs, income and assets. <p>The CPM focuses on operating profits rather than gross profits. CPM analyses are performed utilizing book income (financial statement income), not taxable income.</p> <p> CAUTION: Operating profit is gross profit less operating expenses, which is not the same as taxable income.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. § 1.482-5(c)(3), <i>Data and Assumptions</i> ▪ Treas. Reg. § 1.482-5(d)(3) and (4), Operating Expenses and Operation Profit Definitions

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Issue 4, Step 3: Additional Factual Development

CPM Simple Distributor Outbound

Issue 4

Did the Taxpayer use the appropriate financial data and assumptions?

Fact Element	Resources
<ul style="list-style-type: none"> ▪ Was there consistency in accounting principles between the Tested Party and the uncontrolled comparables? <ul style="list-style-type: none"> – Did the Tested Party and uncontrolled comparables use the same accounting methods? – Were the same multiple years used to evaluate the Tested Party and the uncontrolled comparables? – Did the Taxpayer use an interquartile range of results? – Were fiscal years properly aligned? – What adjustments were made to the Tested Party and/or to the accepted uncontrolled comparable companies? – Are the adjustments accurate and reliable? 	<p><i>Request and/or Review the following:</i></p> <ul style="list-style-type: none"> ▪ Transfer Pricing Studies including Exhibits detailing the comparable companies ▪ Financial Statements ▪ SEC Reports for Financial data ▪ Transfer Pricing Roadmap


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Issue 4, Step 3: Additional Factual Development (cont'd)

CPM Simple Distributor Outbound

Issue 4

Did the Taxpayer use the appropriate financial data and assumptions?

Fact Element	Resources
 <p>DECISION POINT: Were the allocations of costs, income and assets directly based on factual relationships? If not, were the allocations based on a reasonable allocation formula?</p> <ul style="list-style-type: none"> ▪ Were the costs, income and assets directly allocated, or were there indirect allocations or apportionments? <ul style="list-style-type: none"> – Did the Tested Party use segmented data? – Does the segmented data appear reasonable in light of the financials and unallocated residual costs? – Does the segmented data include the controlled transaction? – Is the composition of the Tested Party's operating expenses similar to that of the uncontrolled comparables (<i>i.e.</i>, is there consistency between the Tested Party and uncontrolled comparable regarding classifying items as COGS or operating expenses)? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Studies ▪ Financial Statements ▪ General Ledger ▪ Trial Balance ▪ Journal Entries ▪ Security and Exchange Commission ("SEC") Filings ▪ Capital IQ ▪ Workpapers for Supporting Computations ▪ Transfer Pricing Roadmap

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Issue 4, Step 4: Develop Arguments

CPM Simple Distributor Outbound

Issue 4

Did the Taxpayer use the appropriate financial data and assumptions?

Explanation of Approach

Whether the results derived from the application of the CPM are reliable depends on the quality of the data and assumptions utilized. Consistency in the accounting principles between the Tested Party and the uncontrolled comparables is needed.

In addition, if it is necessary to make an allocation of costs, income or assets between the relevant business activity and other activities of the Tested Party or uncontrolled comparables, such allocations should be directly based on factual relationships.

If taxpayer did not use appropriate financial data and assumptions, an adjustment to achieve an arm's length price should be considered.



CONSULTATION: Consult with an Economist, the TPP, or International Issue Specialist if you have questions determining if the allocations were based on a reasonable allocation formula.

Resources

- *Treas. Reg. § 1.482-5(c)(3), Data and Assumptions*

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Sales of Leases of Tangible Property/Goods	Outbound Distributor – Sales or Leases of Tangible Property/Goods	N/A

Training and Additional Resources

Chapter 1.5.1 Outbound Distributor - 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"> ▪ FY2012 Transfer Pricing Introduction to 482. ▪ FY2013 IRC 482 Overview. ▪ FY2012 Comparable Profits Method – High Value. ▪ FY2012 PLIs in a CPM World. 	<ul style="list-style-type: none"> ▪ Transfer Pricing Introduction to 482 (QRP785958). ▪ IBC IRC 482 OVERVIEW 50767 (HLL028040). ▪ IBC Comparable Profits Method 44755 (LHL430034). ▪ IBC PLIs in a CPM World (FPM304428).
Issue Toolkits	<ul style="list-style-type: none"> ▪ IRM 4.61.3-4 Functional Analysis Questionnaire Income Shifting Outbound, IPN Resources, Audit Tools ▪ Transfer Pricing Checklist, Income Shifting Outbound IPN, IPN Resources, Audit Tools ▪ IRM 4.61.3 Development of IRC section 482 Cases. 	<ul style="list-style-type: none"> ▪ Transfer Pricing Functional Analysis Questionnaire ▪ Checklist – IRC § 482 (Transfer Pricing) ▪ IRM 4.61.3 - Development of IRC 482 Issues

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Sales of Leases of Tangible Property/Goods	Outbound Distributor – Sales or Leases of Tangible Property/Goods	N/A

Training and Additional Resources (cont'd)

Chapter 1.5.1 Outbound Distributor - Sales or Leases of Tangible Property/Goods

Type of Resource	Descriptions and/or Instructions for Accessing	References
Podcasts / Videos	<ul style="list-style-type: none"> ▪ CENTRA-FY2011 International CPE–Risk and Comparability. ▪ CENTRA-FY2011 International CPE–Economic Analysis. 	
Other Training Materials	<ul style="list-style-type: none"> ▪ International Examiner Phase III Training, Module E-1, Overview of IRC 482. ▪ International Examiner Phase II Training, Lesson 3, Controlled Services Transactions. ▪ Economist Phase V Training – Legal Matters ▪ APA Study Guide. ▪ Charles H. Berry, “Berry Ratios: Their Use and Misuse,” Journal of Global Transfer Pricing, April-May 1999, reprinted by CCH Inc. ▪ Transfer Pricing Roadmap. ▪ Bittker and Lokken, Chapter 79: Reallocation of Income and Deductions. ▪ OECD Transfer Pricing Guidelines. 	<ul style="list-style-type: none"> ▪ Overview of IRC 482 ▪ Controlled Services Transactions ▪ 2012 (TPO) Economist Phase V Training-Legal Matters (Transfer of Intangibles Off-shore) ▪ APA Study Guide ▪ Berry Ratios ▪ Transfer Pricing Roadmap ▪ Bittker and Lokken, Fundamentals of International Taxation, Chapter 79 ▪ OECD Transfer Pricing Guidelines

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Glossary of Terms and Acronyms

Acronym	Definition
APMA	Advance Pricing and Mutual Agreement Program
CFC	Controlled Foreign Corporation
COGS	Cost of Goods Sold
CPE	Certified Professional Education
CPM	Comparable Profits Method
CUP	Comparable Uncontrolled Price
FP	Foreign Parent
GAAP	Generally Accepted Accounting Principles
IBC	International Business Compliance
IFRS	International Financial Reporting Standards
IIS	International Issue Specialist
IPN	International Practice Network
IPS	Issue Practice Service
IRC	Internal Revenue Code
IRM	Internal Revenue Manual

Volume	Part	Chapter	Sub-Chapter
Outbound Income Shifting	Sales of Leases of Tangible Property/Goods	Outbound Distributor – Sales or Leases of Tangible Property/Goods	N/A

Glossary of Terms and Acronyms (cont'd)

Acronym	Definition
IRS	Internal Revenue Service
ISI	Income Shifting Inbound
ISO	Income Shifting Outbound
LB&I	Large Business & International
NAICS	North American Industry Classification System
NOPA	Notice of Proposed Adjustment
OECD	Organisation for Economic Co-operation and Development
PLI	Profit Level Indicator
SEC	Securities and Exchange Commission
SIC	Standard Industry Classification
TPD	Transfer Pricing Documentation
TPM	Transfer Pricing Method
TPP	Transfer Pricing Practice
U.S.	United States
USP	United States Parent

Volume	Part	Chapter	Sub-Chapter
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Index of Related Issues

Issue	Associated UIL(s)	References
Comparability	▪ 9411	IPS Unit: Comparability Analysis for Tangible Goods Transactions Outbound, PUO/V_1_01(2014)
Functional Analysis	▪ 9411	IPS PUO: Functional Analysis for Tangible Goods Transactions-Outbound , PUO/V_1_01(2014) Coming Soon
Transfer Pricing Documentation	▪ 9411	IPS PUO: Review of Transfer Pricing Documentation for Inbound Taxpayers, PUO/P_1_07_02(2014) Coming Soon
Competent Authority	▪ 9411	IPS PUO: Competent Authority and Rev. Proc. 2006-54, ISO/PUO/V_1_07_03(2014) Coming Soon
Controlled Transactions	▪ 9411.07	IPS CU: Controlled Transactions for IRC 482-Outbound, ISO/CU/V_1_02(2014) Coming Soon
Core 482 Outbound	▪ 9411.07	IPS Unit: Overview of IRC Section 482, DCN: ISI/9411.07_01(2013)
Resale Price Method Simple Distributor	▪ 9422.07	IPS Unit: Inbound Resale Price Method Routine Distributor, ISI/9422.07_04(2013)
Tangible Goods-Inbound CUP	▪ 9422.07	IPS Unit: Sale of Tangible Goods from a CFC to a USP CUP Method, ISI/9422.07_05(2013)
CPM-Simple Distributor Inbound	▪ 9422.07	IPS Unit: CPM Simple Distributor Inbound, DCN: ISI/9422.07_07(2013)

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Index of Other Related Issues (cont'd)

Issue	Associated UILs	References
3 Requirements of IRC 482	▪ 9422.09	IPS Unit – Three Requirements of IRC 482, ISI/9422.09_02(2013)
Arm's Length Standard	▪ 9422.09	IPS Unit: Arms Length Standard, ISI/9422.09_06(2013)
Rev. Proc. 99-32	▪ 9422.09	IPS Unit: Revenue Procedure 99-32 Guidance, ISI/9422.09_08(2013) Coming Soon
MAP Procedural Issues	▪ 9450.12	IPS Unit Coming Soon
Exchange of Information	▪ 9450.13	IPS Unit Coming Soon
Treaty-based EOI	▪ 9460.01	IPS Unit Coming Soon
Penalties-Substantial	▪ 9560.11	IPS Unit Coming Soon
Penalties-Gross	▪ 9560.12	IPS Unit Coming Soon