Register in accordance with 5 U.S.C. 552(a) and 1 CFR part 51. Copies may be obtained from Shorts Brothers, PLC, 2011 Crystal Drive, Suite 713, Arlington, Virginia 22202–3719. Copies may be inspected at the FAA, Transport Airplane Directorate, 1601 Lind Avenue, SW., Renton, Washington; or at the Office of the Federal Register, 800 North Capitol Street, NW., suite 700, Washington, DC.

(f) This amendment becomes effective on February 25, 1993.

Issued in Renton, Washington, on December 18, 1992.

Bill R. Boxwell,

Acting Manager, Transport Airplane Directorate, Aircraft Certification Service.

[FR Doc. 93–1357 Filed 1–19–93; 8:45 am]

BILLING CODE 4910–13–M

NATIONAL AERONAUTICS AND SPACE ADMINISTRATION

14 CFR Part 1203b

RIN 2700–AA80

Security Programs; Arrest Authority and Use of Force by NASA Security Force Personnel

AGENCY: National Aeronautics and Space Administration (NASA).

ACTION: Final rule.

SUMMARY: This document amends agency regulations on security programs to comply with the changes identified by the General Counsel and the Inspector General and approved by Attorney General William P. Barr. This regulation implements section 304(f) of the National Aeronautics and Space Act of 1958, as amended (42 U.S.C. 2456a), by establishing guidelines for the exercise of arrest authority and for the exercise of physical force, including deadly force, in conjunction with such arrest authority.

EFFECTIVE DATE: January 21, 1993.

FOR FURTHER INFORMATION CONTACT: John C. Hagen, 202–358–2312.

SUPPLEMENTARY INFORMATION: On February 11, 1992, NASA published its final rule, 14 CFR part 1203b, "Security Programs; Arrest Authority and Use of Force by NASA Security Force Personnel," in the **Federal Register** (57 FR 4926). This amendment changes paragraph 1203b(a)(3) concerning the issue of weapons being aimed to disable, and makes administrative, editorial changes to paragraphs 1203b.107(c)(1) and 1203b.108(d)(2).

NASA has determined that:

1. This rule is not subject to the requirements of the Regulatory Flexibility Act, 5 U.S.C. 601–612, since it will not exert a significant economic impact on a substantial number of small business entities.

2. This rule is not a major rule as defined in Executive Order 12291.

List of Subjects in 14 CFR Part 1203b

Security programs, Arrest authority, Use of force.

PART 1203B—SECURITY PROGRAMS; ARREST AUTHORITY AND USE OF FORCE BY NASA SECURITY FORCE PERSONNEL

For reasons set forth in the Preamble, 14 CFR part 1203b is amended as follows:

1. The authority citation for 14 CFR part 1203b continues to read as follows:

Authority: Sec. 304(f) of the National Aeronautics and Space Act of 1958 (42 U.S.C. 2456a).

2. Section 1203b.107 is amended by revising paragraphs (a)(3) and (c)(1) to read as follows:

§ 1203b.107 Use of firearms.

* * * * *

(a) * * *

(3) Shoot to stop.

* * * * *

(c) * * *

(1) The incident shall be reported to the Installation Chief of Security who, in turn, will report it to the NASA Security Office as expeditiously as possible, with as many details supplied as are available.

(3) Section 1203(b).108 is amended by revising paragraph (d)(2) to read as follows:

§ 1203b.108 Management oversight.

* * * * *

(d) * * *

(2) Require security force officers exercising arrest authority to requalify semiannually with their assigned firearms; and

* * * * *

Dated: January 6, 1993.

Daniel S. Goldin,

Administrator.

[FR Doc. 93–1211 Filed 1–19–93; 8:45 am]

BILLING CODE 7510–01–M

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1 and 602

[T.D. 8470]

RIN 1545–AR21

Intercompany Transfer Pricing Regulations Under Section 482

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary Income Tax Regulations relating to intercompany transfer pricing under section 482 of the Internal Revenue Code. The Tax Reform Act of 1986 amended section 482. These regulations provide guidance implementing the amendment.

EFFECTIVE DATE: April 21, 1993.

FOR FURTHER INFORMATION CONTACT: Sim Seo of the Office of Associate Chief Counsel (International), Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224, Attention: CC:CORP:T:R (INTL–0401–88) (202–622–3840, not a toll-free call).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under control number 1545–1369. The estimated annual burden per respondent/recordkeeper varies from .5 hours to 10 hours, depending on individual circumstances, with an estimated average 5.25 hours.

These estimates are approximations. They are based on such information as is available to the Internal Revenue Service. Individual respondents/recordkeepers may require greater or less time, depending on their particular circumstances.

For further information concerning this collection of information, and where to submit comments on this collection of information, the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble in the cross-reference notice of proposed rulemaking published in the Proposed Rules section of this issue of the **Federal Register**.

Background

This document contains temporary regulations amending the Income Tax Regulations (26 CFR part 1) under section 482 of the Internal Revenue Code. Section 482 was amended by the Tax Reform Act of 1986, Public Law 99–514, 100 Stat. 2085, 2561, *et seq.* Proposed regulations under section 482 were issued on January 30, 1992 (INTL–0372–88; INTL–0401–88, 57 FR 3571).

Need for Temporary Regulations

The provisions contained in this Treasury decision are needed immediately to provide guidance to the public with respect to intercompany transfer pricing under section 482. Therefore, it is found impracticable and contrary to the public interest to issue this Treasury decision with prior notice under section 553(b) of title 5 of the United States Code.

Explanation of Provisions

Introduction

The Tax Reform Act of 1986 (the Act) amended section 482 to require that consideration for intangible property transferred in a controlled transaction be commensurate with the income attributable to the intangible. The legislative history of the Act states that the change was intended to assure that the division of income between related parties reasonably reflects the economic activities that each undertakes. See H.R. Rep. 99–281, 99th Cong., 2d Sess. (1986) at II–637. The legislative history also expresses concern that insufficiently stringent standards had been used in determining whether an uncontrolled transfer is comparable to a controlled transfer. The legislative history specifically notes concern about the improper use of comparables with regard to "high-profit" potential intangibles, noting that it is especially difficult to obtain realistic comparables with respect to such intangibles because they seldom if ever are transferred to unrelated parties. See H.R. Rep. 99–426, 99th Cong., 1st Sess. (1985) at 424.

The White Paper

The Conference Committee report on the Act recommended that the Internal Revenue Service (the Service) conduct a comprehensive study of transfer pricing and consider whether regulations under section 482 should be "modified in any respect." In response, the Treasury Department and the Service issued a study of intercompany pricing (Notice 88–123, 1988–2 C.B. 458) on October 18, 1988 (the White Paper). Although the White Paper primarily addressed transfers of intangible property, it also addressed the application of section 482 to other types of transactions.

The White Paper proposed two approaches for determining an arm's length charge for intangible property in light of the commensurate with income standard. The first was a pricing approach that relied on two types of comparable transactions: the exact comparable method and the inexact comparable method. The second approach was an income-based approach that included two methods: the basic arm's length return method (the BALRM) and BALRM with profit split. The BALRM generally allocated income to the parties to a controlled transaction by assigning industry average returns to the assets and functions that the parties devoted to the business activity connected with the controlled transaction. In cases involving the exploitation of so-called "high-profit" intangibles, any residual profit would be divided among the parties on the basis of an estimate of the relative values of the intangibles that each contributed to the activity.

Many comments on the White Paper criticized the BALRM, arguing that the information needed to apply it generally would be unavailable, would be unfair to corporations whose returns vary considerably from the average, and would allocate too much income to U.S. entities. The Service also was urged to assign a greater role to inexact comparables and to reconsider the use of safe harbor rules.

The Proposed Regulations

In response to the comments received on the White Paper, the Internal Revenue Service issued proposed regulations under section 482 on January 30, 1992 (INTL–0372–88; INTL–0401–88, 57 FR 3571) (the proposed regulations). The proposed regulations proposed four major changes in the current regulations under section 482: That the scope and purpose of the regulations be modified to reflect the legislative changes to section 482; that new rules with respect to intangible property transfers be implemented; that the rules with respect to tangible property transfers be modified; and that detailed new cost-sharing regulations be introduced. The most significant change to the tangible and intangible property rules was the introduction of a new pricing method known as the comparable profit interval.

As part of the recommended changes to the scope and purpose of the regulations, the proposed regulations included a statement that a broad principle to be applied in all cases was whether uncontrolled taxpayers exercising sound business judgment would have agreed to the same terms in the same circumstances. In particular, the proposed regulations provided that so-called "round-trip" transactions (an integrated series of controlled transactions in which intangible property is licensed to an affiliate and the affiliate uses the intangible to produce tangible property for sale back to the licensor or another affiliate) be analyzed together.

The existing regulations (§ 1.482–2(d)) contain two approaches for determining an arm's length consideration for intangible property. The preferred approach is based on the comparable uncontrolled price method set forth in the tangible property rules, and the second is based on an analysis of twelve factors. The proposed regulations recommended that these rules be replaced with three new methods: The matching transaction method (the MTM), the comparable adjustable transaction method (the CATM), and the comparable profits method (the CPM).

A controlled transaction would satisfy the MTM if there was an uncontrolled transfer of the same intangible under the same, or substantially similar, economic conditions and contractual terms. This standard represented a tightening of the standards of comparability under the analog to the comparable uncontrolled price method of the existing regulations.

A controlled transaction would satisfy the CATM if there was an uncontrolled transfer of the same or a similar intangible under "adjustable" circumstances. Adjustments to the contractual terms and economic circumstances would be allowed if the effect of any differences could be determined with reasonable accuracy. In addition, the result of the controlled transaction was subject to verification by application of the Comparable Profit Interval (the CPI).

Under the CPM, the operating income resulting from the consideration charged in a controlled transaction (reported operating income) was compared with the reported operating incomes of similar uncontrolled taxpayers. The consideration charged in the controlled transaction would be considered arm's length if the taxpayer's reported operating income fell within the "comparable profits interval" (CPI).

The CPI was constructed in steps. First, "profit level indicators" (*e.g.*, rate of return on assets) for uncontrolled taxpayers in the applicable business classification of the controlled taxpayer were determined and applied to the controlled taxpayer's financial data for a period of three years to compute constructive operating incomes (COIs)

for the controlled taxpayer. The COIs that tended to converge comprised the CPI. If a taxpayer's actual results fell outside the CPI, the taxpayer generally was subject to adjustment to a point within the CPI known as the "most appropriate point." Relatively little guidance was provided with respect to determining the constructive operating incomes that converged to form the CPI and to determining the most appropriate point.

Unless one of three narrow exceptions applied, the proposed regulations implemented the commensurate with income standard of the Act by providing that these three methods could be applied to adjust the consideration charged for an intangible in the year of examination despite the fact that the same consideration may have been determined to be arm's length for an earlier taxable year.

The proposed regulations also modified the rules with respect to transfers of tangible property (§ 1.482–2(e)). The principal change was to require that results obtained from the application of the resale price method, the cost-plus method and so-called fourth methods fall within the CPI. This change was made in order to eliminate the need to allocate the value of an item of tangible property between its tangible and intangible components when such property contained elements of both types of property.

Finally, the proposed regulations altered the priority of methods under both the tangible and intangible property rules. While preserving a fixed priority of methods, the proposed regulations stated that it was not necessary to disprove the applicability of a method before applying a lower-priority method. Either the Service or the taxpayer could, however, subsequently establish that a higher-priority method applied and thereby override the results obtained under the lower-priority method.

The Service received numerous comments on the proposed regulations. In addition to receiving helpful comments from a large number of taxpayers and industry or professional groups, the Service received constructive comments from several tax treaty partners, both from individual countries and through such international fora as the Organization for Economic Cooperation and Development.

Commenters criticized several aspects of the proposed regulations. Many criticized the requirement that the results obtained under all methods except for exact comparable fall within the CPI, based on the view that such a requirement would elevate the CPM to equal or greater priority than the more traditional transaction-based methods such as the resale price method. Many commenters felt that elevating CPM to such a high level of priority was inconsistent with the arm's length standard. Other commenters criticized the very tight standards of comparability under the MTM, the narrow scope of the exceptions to the periodic adjustment rule, the degree of knowledge imputed to taxpayers under the sound business judgment rule, the relationship between the tangible and intangible property rules, the lack of guidance with respect to determining convergence and the most appropriate point under the CPM, and the failure to provide a safe harbor. Commenters generally praised the introduction of a range of acceptable results and the use of multi-year averages under the CPI, as well as the relaxation of the strict priority of methods under the existing regulations. Further description of the comments received is set forth in the discussion below.

Provisions of the Temporary Regulations

Section 1.482–1T

The scope and purpose provisions have been reorganized to make clear that the arm's length standard is the guiding principle for all allocations under section 482, and to provide additional guidance for determining comparability under the arm's length standard. Section 1.482–1T(a)(1) reaffirms that the purpose of section 482 is to ensure that taxpayers clearly reflect their income by placing a controlled taxpayer on a tax parity with an uncontrolled taxpayer by determining the controlled taxpayer's true taxable income. Section 1.482–1T(a)(2) authorizes the district director to allocate income, deductions, credits, allowances, basis, or any other item or element affecting taxable income among a group of controlled taxpayers when they have not reflected their true taxable income. Section 482–1T(a)(3) provides, as do the current regulations, that only the district director may apply the provisions of section 482, but clarifies that this restriction does not limit the taxpayer's ability to report its true taxable income. It has been asserted in the past that taxpayers were not permitted to report results that differed from transactional results in order to reflect an arm's length result on the tax return. A taxpayer's ability to report results that differ from its transactional results may be limited, however, by section 1059A.

Section 1.482–1T(b) summarizes several key principles that guide the application of section 482. These principles are summarized in this portion of the regulation because they are relevant under subsequent provisions. More specific guidance is provided under such subsequent provisions.

Section 1.482–1T(b)(1) reaffirms that in determining a taxpayer's true taxable income, the standard to be applied is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer (the arm's length standard). In this respect the regulations are consistent with the current regulations and reflect many comments on the proposed regulations, which stressed the importance of adhering to the arm's length standard. The arm's length standard is satisfied if the results of controlled transactions are consistent with the results that would have been realized had uncontrolled taxpayers engaged in a comparable transaction under comparable circumstances. Guidance for determining comparability of an uncontrolled transaction is provided in § 1.482–1T(c), discussed below.

Section 1.482–1T(b)(2) provides rules for determining the method or methods that will be applied in a particular case to test whether transactions between controlled taxpayers are at arm's length. First, § 1.482–1T(b)(2)(ii) provides that for some transactions it may be necessary to apply different methods to related transactions where such transactions are most reasonably tested on a separate basis (such as services and property).

Second, § 1.482–1T(b)(2)(iii)(A) provides a "best method rule" for selecting the method to be applied to test the arm's length character of a controlled transaction. In response to comments, the strict priority of methods in the proposed and current regulations has been abandoned. Rather, a much more flexible approach has been adopted. While the problems with a strict priority of methods are acknowledged, the drawbacks of such rigidity must be balanced against the need to provide some guidance as to which methods are most appropriate for particular cases. The best method rule attempts to achieve this balance by recognizing that the method that provides the most accurate determination of an arm's length result will vary depending upon the facts and circumstances of the transaction under review. In considering which method provides the best measure of an arm's length result, factors to be considered include the completeness and accuracy of the available data, the degree of

comparability between controlled and uncontrolled transactions, and the extent of adjustments necessary to apply the method. While the best method rule provides that any available method may be employed to determine an arm's length result without first disproving the applicability of other methods, if it subsequently is demonstrated that under the facts and circumstances another method provides a more accurate determination, the district director must apply such method. Further guidance concerning the circumstances under which particular methods may apply is provided under the provisions describing each method.

In addition, § 1.482–1T(b)(2)(iii)(B) provides for the application of the best method rule when two or more methods produce inconsistent results. If the best method rule does not clearly indicate the preferred method, this paragraph provides that an additional factor to be considered in selecting a method is whether any of the competing methods produce results that are consistent with results obtained under another appropriate method. A similar analysis applies when two or more applications of the same method produce different results.

Section 1.482–1T(c) provides general guidance for determining comparability. General guidance on comparability is provided in this portion of the regulation because the factors set forth in this section are applicable under all the methods. Section 1.482–1T(c)(1)(i) provides that under all methods an arm's length result generally is estimated based on data derived from comparable uncontrolled taxpayers. In determining whether controlled and uncontrolled taxpayers are comparable, functions, risks, contractual terms, economic conditions, and property or services normally must be compared.

Section 1.482–1T(c)(1)(ii) provides that the relative importance of these factors depends on the method applied, because some methods emphasize product comparability, others emphasize functional comparability, and others emphasize broad similarity in terms of products and functions while comparing financial returns.

Section 1.482–1T(c)(2)(i) provides that for two transactions to be comparable, they do not need to be identical, but only must be sufficiently similar that the uncontrolled transaction provides a reasonable and reliable benchmark for estimating an arm's length result. When there are differences between uncontrolled and controlled transactions, § 1.482–1T(c)(2)(ii) permits a reasonable number of adjustments to account for differences between the transactions if they have a definite and reasonably ascertainable effect on the result. If such adjustments cannot be made (either because of a lack of data or the extent of the adjustments renders them unduly speculative), the uncontrolled transaction normally cannot serve as a comparable transaction. Finally, § 1.482–1T(c)(2)(iii) emphasizes that these general standards of comparability are subject to modification under each method.

Section 1.482–1T(c)(3) describes the factors for determining comparability in more detail. The first factor discussed is functions. A functional analysis compares the activities performed by the parties to two transactions. For two transactions to be comparable, the parties normally should perform the same functions with respect to the transactions. A list of functions that normally must be considered is provided.

The second factor that must be considered is risk. For two transactions to be comparable, the risks borne by the parties to each transaction should be similar. Allocation of risk is potentially subject to manipulation by controlled taxpayers, who may purport to allocate risk inconsistently with the substance of their transactions. Accordingly, § 1.482–1T(c)(3)(ii)(B) provides that with respect to adequately documented risk (as described in § 1.482–1T(c)(3)(ii)(C)), the allocation will be subject to review under the following factors: whether the risks assumed are commensurate with the potential economic benefit from the controlled transaction; whether the controlled taxpayer's capacity to absorb losses attributable to the risk is proportionate to the risk; and whether the controlled taxpayer is engaged in the active conduct of a trade or business to which the risk relates and exercises control over the activities that influence the amount of income or loss to be realized from the controlled transaction. These factors are intended to ensure that a controlled taxpayer only will be considered to have assumed a risk in cases where the economic substance of the transaction is consistent with the assumption of such risk. Section 1.482–1T(c)(3)(ii)(C) provides that, with the exception of routine risks (such as those assigned by operation of the Uniform Commercial Code), the district director may disregard a purported allocation of risk unless the taxpayer executed documentation substantiating the asserted allocation of risk, before the result of the risk was known or reasonably knowable, and the actual conduct of the taxpayers was consistent with such allocation. Finally, § 1.482–1T(c)(3)(ii)(D) provides that risks must be allocated consistently from year to year, so that, for example, a risk that causes a taxpayer to earn a below average return in the early years of an activity will tend to cause above average returns in subsequent years for the same taxpayer. It would not be consistent with the arm's length standard for a party to bear a risk when that risk is most likely to cause losses, and then not to derive the subsequent returns attributable to the assumption of the risk in the preceding years.

The third factor is contractual terms. For two transactions to be comparable, the contractual terms that would affect the prices charged should be comparable.

Fourth, § 1.482–1T(c)(3)(iv) provides that the economic conditions surrounding the two transactions also should be similar. Among the economic conditions that must be considered are the realistic alternatives to the actual transactions that were available to the parties. The treatment of alternatives is addressed in more detail in § 1.482–1T(d)(2)(ii), which is discussed below.

Fifth, § 1.482–1T(c)(3)(v) provides that various degrees of similarity between the products or services that are the subject of the controlled and uncontrolled transactions are required under the various methods, and more specific guidance is provided under those methods.

Section 1.482–1T(c)(4) describes special circumstances that require analysis in addition to that described in § 1.482–1T(c)(3) to determine comparability. First, § 1.482–1T(c)(4)(i) provides that in certain cases the arm's length charge may, for a limited time, differ from that charged in an otherwise comparable uncontrolled transaction because the parties in the controlled transaction have agreed to a market penetration strategy. Next, § 1.482–1T(c)(4)(ii)(A) provides rules for making allocations when the controlled taxpayers operate in different geographic markets than the uncontrolled taxpayers. Adjustments reflecting the effect of such differences may be made to the extent information permitting such adjustments is available, and if not, then information from uncontrolled taxpayers operating in the most similar market for which information is available must be used. Finally, in cases where the controlled taxpayer realizes "location savings" from operating in a low-cost jurisdiction and the uncontrolled taxpayers do not realize such savings, § 1.482–1T(c)(4)(ii)(B) provides that the adjustments to make the two transactions comparable must reflect the allocation of location savings that would

occur between unrelated parties, taking into account competitive conditions in the low-cost market; the effect of such competition may be that all or a portion of the location savings might inure to the benefit of the other party to the controlled transaction.

Sections 1.482–1T(c)(4) (iii) and (iv) relates to isolated transactions and mineral transactions, respectively, and are consistent with guidance provided in the current regulations.

Section 1.482–1T(d) describes the scope of review under section 482. Consistent with the current regulations, this section provides that a section 482 allocation may be made whenever the taxable income of a controlled taxpayer differs from what it would have been had the controlled taxpayer been dealing at arms length with an uncontrolled party. More specifically, § 1.482–1T(d)(1)(i) provides that the district director is not limited to cases in which the taxpayer intentionally distorted its taxable income, and § 1.482–1T(d)(1)(ii) provides that the district director may make an allocation even if the ultimate income anticipated (by any party to the controlled transaction) from a series of transactions is not realized. Sections 1.842–1T(d)(1)(iii) and (iv) relate to the interactions between section 482 and the nonrecognition and consolidated returns provisions, respectively, and are consistent with guidance set forth in the current regulations.

Section 1.482–1T(d)(2) provides several limitations on adjustments. Section 1.482–1T(d)(2)(i)(A) provides that no allocation will be made when the controlled taxpayer's results fall within a range of arm's length results (the "arm's length range") derived from two or more applications of the same pricing method to different uncontrolled comparables. This rule responds to comments that were received with respect to the CPM under the proposed regulations, in which many commenters approved of the recognition of a range of arm's length results rather than a single arm's length price. It was felt that requiring a single precise result was inconsistent with the fact that the various methods were not always precise measures of an arm's length result, and ignored the economic fact that there often will be more than one arm's length price. The temporary regulations therefore extend the use of a range to all methods. To form a part of the range, however, each application of the applicable pricing method must independently satisfy the criteria for the application of that method and the general comparability standards under § 1.482–1T(c)(2). With the exception of the comparable profit method, there is no limitation on the extent of the range, although a wide range may suggest that insufficient adjustments have been made for differences between the controlled and uncontrolled transactions.

Section 1.482–1T(d)(2)(i)(C) provides that results falling outside the arm's length range may be adjusted to any point in the range, and ordinarily will be adjusted to the midpoint of the range. Section 1.482–1T(d)(2)(i)(D) states that the district director may properly propose an allocation based on a single comparable uncontrolled price. However, if the taxpayer subsequently demonstrates that its results are within a range established by additional comparable transactions, then no allocation will be made.

Section 1.482–1T(d)(2)(ii) provides that it is not necessary for the district director to determine whether the method that a taxpayer employs to determine the amounts charged in its controlled transactions correspond to the method that the taxpayer might have used in uncontrolled transactions. The only relevant consideration is whether the results of those transactions is arm's length, as determined under one of the prescribed methods.

Section 1.482–1T(d)(3) provides guidelines for allocations under section 482. Section 1.482–1T(d)(3)(i) provides that multiple transactions (generally within the same product grouping) may be aggregated for purposes of determining an arm's length result when they are so interrelated that it is necessary to view them as a whole. Section 1.482–1T(d)(3)(ii) provides that the terms of contractual arrangements will be respected as long as the parties' conduct is consistent with such terms. In addition, when no written agreement exists, but the conduct of taxpayers is consistent with an agreement in substance, the district director may conclude that if such parties were unrelated they would have executed an agreement, and therefore may give effect to such an agreement in determining an arm's length result. This section responds to comments indicating that the proposed regulations gave the district director too much latitude to disregard the existence of contracts between controlled taxpayers, by clarifying that such contracts will only be disregarded when the parties themselves do not in economic substance adhere to their terms.

Section 1.482–1T(d)(3)(iii) provides that the district director ordinarily will evaluate controlled transactions based on the structure of the actual transaction, and will not treat the transaction as if it were structured differently. The district director, may, however, consider the alternatives that were available to the taxpayer in determining whether the terms of the controlled transaction would be acceptable to an uncontrolled taxpayer faced with alternatives similar to those that the controlled taxpayer faced.

This analysis is central to the arm's length standard and the traditional notion of comparability. For example, under the comparable uncontrolled price method, the objective is to identify an alternative price at which the taxpayer could have conducted the controlled transaction. This section merely broadens this traditional analysis by permitting examination of other alternatives when the controlled taxpayer has the option of internally obtaining the goods or services that it obtained in the controlled transaction. In such a case, an otherwise acceptable comparable transaction may not provide a reliable measure of an arm's length result if the controlled taxpayer could have obtained the object of the controlled transaction more cheaply by obtaining it from internal sources. This approach duplicates the analysis that an uncontrolled taxpayer would employ in considering whether to obtain a product from an unrelated party or to produce the product itself, and the amount that it would be willing to pay an unrelated supplier of that product. This section responds to comments on the provisions of the proposed regulations indicating that the district director was authorized to impose his own judgment on taxpayers after the fact and to restructure transactions based on perfect *ex post* knowledge of the results of a series of transactions. This provision significantly limits the ability of the district director to examine alternative, generally limiting such authority to permit examination of alternatives only for the purpose of determining an arm's length price.

Section 1.482–1T(d)(3)(iv) provides that the district director will ordinarily evaluate the results of controlled transactions based on data from uncontrolled taxpayers attributable to the same period as the controlled transactions. The district director may, however, use data from different years under certain specified conditions. Data from multiple years also may be relevant for purposes of certain enumerated provisions. If data from other years is employed, such data should be compared to the controlled taxpayer's results from the same years. Section 1.482–1T(d)(3)(iv)(C) provides that the district director may examine results from other years to determine

whether the same economic conditions that caused the uncontrolled taxpayer's result also caused the controlled taxpayer's result. For example, in cases where a controlled taxpayer realizes a loss from a controlled transaction, the taxpayer may seek to demonstrate that the loss is within the arm's length range, based upon losses realized by comparable uncontrolled taxpayers. The district director may consider data from other taxable years to determine whether the same conditions that caused the controlled taxpayer's loss also had a similar effect on the uncontrolled taxpayers. If the controlled taxpayer consistently realized losses from year to year, and the uncontrolled taxpayers with losses on average are profitable over a period of years, then the transactions may not be considered to be sufficiently comparable.

Section 1.482–1T(d)(3)(v) permits evaluation of product lines and statistical groupings in a manner analogous to that permitted under the current regulations.

Section 1.482–1T(e) provides procedural rules with respect to collateral adjustments arising as a result of a section 482 allocation. Such adjustments include compensating, correlative and conforming adjustments.

Section 1.482–1T(e)(2) defines a compensating adjustment as an adjustment made to reflect an arrangement between controlled taxpayers for reimbursement or other payments. The arrangement will be given effect if it is written, it provides for adjustments as necessary to ensure that the controlled transactions produce arm's length results, and the adjustments are made before the filing of the controlled taxpayer's timely U.S. income tax return. The adjustment accrues to the recipient as of the earlier of the date of payment or the last day of the taxable year to which it relates. Finally, § 1.482–1T(e)(2)(iii) provides an anti-abuse rule.

Section 1.482–1T(e)(3) provides guidance on correlative adjustments that is generally consistent with the guidance set forth in the current regulations.

Section 1.482–1T(e)(4), relating to conforming adjustments, provides that the Commissioner may provide revenue procedures under which the district director may permit adjustments to conform a taxpayer's accounts to an adjustment under section 482.

Section 1.482–1T(e)(5) provides rules relating to setoffs that are similar to those provided in the current regulations.

In response to many comments requesting that a safe harbor be included in the regulations, § 1.482–1T(f)(1) provides a safe harbor under section 482. A safe harbor has been provided for taxpayers that have relatively small levels of controlled transactions. While taxpayers electing this safe harbor would face a much reduced compliance burden, some taxpayers may find that the results they achieve under the safe harbor are somewhat less favorable than they could have achieved if they did not elect the safe harbor, and others might achieve a more favorable result, reflecting the consequences of a less flexible but more certain rule.

This provision provides that an electing controlled taxpayer will not be subject to an adjustment under section 482 if its taxable income is determined in accordance with published measures of profitability, and the taxpayer complies with various procedural rules. To be eligible for the safe harbor, either the U.S. party or the foreign counterpart to a cross border controlled transaction must have less than $10 million in gross receipts for the year at issue. For this purpose, all U.S. affiliates must be aggregated with the U.S. controlled taxpayer, and all foreign affiliates that also engage in cross border transactions with the U.S. controlled taxpayer must be aggregated. The definition of an eligible taxpayer does not include the U.S. branch of a foreign corporation. It was felt that relatively few taxpayers would benefit from the inclusion of a branch rule, and that the additional complexity entailed in including branches in the definition was not justified. The election to apply the safe harbor may only be revoked with the consent of the Commissioner, and § 1.482–1T(f)(1)(iv)(C) provides that the election will not apply for any year in which the eligible taxpayer test is not met, but that the election will be effective if the taxpayer meets the test in a succeeding year, subject to an anti-abuse rule.

Section 1.482–1T(f)(2), relating to foreign legal restrictions, is reserved.

Section 1.482–1T(f)(3) provides a coordination rule between sections 936 and 482. It provides that in the case of a controlled taxpayer that has made a cost sharing election under section 936(h), the amount of the cost sharing payment required under section 936 will not be less than that required under the section 482 regulations, and further that such payment may not be computed under the provisions of § 1.482–2T(d)(4).

Section 1.482–1T(g) defines ten terms that are employed in the regulations.

An important term used under several methods is "non-routine intangible." This term has not been defined because it has not been possible to formulate an acceptably precise definition. In general, this term means intangible property that is central to the conduct of a business activity and without which the business activity could not be conducted. It normally would be expected that such property is unique or nearly unique, that its use or application is very valuable, and that there consequently would not be examples of substantially similar transactions between unrelated parties. Examples of such an intangible would be a composition of matter patent for a pharmaceutical, or a manufacturing intangible without which a particular product could not be produced. The term would not include intangible property that is a normal result of conducting a business, such as manufacturing economies resulting from protracted manufacturing operations, or intangible property for which there may be acceptable substitutes available in the marketplace at a comparable price.

Section 1.482–2T(d)

Section 1.482–2T(d) provides that guidance with respect to transfers of property is set forth in §§ 1.482–3T through 1.482–5T.

Section 1.482–3T

Section 1.482–3T provides rules with respect to the transfer of tangible property. Five methods are provided: The comparable uncontrolled price method; the resale price method; the cost plus method; the comparable profits method; and other methods. In addition, a sixth method based on profit splits is proposed in the accompanying notice of proposed rulemaking.

Section 1.482–3T(b) describes the comparable uncontrolled price (CUP) method. It is generally similar to the CUP method under the current regulations. For purposes of the best method rule, a result obtained under the CUP method generally will provide the most accurate measure of an arm's length result. Section 1.482–3T(b)(2) sets forth specific guidance with respect to the standard of comparability that must be satisfied for an uncontrolled transaction to be sufficiently comparable to a controlled transaction under this method. The property transferred and the underlying circumstances of the two transactions must be substantially the same. This requirement is met if any minor differences can be reflected by a reasonable number of adjustments that have a definite and reasonably ascertainable effect on the amount charged. If there are material differences between the transactions, this method cannot be applied based on the

uncontrolled transaction. Although the text of this rule differs somewhat from its counterpart under the final regulations, the changes were intended to be clarifications of the current standard rather than substantive changes.

Section 1.482–3T(c) describes the resale price method. It is generally similar to the resale price method under the current regulations. In response to comments, the results achieved under the resale price method are not subject to a mandatory check under CPI. For purposes of the best method rule, the resale price method ordinarily will provide an accurate measure of an arm's length result if the controlled taxpayer performs a distribution function and does not add substantial value to the goods that are distributed. Section 1.482–3T(c)(3) sets forth specific guidance with respect to the standard of comparability that must be satisfied for an uncontrolled transaction to be sufficiently comparable to a controlled transaction under this method. The controlled and uncontrolled transactions should involve distribution of products within the same broad product categories. Adjustments may be made to account for the differences enumerated in § 1.482–1T(c)(3) between the transactions, but only if such differences have a definite and reasonably ascertainable effect on gross profit.

Section 1.482–3T(d) describes the cost plus method. It is generally similar to the cost plus method under the current regulations. As with the resale price method, the results obtained under the cost plus method are not subject to a mandatory check under the CPI. For purposes of the best method rule, the cost plus method ordinarily will provide an accurate measure of an arm's length result if the controlled taxpayer manufactures or assembles goods that are sold to related parties. Section 1.482–3T(d)(3) sets forth specific guidance with respect to the standard of comparability that must be satisfied for an uncontrolled transaction to be sufficiently comparable to a controlled transaction under this method. The controlled and uncontrolled transactions should involve production of products within the same broad product categories or within the same industry. Adjustments may be made to account for the differences enumerated in § 1.482–1T(c)(2) between the transactions, but only if such differences have a definite and reasonably ascertainable effect on gross profit. Section 1.482–3T(d)(3)(iv) provides that in determining an appropriate markup percentage, accounting reclassifications may be required to ensure consistent treatment of the elements that enter into the computation of the production price.

Section 1.482–3T(e) provides that when none of the other enumerated methods can reasonably be applied, any other reasonable method may be used. A taxpayer may employ another method only if such method is disclosed on the taxpayer's U.S. income tax return and the taxpayer prepared contemporaneous documentation supporting the method adopted. Such documentation must explain why the method selected provides the most accurate measure of an arm's length price. The taxpayer must furnish such documentation to the district director within 30 days of a written request for such documentation. Section 1.482–3T(e)(3) provides that application of a method under § 1.482–3T(e) does not in itself satisfy the reasonable cause and good faith exception from the application of penalties under section 6662(e) or 6664(c).

Section 1.482–3T(f) provides rules coordinating the application of the tangible property rules with the rules governing transfers of intangible property.

Section 1.482–4T

Section 1.482–4T provides rules with respect to the transfer of intangible property. Three methods are provided: the comparable uncontrolled transactions method; the comparable profits method; and other methods. In addition, the proposed profit split method would apply with respect to transfers of intangibles.

Section 1.482–4T(b) provides a definition of intangible property that is similar to that provided in the proposed regulations.

Section 1.482–4T(c) describes the comparable uncontrolled transactions (CUT) method. Unlike the proposed regulations, which included two comparable transaction methods, only one such method is provided. Comments on the proposed regulations asserted that the scope of the first such method (the MTM) was too narrow, and further that the CPI should not be a mandatory check on the results obtained under the second method (the CATM). In response to these comments, the MTM and the CATM have been combined into a single method, and the results obtained under this method are not subject to mandatory check under the CPI. The removal of this check is offset by incorporating a reference to profit potential in the definition of comparability, reflecting Congressional concern that royalty rates for "high-profit" intangibles could "be set on the basis of industry norms for transfers of much less profitable items." General Explanation of the Tax Reform Act of 1986, H.R. 3838, Public Law 99–514 (May 4, 1987) at 1014. For purposes of the best method rule, a result obtained under the CUT method generally will provide the most accurate measure of an arm's length result. Section 1.482–4T(c)(2) sets forth specific guidance with respect to the standard of comparability that must be satisfied for an uncontrolled transaction to be sufficiently comparable to a controlled transaction under this method. In addition to the factors enumerated in § 1.482–1T(c)(3), the property transferred in the two transactions must be from the same class of intangible property, relate to the same class of products or services, and have substantially the same profit potential. In addition, § 1.482–4T(c)(2)(B) requires that the underlying circumstances of the two transactions must be sufficiently similar that any differences can be reflected by a reasonable number of adjustments that have a definite and reasonably ascertainable effect on the amount charged. These circumstances are similar to the factors listed in the final regulations. Section 1.482–2(d)(2)(iii).

Section 1.482–4T(d) provides that when none of the other enumerated methods can reasonably be applied, any other reasonable method may be used. A taxpayer may employ another method only if such method is disclosed on the taxpayer's U.S. income tax return, the taxpayer prepared contemporaneous documentation supporting the method adopted, explaining why the other enumerated methods cannot be applied, and explaining why the method selected provides the most accurate measure of an arm's length price, and the taxpayer furnishes such documentation to the district director within 30 days of a written request for such documentation. Section 1.482–4T(d)(3) provides that application of a method under § 1.482–4T(d) does not in itself satisfy the reasonable cause and good faith exception from the application of penalties under section 6662(e) or 6664(c).

Section 1.482–4T(e) provides special rules for the transfer of intangible property. Section 1.482 4T(e)(1) provides that the form of the consideration for a transfer of intangible property must be consistent with that which would be adopted by unrelated parties under comparable circumstances, and that consideration normally should be in the form of a royalty.

Section 1.482–4T(e)(2)(i) provides that if an intangible is transferred for a period in excess of one year, the consideration charged is generally subject to annual adjustment to ensure that it is commensurate with the income attributable to the intangible. This provision is required by the 1986 amendment to section 482.

Section 1.482–4T(e)(2)(ii) sets forth two exceptions from this rule. In response to comments on the proposed regulations that indicated that the scope of the exceptions in the proposed regulations was too narrow, the scope of the exceptions from periodic adjustments has been broadened. The first exception provides that no periodic adjustment will be made if certain specified conditions are met, including that the controlled taxpayers entered into a written license agreement with a comparable term to an actual license agreement between uncontrolled taxpayers, the consideration charged was an arm's length amount under the CUT method for the first year in which substantial royalties were required to be paid under the agreement, the comparable license agreement generally did not permit changes to the royalty, and the aggregate profits earned by the controlled transferee from the exploitation of the intangible fall within a range of the profits that were anticipated when the license agreement was executed. The second exception is generally similar, except that it applies if the consideration was determined to be arm's length under any method other than the CUT method.

Section 1.482–4T(e)(3) provides rules for identifying the controlled party that is considered the developer of an item of intangible property that are similar to the rules set forth in the proposed regulations.

Section 1.482–4T(e)(4) clarifies that the arm's length consideration for an intangible is not limited to the prevailing rates in an industry or the rates paid in any uncontrolled transactions that do not meet the requirements of the CUT method. This provision was included to clarify that arm's length consideration in a controlled transaction, particularly for non-routine intangibles that are not ordinarily transferred between uncontrolled taxpayers, may not be limited by the amount of consideration identified in uncontrolled transactions.

Section 1.482–4T(e)(5), relating to lump sum payments, is reserved.

Section 1.482–5T

Section 1.482–5T describes the comparable profits method. The comparable profits method relies on the general principle that similarly situated taxpayers will tend to earn similar returns over a reasonable period of time. In broad outline this method is similar to the comparable profits method set forth under the proposed regulations. Although this method is included in the methods available under both §§ 1.482–3T (tangible property) and 1.482–4T (intangible property), in response to comments it no longer provides a mandatory check on the results obtained under other methods. This method generally will provide an accurate measure of an arm's length result unless the tested party uses a valuable, non-routine intangible that is either (1) acquired from uncontrolled taxpayers, and the tested party assumes significant risks and possesses the right to significant economic benefits from the use of the intangible, or (2) is self-developed. The comparable profits method generally will not provide an accurate measure of an arm's length result in cases involving non-routine self-developed intangibles or many intangibles that were acquired from third parties because it will be difficult, if not impossible, to locate uncontrolled taxpayers that also possess comparable intangible property, and the comparable profits method could understate the income properly attributable to such assets.

Section 1.482–5T(b) provides that the tested party generally will be the controlled taxpayer that performs the simplest and therefore most easily compared operations. In the case of the license of intangible property, this party normally will be the licensee. Generally the comparable profits method will be applied separately to each industry segment (as defined under the section 6038A regulations). In addition, the comparable profits method only is applied after taking into account all other adjustments under section 482.

Section 1.482–5T(c) provides that the standard of comparability required to apply this method is not as strict as under other methods. Some diversity between the transactions, products and functions of the controlled and uncontrolled taxpayers is acceptable. The degree of comparability achieved will, however, affect the reliability of the results, and the size of the arm's length range, as discussed below.

Section 1.482–5T(c)(2) describes a number of adjustments that should be (but are not required to be) made with respect to the comparable parties. Such adjustments are made only to the extent that they have a definite and reasonably ascertainable effect on operating profits. Accounting reclassifications also may be made to ensure that various items are measured consistently.

Section 1.482–5T(d)(i) provides that a result will be an arm's length result if it falls within the range of constructive operating profits, based on a single profit level indicator, derived from comparable parties. As under the comparable profits method of the proposed regulations, constructive operating profit is calculated by measuring profit level indicators of uncontrolled taxpayers, and applying those indicators to the financial data of the tested party to measure an arm's length result for the tested party.

Unlike the other methods, § 1.4825T(d)(ii) provides that the arm's length range can be determined in two ways, depending on the degree of comparability between the tested party and the uncontrolled taxpayers and the adjustments that were made to account for any differences. If the adjustments described in § 1.4825T(c)(2) have been made, the arm's length range will include all the results obtained, as with the other methods. If, however, the specified adjustments are not made, the range will be limited to either the interquartile range, or the range determined by some other statistically valid method. In the latter case the comparable profits method cannot be used if there are less than four comparable parties.

Section 1.482–5T(e) describes the profit level indicators that may be used under the comparable profits method. They include two types of measures: The rate of return on capital employed and financial ratios. Financial ratios include the ratio of operating profit to sales and the ratio of grass profit to operating expenses. Finally, § 1.482–5T(e)(3) provides that other reliable measures may be employed.

Section 1.482–5T(f) sets forth a number of definitions that are relevant for purposes of the comparable profits method.

Section 1.482–6T

Section 1.482–6T, which deals with the profit split method, is reserved under these temporary regulations. However, the provisions of the profit split method are proposed in the accompanying notice of proposed rulemaking.

Advance Pricing Agreements

Based on the Service's experience to date with the advance pricing agreement program, as well as favorable comments received in response to the proposed regulations, the principle of advance pricing agreements continues to be an integral component of the Service's

overall section 482 compliance effort. The Service may execute an advance pricing agreement addressing the prospective application of section 482 to any transaction between or among members of a controlled group. Such agreements may also address any collateral income tax consequences related to such transactions. Where an advance pricing agreement is in effect, an allocation under section 482 is permitted only to the extent provided in the agreement. The procedures for obtaining an advance pricing agreement are contained in Revenue Procedure 91–22, 1991–1 C.B. 526.

Special Analyses

It has been determined that these regulations are not major rules as defined in Executive Order 12291. Therefore, a Regulatory Impact Analysis is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and, therefore, a final Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, a copy of these regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

Personnel from the Internal Revenue Service and Treasury Department participated in developing these regulations.

List of Subjects

26 CFR 1.481–1 Through 1.483–2T

Accounting, Income taxes, Reporting and recordkeeping requirements.

26 CFR Part 602

Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1986

Paragraph 1. The authority citation for part 1 is amended by removing the entry for "§ 1.482–2" and adding new citations in numerical order to read as follows:

Authority: 26 U.S.C. 7805. * * * Section 1.482–1T also issued under 26 U.S.C. 482 and 936. Section 1.482–2T also issued under 26 U.S.C. 482. Section 1.482–3T also issued under 26 U.S.C. 482. Section 1.482–4T also issued under 26 U.S.C. 482. Section 1.482–5T also issued under 26 U.S.C. 482. Section 1.482–2A also issued under 26 U.S.C. 482.

§§ 1.482–1 and 1.482–2 [Redesignated as §§ 1.482–1A and 1.482–2A]

Par. 1a. Sections 1.482–1 and 1.482–2 are redesignated § 1.482–1A and § 1.482–2A and an undesignated centerheading preceding § 1.482–1A is added to read as follows:

Regulations Applicable for Taxable Years Beginning on or Before April 21, 1993

Par. 2. Sections 1.482–0T through 1.482–7T are added to read as follows:

§ 1.482–0T Outline of regulations under section 482.

This section lists the major headings for § 1.482–1T through § 1.482–5T.

§ 1.482–1T Allocation of income and deductions among taxpayers

(a) In general.
(1) Purpose and scope.
(2) Authority to make allocations.
(3) Taxpayer's use of section 482.
(b) Arm's length standard.
(1) In general.
(2) Arm's length methods.
(i) Methods.
(ii) Selection of category of method applicable to transaction.
(iii) Choice of method.
(A) Best method rule.
(B) Multiple methods.
(C) Examples.
(c) Comparability.
(1) In general.
(i) Basic factors to be evaluated.
(ii) Basic types of comparables.
(2) Standard of comparability.
(i) In general.
(ii) Comparability adjustments.
(iii) Example.
(iv) Standards of comparability under specific methods.
(3) Factors for determining comparability.
(i) Functional analysis.
(ii) Analysis of risks.
(A) In general.
(B) Determination of party that bears risk and income commensurate with risk.
(C) Documentation of risks assumed.
(D) Consistent allocation of risk.
(E) Examples.
(iii) Contractual terms.
(iv) Economic conditions.
(v) Property or services.
(4) Special circumstances.
(i) Market share strategy.
(ii) Different geographic markets.
(A) In general.
(B) Example.
(C) Location savings.
(D) Example.
(iii) Isolated transactions.
(iv) Mineral transactions.
(d) Scope of review.
(1) In general.
(i) Intent to evade or avoid tax not a prerequisite.
(ii) Realization of income not a prerequisite.
(A) In general.
(B) Example.
(iii) Nonrecognition provisions may not bar allocation.
(iv) Consolidated returns.
(2) Limitations on allocations.
(i) No allocation where results are within arm's length range.
(A) In general.
(B) Determination of arm's length range.
(C) Adjustment where taxpayer's results are outside arm's length range.
(D) Arm's length range not prerequisite to allocation.
(E) Examples.
(ii) Allocations apply to results, not methods.
(iii) Example.
(3) Rules relating to allocations under section 482.
(i) Aggregation of transactions.
(A) In general.
(B) Examples.
(ii) Contractual arrangements.
(iii) Allocation based on taxpayer's actual transactions.
(iv) Example.
(v) Multiple year data.
(A) In general.
(B) Circumstances warranting consideration of multiple year data.
(C) Comparable effect over comparable period.
(D) Examples.
(vi) Product lines and statistical techniques.
(e) Collateral adjustments with respect to allocations under section 482.
(1) In general.
(2) Compensating adjustments.
(i) In general.
(ii) Treatment of adjustments.
(iii) Pattern of abuse.
(iv) Example.
(3) Correlative allocations.
(i) In general.
(ii) Manner of carrying out correlative allocation.
(iii) Events triggering correlative allocation
(iv) Examples.
(4) Adjustments to conform accounts to reflect section 482 allocations.
(5) Setoffs.
(i) In general.
(ii) Examples.
(f) Special rules.
(1) Small taxpayer safe harbor.
(i) In general.
(ii) Eligible taxpayer.
(iii) Aggregation.
(iv) Election to apply the appropriate measure of profitability.
(2) Effect of foreign legal restrictions [Reserved].
(3) Coordination with section 936.
(i) Cost sharing under section 936.
(ii) Use of terms.
(g) Definitions.
(h) Effective dates.

§ 1.482–2T Determination of taxable income in specific situations

(a) [Reserved].
(b) [Reserved].

§ 1.482–1T Allocation of income and deductions among taxpayers

(a) *In general*—(1) *Purpose and scope.* The purpose of section 482 is to ensure that taxpayers clearly reflect income attributable to controlled transactions, and to prevent the avoidance of taxes with respect to such transactions. Section 482 places a controlled taxpayer on a tax parity with an uncontrolled taxpayer by determining the true taxable income of the controlled taxpayer in a manner that reasonably reflects the relative economic activity undertaken by each taxpayer. This § 1.482–1T sets forth general principles and guidelines to be followed under section 482. Section 1.482–2T provides rules for the determination of the true taxable income of controlled taxpayers in specific situations, including controlled transactions involving loans or advances, services, and property. Sections 1.482–3T through 1.482–5T elaborate on the rules that apply to controlled transactions involving property.

(2) *Authority to make allocations.* If a controlled taxpayer has not reported its true taxable income, the district director may make allocations between or among the members of a controlled group. In such cases, the district director may allocate income, deductions, credits, allowances, basis, or any other item or element affecting taxable income (referred to as "allocations"). The appropriate allocation may take the form of an increase or decrease in any relevant amount.

(3) *Taxpayer's use of section 482.* Section 482 grants no right to a controlled taxpayer to apply the provisions of section 482 at will or to compel the district director to apply such provisions. However, section 482 does not limit a taxpayer's ability to report its true taxable income with respect to its controlled transactions. A controlled taxpayer may report the results of its controlled transactions based upon prices different from those actually charged if necessary to reflect an arm's length result. If reported results differ from transactional results recorded in the regular books and records of the taxpayer, such difference must be accounted for in accordance with the provisions of § 1.482–1T(e)(2) (regarding compensating adjustments). A taxpayer that fails to report its true taxable income with respect to its controlled transactions may be subject to penalties under section 6662(e) and other applicable sections.

(b) *Arm's length standard*—(1) *In general.* In determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer. A controlled transaction meets the arm's length standard if the results of that transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in a comparable transaction under comparable circumstances. Thus, for purposes of section 482, the "arm's length result" of a controlled transaction is the amount of consideration that would have been charged or paid (or the profits that would have been earned) in comparable transactions between uncontrolled taxpayers. The comparability of controlled and uncontrolled transactions must be determined under the provisions of paragraph (c) of this section.

(2) *Arm's length methods*—(i) *Methods.* Sections 1.482–2T through 1.482–6T provide specific methods to be used by the district director to test whether transactions between or among members of the controlled group satisfy the arm's length standard, and if they do not, to determine the arm's length results.

(ii) *Selection of category of method applicable to transaction.* The methods listed in § 1.482–2T apply to different types of transactions (*i.e.*, transfers of property, services, loans or advances, and rentals). Accordingly, the district director must select the appropriate method or methods applicable to

controlled transactions, and may apply different methods to related transactions where such transactions are most reasonably tested on a separate basis. For example, where services are provided in connection with the transfer of property, the district director may find it appropriate to separately apply the methods applicable to services and property in order to determine an arm's length result. In addition, other applicable provisions of the Code may affect the characterization of a transaction, and therefore affect the methods applicable under section 482. For example, section 483 may characterize a portion of certain deferred payments as interest income.

(iii) *Choice of method*—(A) *Best method rule.* The arm's length result of a controlled transaction must be determined under the method that provides the most accurate measure of an arm's length result under the facts and circumstances of the transaction under review. The factors to be considered in selecting a method include the completeness and accuracy of the data used to apply each method, the degree of comparability between controlled and uncontrolled transactions, and the number, magnitude, and accuracy of the adjustments required to apply each method. An arm's length result may be determined under any of the available methods without first establishing the inapplicability of any other method. If additional evidence becomes available permitting the application of another method that is more accurate, the district director will apply such method to determine an arm's length result. Additional guidance concerning the circumstances under which particular methods may be applicable is provided under the description of each method in §§ 1.482–2T through 1.482–6T. The rule of this paragraph (b)(2)(iii)(A) is hereinafter referred to as the "best method rule."

(B) *Multiple methods.* If two or more methods produce inconsistent results, the best method rule will be applied to select the method that provides the most accurate determination of an arm's length result under the facts and circumstances, without establishing a priority or presumption of correctness to any one method. If the best method rule does not clearly indicate which method should be preferred, and additional factor that may be taken into account in selecting a method is whether any of the competing methods produce results that are consistent with the results obtained under another appropriate method. Further, in choosing between two or more applications of the same method that produce different results, the fact that another method produces results that are consistent with one or more of the competing applications may be taken into account.

(C) *Examples.* The following examples illustrate this paragraph (b)(2)(iii).

Example 1. (i) Manuco manufactures televisions that it sells to Sub, its wholly owned distributor. Sub resells the televisions to unrelated retailers. To test whether the price Sub paid to Manuco is at arm's length, the district director uses data from Unco, an uncontrolled distributor, to apply the resale price method. Numerous substantial adjustments are made to Unco's gross profit margin to reflect differences between the controlled and uncontrolled transactions. This application of the resale price method indicates that the price Sub paid Manuco for the televisions was not an arm's length price.

(ii) Sub, however, provides to the district director data regarding an uncontrolled transaction that, with a small number of minor adjustments, permits the district director to apply the comparable uncontrolled price method, and indicates that the price Sub paid Manuco was an arm's length price.

(iii) Because it requires fewer and smaller adjustments in this situation, the comparable uncontrolled price method provides the most accurate measure of the arm's length price. Therefore, pursuant to the best method rule of paragraph (b)(2)(iii)(A) of this section the district director uses the comparable uncontrolled price method to determine that the price Sub paid to Manuco is an arm's length price.

Example 2. Markco, a foreign distributor, and Manuco, a U.S. manufacturer, are members of the same group of controlled taxpayers. In 1994, Markco buys radios from Manuco for $10 per unit. In 1996, during an audit for the 1994 taxable year, Manuco presents the district director with information showing that an uncontrolled distributor in similar uncontrolled transactions also bought radios for $10, but several adjustments are required to apply the comparable uncontrolled price method. On the other hand, information derived from other uncontrolled transactions indicates under the resale price method that the arm's length price for the controlled transaction between Markco and Manuco is $15. In addition, application of the comparable profit method provides a range of constructive operating profits that is consistent with the $15 price. The consistency of the results from the application of the resale price method with the results from the application of the comparable profits method may be taken into account in selecting which method to use to test whether the $10 paid by Markco to Manuco is an arm's length price.

Example 3. To determine whether the price paid by controlled taxpayer, Corp, to its wholly owned subsidiary for a product was at arm's length, the district director applies the comparable uncontrolled price method to data from three different uncontrolled transactions, UT1, UT2, and UT3. These three applications of the comparable uncontrolled price method produce different results. To determine whether the three applications of the comparable uncontrolled price method are within the arm's length range as provided in § 1.482–1T(d)(2)(i), the district director applies a second method. The results of UT1 and UT3 under the comparable uncontrolled price method are consistent with the results obtained from the application of the second method. The application of the second method, however, produces results that deviate from the results obtained from the application of the comparable uncontrolled price method with respect to UT2. The consistency of the results from UT1 and UT3 with the application of the second method may be taken into account by the district director in determining the arm's length price for the transaction under review.

(c) *Comparability*—(1) *In general*—(i) *Basic factors to be evaluated.* The arm's length character of a controlled transaction is tested by comparing the results of that transaction with the results of uncontrolled taxpayers engaged in comparable transactions under comparable circumstances. For this purpose, the comparability of transactions and circumstances must be evaluated using the following factors, which are further described in paragraph (c)(3) of this section—

(A) Functions;

(B) Risks;

(C) Contractual terms;

(D) Economic conditions; and

(E) Property or services.

(ii) *Basic types of comparables.* The relative importance of any one of the factors listed may depend upon the pricing method being applied. In particular, some methods focus primarily upon an analysis of whether the controlled and uncontrolled transactions involve the same or similar property or service (product comparables). See, for example, the comparable uncontrolled price method under § 1.482–3T(b), and the comparable uncontrolled transaction method under § 1.482–4T(c). Other methods focus primarily upon an analysis of whether the controlled and uncontrolled taxpayers undertake the same or similar functions, employ similar resources, and bear similar risks (functional comparables). See, for example, the resale price and cost plus methods under § 1.482–3T(c) and (d). Finally, other methods determine an arm's length result by ascribing a similar return on capital to taxpayers that are broadly similar in terms of products and functions. See, for example, the comparable profits method under § 1.482–5T. While the terms product comparables and functional comparables describe the primary focus of various methods, each method

ordinarily requires analysis of all of the factors that affect comparability under that method. In particular, the analysis of functions and risks will be essential to the application of any method. Thus, for example, two transactions involving identical products may not be sufficiently comparable for purposes of the comparable uncontrolled price method if the relevant functions, risks, or other factors described in paragraph (c)(3) of this section are different.

(2) *Standard of comparability*—(i) *In general.* For two transactions to be considered comparable, an uncontrolled transaction need not be identical or exactly comparable to the controlled transaction, but must be sufficiently similar that it provides a reasonable and reliable benchmark for determining whether the controlled transaction led to an arm's length result.

(ii) *Comparability adjustments.* Where necessary, a reasonable number of adjustments may be made to the results of an uncontrolled transaction to account for material differences between the controlled and uncontrolled transactions if such differences have a definite and reasonably ascertainable effect on prices or profits. Such adjustments should be based on commercial practices, economic principles, or statistical analyses, as applied to the available data. If the differences can be reflected by such adjustments, then the price, profit, or margin of the uncontrolled transaction, as adjusted, constitutes the arm's length result for the controlled transaction.

(iii) *Example.* The following example illustrates paragraph (c)(2)(ii) of this section.

Example. (i) FS manufactures product XX and sells that product to its parent corporation, P. FS also sells product XX to uncontrolled taxpayers at a price of $100 per unit. Except for the volume of each transaction, the sales to P and to uncontrolled taxpayers take place under substantially the same economic conditions and contractual terms. In uncontrolled transactions, FS offers a 2% discount for quantities of 20 per order, and a 5% discount for quantities of 100 per order. If P purchases product XX in quantities of 60 per order, it may be assumed that the arm's length price to P would be $100, less a discount of 3.5%.

(ii) If P purchases product XX in quantities of 1,000 per order, in the absence of further information about uncontrolled transactions at similar order quantities, a volume discount greater than 5% can be assumed only on the basis of proper economic and statistical analysis, not necessarily a linear extrapolation from the 2% and 5% catalog discounts applicable to sales of 20 and 100 units, respectively.

(iv) *Standards of comparability under specific methods.* The general standards of comparability provided in this paragraph (c)(2) are subject to modification under the specific provisions of certain applicable methods. For example, the provisions of § 1.482–3T(b) impose stricter limitations on the adjustments that are permitted for purposes of the comparable uncontrolled price method. Further, in connection with each of the methods, §§ 1.482–T through 1.482–5T provide more detailed guidance concerning the factors described in paragraph (c)(3) of this section.

(3) *Factors for determining comparability.* The following factors must be considered in determining whether two transactions are comparable. In addition, in certain cases involving special circumstances, the rules under paragraph (c)(4) of this section must be considered.

(i) *Functional analysis.* The determination of whether controlled and uncontrolled transactions are comparable requires a comparison of the functions performed by the controlled and uncontrolled taxpayers. This comparison is based upon a functional analysis, which identifies and compares the economically significant activities actually undertaken or to be undertaken by the taxpayers in both controlled and uncontrolled transactions. A functional analysis is not a pricing method and does not itself determine the arm's length result for the controlled transaction under review. Functions that may need to be accounted for in determining the comparability of two transactions include research and development; product design and engineering; manufacturing or process engineering; product fabrication, extraction, and assembly; purchasing and materials management; marketing and distribution functions including inventory management, warranty administration, and advertising and marketing activities; transportation and warehousing; and managerial, legal, accounting and finance, credit and collection, training, and personnel management services.

(ii) *Analysis of risk*—(A) *In general.* The determination of whether controlled and uncontrolled transactions are comparable requires a comparison of the risks borne in each transaction. This comparison ordinarily consists of a two-step analysis. First, the district director must determine which controlled taxpayer bears the risks associated with the transaction, which includes a consideration of whether the income earned by that controlled taxpayer over a reasonable period of time is commensurate with the risk assumed. Second, the district director must determine whether the risks borne by the controlled taxpayer are comparable to those borne by the uncontrolled taxpayer. Risks that ordinarily must be considered include market risks including fluctuations in cost, demand, pricing, and inventory levels; risks associated with the success or failure of research and development activities; financial risks including fluctuations in foreign currency rates of exchange and interest rates; credit and collection risks; product liability risks; and general business risks related to the ownership of property, plant, and equipment.

(B) *Determination of party that bears risk and income commensurate with risk.* In determining the extent to which a controlled taxpayer actually bears a risk and in determining whether the income earned by the controlled taxpayer over a reasonable period of time is commensurate with the risk assumed, the district director will evaluate the economic substance of the controlled transactions. In particular, the district director will determine whether—

(*1*) The controlled taxpayer has a reasonable opportunity to realize an economic benefit that is commensurate with the risks assumed, and that would cause a similarly-situated uncontrolled taxpayer to bear the risk that the controlled taxpayer assumed;

(*2*) The risks that the controlled taxpayer assumed are proportionate to its financial capacity to fund losses that may be expected to occur as a result of the assumption of such risk; and

(*3*) The controlled taxpayer is engaged in the active conduct of a trade or business to which the risk at issue relates, and carries out substantial managerial and operational control over the principal business activities that directly influence the amount of income or loss to be realized. See § 1.367(a)–2T(b)(2) and (b)(3).

(C) *Documentation of risks assumed.* Notwithstanding paragraph (c)(3)(ii)(B) of this section, the district director may disregard a controlled taxpayer's nominal assumption of a risk unless documentation reflecting the allocation of risks among the controlled taxpayers was executed before the result of such risk was known or reasonably knowable by any such taxpayer, and the actual conduct of the controlled taxpayer is consistent with such documentation. However, this rule does not apply to routine risks that are assumed by a controlled taxpayer under normal commercial practices. Thus, for example, where the risk of loss during shipment is assigned under the Uniform Commercial Code, separate

documentation of the allocation of such risk would not be necessary.

(D) *Consistent allocation of risk.* Because parties dealing at arm's length bear risks to obtain the potential for greater returns over a reasonable period of time, the allocation of risks among uncontrolled taxpayers is ordinarily consistent over such a period. Thus, risks must also be allocated consistently among controlled taxpayers over such a period, and not reallocated from year to year in response to changes in market conditions without a corresponding change in the transfer price. Thus, for example, a controlled taxpayer that experiences losses as the result of its assumption of market risk during a market downturn, would ordinarily be expected to receive greater returns during other periods.

(E) *Examples.* The following examples illustrate this paragraph (c)(3)(ii).

Example 1. FD, the wholly-owned foreign distributor of USM, a U.S. manufacturer, buys Widgets from its parent under a written five-year contract that was entered into before any transaction between the two parties. FD has adequate financial capacity to fund losses that may be expected to occur as a result of the transaction. Widgets are a new product in the market in which FD operates. Under the terms of the contract, FD must buy 20,000 units of widgets at $5 per unit for each of the five years of the contract, and FD must finance any marketing strategies to introduce Widgets to the foreign market. In Years 1, 2, and 3, a total of only 10,000 Widgets were sold by FD to unrelated parties at $11 per Widget. However, FD, as required by the contract, bought 20,000 units each year. In Year 4, the demand for Widgets rose dramatically. FD was able to sell its entire inventory of Widgets at $25 per Widget. Because the allocation of the market risks borne by FD was documented in a written agreement entered into before the result of the risk was known or reasonably knowable, and the conduct of FD was consistent with the economic substance of the contract, FD will be deemed to bear the market risk.

Example 2. The facts are the same as in *Example 1*, except that in Year 1 FD has only $100,000 in total capital, including loans. In the subsequent years USM does not make any further capital contributions to FD, and FD is unable to obtain any capital through loans from an unrelated party. However, each year, USM continues to send 20,000 Widgets to FD and permits FD to finance the purchase through an extension of credit. Because FD does not have the financial capacity in Years 1 and 2 to finance the market risk, FD does not in substance bear the risk.

Example 3. A wholly-owned foreign subsidiary of a U.S. parent corporation manufactures a product to the design and specifications of the parent. Substantially all of the subsidiary's output is sold to the parent, and the parent substantially controls the time and volume of the subsidiary's production schedules in order to coordinate the subsidiary's output with the parent's own production and sales requirements. The subsidiary does not bear any market risk associated with products sold to the parent. Because the parent regularly purchases substantially all of the subsidiary's output, the result would be the same whether or not there is a written contract between the parent and subsidiary that expressly provides for the parent's purchase of the subsidiary's output. Sub is, however, entitled to a return on other risks it may bear, such as general business risks.

Example 4. S, a Country X corporation, manufactures small motors that it sells to P, its U.S. parent. P incorporates the motors into various products that P manufactures and sells to uncontrolled customers located in the United States. The contract price of the motors sold to P is expressed in Country X currency. Thus, P documents that it assumes all of the currency risk associated with fluctuations in the exchange rate between the U.S. dollar and the Country X currency in connection with the motor sales. In determining whether the price charged for the motors is arm's length, the district director will consider whether P bears that risk in substance, and whether P's income over a reasonable period of time is commensurate with the risk assumed. For this purpose the district director will not ordinarily determine whether an uncontrolled purchaser of the motors would have been willing to assume the same foreign currency risk, but rather will determine what price an uncontrolled purchaser would have been willing to pay for the motors assuming it had, in fact, assumed the currency risk actually borne by P.

(iii) *Contractual terms.* The determination of whether the controlled and uncontrolled transactions are comparable requires a comparison of the significant contractual terms that could affect the prices that would be charged or paid, or the profit that would be earned in the two transactions. These terms include the form of consideration charged or paid; payment terms or related financing arrangements; the volume of products purchased or sold; warranty obligations; rights to updates, revisions, or modifications; the duration of relevant contracts and related termination or renegotiation rights; and collateral transactions or ongoing business relationships between the buyer and the seller, including arrangements for the provision of ancillary or subsidiary services. If the time for payment of the amount charged in a controlled transaction differs from the time for payment of the amount charged in an uncontrolled transaction, the payment term in the controlled transaction should be adjusted to reflect the payment term of the uncontrolled transaction, even if no interest would be allocated or imputed under § 1.482–2(a) or other applicable provisions of the Internal Revenue Code or regulations.

(iv) *Economic conditions.* The determination of whether the controlled and uncontrolled transactions are comparable requires a comparison of the significant economic factors that could affect the prices that would be charged or paid, or the profit that would be earned in the two transactions. These factors include—

(A) The alternatives realistically available to a buyer and seller, respectively;

(B) The similarity of geographic markets;

(C) The relative size of each market, the extent of the overall economic development in each market;

(D) The level of the market;

(E) The relevant market shares for the products, properties, or services transferred or provided;

(F) The location-specific costs of the factors of production and distribution; and

(G) The extent of competition in each market with regard to the property or services under review.

(v) *Property or services.* The determination of whether controlled and uncontrolled transactions are comparable requires a comparison of the property or services transferred in the transactions. With respect to transfers of tangible or intangible property, the degree of similarity required will vary depending upon the method applied. For guidance concerning the specific standard of comparability applicable to transfers of tangible and intangible property, see §§ 1.482–3T through 1.482–5T.

(4) *Special circumstances*—(i) *Market share strategy.* In certain circumstances, the price for a controlled transfer of property may, for a limited time, be other than the amount charged in an otherwise comparable uncontrolled transaction because the controlled transfer is subject to a pricing strategy that is undertaken to enter new markets, to increase a product's share of an existing market, or to meet competition in an existing market (market share strategy). A controlled transaction may be priced in such a manner only if it can be shown that such price would have been charged in an uncontrolled transaction under comparable circumstances, determined under the factors of paragraph (c)(3) of this section, including in particular the analysis of risk under paragraph (c)(3)(ii) of this section. The following additional conditions must also be met—

(A) The controlled taxpayer is engaged in business strategies reasonably likely to achieve the intended results (*e.g.*, the distributor makes corresponding reductions in the resale price to uncontrolled purchasers;

the distributor engages in substantially greater sales promotion activities with respect to the product involved in the controlled transfer than with respect to other products);

(B) The market share strategy is reasonably likely to result in future profits for the controlled taxpayer that reflect an appropriate return on the costs incurred to implement it;

(C) The market share strategy, the related costs and expected returns, and any agreement between the controlled taxpayers to share the related costs are documented before the strategy is implemented; and

(D) The market share strategy is pursued for a period of time that is reasonable taking into consideration the industry and product in question.

(ii) *Different geographic markets*—(A) *In general.* Uncontrolled comparables ordinarily should be derived from the same geographic market in which the controlled taxpayer operates, since there may be significant differences in the relevant costs and the applicable resale price in different markets. If information from the same market is not available, an uncontrolled comparable derived from a different geographic market may be considered if adjustments are made to account for differences between the two markets. If information permitting such adjustments is not available, then information derived from uncontrolled taxpayers located in the most similar location for which reliable data is available may be used, but use of such information may affect the accuracy of the method applied for purposes of the best method rule. For this purpose, a "geographic market" is any geographic area in which the market conditions for the relevant product or service are substantially the same, and may include multiple countries, depending on the market conditions.

(B) *Example.* The following example illustrates paragraph (c)(4)(ii)(A) of this section.

Example. Manuco, a wholly-owned foreign subsidiary of P, a U.S. corporation, manufactures products in Country Z for sale to P. Information on uncontrolled taxpayers performing comparable functions under comparable circumstances in the same geographic market is not available. Since reliable data from uncontrolled manufacturers in the same geographic market is unavailable, adjusted data from uncontrolled manufacturers in other markets may be considered. In this case, comparable uncontrolled manufacturers are found in the United States. Accordingly, data from the comparable U.S. uncontrolled manufacturers, as adjusted to account for differences between the U.S. and Country Z's geographic market, is used to test the arm's length price paid by P to Manuco

(C) *Location savings.* If an uncontrolled taxpayer operates in a different geographic market than the controlled taxpayer, adjustments may be necessary to account for significant differences in costs attributable to the geographic locations. These adjustments must be based on the effect such differences may have on the consideration charged or paid in the controlled transfer given the relative competitive positions of buyers and sellers in each location. Thus, the fact that production is less costly in the taxpayer's geographic market ordinarily justifies additional profits only where the location savings would increase the profits of uncontrolled taxpayers operating at arm's length, given the competitive positions of buyers and sellers in that market.

(D) *Example.* The following example illustrates paragraph (c)(4)(ii)(C) of this section.

Example. Couture, a U.S. apparel design corporation, contracts with Sewco, its wholly owned Country Y subsidiary, to manufacture its clothes. Costs of production in Country Y are significantly lower than the costs of manufacturing in the United States. Although clothes with the Couture label sell for a premium price, the actual production of the clothes does not require significant specialized knowledge, and could be performed by several apparel-production firms comparable to Sewco in similar geographic markets. Thus, the fact that production is less costly in Country Y will not, in and of itself, justify additional profits derived from lower costs of manufacturing in Country Y inuring to Sewco, because of the competitive effects attributable to the other producers in similar geographic markets capable of performing the same functions at the same low costs.

(iii) *Isolated transactions.* Isolated transactions between uncontrolled taxpayers, and transactions arranged primarily for the purpose of establishing an arm's length result with respect to a controlled transaction, ordinarily will not constitute comparable transactions for purposes of this section. In the case of tangible property, uncontrolled transactions should ordinarily be significant in number and amount, and should occur in the ordinary course of business in order to be considered comparable uncontrolled transactions for purposes of section 482.

(iv) *Mineral transactions.* The price for a mineral product that is sold at the stage at which mining or extraction ends will be determined under the provisions of §§ 1.613–3 and 1.613–4.

(d) *Scope of review*—(1) *In general.* The authority to determine true taxable income extends to any case in which either by inadvertence or design the taxable income, in whole or in part, of a controlled taxpayer is other than it would have been had the taxpayer, in the conduct of its affairs, been dealing at arm's length with an uncontrolled taxpayer.

(i) *Intent to evade or avoid tax not a prerequisite.* In making allocations under section 482, the district director is not restricted to the case of improper accounting, to the case of a fraudulent, colorable, or sham transaction, or to the case of a device designed to reduce or avoid tax by shifting or distorting income, deductions, credits, or allowances.

(ii) *Realization of income not a prerequisite*—(A) *In general.* The district director may make an allocation under section 482 even if the ultimate income anticipated from a series of transactions has not been or is never realized. For example, if one member of a controlled group sells a product at less than an arm's length price to a second member of the group in one taxable year and the second member resells the product to an unrelated party in the next taxable year, the district director may make an appreciate allocation to reflect an arm's length price for the sale of the product in the first taxable year, even though the second member of the group had not realized any gross income from the resale of the product in the first year. Similarly, if one member of a group lends money to a second member of the group in a taxable year, the district director may make an appropriate allocation to reflect an arm's length charge for interest during such taxable year even if the second member does not realize income during such year. Finally, even if two controlled taxpayers realize an overall loss that is attributable to a particular controlled transaction, an allocation under section 482 is not precluded.

(B) The following example illustrates this paragraph (d)(1)(ii).

Example. Sub is a U.S. subsidiary of Parent, a foreign corporation. Parent manufactures product X and sells it to Sub. Sub functions as a distributor of product X to unrelated customers in the United States. The fact that P may incur a loss on the manufacture and sale of product X does not by itself establish that Sub, dealing with P at arm's length, also would incur a loss. An independent distributor acting at arm's length with its supplier would in many circumstances be expected to earn a profit without regard to the level of profit earned by the supplier.

(iii) *Nonrecognition provisions may not bar allocation.* When necessary to prevent the avoidance of taxes or to clearly reflect income, the district director may make an allocation under section 482 with respect to transactions

that otherwise qualify for nonrecognition of gain or loss under applicable provisions of the Internal Revenue Code (such as section 351 or 1031).

(iv) *Consolidated returns.* Section 482 and the regulations under that section apply to all controlled taxpayers, whether the controlled taxpayer files a separate or consolidated U.S. tax return. If a controlled taxpayer files a separate return, its true separate taxable income will be determined. If a controlled taxpayer is a party to a consolidated return, the true consolidated taxable income of the affiliated group and the true separate taxable income of the controlled taxpayer must be determined consistently with the principles of a consolidated return.

(2) *Limitations on allocations*—(i) *No allocation where results are within arm's length range*—(A) *In general.* Uncontrolled taxpayers that engage in comparable transactions under comparable circumstances do not always achieve identical results. Taken together, their differing results, each of which is an arm's length result, will establish a range of arm's length results (arm's length range). Thus, an arm's length result of a controlled transaction is not necessarily a single amount, and a result from a controlled transaction will not be subject to allocation under section 482 if it falls within the arm's length range established by two or more uncontrolled comparables.

(B) *Determination of arm's length range.* The arm's length range is determined by applying a single pricing method using two or more uncontrolled comparables, each of which independently establishes an arm's length result under the comparability analysis of paragraph (c) of this section and the provisions of the applicable method. The arm's length range may not be determined by applying two or more methods with respect to the controlled transaction under review. Although the size of an arm's length range will depend upon the facts and circumstances of each case, an unusually wide range may suggest that there are material differences among the uncontrolled comparables that have not been adequately taken into account, and for which adjustments may be required. For guidance concerning the computation of the arm's length range on the basis of multiple year data, see paragraph (d)(3)(v) of this section. For additional guidance concerning the determination of an arm's length range under the comparable profits method, see § 1.482–5T(d).

(C) *Adjustment where taxpayer's results are outside arm's length range.* If the results of a controlled transaction fall outside the arm's length range, the district director may make allocations that adjust the controlled taxpayer's result to any point within the arm's length range. Such adjustment ordinarily will be to the mid-point of the range.

(D) *Arm's length range not prerequisite to allocation.* The rules of this paragraph (d)(2)(i) do not require that the district director establish an arm's length range prior to making an allocation under section 482. Thus, for example, the district director may properly propose an allocation on the basis of a single comparable uncontrolled price that establishes an arm's length result under the provisions of paragraph (c) of this section and § 1.482–3T (b). However, if the taxpayer subsequently demonstrates that its results are within the range established by additional comparable uncontrolled prices that independently establish an arm's length result, then no allocation will be made.

(E) *Examples.* The principles of this paragraph (d)(2)(i) are illustrated by the following examples. In each example, P and S are members of the same group of controlled taxpayers.

Example 1. P, a U.S. corporation, manufactures product X and sells it to S, which acts as P's exclusive distributor of product X in Country M. The district director applies the resale price method to determine whether the transfer price for product X charged by P to S is at arm's length. The district director determines that the transactions of uncontrolled distributors A, B, and C are comparable, under the provisions of §§ 1.482–1T(c) and 1.482–3T(c)(3), to the controlled transaction between P and S. After making appropriate adjustments in accordance with §§ 1.482–1T(c)(2) and 1.482–3T(c)(3)(ii), the gross profit margins for A, B, and C are 8%, 10%, and 12%, respectively; S's gross profit margin is 9.5%. A range of 8% to 12% gross profit margins is not an unusually wide range given the norms of the industry involved. Therefore, because S's gross profit margin is within the range of gross profit margins earned by a group of uncontrolled comparable distributors, the transfer price charged by P for product X is an arm's length price, and no reallocation under this section is necessary.

Example 2. The facts are the same as in *Example 1*, except that S's gross profit margin is 15%. Since this result is not within the arm's length range, the district director allocates income from S to P in order to decrease S's gross profit margin to an amount that is within the arm's length range. Such adjustment would ordinarily be to the mid-point of the arm's length range, or 10%.

(ii) *Allocations apply to results, not methods.* In determining whether the result of a controlled transaction is arm's length, it is not necessary for the district director to determine whether the method or procedure that a controlled taxpayer employs to set the terms for its controlled transactions corresponds to the method or procedure that might have been used by a taxpayer dealing at arm's length with an uncontrolled taxpayer.

(iii) *Example.* The following example illustrates paragraph (d)(2)(ii) of this section.

Example. (i) FS is a foreign subsidiary of P, a U.S. corporation. P manufactures and sells household appliances. FS operates as P's exclusive distributor in Europe. P annually establishes the price for each of its appliances sold to FS as part of its annual budgeting, production allocation and scheduling, and performance evaluation processes. FS's aggregate gross margin earned in its distribution business is 18%.

(ii) ED is an uncontrolled European distributor of competing household appliances. After adjusting for minor differences in the level of inventory, volume of sales, and warranty programs conducted by FS and ED, ED's aggregate gross margin is also 18%. Thus, the district director may conclude that the aggregate prices charged by P for its appliances sold to FS are arm's length, without determining whether the budgeting, production, and performance evaluation processes of P are similar to such processes used by ED. In addition, the district director does not need to consider whether P and FS have treated inventory and warranty in the same manner as these factors have been treated by ED and its uncontrolled suppliers, since the results of the controlled transactions are the same as the results of the comparable uncontrolled transactions.

(3) *Rules relating to allocations under section 482.* In determining the extent to which an allocation should be made to reflect the true taxable income of a controlled taxpayer, the district director shall take into consideration the following rules.

(i) *Aggregation of transactions*—(A) *In general.* The district director may consider the combined effect of two or more separate transactions (whether before, during, or after the taxable year under review), where such transactions, taken as a whole, are so interrelated that consideration of multiple transactions is necessary to determine 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 § 1.6038A–3(c)(7)(vii).

(B) *Examples.* The following examples illustrate this paragraph (d)(3)(i). In each example, P, S1, S2, and S3 are members of the same group of controlled taxpayers.

Example 1. P enters into a license agreement with S1 that permits S1 to use a proprietary manufacturing process and to sell

the output from this process throughout a specified region. S1 uses the manufacturing process and sells its output to S2, which in turn resells the output to uncontrolled parties in the specified region. In testing the arm's length character of the royalty paid by S1 to P, the district director may consider the arm's length character of the transfer prices charged by S1 to S2 and the aggregate profits earned by S1 and S2 from the use of the manufacturing process and the sale to uncontrolled parties of the products produced by S1.

Example 2. S1, S2, and S3 are Country Z subsidiaries of U.S. manufacturer P. S1 is the exclusive Country Z distributor of computers manufactured by P. S2 provides marketing services in connection with sales of P computers in Country Z, and in this regard uses significant marketing intangibles provided by P. S3 administers the warranty program with respect to P computers in Country Z, including maintenance and repair services. In testing the arm's length character of the transfer price paid by S1 to P, of the fees paid by S2 to P for the use of P marketing intangibles, and of the service fees earned by S2 and S3, the district director may consider the combined effects of these separate transactions because they are so interrelated that they are most reasonably analyzed on an aggregate basis.

Example 3. The facts are the same as in *Example 2*. In addition, U1, U2, and U3 are uncontrolled taxpayers that carry out functions comparable to those of S1, S2, and S3, respectively, with respect to computers produced by unrelated manufacturers. R1, R2, and R3 are a controlled group of taxpayers (unrelated to the P controlled group) that also carry out functions comparable to those of S1, S2, and S3 with respect to computers produced by their common parent. Prices charged to uncontrolled customers of the R group differ from the prices charged to customers of U1, U2, and U3. In determining whether the transactions of U1, U2, and U3, or the transactions of R1, R2, and R3 may be reliable uncontrolled comparables, the district director may determine that the interrelated R group transactions are more reliable than the wholly independent transactions of U1, U2, and U3, given the interrelationship of the P group transactions.

Example 4. P enters into a license agreement with S1 that permits S1 to use a propriety process for manufacturing product X and to sell product X to uncontrolled parties throughout a specified region. P also sells to S1 product Y which is manufactured by P in the United States, and which is unrelated to product X. Product Y is resold by S1 to uncontrolled parties in the specified region. In testing the arm's length character of the royalty paid by S1 to P for the use of the manufacturing process for product X, and the transfer prices charged for unrelated product Y, the district director ordinarily would not consider the combined effects of these separate and unrelated transactions.

(ii) *Contractual arrangements.* The district director will ordinarily respect the terms of contractual arrangements between controlled taxpayers if such terms are consistent with the economic substance of the underlying transactions and the actual conduct of the parties. If the conduct of controlled taxpayers is inconsistent with their contractual arrangements, the district director may disregard such arrangements and instead give appropriate consideration to the actual conduct of the taxpayers. Similarly, where the regular and continuing conduct of controlled taxpayers is consistent with an agreement in substance, the district director may disregard the absence of a written document setting forth the terms of such an agreement. For example, when a controlled taxpayer that produces tangible property regularly sells substantially all its output to another member of its controlled group, in determining the producer's true taxable income, the district director may determine from the course of conduct of the controlled parties that the producer does not bear the risk that the buyer will fail to purchase its output, even if there is no written contract that expressly requires the buyer to do so. See *Example 3* of paragraph (c)(3)(ii)(E) of this section.

(iii) *Allocation based on taxpayer's actual transactions.* Except where a controlled transaction lacks economic substance, the district director will test the arm's length character of the results of a taxpayer's transaction as actually structured by the taxpayer, and ordinarily will not treat the transaction as if it has been structured in a different manner. Pursuant to the comparability analysis of § 1.482–1T(c)(3), however, the district director may consider the alternatives available to the taxpayer in determining whether the terms of the controlled transaction would be acceptable to an uncontrolled taxpayer faced with the same alternatives and operating under comparable circumstances. In such cases the district director may adjust the consideration charged in the controlled transaction based on the cost of an alternative, but will not restructure the transaction as if the alternative had been adopted by the taxpayer.

(iv) *Example.* The following example illustrates paragraph (d)(3)(iii) of this section.

Example. P and S are controlled taxpayers. P enters into a license agreement with S that permits S to use a proprietary process for manufacturing product X. Using its sales and marketing employees, S sells product X to related and unrelated customers outside the United States. If the license agreement between P and S has economic substance, the district director ordinarily will not restructure the taxpayer's transaction to treat P as if it had elected to exploit directly the manufacturing process. However, the fact that P could have manufactured product X may be taken into account as an alternative, under § 1.482–1T(c)(3)(iv), in determining the arm's length consideration for the controlled transaction. For an example of such an analysis, see § 1.482–4T(c)(2)(iv).

(v) *Multiple year data*—(A) *In general.* When testing the arm's length character of a controlled transaction, the district director will ordinarily compare the results of the controlled transaction under review with the actual prices charged or paid, or the actual profit earned, in uncontrolled transactions in the same year as the taxable year of the controlled taxpayer that is under review. Where appropriate, however, the district director may consider information about the uncontrolled comparables or the controlled taxpayer for one or more years before or after the year under review. Where data of uncontrolled comparables from multiple years is used, data from the controlled taxpayer for the same years ordinarily must be considered. However, if such data is not available, reliable data from other years, as adjusted under paragraph (c)(2)(ii) of this section, may be used. Where data from multiple years is considered, it may be appropriate to compare the controlled taxpayer's average results over the multi-year period with the average results of the uncontrolled comparables over the same period. See *Example 4* of § 1.482–1T(d)(3)(v)(D).

(B) *Circumstances warranting consideration of multiple year data.* Circumstances that may warrant consideration of information from multiple years include the unavailability of adequate and reliable data for the taxable year under review, the effect of business cycles in the controlled taxpayer's industry, or the effects of life cycles of the product or intangible being examined. Information from one or more years before or after the taxable year under review must ordinarily be considered for purposes of applying the provisions of § 1.482–1T(c)(3)(ii) (analysis of risk), § 1.482–1T(c)(4)(i) (market share strategy), § 1.482–1T(d)(2)(i) (arm's length range), § 1.482–4T(e)(2) (periodic adjustments), and § 1.482–5T (comparable profits method).

(C) *Comparable effect over comparable period.* The district director may review data from multiple years to determine whether the same economic conditions that caused the controlled taxpayer's results had a comparable effect over a comparable period of time on the uncontrolled comparables that establish the arm's length range. For example, where a controlled taxpayer

that realizes a loss with respect to a controlled transaction seeks to demonstrate that the loss is within the arm's length range, the district director may take into account data from taxable years other than the taxable year of the transaction to determine whether the same economic conditions that resulted in the controlled taxpayer's loss had a comparable effect over a comparable period of time on the uncontrolled comparables. The rule of this paragraph (d)(3)(v)(C) is illustrated by *Example 3* of paragraph (d)(3)(v)(D) of this section.

(D) *Examples.* The following examples, in which S and P are controlled taxpayers, illustrate this paragraph (d)(3)(v). *Examples 1* and *4* also illustrate the principle of the arm's length range of paragraph (d)(2)(i) of this section.

Example 1. P sold product Z to S for $60 per unit in 1995. Applying one of the methods provided in § 1.482–3T to data from uncontrolled comparables for the same year establishes an arm's length range of prices for the controlled transaction from $52 to $59 per unit. Since the price charged in the controlled transaction falls outside the range, the district director would ordinarily make an allocation under section 482. However, in this case there are short-run factors that affect the results of the uncontrolled comparables (and that of the controlled transaction) that cannot be adequately accounted for by specific adjustments to the data for 1995. Therefore, the district director considers results over multiple years to account for these factors. Under these circumstances, it is appropriate to average the results of the uncontrolled comparables over the years 1993, 1994, and 1995 to determine an arm's length range. The averaged results establish an arm's length range of $56 to $58 per unit. For consistency, the results of the controlled taxpayers must also be averaged over the same years. The average price in the controlled transaction over the three years is $57. Because the controlled transfer price of product Z falls within the arm's length range, the district director makes no allocation.

Example 2. (i) P, a Country X corporation, designs and manufactures machinery in Country X. P's costs are incurred in Country X currency. S is the exclusive distributor of P's machinery in the United States. The price of the machinery sold by P to S is expressed in Country X currency. Thus, S bears all of the currency risk associated with fluctuations in the exchange rate between the U.S. dollar and the Country X currency. The prices charged by P to S for 1995 are under examination. In that year, the value of the dollar depreciated against the currency of Country X, and as a result, S's gross margin was only 8%.

(ii) UD is an uncontrolled distributor of similar machinery that performs distribution functions substantially the same as those performed by S, except that UD purchases and resells machinery in transactions where both the purchase and resale prices are denominated in U.S. dollars. Thus, UD had no currency exchange risk. UD's gross margin in 1995 was 10%. UD's average gross margin for the period 1990 to 1998 has been 12%.

(iii) In determining whether the price charged by P to S in 1995 was arm's length, the district director may consider S's average gross margin for an appropriate period before and after 1995 to determine whether S's average gross margin during the period was sufficiently greater than UD's average gross margin during the same period such that S had a reasonable opportunity to realize above normal profits commensurate with the currency risk it bore throughout the period. See § 1.482–1T(c)(3)(ii).

Example 3. P manufactures product X in Country M and sells it to S, which distributes X in the United States. S realizes losses with respect to the controlled transactions in each of five consecutive taxable years. In each of the five consecutive years a different uncontrolled comparable realized a loss with respect to comparable transactions equal to or greater than S's loss. Pursuant to paragraph (d)(3)(v)(C) of this section, the district director examines whether the uncontrolled comparables realized similar losses over a comparable period of time, and finds that each of the five comparables realized losses in only one of the five years, and their average result over the five-year period was a profit. Based on this data, the district director may conclude that the controlled taxpayer's results are not within the arm's length range over the five year period, since the economic conditions that resulted in the controlled taxpayer's loss did not have a comparable effect over a comparable period of time on the uncontrolled comparables.

Example 4. (i) P manufactures product Y and sells it to S, which acts as P's exclusive distributor of product Y in Country N. The arm's length character of the transfer price charged by P to S for the 1993 taxable year for product Y is tested using the resale price method described in § 1.482–3T(c). For the period 1992 through 1994, S had a gross profit margin for each year of 3%. A, B, C and D are uncontrolled distributors of products that compete directly with product Y in country N. A, B, C and D are uncontrolled comparables within the meaning of § 1.482–1T(g)(10), and after making appropriate adjustments in accordance with §§ 1.482–1T(c)(2) and 1.482–3T(c), the gross profit margins for A, B, C, and D are as follows:

	1992	1993	1994	Average
A	12	2	9	7.67
B	10	13	2	8.33
C	2	9	11	7.00
D	8	11	7	8.67

(ii) Based on this data, the district director may conclude that S's gross margin of 3% is not within the arm's length range, despite the fact that A's gross margin for 1993 was only 2 percent, since the economic conditions that caused S's result did not have a comparable effect over a comparable period of time on the results of A or the other uncontrolled comparables.

(vi) *Product lines and statistical techniques.* The methods described in §§ 1.482–2T through 1.482–5T are generally stated in terms of individual transactions. However, because a taxpayer may have controlled transactions involving many different products, or many separate transactions involving the same product, it may be impractical to analyze every individual transaction to determine its arm's length price. In such cases, it is permissible to determine or verify arm's length results by applying the appropriate methods to the overall results for product lines or other groupings. In addition, the district director may determine or verify the arm's length price of all transactions to a controlled taxpayer by employing sampling and other valid statistical techniques.

(e) *Collateral adjustments with respect to allocations under section 482*—(1) *In general.* The district director will take into account appropriate collateral adjustments that affect the amount or the effect of an allocation under section 482. Appropriate collateral adjustments may include compensating adjustments, correlative adjustments, conforming adjustments, and setoffs, as described in this paragraph.

(2) *Compensating adjustments*—(i) *In general.* Except as provided in paragraph (e)(2)(iii) of this section, in making an allocation under section 482, the district director will take into account the effect of an arrangement between members of the group for reimbursement or other compensating adjustments. Such an arrangement will be taken into account only if the taxpayer establishes that—

(A) The reimbursement or other compensating adjustment is made pursuant to a written agreement between the controlled taxpayers;

(B) The arrangement provides for reimbursement or compensating adjustments among members of the group, as necessary to achieve an arm's length result for the controlled transaction under review; and

(C) The adjustments are made before the taxpayer's timely filing (including extensions) of a U.S. income tax return for the taxable year of the transaction.

(ii) *Treatment of adjustments.* A compensating adjustment under this paragraph (e)(2) will be deemed to accrue to the recipient as of the earlier of the date of actual payment or the last day of the taxable year to which it relates. The adjusted results will constitute the taxable income of the taxpayer for all U.S. income tax purposes. On or before the due date (with extensions) of the taxpayer's U.S. income tax return for the taxable year of the transaction, the parties may satisfy an accrued compensating adjustment in

any appropriate manner, including cash payment or adjustment to controlled taxpayers' books and records. Appropriate adjustments to the books and records include offsets to other accounts receivable or payable, recharacterizations of dividends paid, or contributions of capital. Any such adjustment to the books and records will relate to the taxable year giving rise to the compensating adjustment. If the compensating adjustment is not satisfied in such manner by the due date (with extensions) of the taxpayer's U.S. income tax return for the taxable year of the transaction, interest will accrue on the receivable from that date. The compensating adjustment may thereafter be satisfied at any time by cash payment or adjustments to the current taxable year's books and records.

(iii) *Pattern of abuse.* The district director may refuse to take into account a compensating adjustment if the district director determines that the controlled taxpayer has engaged in a pattern of transactions designed to abuse the provisions of this paragraph (e)(2).

(iv) *Example.* The following example illustrates this paragraph (e)(2).

Example. (i) FS is a foreign subsidiary of P, a U.S. corporation. P manufactures and sells a variety of household appliances in the United States. Both P and FS are calendar year corporations. FS operates as P's exclusive distributor of appliances in Europe. FS maintains inventory of various appliances, conducts advertising campaigns on behalf of P, and administers P's warranty program in Europe. P annually establishes the transfer price for each of its appliances sold to FS as part of its annual budgeting, production allocation and scheduling, and performance evaluation processes. P and FS have a written transfer pricing agreement that provides for retroactive price adjustments to reflect actual market conditions in a taxable year. The adjustments are made pursuant to a predetermined formula that is specified in the written agreement.

(ii) For purposes of setting transfer prices for 1994 in December 1993, P estimates that FS's sales volume will be 1,000 Foreign Currency Units (FCUs) and its advertising budget will be 15 FCUs. P also estimates that the average gross margin of comparable uncontrolled distributors in 1994 will be 18%. FS's actual sales volume in 1994 turns out to be only 900 FCUs, and its actual advertising expenses were 25 FCUs. FS's actual gross margin in 1994 was 16%. Pursuant to the transfer pricing agreement and price adjustment formula, P makes a price rebate to FS in January 1995 to take account of differences between budgeted and actual results.

(iii) In July, 1995, P determines that the comparable uncontrolled distributors actually earned an average gross margin of 14% in 1994. Pursuant to the price adjustment formula, FS returns a portion of the rebate it received in January. The compensating adjustments made by P and FS in January and July 1995 will be given effect and will be deemed to have accrued as of December 31, 1994.

(3) *Correlative allocations*—(i) *In general.* When the district director makes an allocation under section 482 (referred to in this paragraph (e)(3) as the "primary" allocation), appropriate correlative allocations will also be made with respect to any other member of the group affected by the allocation. Thus, if the district director makes an allocation of income, the district director will not only increase the income of one member of the group, but correspondingly decrease the income of the other member. In addition, where appropriate, the district director may make such further correlative allocations as may be required by the initial correlative allocation.

(ii) *Manner of carrying out correlative allocation.* The district director shall furnish to the taxpayer with respect to which the primary allocation is made a written statement of the amount and nature of the correlative allocation. The correlative allocation must be reflected in the documentation of the other member of the group that is maintained for U.S. tax purposes, without regard to whether it affects the U.S. income tax liability of the other member for any open year. In some circumstances the allocation will have an immediate U.S. tax effect, by changing the taxable income computation of the other member (or the taxable income computation of a shareholder of the other member, for example, under the provisions of subpart F of the Internal Revenue Code). Alternatively, the correlative allocation may not be reflected on any U.S. tax return until a later year, for example when a dividend is paid.

(iii) *Events triggering correlative allocation.* For purposes of this paragraph (e)(3), a primary allocation will not be considered to have been made (and therefore, correlative allocations are not required to be made) until the occurrence of any of the following events with respect to the primary allocation—

(A) The date of assessment of the tax following execution by the taxpayer of a Form 870 (Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment) with respect to such allocation;

(B) Acceptance of a Form 870–AD (Offer of Waiver of Restriction on Assessment and Collection of Deficiency in Tax Acceptance of Overassessment);

(C) Payment of the deficiency;

(D) Stipulation in the Tax Court of the United States; or

(E) Final determination of tax liability by offer-in-compromise, closing agreement, or final resolution (determined under the principles of section 7481) of a judicial proceeding.

(iv) *Examples.* The following examples illustrate this paragraph (e)(3). In each example, X and Y are members of the same group of controlled taxpayers and each regularly computes its income on a calendar year basis.

Example 1. (i) In 1996, Y, a U.S. corporation rents a building owned by X, also a U.S. corporation. In 1998 the district director determines that the rental charge paid by Y to X was not at arms's length and proposes to adjust X's income to reflect an arm's length rental charge. X consents to the assessment reflecting such adjustment by executing Form 870, a Waiver of Restrictions on Assessment and Collection of Deficiency in Tax and Acceptance of Overassessment. The assessment of the tax with respect to such adjustment is made in 1998. Thus, the primary allocation, as defined in paragraph (e)(3)(i) of this section, is considered to have been made in 1998.

(ii) The adjustment made to X's income under section 482 requires a correlative allocation with respect to Y's income. The district director notifies X in writing of the amount and nature of the adjustment made with respect to Y. Y had net operating losses in 1993, 1994, 1995, 1996, and 1997. Although a correlative adjustment will not have an effect on Y's U.S. income tax liability for 1996, an adjustment increasing Y's net operating loss for 1996 will be made for purposes of determining Y's U.S. income tax liability for 1998 or a later taxable year to which the increased net operating loss may be carried.

Example 2. (i) In 1995, X, a U.S. construction company, provided engineering services to Y, a U.S. corporation, in the construction of Y's factory. In 1997, the district director determines that the fees paid by Y to X for its services were not arm's length and proposes to make an adjustment to the income of X. X consents to an assessment reflecting such adjustment by executing Form 870. An assessment of the tax with respect to such adjustment is made in 1997. The district director notifies X in writing of the amount and nature of the adjustment to be made with respect to Y.

(ii) The fees paid by Y for X's engineering services properly constitute a capital expenditure. Y does not place the factory into service until 1998. Therefore, a correlative adjustment increasing Y's basis in the factory does not affect Y's U.S. income tax liability for 1997. However, the correlative adjustment must be made in the books and records maintained by Y for its U.S. income tax purposes and such adjustment will be taken into account in computing Y's allowable depreciation or gain or loss on a subsequent disposition of the factory.

Example 3. In 1995, X, a U.S. corporation, makes a loan to Y, its foreign subsidiary not

engaged in a U.S. trade or business. In 1997, the district director, upon determining that the interest charged on the loan was not arm's length, proposes to adjust X's income to reflect an arm's length interest rate. X consents to an assessment reflecting such allocation by executing Form 870, and an assessment of the tax with respect to the section 482 allocation is made in 1997. The district director notifies X in writing of the amount and nature of the correlative allocation to be made with respect to Y. Although the correlative adjustment does not have an effect on Y's U.S. income tax liability, the adjustment must be reflected in the documentation of Y that is maintained for U.S. tax purposes. Thus, for example, the adjustment must be reflected in the determination of the amount of Y's earnings and profits for 1995 and subsequent years, and of any other effect it may have on any person's U.S. income tax liability for any taxable year.

(4) *Adjustments to conform accounts to reflect section 482 allocations.* Pursuant to such applicable revenue procedures as may be provided by the Commissioner, the district director may permit adjustments to conform a taxpayer's accounts to reflect allocations made by the district director under section 482.

(5) *Setoffs*—(i) *In general.* When making an allocation under section 482 to determine the taxpayer's true taxable income for a taxable year, the district director will take into account any other controlled transaction in the same taxable year that is not at arm's length and that would result in a setoff against the allocation that would otherwise be made with regard to the first transaction. The district director will take into account such a setoff only if the taxpayer establishes that the other transaction was not at arm's length and the amount of the appropriate arm's length charge. If the effect of the setoff is to change the characterization or source of the income or deductions, or otherwise distort taxable income, in such a manner as to effect the U.S. tax liability of any member, allocations will be made to reflect the correct amount of each category of income or deductions. In order to establish that a setoff to the adjustments proposed by the district director is appropriate, the taxpayer must notify the district director of the basis of any claimed setoff within 30 days after the date of a letter by which the district director transmits an examination report notifying the taxpayer of proposed adjustments. For this purpose, the term arm's length refers to the amount defined in paragraph (b) of this section, without regard to the rules in § 1.482–2T under which certain charges are deemed to be equal to arm's length.

(ii) *Examples.* The following examples illustrate this paragraph (e)(5). In each example, P and S are members of the same group of controlled taxpayers.

Example 1. P renders services to S in connection with the construction of S's factory. An arm's length charge for such services, determined under § 1.482–2T(b) would be $100,000. During the same taxable year P makes available to S a machine to be used in such construction. P bills S $125,000 for the services, but does not bill for the use of the machines. No allocation will be made with respect to the excessive charge for services or the undercharge for the machine if P notifies the district director of the basis of any claimed setoff within 30 days after the date of a letter by which the district director transmits an examination report notifying the taxpayer of proposed adjustments, and can establish that the excessive charge for services was equal to an arm's length charge for the use of the machine and if the taxable income and income tax liabilities of P and S are not distorted.

Example 2. The facts are the same as in *Example 1*, except that, if P had reported $25,000 as rental income and $25,000 less service income, it would have been subject to the tax on personal holding companies. Allocations will be made to reflect the correct amounts of rental income and service income.

(f) *Special rules*—(1) *Small taxpayer safe harbor*—(i) *In general.* No allocations will be made under section 482 in the case of an eligible taxpayer that—

(A) Elects the provision of this paragraph (f)(1);

(B) Determines aggregate taxable income from all controlled transactions by applying the appropriate profit level indicator that the Commissioner provides in applicable revenue procedures; and

(C) Complies with the procedural requirements set forth in such revenue procedures.

(ii) *Eligible taxpayer.* An eligible taxpayer is a controlled taxpayer that either—

(A) Is a U.S. person with less than $10 million in sales revenue, as defined in § 1.482–5(f)(1), for the taxable year at issue; or

(B) Is a U.S. person that engages in cross-border transactions with a controlled taxpayer that is foreign (foreign controlled taxpayer) and such foreign controlled taxpayer has less than $10 million in sales revenue for the taxable year at issue. For this purpose, a cross-border controlled transaction is a controlled transaction in which property or services are transferred either to or from the United States by a controlled taxpayer.

(iii) *Aggregation.* (A) For purposes of paragraph (f)(1)(ii)(A) of this section, the sales revenue of all U.S. members of the transferee's controlled group must be aggregated.

(B) For purposes of paragraph (f)(1)(ii)(B) of this section, the sales revenue of all foreign controlled taxpayers with which the U.S. person engaged in cross-border transactions must be aggregated.

(iv) *Election to apply the appropriate profit level indicator.* (A) An eligible taxpayer elects under this paragraph (f)(1) to apply the appropriate profit level indicator by attaching to a timely filed U.S. income tax return a written statement indicating that the provisions of this paragraph (f)(1) are being elected In addition, the written statement shall contain all other information as may be required in applicable revenue procedures.

(B) An election made pursuant to this paragraph (f)(1) will apply to the taxable year in which it was made and to all subsequent taxable years. An election under this paragraph (f)(1) may be revoked only with the consent of the Commissioner.

(C) An election under this paragraph (f)(1) will not apply in any taxable year in which the controlled taxpayer is not an eligible taxpayer. The election will apply in all subsequent years in which the controlled taxpayer again qualifies as an eligible taxpayer. The election will not apply in a subsequent year, however, if the district director determines that the controlled taxpayer has engaged in a pattern of transactions designed to abuse the provisions of this paragraph (f)(1).

(2) *Effect of foreign legal restrictions.* [Reserved]

(3) *Coordination with section 936*—(i) *Cost sharing under section 936.* If a possessions corporation makes an election under section 936(h)(5)(C)(i)(I), the corporation must make a section 936 cost sharing payment that is at least equal to the payment that would be required under section 482 if the electing corporation were a foreign corporation. In determining the payment that would be required under section 482 for this purpose, the provisions of §§ 1.482–1T and 1.482–4T through 1.482–5T will be applied. The provisions of section 936(h)(5)(C)(i)(II) ("Effect of Election"—electing corporation treated as owner of intangible property) do not apply until the payment that would be required under section 482 has been determined.

(ii) *Use of terms.* A cost sharing payment, for the purposes of section 936(h)(5)(C)(i)(I), is calculated using the provisions of section 936 and the regulations thereunder and the provisions of this paragraph (f)(3). The

provisions relating to cost sharing under section 482 do not apply to payments made pursuant to an election under section 936(h)(5)(C)(i)(I). Similarly, a profit split payment, for the purposes of section 936(h)(5)(C)(ii)(I), is calculated using the provisions of section 936 and the regulations thereunder, not section 482 and the regulations thereunder.

(g) *Definitions.* The definitions set forth in paragraphs (g)(1) through (10) of this section apply to §§ 1.482–1T through 1.482–6T.

(1) *Organization* includes any organization of any kind, whether a sole proprietorship, a partnership, a trust, an estate, an association, or a corporation (as each is defined or understood in the Internal Revenue Code or the regulations thereunder), irrespective of the place of its organization, operation, or conduct of its trade or business, and regardless of whether it is a domestic or foreign organization, whether it is an exempt organization, or whether it is a member of an affiliated group that files a consolidated U.S. income tax return, or a member of an affiliated group that does not file a consolidated U.S. income tax return.

(2) *Trade* or *business* includes a trade or business activity of any kind, regardless of whether or where organized, whether owned individually or otherwise, and regardless of the place of operation.

(3) *Taxpayer* means any person, organization, trade or business, whether or not subject to any internal revenue tax.

(4) *Controlled* includes any kind of control, direct or indirect, whether legally enforceable, and however exercisable or exercised. It is the reality of the control that is decisive, not its form or the mode of its exercise. A presumption of control arises if income or deductions have been arbitrarily shifted as a result of the actions of two or more taxpayers acting in concert or with a common goal or purpose.

(5) *Controlled taxpayer* means any one of two or more taxpayers owned or controlled directly or indirectly by the same interests. The term *uncontrolled taxpayer* means any one of two or more taxpayers not owned or controlled directly or indirectly by the same interests.

(6) *Group, controlled group* and *group of controlled taxpayers* mean the taxpayers owned or controlled directly or indirectly by the same interests.

(7) *Transaction* means any sale, assignment, lease, license, loan, advance, contribution, or any other transfer of any interest in or a right to use any property (whether tangible or intangible, real or personal) or money, however such transaction is effected, and whether or not the terms of such transaction are formally documented. A transaction also includes the performance of any services for the benefit of, or on behalf of, another taxpayer.

(8) *Controlled transaction* or *controlled transfer* means any transaction or transfer between two or more members of the same group of controlled taxpayers. The term *uncontrolled transaction* means any transaction between two or more taxpayers that are not members of the same group of controlled taxpayers.

(9) *True taxable income* means, in the case of a controlled taxpayer, the taxable income that would have resulted had it dealt with the other member or members of the group at arm's length. It does not mean the taxable income resulting to the controlled taxpayer by reason of the particular contract, transaction, or arrangement the controlled taxpayer chose to make (even though such contract, transaction, or arrangement is legally binding upon the parties thereto).

(10) *Uncontrolled comparable* means the uncontrolled transaction or uncontrolled taxpayer that is compared with a controlled transaction or taxpayer under any applicable pricing methodology. Thus, for example, when applying the comparable profits method, an uncontrolled comparable is any uncontrolled taxpayer from which data is used to establish a constructive operating profit.

(h) *Effective dates.* These regulations are generally effective for taxable years beginning after April 21, 1993. They will not apply with respect to transfers made or licenses granted to foreign persons before November 17, 1985, or before August 17, 1986, for transfers or licenses to others. Nevertheless, they will apply with respect to transfers or licenses before such dates if, with respect to property transferred pursuant to an earlier and continuing transfer agreement, such property was not in existence or owned by the taxpayer on such date. Although these regulations are generally effective for taxable years as stated, the final sentence of section 482 (requiring that the income with respect to transfers or licenses of intangible property be commensurate with the income attributable to the intangible) is generally effective for taxable years beginning after December 31, 1986. For the period prior to the effective date of these regulations, the final sentence of section 482 must be applied using any reasonable method not inconsistent with the statute. The Internal Revenue Service considers a method that applies these regulations or their general principles to be a reasonable method.

§ 1.482–2T Determination of taxable income in specific situations.

(a) through (c). [Reserved]. (For further information see § 1.482–2A (a) through (c).)

(d) *Transfer of property.* For rules governing allocations under section 482 to reflect an arm's length consideration for controlled transactions involving the transfer of property, see §§ 1.482–3T through 1.482–5T.

§ 1.482–3T Methods to determine taxable income in connection with a transfer of tangible property.

(a) *In general.* The arm's length character of the amount charged in a controlled transfer of tangible property must be determined under one of the five methods listed in this paragraph (a). The five methods must be applied in accordance with the provisions of § 1.482–1T. The selection of a method for the particular transaction under review will be subject to the best method rule of § 1.482–1T(b)(2)(iii)(A). The methods are—

(1) The comparable uncontrolled price method, described in paragraph (b) of this section;

(2) The resale price method, described in paragraph (c) of this section;

(3) The cost plus method, described in paragraph (d) of this section;

(4) The comparable profits method, described in § 1.482–5T; and

(5) Other methods, described in paragraph (e) of this section.

(b) *Comparable uncontrolled price method*—(1) *In general.* Under the comparable uncontrolled price method, the arm's length price for a controlled sale of tangible property is equal to the price paid in a comparable uncontrolled transaction. For purposes of applying the best method rule of § 1.482–1T(b)(2)(iii)(A), the comparable uncontrolled price method, when it can be reasonably applied on the basis of available data, ordinarily will provide the most accurate measure of an arm's length price for the transfer of tangible property. This method relies upon a product comparable, as described in § 1.482–1T(c)(1)(ii). Factors to be considered in the application of this method include the access to relevant pricing and other financial information, and the existence of an active market, which would include contemporaneous transactions between uncontrolled taxpayers involving comparable property.

(2) *Standard of comparability*—(i) *In general.* Whether an uncontrolled

transaction is comparable to a controlled transaction must generally be determined under the standards of § 1.482–1T(c). However, for purposes of the comparable uncontrolled price method, transactions are considered comparable only if the tangible property and circumstances of the controlled transaction are substantially the same as those of the uncontrolled transaction. The tangible property and circumstances of an uncontrolled transaction will be considered substantially the same as those of a controlled transaction only if any minor differences between the transactions either have no effect on the amount charged, or can be accounted for by a reasonable number of adjustments to the uncontrolled transaction. If there are material differences between the controlled and uncontrolled transactions, other methods must be applied, such as the resale price method described in paragraph (c) of this section, the cost plus method described in paragraph (d) of this section, or the comparable profits method described in § 1.482–5T. For example, if the functions performed by the taxpayer in the controlled transaction are materially different from the functions performed in the uncontrolled transaction, the comparable uncontrolled price method cannot be applied.

(ii) *Factors for determining comparability and required adjustments.* The comparability of controlled and uncontrolled transactions, the effect of any differences between them on the amount charged, and any adjustment required under paragraph (b)(2)(i) of this section, depend upon the particular property and circumstances involved. Although all of the factors described in § 1.482–1T(c)(3) must be considered, specific factors that may be particularly relevant to this method include the following—

(A) Quality of the product;

(B) Sales volume;

(C) The level of the market (*e.g.*, wholesale, retail, etc.);

(D) The geographic market in which the transaction takes place;

(E) Date of the transaction;

(F) The alternative commercial arrangements realistically available to the buyer and seller; and

(G) Intangible property associated with the sale.

(iii) *Arm's length range.* Where two or more uncontrolled transactions independently establish an arm's length price under this paragraph (b), such transactions will establish an arm's length range, as described in § 1.482–1T(d)(2)(i).

(iv) *Examples.* The principles of this paragraph (b) are illustrated by the following examples. In each example, X sells the same product in both controlled and uncontrolled sales:

Example 1. The circumstances surrounding the controlled and uncontrolled transactions are substantially the same, except that the controlled sales price is a delivered price and the uncontrolled sales are made f.o.b. X's factory. Since differences in the contractual terms of transportation and insurance generally have a definite and reasonably ascertainable effect on price, the uncontrolled transactions are comparable for purposes of the comparable uncontrolled price method, provided the adjustments are made to the price of the uncontrollable transaction to reflect such differences.

Example 2. The circumstances surrounding the controlled and uncontrolled transactions are substantially the same, except that X affixes its valuable trademark to the property sold in the controlled transactions, but does not affix its trademark to the property sold in the uncontrolled transactions. Since the effects on price of such differences that are attributable to the intangible property associated with the sale of tangible property are ordinarily significant but not reasonably ascertainable, such differences would ordinarily render the uncontrolled transactions noncomparable for purposes of applying the comparable uncontrolled price method.

Example 3. The circumstances surrounding the controlled and uncontrolled transactions are substantially the same except that X, a manufacturer of business machines, makes certain minor modifications in the physical properties of the machines to satisfy specific requirements of a customer in controlled sales, but does not make these modifications in uncontrolled sales. Since minor physical differences in the product generally have a definite and reasonably ascertainable effect on prices, such differences do not normally render the uncontrolled transactions noncomparable for purposes of applying the comparable uncontrolled price method.

Example 4. The circumstances surrounding the controlled and uncontrolled sales are substantially the same, except that, in the controlled sales, the seller bears the warranty obligations that arise upon the resale of the product. If this difference is minor and the effect of this difference on the price can be reasonably ascertained, for purposes of the comparable uncontrolled price method, the uncontrolled sales will be comparable to the controlled sales.

Example 5. The circumstances surrounding the controlled and uncontrolled sales are substantially the same, except for the fact that the volume of controlled sales is greater than the volume of uncontrolled sales. The volume of controlled sales produces a reasonably ascertainable volume discount. The price of the uncontrolled transaction, adjusted to account for the difference in volume from the controlled transaction, provides an arm's length price of the controlled transaction. See also the *Example* under § 1.482–1T(c)(2)(iii).

Example 6. The circumstances surrounding the controlled and uncontrolled transactions are substantially the same, except that the controlled sales are made into country A and the uncontrolled sales are made into country B. In both controlled and uncontrolled transactions, the buyer is a distributor of X's products at the wholesale market level. In this case, differences in geographic markets may result in differences in significant costs and the applicable resale price. Such differences are material and render the uncontrolled transactions noncomparable to the controlled transactions, even if the effect of any such differences could be reasonably ascertained. However, the uncontrolled sales may qualify as comparable uncontrolled transactions for purposes of applying the resale price method described in paragraph (c) of this section.

(c) *Resale price method*—(1) *In general.* The resale price method tests the arm's length character of a controlled transaction by reference to the gross profit margin realized in comparable uncontrolled transactions. The resale price method measures the value of distribution functions and is ordinarily used in cases involving the purchase and resale of tangible property where the distributor has not added substantial value to the tangible goods by physically altering the goods before resale or by the use of intangible property. For this purpose packaging, repackaging, labelling, or minor assembly do not ordinarily constitute physical alteration. This method relies upon a functional comparable, as described in § 1.482–1T(c)(1)(ii).

(2) *Determination of arm's length price*—(i) *In general.* An arm's length price is determined under the resale price method by subtracting the appropriate gross profit from the applicable resale price for the property involved in the controlled transaction under review.

(ii) *Applicable resale price.* The applicable resale price is equal to either the resale price of the particular item of property involved or the price at which contemporaneous resales of the same property are made. Where the property purchased in the controlled sale is resold to one or more related parties in a series of controlled sales before being resold in an uncontrolled sale, the applicable resale price is the price at which the property is resold to an uncontrolled party, or the price at which contemporaneous resales of the same property are made. In such case, the determination of the appropriate gross profit will take into account the functions of all members of the group participating in the series of controlled sales and final uncontrolled resale, as well as any other relevant factors described in § 1.482–1T(c)(3).

(iii) *Appropriate gross profit.* The appropriate gross profit is computed by

multiplying the applicable resale price by the appropriate gross profit margin (expressed as a percentage of total revenue derived from sales) earned in comparable uncontrolled transactions. In order to achieve comparability when calculating the appropriate gross profit margin, the elements that enter into the computation of the sales price and the cost of goods sold of the property involved in the controlled and uncontrolled transactions must be the same. Accounting reclassifications may be required to ensure consistent treatment of such items as discounts, returns and allowances, freight-in and freight-out, insurance, and packaging. Whenever possible, gross profit margins should be derived from comparable uncontrolled purchases and resales of the distributor involved in the controlled sale, because similar characteristics are more likely to be found among different resales of property made by the same distributor than among sales made by other distributors. In the absence of comparable uncontrolled transactions by the same distributor, an appropriate gross profit margin may be derived from comparable uncontrolled transactions of other distributors.

(iv) *Arm's length range.* Where two or more uncontrolled transactions independently establish an arm's length price under paragraph (c)(3) of this section, such transactions will establish an arm's length range, as described in § 1.482–1T(d)(2)(i).

(3) *Standard of comparability*—(i) *In general.* The determination of whether an uncontrolled transaction is comparable to the controlled transaction will be made by applying the standards of § 1.482–1T(c). A distributor's gross profit provides compensation for the performance of distribution functions related to the product or products under review, including an operating profit in return for the distributor's investment of capital and the assumption of risks. Therefore, for purposes of the resale price method, close physical similarity of the property involved in the controlled and uncontrolled transactions is not ordinarily necessary to establish the comparability of the distributor's gross profit margin. For example, distributors of a wide variety of consumer durables might perform comparable distribution functions without regard to the specific durable goods distributed. It would ordinarily be expected, however, that the controlled and uncontrolled transactions involve the distribution of products within the same product categories. In the absence of such sales, the prevailing gross profit margins in the general industry involved may be appropriate.

(ii) *Adjustments for differences between controlled and uncontrolled transactions.* Appropriate adjustments for differences must be made to the gross profit margins earned with respect to uncontrolled transactions, pursuant to the standards of § 1.482–1T(c)(2)(ii). For this purpose, it is necessary to consider operating expenses associated with functions performed and risks assumed. If there are differences in functions performed, the effect on price of such differences is not necessarily equal to the differences in the amount of related operating expenses. Although all of the criteria of § 1.482–1T(c)(3) must be considered, specific factors that may be particularly relevant to this method include—

(A) The inventory levels and turnover rates;

(B) The scope and terms of warranties provided;

(C) Sales, marketing, advertising programs and services, (including promotional programs, rebates, and co-op advertising);

(D) Sales volumes;

(E) The level of the market;

(F) Foreign currency risks; and

(G) Extensions of credit and payment terms.

(iii) *Sales agent.* Where the controlled taxpayer is comparable under the standards of comparability under paragraph (c)(3) of this section and § 1.482–1T(c) to a sales agent that does not take title to goods, the commission earned by such sales agent, expressed as a percentage of the uncontrolled sales price of the goods involved, may constitute the appropriate gross profit margin.

(4) *Examples.* The following examples illustrate this paragraph (c).

Example 1. A controlled taxpayer sells property to another member of its controlled group that resells the property in uncontrolled sales. If the applicable resale price of the property involved in the controlled sale is $100 and the appropriate gross profit margin for resales is 20%, the arm's length price of the controlled sale is $80 ($100 minus 20% x $100).

Example 2. (i) A controlled taxpayer, P, sells property to another member of its controlled group, S, which resells such property in uncontrolled sales. S's total reported cost of goods sold is $800, consisting of $600 for property purchased from P and $200 of other costs of goods sold incurred to unrelated parties. S's applicable resale price and reported gross profit are as follows:

Applicable resale price	$1000
Cost of goods sold:	
Cost of purchases from P	600
Costs incurred to unrelated parties	200
Reported gross profit	$200

(ii) The district director determines that the appropriate gross profit margin is 25%. Therefore, S's appropriate gross profit is $250 (*i.e.*, 25% of the applicable resale price of $1000). Because S is incurring costs of sales to unrelated parties, the arm's length price for property purchased from P must be determined under a two-step process. First, the appropriate gross profit ($250) is subtracted from the applicable resale price ($1000). The resulting amount ($750) is then reduced by the costs of sales incurred to unrelated parties ($200). Therefore, the arm's length price in this case equals $550 (*i.e.*, $750 minus $200).

Example 3. If X sells a product to Y in a controlled sale, Y sells the product to Z in a controlled sale, and Z sells the product in an uncontrolled sale, the applicable resale price is the price at which Z sold the product in the uncontrolled sale. The determination of the appropriate gross profit margin will take into account the functions performed by X, Y, and Z, as well as relevant factors described in § 1.482–1T(c).

Example 4. (i) S, a domestic corporation, distributes clothing that it purchases from its foreign parent corporation. S's gross profit margin is 25%. Another domestic corporation, U, distributes comparable clothing that it purchases from uncontrolled taxpayers. U's gross profit margin also is 25%. S's controlled transaction and U's uncontrolled transaction are comparable under paragraph (c)(3) of this section and no adjustment for differences in functions or circumstances is required under § 1.482–1T(c). However, U treats warranty as expenses included in cost of goods sold while S treats warranty as an operating expense. Accordingly, adjustments are required to U's gross margin to ensure accounting consistency between U and S.

(ii) U's warranty represents 10% of U's total revenue from sales. After reclassifying the expense as below-the-line expenses, U's gross profit margin is 35%. Thus, S's appropriate gross profit margin is 35%.

Example 5. P and S are members of the same controlled group. S purchases electric mixers from P and electric toasters from unrelated parties. S performs comparable functions with respect to resales of both the mixers and the toasters, except that it does not warrant the toasters, but does provide a 90-day warranty for the mixers. S normally earns a gross profit on toasters of 20% of gross selling price. The 20% gross profit on the resale of toasters must be adjusted to reflect the difference in functions (the warranty), and as adjusted, is an appropriate gross profit margin.

Example 6. (i) P manufactures Product X, an unbranded widget, and sells it to S, its wholly owned subsidiary. S acts as a distributor of Product X in country M, and sells it to uncontrolled taxpayers in that country. Uncontrolled distributors A, B, and C distribute competing products in country M. All such products are unbranded, and the resale price in country M is $100 per unit.

(ii) Based on an analysis of the functions performed and risks assumed by S and by A, B, and C and a review of their financial statements, the district director has determined the following for 1994:

	S	A	B	C
Reported gross profit ($)	18	22	14	16
Accounting reclassifications		[2]	4	1
Comparability adjustments:				
Inventory		2	[1]	
Advertising		[3]	2	1
Warranty		1	[3]	[1]
Volume			[1]	[1]
Adjusted gross profit	($)18	20	15	16

(iii) Applying the resale price method to test the arm's length character of the amount paid by P for the distribution functions performed by S, the district director determines that any gross profit between $15 and $20 will produce an arm's length margin, and any price for product X between $80 and $85 would be an arm's length price.

Example 7. The facts are the same as in *Example 6*, except that Product X is a branded widget and the resale price in country M is $110. P owns the worldwide rights to the brand name, including in country M. The district director determines that there has been no transfer of an intangible, and that P retains all rights to the brand name. The district director determines that the resale price method applies to price the distribution functions of S, and that the transactions of distributors A, B, and C are comparable uncontrolled transactions. No additional comparability adjustments are required. Because the entire value of the brand name should inure to the benefit of P, S should continue to earn gross profit of between $15 and $20 to compensate it for its distribution functions. An arm's length transfer price would be any price between $90 and $95.

Example 8. (i) The facts are the same as in *Example 7*, except that the brand name is not widely known within country M, and it does not command any price premium over its competitors. Thus, the resale price of Product X is $100, and the arm's length transfer price in 1994 is between $80 and $85. In year 1996, P and S decide to develop a premium image for Product X in country M. S is to supervise the advertising and other marketing efforts that will be required to develop the brand name in country M. S increases strategic advertising and promotion expenses by $5, for which it is not directly reimbursed by P. However, P reduces the transfer price from $82 to $77.

(ii) The district director determines that there has been no transfer of an intangible from P to S in 1996, and that the resale price method applies to test the arm's length character of the price paid by S to P for product X. The transactions of distributors A, B, and C are comparable uncontrolled transactions after the adjustments shown in *Example 6* are made. However, an additional comparability adjustment is required to reflect the $5 additional advertising and promotional activities undertaken by S. Thus, the district director determines that the adjusted gross profit margins of distributors A, B, and C for 1996 are as follows:

	S	A	B	C
Reported gross profit ($)	23	22	14	16
Accounting reclassifications		[2]	4	1
Comparability adjustments:				
Inventory		2	[1]	
Advertising		2	7	6
Warranty		1	[3]	[1]
Volume			[1]	[1]
Adjusted gross profit	($)23	25	20	21

(iii) Thus, the district director determines that S should earn a gross profit of between $20 and $25 and an arm's length transfer price in 1996 would be any price between $75 and $80.

Example 9. The facts are the same as in *Example 8*, except that the brand name for Product X takes on value and begins to command a premium price in the marketplace. The value should inure to the benefit of P since there has been no transfer to S of any intangible rights in the brand name. Thus, as the applicable resale price goes up, the transfer price would go up accordingly. In addition, if S begins to reduce its advertising and promotional efforts, the comparability analysis would be adjusted to reflect that change, and the transfer price would again increase.

Example 10. (i) P manufactures and sells Product X to S, its wholly owned subsidiary, and to A, B, and C, which are uncontrolled taxpayers comparable to S. P sells Product X to S, A, B, and C under comparable circumstances for $82. In 1995, S decides to adopt a new marketing strategy and intends to develop a brand name, XY, for Product X with the expectation that it will command a premium price in the marketplace. Thus, S increases its expenditures for strategic advertising and promotion by $5, for which it is not directly reimbursed by P. Moreover, P does not reduce the transfer price below $82. In 1996, Product XY begins to command a price premium in the marketplace, and the resale price for Product XY increases from $100 to $110. P increases its price to S to $92.

(ii) There has been no transfer of an intangible from P to S since S has invested in the development of its own intangible. The district director applies the resale price method to test the arm's length character of the transfer price for Product XY in both 1995 and 1996. In 1995, the investment does not give rise to a price premium. Thus, no comparability adjustment is made to reflect S's investment in strategic advertising intended to develop S's brand name since that investment has not resulted in a price premium and therefore, has not had an effect on S's gross profit in that year. In 1996, as the brand name takes on value and begins to command a price premium, an adjustment must be made to the gross profit margins of the uncontrolled distributors to reflect S's increase in the resale price of Product XY. Assuming the gross profit of distributors A, B, and C is $20, $15, and $16, respectively, after adjustments for differences other than the increase in the S's resale price of product XY, then a further adjustment to their gross profit is made for the difference in market price premium, as follows:

	S	A	B	C
Partially adjusted gross profit ($)	18	20	15	16
Adjustment for price premium		10	10	10
Adjusted gross profit ($)	18	30	25	26

S's appropriate gross profit should range between $25 and $30. By increasing the transfer price of product XY sold to S in 1996, P, in effect, obtained the benefit of the price premium that should have insured to S, as a result of its successful market development strategies. Thus, an arm's length price would be any price between $80 and $85 and the $92 price charged by P to S in 1996 is not arm's length.

Example 11. (i) P has developed and manufactures Product X, a diskette that contains proprietary computer software. The computer software can be used without significant ' systems engineering" or "application engineering" by the ultimate customer, and is sold through common retail outlets. P sells the diskette to S, its controlled distributor, and S distributes to diskette to uncontrolled computer sales outlets in country M.

(ii) Regardless of whether the taxpayer characterizes the controlled transaction as a transfer of tangible or intangible property, the district director determines that an analysis of the functions performed and risks assumed by S demonstrates that these functions and risks do not materially differ from the functions and risks of distributors A, B, and C. Thus, the district director determines that the resale price method would apply to the price paid by S for Product X. The value of the software itself (an intangible) is reflected in the resale price of the diskette when it is sold to the uncontrolled computer sales outlets, and is, therefore, established by the marketplace. The entire value of the intangible inures to the benefit of P.

(d) *Cost plus method*—(1) *In general.* The cost plus method tests the arm's length character of a controlled transaction by reference to the gross profit markup realized in comparable uncontrolled transactions. The cost plus method is ordinarily used in cases involving the manufacture, assembly, or other production of goods that are sold to related parties. This method relies upon a functional comparable, as described in § 1.482–1T(c)(1)(ii).

(2) *Determination of arm's length price*—(i) *In general.* An arm's length price for the controlled transfer is equal to the controlled taxpayer's costs of producing the property involved in the controlled transaction plus an amount equal to those costs multiplied by the appropriate gross profit markup.

(ii) *Appropriate gross profit markup.* The appropriate gross profit markup is equal to the gross profit earned in

comparable uncontrolled transactions, expressed as a percentage of cost. Whenever possible, the gross profit markup should be derived from comparable uncontrolled sales made by the taxpayer involved in the controlled sale, because similar characteristics are more likely to be found among sales of property made by the same producer than among sales by other producers. In the absence of such sales, an appropriate gross profit markup may be derived from comparable uncontrolled sales of other producers whether or not such producers are members of the controlled group.

(iii) *Consistency in accounting.* The costs of producing the property involved in the controlled transaction and the costs that enter into the computation of the appropriate gross profit markup must be computed in a consistent manner in accordance with sound accounting practices for allocating and apportioning costs, which neither favors nor disfavors controlled transactions in comparison with the uncontrolled transaction. Thus, if the costs used in computing the appropriate gross profit markup are comprised of the full cost of goods sold, including direct and indirect costs, then the cost of producing the property involved in the controlled transaction must be comprised of the full cost of goods sold, including direct and indirect costs. However, if the costs used in computing the appropriate gross profit markup are comprised only of direct costs, then the costs of producing the property involved in the controlled transaction must be comprised only of direct costs. The term "cost of producing" includes the cost of acquiring property that is held for resale.

(iv) *Arm's length range.* Where two or more uncontrolled transactions independently establish an arm's length price under this paragraph (d), such transactions will establish an arm's length range, as described in § 1.482–1T(d)(2)(i).

(3) *Standard of comparability*—(i) *In general.* The determination of whether an uncontrolled transaction is comparable to the controlled transaction will be made by applying the standards of § 1.482–1T(c). A producer's gross profit markup provides compensation for the performance of the production functions related to the product or products under review, including an operating profit for the producer's investment of capital and assumption of risks. Therefore, for purposes of the cost plus method, close physical similarity of the property involved in the controlled and the uncontrolled transactions is not ordinarily necessary to establish the comparability of the producers' gross profit markups. It would ordinarily be expected, however, that the controlled and uncontrolled transactions involve production of products within the same product categories. For example, producers of a wide variety of components for consumer electronics might perform comparable manufacturing and assembly functions without regard to the specific products produced, but producers of pharmaceuticals may not be comparable to producers of apparel. In the absence of such sales, the prevailing gross profit markup in the general industry involved may be appropriate.

(ii) *Adjustments for differences between controlled and uncontrolled transactions.* Appropriate adjustments for differences must be made to the gross profit with respect to comparable uncontrolled transactions, pursuant to the standards of § 1.482–1T(c)(2)(ii). For this purpose, it is necessary to consider operating expenses associated with functions performed and risks assumed. If there are differences in functions performed, the effect on price of such differences is not necessarily equal to the differences in the amount of related operating expenses. Although all of the criteria of § 1.482–1T(c)(3) must be considered, specific factors that may be particularly relevant to this method include—

(A) The complexity of manufacturing or assembly;

(B) Manufacturing, production, and process engineering;

(C) Procurement, purchasing, and inventory control activities;

(D) Testing functions;

(E) Selling, general, and administrative expenses;

(F) Foreign currency risks; and

(G) Extension of credit and payment terms.

(iii) *Purchasing agent.* Where a controlled taxpayer is comparable under the criteria under this paragraph (d)(3) and § 1.482–1T(c)(3) to a purchasing agent that does not take title to property, the commission earned by such purchasing agent, expressed as a percentage of the purchase price of the goods, may constitute the appropriate gross profit markup.

(4) *Examples.* The following examples illustrate the principles of this paragraph (d). In these examples, X and Y are members of the same group of controlled taxpayers.

Example 1. (i) X is a domestic manufacturer of computer chips that sells computer chips to its foreign subsidiary Y. X earns an 8% gross profit markup with respect to its manufacturing operations. UT1, UT2, and UT3 are domestic computer chip manufacturers that sell to uncontrolled foreign purchasers. UT1, UT2, and UT3 earn gross profits markups with respect to their manufacturing operations that range from 6% to 8%.

(ii) The controlled sales by X, and the uncontrolled sales by UT1, UT2, and UT3 are comparable under paragraph (d)(3) of this section. X accounts for supervisory, general, and administrative costs as operating expenses, which are not allocated to its sales to Y. The gross profit markups of UT1, UT2, and UT3, however, reflect supervisory, general, and administrative expenses because they are accounted for as costs of goods sold. Accordingly, the gross profit markups of UT1, UT2, and UT3 must be adjusted as provided in paragraph (d)(3)(ii) of this section to provide accounting consistency.

(iii) After subtracting these expenses from the cost of goods sold of UT1, UT2, and UT3, the gross profit markups of UT1, UT2, and UT3 are between 10% and 12%. Thus, X's 8% gross profit markup is not within the range established by the results of UT1, UT2, and UT3 (assuming no other adjustments are required for other differences that may exist between X and UT1, UT2, and UT3). Consequently, the price at which X sells compact disc players to Y is not arm's length

Example 2. The facts are the same as in *Example 1*, except that under its contract with Y, X uses materials consigned by Y. UT1, UT2, and UT3, on the other hand, purchase their own materials, and their gross profit markups are determined by including the costs of material. The fact that X does not carry an inventory risk by purchasing its own materials while the uncontrolled producers carry inventory is a significant difference that may require an adjustment if the difference has an effect on the gross profit markups of the uncontrolled producers. Inability to reasonably ascertain the effect of the difference on the gross profit markups would render UT1, UT2, and UT3 noncomparable for purposes of applying the cost plus method.

(e) *Other methods*—(1) *In general.* Where none of the methods listed in paragraph (a) (1), (2), (3), or (4) of this section can reasonably be applied under the facts and circumstances of a particular case, another method may be used to determine the arm's length consideration for the controlled transaction. Any method used under this paragraph (e) must be applied in accordance with the provisions of § 1.482–1T.

(2) *Conditions for taxpayers's use of other methods.* A taxpayer may use a method under this paragraph (e) to establish the arm's length consideration for a controlled transaction only if—

(i) The taxpayer discloses the use of the method by attaching an appropriate disclosure statement to the timely filed U.S. income tax return for the taxable year of the controlled transaction;

(ii) The taxpayer prepares contemporaneous supporting

documentation setting forth the specific analysis adopted, an analysis of why the method used provides the most accurate measure of an arm's length price, and the data supporting its application; and

(iii) Within 30 days of a written request, the taxpayer furnishes to the district director the documentation described in paragraph (e)(2)(ii) of this section.

(3) *Coordination with penalty provisions.* In the case of a taxpayer that uses a method under this paragraph (e), compliance with the documentation and disclosure requirements of paragraph (e)(2) of this section will not in itself be sufficient to establish reasonable cause and good faith under section 6662(e)(3)(B) or 6664(c)(1) and the regulations thereunder. However, the district director may otherwise determine that the taxpayer acted with reasonable cause and good faith.

(f) *Coordination with intangible property rules.* The methods described in this § 1.482–3T will ordinarily not take adequate account of significant, non-routine intangibles that may be transferred or used with the sale of tangible property. In such cases, it may be necessary to adjust results obtained under the methods described in this section using the principles of § 1.482–4T. Similarly, in appropriate circumstances the methods described in this § 1.482–3T may be applied in connection with the determination of the arm's length consideration for transfers of intangible property, for example, where the value of the property transferred reflects a combination of tangible and intangible elements.

§ 1.482–4T Methods to determine taxable income in connection with a transfer of intangible property.

(a) *In general.* The arm's length character of the amount charged in a controlled transfer of intangible property must be determined under one of the three methods listed in this paragraph (a). The methods must be applied in accordance with the provisions of § 1.482–1T. The selection of a method for a particular transactions under review will be subject to the best method rule of § 1.482–1T(b)(2)(iii)(A). The arm's length consideration for the transfer of an intangible determined under this section must be commensurate with the income attributable to the intangible. The available methods are—

(1) The comparable uncontrolled transactions method, described in paragraph (c) of this section;

(2) The comparable profits method, described in § 1.482–5T; and

(3) Other methods, described in paragraph (d) of this section.

(b) *Definition of intangible.* For purposes of section 482, the term "intangible" means any commercially transferable interest in any item including in the following six classes of intangibles, that has substantial value independent of the services of any individual—

(1) Patents, inventions, formulae, processes, designs, patterns, or know-how;

(2) Copyrights and literary, musical, or artistic compositions;

(3) Trademarks, trade names, or brand names;

(4) Franchises, licenses, or contracts;

(5) Methods, programs, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data; and

(6) Other similar items.

(c) *Comparable uncontrolled transaction method*—(1) *In general.* Under the comparable uncontrolled transaction method, the arm's length consideration for a controlled transfer of intangible property is equal to the consideration charged or incurred in a comparable uncontrolled transaction. For purposes of applying the best method rule of § 1.482–1T(b)(2)(iii)(A), the comparable uncontrolled transaction method, when it can reasonably be applied on the basis of available information, ordinarily will provide the most accurate measure of an arm's length charge for the transfer of intangible property. Factors to be considered in the application of this method include access to relevant pricing and other financial information and the existence of an active market, including contemporaneous transactions involving comparable property between uncontrolled taxpayers. The amount determined under this method may be adjusted as required by paragraph (e)(2) of this section.

(2) *Standard of comparability*—(i) *In general.* Whether an uncontrolled transaction is comparable to a controlled transaction must generally be determined under the standards of § 1.482–1T(c). For purposes of this section, an uncontrolled transaction is comparable to a controlled transaction if it involves comparable intangible property and takes place under comparable circumstances. The intangible property involved in an uncontrolled transaction is comparable to the property involved in the controlled transaction if the requirements of paragraph (c)(2)(ii)(A) of this section are met. The circumstances involved in an uncontrolled transaction are comparable to those of a controlled transfer if any differences can be accounted for under § 1.482–1T(c)(2)(ii).

(ii) *Factors to be considered in determining comparability*—(A) *Comparable intangible property.* The intangible property involved in an uncontrolled transfer will be considered comparable to the intangible property involved in the controlled transfer if both intangibles—

(*1*) Are in the same class of intangibles, as defined under paragraph (b) of this section;

(*2*) Relate to the same type of products, processes, or know-how within the same general industry or market; and

(*3*) Have substantially the same profit potential. For this purpose, the profit potential of an intangible is measured by the net present value of the benefits to be realized (based on prospective profits to be realized or costs to be saved) through the use or subsequent transfer of the intangible, taking into consideration the capital investment and startup expenses required, the risks to be assumed, and other relevant considerations.

(B) *Comparable circumstances.* In evaluating the comparability of the circumstances of the controlled and uncontrolled transactions, although all of the factors described in § 1.482–1T(c)(3) must be considered, specific factors that may be particularly relevant to this method include the following—

(*1*) The terms of the transfer, including the exploitation rights granted in the intangible, the exclusive or nonexclusive character of any rights granted, any restrictions on use, or any limitations on the geographic area where the rights may be exploited;

(*2*) The stage of development of the intangible (including, where appropriate, necessary governmental approvals, authorizations, or licenses);

(*3*) Any rights to receive periodic updates or improvements to the intangible;

(*4*) The uniqueness of the property and the period for which it remains unique, including the degree and duration of protection afforded to the property under the laws of the relevant countries;

(*5*) The duration of the license contract, or other agreement, and any termination or renegotiation rights;

(*6*) Any economic and product liability risks to be assumed by the transferee;

(*7*) The existence and extent of any collateral transactions or ongoing business relationships between the transferee and transferor; and

(8) The functions to be performed by the transferor and transferee, including any ancillary or subsidiary services.

(iii) *Arm's length range.* If two or more comparable uncontrolled transactions independently meet the standard of comparability of this paragraph (c)(2), such transactions will establish an arm's length range, as described in § 1.482–1T(d)(2)(i).

(iv) *Example.* The following example illustrates the principles of this paragraph (c).

Example. (i) P and S are controlled taxpayers. P licenses to S a proprietary process that permits the manufacture of product X at a substantially lower cost than otherwise would be possible. If P directly manufactured and sold product X, a selling price of $2 per unit would cover its costs and provide a reasonable return on its functions and associated risks. Using the proprietary process, S manufactures product X and sells it to related and unrelated parties for a price of $6 per unit.

(ii) an uncontrolled transaction involving the license of a similar proprietary process provides for the payment of a royalty equivalent to $1 per unit. In testing the comparability of the controlled and uncontrolled transactions, under the provisions of § § 1.482–1T(c)(3)(iv) and 1.482–4T(c)(2), the district director may consider P's alternative of producing and selling product X itself as a factor that may affect the amount P would demand as a royalty for the proprietary process if dealing with an uncontrolled taxpayer at arm's length. Given that P owned the proprietary process that would enable it to produce and sell product X for $2 per unit, and that the market price of product X is $6 per unit, P would be unlikely to accept a royalty for the proprietary process of less than $4 per unit. Accordingly, the uncontrolled transaction is not a comparable uncontrolled transaction within the meaning of this paragraph (c). In considering P's alternatives in this manner, the district director does not treat P as if it had actually manufactured and sold product X to the related and unrelated parties. See § 1.482–1T(d)(3)(iii).

(d) *Other methods*—(1) *In general.* Where none of the methods listed in paragraph (a)(1), or (2) of this section can reasonably be applied under the facts and circumstances of a particular case, another method may be used to determine the arm's length consideration for the controlled transaction. A method used under this paragraph (d) must be applied in accordance with the provisions of § 1.482–1T. Pursuant to § 1.482–3T(f) (coordination rule for methods applicable to transfers of tangible and intangible property), methods ordinarily applicable to transfers of tangible property may be applied in connection with the determination of the arm's length consideration for transfers of intangible property, for example, where the value of the property transferred reflects a combination of tangible and intangible elements.

(2) *Conditions for taxpayer's use of other methods.* A taxpayer may use a method under this paragraph (d) to establish the arm's length consideration for a controlled transaction only if—

(i) The taxpayer discloses the use of the method by attaching an appropriate disclosure statement to the timely filed U.S. income tax return for the taxable year of the controlled transaction;

(ii) The taxpayer prepares contemporaneous supporting documentation setting forth the specific analysis adopted, an analysis of why the method used provides the most accurate measure of an arm's length price, and the data supporting its application; and

(iii) The taxpayer furnishes to the district director within 30 days of a written request the documentation described in paragraph (d)(2)(ii) of this section.

(3) *Coordination with penalty provisions.* In the case of a taxpayer that uses a method under this paragraph (d), compliance with the documentation and disclosure requirements of paragraph (d)(2) of this section will not in itself be sufficient to establish reasonable cause and good faith under section 6662(e)(3)(B) or 6664(c)(1) and the regulations thereunder. However, the district director may otherwise determine that the taxpayer acted with reasonable cause and good faith.

(e) *Special rules for transfers of intangible property*—(1) *Form of consideration.* An arm's length consideration for the transfer of intangible property must be in a form that is consistent with a form that would be adopted in transactions between uncontrolled taxpayers under comparable circumstances. If a transferee of an intangible pays nominal or no consideration and the transferor has retained a substantial interest in the property, the arm's length consideration shall be in the form of a royalty unless a different form is demonstrably more appropriate. Paragraph (e)(5) of this section is reserved for rules regarding consideration that takes the form of a lump sum payment for an intangible.

(2) *Periodic adjustments*—(i) *General rule.* If an intangible is transferred under an arrangement that covers more than one year, the consideration charged in each taxable year may be adjusted to ensure that it is commensurate with the income attributable to the intangible. Adjustments made pursuant to this paragraph (e)(2) shall be consistent with the arm's length standard and the provisions of § 1.482–1T. In determining whether to make such adjustments in the taxable year under examination, the district director may consider all relevant facts and circumstances throughout the period the intangible is used. The determination in an earlier year that the amount charged for an intangible was arm's length will not preclude the district director in a subsequent taxable year from making an adjustment to the amount charged for the intangible in the subsequent year. For an exception to this rule see paragraph (e)(2)(ii) of this section.

(ii) *Exceptions*—(A) *Comparable uncontrolled transactions.* No allocation will be made under paragraph (e)(2)(i) of this section if each of the following facts is established—

(*1*) The controlled taxpayers entered into a written agreement (controlled agreement) that provided for an amount of consideration with respect to each taxable year subject to such agreement, such consideration was an arm's length amount under paragraph (c) of this section for the first taxable year in which substantial periodic consideration was required to be paid under the agreement, and such agreement remained in effect for the taxable year under review.

(*2*) There is a written agreement setting forth the terms of the comparable uncontrolled transaction relied upon to establish the arm's length consideration (uncontrolled agreement), which contained no provisions that would have permitted any change to the amount of consideration, a renegotiation, or a termination of the agreement, in circumstances comparable to those of the controlled transaction in the taxable year under review (or that contained provisions permitting only specified, non-contingent, periodic changes to the amount of consideration);

(*3*) The controlled agreement was substantially similar to the uncontrolled agreement, with respect to the time period for which it is effective and the provisions described in paragraph (e)(2)(ii)(A)(*2*) of this section.

(*4*) The controlled agreement limited use of the intangible to a specified field or purpose in a manner that was consistent with industry practice and any such limitation in the uncontrolled agreement.

(*5*) There were no substantial changes in the functions performed by the controlled transferee since the controlled agreement was executed, except changes necessitated by events that were not foreseeable.

(*6*) The aggregate profits actually earned or the aggregate cost savings actually realized by the controlled taxpayer from the exploitation of the intangible in all open years are not less

than 80% nor more than 120% of the prospective profits or cost savings that were foreseeable when the comparability of the uncontrolled agreement was established under paragraph (c)(2) of this section.

(B) *Methods other than comparable uncontrolled transaction.* No allocation will be made under paragraph (e)(2)(i) of this section if each of the facts set forth in paragraphs (e)(2)(ii)(B) (*1*) through (*4*) of this section is established.

(*1*) The controlled taxpayers entered into a written agreement (controlled agreement) that provided for an amount of consideration with respect to each taxable year subject to such agreement, and such agreement remained in effect for the taxable year under review.

(*2*) The consideration called for in the controlled agreement was an arm's length amount for the first taxable year in which substantial periodic consideration was required to be paid; the arm's length amount was determined under any method other than the comparable uncontrolled transaction method; relevant supporting documentation was prepared contemporaneously with the execution of the controlled agreement; and upon audit, such agreement and documentation is furnished by the taxpayer to the district director within 30 days of a written request.

(*3*) There have been no substantial changes in the functions performed by the transferee since the controlled agreement was executed, except changes required by events that were not foreseeable.

(*4*) The total profits actually earned or the total cost savings realized by the controlled transferee from the exploitation of the intangible in all open years are not less than 80% nor more than 120% of the prospective profits or cost savings that were foreseeable when the controlled agreement was entered into.

(3) *Development of an intangible*—(i) *Identification of the developer.* Except as provided in § 1.482–2A(d)(4) (cost sharing provisions) when two or more members of a controlled group undertake the development of an intangible, one member will be regarded as the developer of the intangible, and, therefore, as its owner for purposes of section 482. The other participating members will be regarded as assisters. Which controlled taxpayer is the developer and which controlled taxpayers are assisters will be determined under all the facts and circumstances. In making this determination, greatest weight must be given to the extent to which each member bears the direct and indirect costs and corresponding risk of developing the intangible, and makes available, without adequate compensation, property or services likely to contribute substantially to developing the intangible. A controlled taxpayer will be treated as bearing the costs of development only if it is legally bound before the costs are incurred to bear the costs without regard to the success of the project. The determination of whether a controlled taxpayer bears the risks of development will be made under the analysis of § 1.482–1T(c)(3)(ii). For this purpose, the risk to be borne with respect to development activity is the possibility that such activity will not result in the production of intangible property or that the intangible property produced will not be of sufficient value to allow for the recovery of the costs of developing it. Other factors that may be relevant in determining which controlled taxpayer is the developer include the location of the development activities, the capability of each controlled taxpayer to carry on the project independently, the extent to which each controlled taxpayer controls the project, and the actual conduct of the controlled taxpayers.

(ii) *Allocations with respect to transfers by the developer.* If the developer of an intangible makes the intangible available to another controlled taxpayer (including any assister), the district director may make an allocation with respect to that transfer to reflect an arm's length consideration for the intangible.

(iii) *Allocations with respect to assistance provided to the developer.* The district director may make allocations to reflect arm's length consideration for assistance provided to the developer by another controlled taxpayer in connection with the development of an intangible. Such assistance may include loans, services, or the use of tangible or intangible property. The amount of any allocation required with respect to that assistance must be determined in accordance with the applicable rules under section 482. For example, if one member of a controlled group allows another member of the group to use tangible property, such as laboratory equipment, in connection with the latter's development of an intangible, any allocations with respect to the developer's use of the tangible property will be determined under § 1.482–2A(c).

(iv) *Examples.* The following examples illustrate the principles of this paragraph (e)(3). In all these examples, it is assumed that X and Y are members of the same group of controlled taxpayers.

Example 1. X, at the request of Y, undertakes to develop a new machine that will function effectively in the climate in which Y's factory is located. Y agrees in writing before X incurs any costs to bear all the direct and indirect costs of the project whether or not X successfully develops the machine. X does not make any of its own property available for use in connection with the project without adequate compensation. The machine is successfully developed and X provides to Y the process necessary to produce it. Y is considered the developer of the process and, therefore, shall not be treated as having obtained it in a transfer subject to the rules of § 1.482–4T. The district director may make appropriate allocations with respect to assistance rendered by X. The district director also may treat any use of the process by X as a transfer by Y that is subject to the rules of § 1.482–4T and make allocations with respect to that transfer.

Example 2. The facts are the same as in *Example 1*, except that Y agrees to bear the costs only if the machine is successfully developed. X is considered the developer and Y is regarded as having obtained the process in a transfer subject to the rules of § 1.482–4T. Therefore, the district director may make allocations to reflect an arm's length consideration for the transfer of the process.

Example 3. X undertakes to develop a new chemical product M in its research and development department and incurs direct and indirect costs of $1 million per year in 1994, 1995, and 1996. X employs the formula for compound N which it developed and owns. The value of the use of the formula for compound N in connection with the project is $750,000. In 1995, four chemists employed by Y spend six months working on the project in X's laboratory. The salary and other expenses connected with the chemists' activities during that period total $200,000 and are paid by Y without charge to X. In 1996, product M is perfected and Y obtains patents on its formula. X is considered the developer of product M because, among other things, it bore the greatest share of the costs and risks incurred in connection with the project and made available valuable property (the formula for compound N). The formula for product M is deemed to have been transferred to Y in 1996 by virtue of Y's obtaining patent rights to product M. The district director may make allocations in that year to reflect arm's length consideration for the transfer. The district director also may make allocations in 1995 with respect to the assistance rendered by Y. If the district director does not make an allocation for 1995 with respect to the services of the chemists in accordance with the provisions of § 1.482–2(b) of this section, the district director may treat the amount of an arm's length consideration as a loan to X from Y.

Example 4. X, a foreign producer of cheese, markets its cheese in countries other than the United States under the trade name DR. X owns all worldwide rights to this name. The name is widely known and is valuable outside the United States but is not known within the United States. In 1995, X decides to enter the U.S. market and organizes U.S.

subsidiary Y to be its U.S. distributor and to supervise the advertising and other marketing efforts that will be required to develop the name DR in the United States. Y incurs $5,000,000 of expenses promoting the name DR in that year for which it is not reimbursed by X. Y is considered the developer of the enhanced U.S. rights to the trade name.

(4) *Consideration not artificially limited.* The arm's length consideration for the controlled transfer of an intangible is not limited by the consideration paid in any uncontrolled transactions that do not meet the requirements of the comparable uncontrolled transaction method described in paragraph (c) of this section. Similarly, the arm's length consideration for an intangible is not limited by the prevailing rates of consideration paid for the use or transfer of intangibles within the same or similar industry.

(5) *Lump sum payments.* [Reserved]

§ 1.482–5T Comparable profits method.

(a) *In general.* The comparable profits method determines the arm's length consideration for a controlled transfer of property by referring to objective measures of profitability (profit level indicators) derived from uncontrolled taxpayers that engage in similar business activities with other uncontrolled taxpayers under comparable circumstances (comparable parties). An arm's length range of results is determined based upon the amounts of profit that the tested party (as defined in paragraph (d) of this section) would have earned if its profit level indicators were equivalent to those of the uncontrolled taxpayers (constructive operating profit). For purposes of applying the best method rule of § 1.482–1T(b)(2)(iii)(A), the comparable profits method ordinarily will provide an accurate measure of an arm's length result unless the tested party, in connection with the controlled transaction, uses valuable, non-routine intangibles that it—

(1) Acquired from uncontrolled taxpayers and with respect to which it bears significant risks and possesses the right to significant economic benefits; or

(2) Developed itself.

(b) *Tested party*—(1) *In general.* For purposes of this section, the tested party ordinarily will be the participant in the controlled transaction that does not use valuable, non-routine intangibles that it either acquired from uncontrolled taxpayers and with respect to which it bears significant risks and possesses the right to significant economic benefits or developed itself. The tested party need not be the taxpayer under examination.

(2) *Determination by industry segment.* Ordinarily, the comparable profit method should be applied separately to each "industry segment" of the tested party, as that term is defined in § 1.6038A–3(c)(7), provided that the operating profit and related assets and liabilities for each such industry segment can be determined reliably for the tested party and the comparable parties.

(3) *Adjustments for tested party.* The tested party's operating income must be adjusted to reflect all other allocations under section 482, other than adjustments pursuant to this section.

(c) *Selection of comparable parties*—(1) *Comparability.* The comparable profits method measures the total return on the business activities of a tested party. Therefore, the controlled and uncontrolled taxpayers need be only broadly similar, and significant product diversity and some functional diversity between the controlled and uncontrolled transactions is acceptable. However, the greater the similarity between the tested party and the comparable party, the more reliable is the measure of an arm's length result under this method. Thus, if reliable data relating to comparable parties that operate within the same industry segment as the tested party is available, such data should be employed for purposes of the application of this method. The degree of comparability between the tested party and the comparable parties will affect the size of the arm's length range, as described in paragraph (d)(2) of this section.

(2) *Adjustments to comparable parties.* Adjustments may be made to the profit level indicators of the comparable parties to improve consistency and to achieve greater similarity between such comparable parties and the tested party. For example, material items reflected in the profit level indicators of the uncontrolled transactions should be measured on a basis consistent with the accounting treatment used by the tested party. Accounting reclassifications may be required to more accurately and consistently relate the level of operating profit to the level of investment before determining profit level indicators for the uncontrolled taxpayer. Similarly, adjustments may be made to the actual operating profits earned and operating assets employed by the comparable parties to account for material differences between the controlled and uncontrolled transactions in terms of the functions performed and risks assumed by the respective taxpayers, or any other facts that materially affect profitability, but only to the extent that such adjustments have a definite and reasonably ascertainable effect on operating profit. If the assets of a comparable party are adjusted, the comparable party's operating income must also be adjusted before computing a profit level indicator in order to reflect the income and expense attributable to the adjusted assets. The adjustments described in this paragraph must be made in order to determine the arm's length range under paragraph (d)(2)(i) of this section. If these adjustments are not made, then paragraph (d)(2)(ii) of this section applies.

(d) *Determination of arm's length result*—(1) *In general.* A controlled transaction will be considered arm's length under this method if the tested party's reported operating profits are within the arm's length range consisting of a range of constructive operating profits derived from comparable parties. Constructive operating profits are calculated by applying profit level indicators derived from the comparable parties to the tested party's financial data for the time period to which the profit level indicators are attributable. For purposes of the comparable profits, each arm's length range will be established with constructive operating profits calculated by using one profit level indicator. Ordinarily, the profit level indicators should be derived from a sufficient number of years to reasonably measure returns that accrue to uncontrolled taxpayers with risk characteristics similar to those of the tested party. Generally such a period should encompass at least the taxable year under review and the preceding two taxable years.

(2) *Arm's length range.* As described in this paragraph (d)(2), the degree of comparability between the tested party and the comparable parties, and the adjustments made to the data of the comparable parties, will affect the size of the arm's length range under the comparable profits method. For rules governing the appropriate adjustment where reported operating profit is outside the arm's length range, see § 1.482–1T(d)(2)(i)(C).

(i) If the comparability standards set forth in paragraph (c) of this section are met and appropriate adjustments under paragraph (c)(2) are made, then the arm's length range will include all the constructive operating profits derived from the comparable parties.

(ii) If the arm's length range is not determined as described in paragraph (d)(2)(i) of this section, then the arm's length range ordinarily will consist of the interquartile range from the 25th to the 75th percentile of the constructive operating profits derived from the profit

level indicators of the comparable parties. If other statistical techniques and criteria can be validly applied, they may be used instead of the interquartile range to define the arm's length range. However, an arm's length range cannot not be determined under this paragraph (d)(2)(ii) unless there are at least four comparable parties.

(e) *Profit level indicators.* Profit level indicators are financial ratios that measure the relationships among profits, costs incurred and resources employed. A variety of profit level indicators can be calculated in any given case. The selection of appropriate profit level indicators depends upon a number of factors, including the nature of the activities of the tested party, the reliability of the available data with respect to comparable uncontrolled taxpayers, and the extent to which a particular profit level indicator is likely to produce a reasonable determination of the income that the tested party would have earned had it dealt with controlled taxpayers at arm's length, taking into account all of the facts and circumstances of the particular case under review. Profit level indicators that may provide a reliable basis for comparing operating profits of similar controlled and uncontrolled taxpayers include the following—

(1) *Rate of return on capital employed.* The rate of return on capital employed is the ratio of operating profit to operating assets. The rate of return on capital employed ordinarily will provide an acceptable profit level indicator if the tested party has substantial fixed assets or working capital that plays a significant role in generating operating profit.

(2) *Financial ratios.* Financial ratios are defined by relationships between profit and costs or sales revenue. Since financial ratios do not directly relate operating profit to the level of investment and risk in a trade or business, more stringent comparability is ordinarily required than when a rate of return on capital is used as a profit level indicator. Financial ratios that may be appropriate include the following—

(i) Ratio of operating profit to sales; and

(ii) Ratio of gross profit to operating expenses. This ratio is ordinarily an acceptable profit level indicator if the composition of operating expenses for the tested party and the comparable parties are substantially the same.

(3) *Other profit level indicators.* Other profit level indicators not described in this paragraph (e) may be used. Such other measures should be used only when they provide reasonable indications of the income that the tested party would have earned had it dealt with controlled taxpayers at arm's length.

(f) *Definitions.* The definitions set forth in paragraphs (f)(1) through (7) of this section apply for purposes of this section.

(1) *Sales revenue.* "Sales revenue" means the amount of total receipts from sale of goods and the providing of services, less discounts and returns. Accounting principles and conventions that are generally accepted in the trade or industry of the controlled taxpayer under review must be used.

(2) *Gross profit.* "Gross profit" means sales revenue less cost of goods sold.

(3) *Operating expenses.* "Operating expenses" includes all expenses not included in cost of goods sold except for interest expense, foreign income taxes (as defined in § 1.901–2(a)), and domestic income taxes. Operating expenses ordinarily include expenses associated with advertising, promotion, sales, marketing, warehousing and distribution, administration, and a reasonable allowance for depreciation and amortization.

(4) *Operating profit.* "Operating profit" means gross profit less operating expenses. Operating profit includes all income derived from the industry segment being tested by the comparable profits method, but does not include interest and dividends, income derived from activities not being tested by this method, or extraordinary gains and losses that do not relate to the continuing operations of the tested party.

(5) *Reported operating profit.* "Reported operating profit" means the operating profit of the tested party reflected on a timely U.S. income tax return. If the tested party files a U.S. income tax return, its operating profit is considered reflected on a U.S. income tax return if the calculation of taxable income on its return for the taxable year takes into account the income attributable to the controlled transaction under review. If the tested party does not file a U.S. income tax return, its operating profit is considered reflected on a U.S. income tax return in any taxable year for which income attributable to the controlled transaction under review affects the calculation of the U.S. taxable income of any other member of the same controlled group. Where the constructive operating profit of the tested party is determined from profit level indicators derived from financial statements or other accounting records and reports of the comparable parties, adjustments may be made to the reported operating profit of the tested party as may be required to account for the material differences between the tested party's operating profit reported for U.S. income tax purposes and the tested party's operating profit for financial statement purposes.

(6) *Operating assets.* "Operating assets" means the value of all assets used in the relevant industry segment of the tested party, including fixed assets and current assets (such as cash, cash equivalents, accounts receivable, and inventories). The term does not include investments in subsidiaries, excess cash, and portfolio investments. Operating assets may be measured by their net book value or by their fair market value, provided that the same method is consistently applied to the tested party and the comparable parties, and consistently applied from year to year. Operating assets must be measured by the average of the values for the beginning of the year and the end of the year. It may be necessary to take into account recent acquisitions, leased assets, routine intangibles that have been purchased or self-developed, currency fluctuations, and other assets or liabilities of the taxpayer that may not be explicitly recorded in the financial statements of the controlled or uncontrolled taxpayer. Appropriate adjustments must be made to ensure that the operating assets of the controlled and uncontrolled taxpayer are measured on a consistent basis. For example, non-interest bearing liabilities, such as accounts payable, payroll liabilities, and taxes payable, that are related directly to the regular and recurring operations of the trade or business, would be required to be deducted from operating assets, if differences in such liabilities are material.

(g) *Examples.* The following examples illustrate the application of this section.

Example 1—Transfer of tangible property resulting in no adjustment. (i) Foreign Parent (FP) is a publicly traded foreign corporation with a U.S. subsidiary (USS) that is under audit for its 1994 taxable year. FP manufactures a consumer product for worldwide distribution. USS imports the assembled product and distributes it within the United States at the wholesale level under the FP name.

(ii) FP does not allow uncontrolled taxpayers to distribute the product. Similar products are produced by other companies but none of them are sold to uncontrolled taxpayers or to uncontrolled distributors.

(iii)(A) The district director decides to apply the comparable profits method to determine an arm's length result for the transactions between USS and FP. Because USS does not own any valuable, non-routine intangibles, the district director selects USS as the tested party. In applying this method to test whether the consideration paid by USS for tangible property was at arm's

length, it is necessary to determine whether USS's operating profit is within the arm's length range. The district director reviews the financial reports of USS for the taxable year and the two preceding taxable years. For the taxable years 1992 through 1994, USS shows the following results:

	1992	1993	1994	Average
Operating assets	$310,000	$310,000	$310,000	$310,000
Sales	500,000	560,000	500,000	520,000
Cost of goods sold	393,000	412,400	400,000	401,800
Purchases from FP	350,000	365,000	350,000	355,000
Other	43,000	47,400	50,000	46,800
Operating expenses	80,000	110,000	104,600	98,200
Operating profit	27,000	37,600	(4,600)	20,000

(B) The data from USS in paragraph (iii)(A) of this *Example 1*, averaged over three years, results in a ratio of operating profit to operating assets (OP/OA) of 6.5%.

(iv) To identify comparable parties, the district director seeks data from independent operators of wholesale distribution businesses. These companies are further narrowed to select companies in the same industry segment that perform similar functions and assume broadly similar risks to USS. Because USS has working capital that plays a significant role in generating operating profit and because appropriate adjustments can be made to measure the unrelated distributor's assets consistently with those of USS, the district director determines that the rate of return on capital employed will be the profit level indicator. An analysis of the information available on these taxpayers shows that their ratios are fairly stable when at least three years are included in the average. Calculating the average ratio of operating profit to operating assets for each of the uncontrolled distributors and applying each ratio to USS would lead to the following constructive operating profit (COP) for USS:

Unrelated distributor	OP/OA (percent)	USS COP
A	8.0	$24,800
B	23.3	72,230
C	16.9	52,390
D	8.0	24,800
E	11.5	35,650
F	6.3	19,530
G	5.3	16,430
H	2.7	8,370
I	8.5	26,350
J	7.5	23,250

(v) The products sold by the distributors are not similar enough to allow for the range described in paragraph (d)(2)(ii) of this section. Accordingly, the arm's length range is limited to the constructive operating profits that fall within the interquartile range of results. Accordingly, the arm's length range consists of the results ranging from $19,530 to $35,650. USS's average reported operating profit of $20,000 is within this range. Therefore, the district director determines that no allocation should be made to adjust USS's operating income even though its operating income for 1994 shows a loss of $4,600.

Example 2—Transfer of tangible property resulting in adjustment. (i) The facts are the same as in *Example 1* except that USS reported the following income and expenses:

	1992	1993	1994	Average
Assets	$310,000	$310,000	$310,000	$310,000
Sales	500,000	560,000	500,000	520,000
Cost of goods sold	370,000	460,000	400,000	410,000
Purchases from FP	320,000	410,000	350,000	360,000
Other	50,000	50,000	50,000	50,000
Operating expenses	110,000	110,000	110,000	110,000
Operating profit	20,000	(10,000)	(10,000)	0

(ii) Applying the data in paragraph (i) of this *Example 2*, the ratio described in *Example 3* would now produce the ratio of operating profit to operating assets of 0%.

(iii) The arm's length range remains the interquartile range of constructive operating profits derived in *Example 1*: $19,530 to $35,650. Since USS' average operating profit for the years 1992 through 1994 ($0) falls outside the arm's length range, USS' income for 1994 is increased to the median of the range, $24,800.

Example 3—Transfer of intangible to offshore manufacturer. (i) DevCo is a U.S. developer, producer and marketer of widgets. DevCo develops a new "high tech widget" (htw) which it manufacturers at its foreign subsidiary ManuCo located in Country H. ManuCo sells the htw to MarkCo (a U.S. subsidiary of DevCo) for distribution and marketing in the United States. The taxable year 1994 is under audit, and the district director examines whether the royalty rate of 5 percent paid by ManuCo to DevCo is an arm's length consideration for the htw technology. No comparable uncontrolled transactions are available. Because ManuCo did not use any valuable non-routine intangible that it acquired from uncontrolled taxpayers or that it developed, the district director applies the comparable profit method to determine whether the operating income of ManuCo is within the arm's length range. ManuCo's financial data from 1992–1994 is as follows:

	1992	1993	1994	Average
Assets	$24,000	$25,000	$26,000	$25,000
Sales to MarkCo	25,000	30,000	35,000	30,000
Cost of goods sold	6,250	7,500	8,750	7,500
Royalty to DevCo (5%)	1,250	1,500	1,750	1,500
Other	5,000	6,000	7,000	6,000
Operating expenses	1,000	1,000	1,000	1,000
Operating profit	17,750	21,500	25,250	21,500

(ii) Two ratios derived from the data in paragraph (i) of this *Example 3* produce the following results:

	Percent
Operating Profit/Sales (OP/S)	71.7
Operating Profit/Assets (OP/OA)	86.0

(iii) In order to compare ManuCo's results with those of other comparable companies, the district director analyzes companies performing similar functions and assuming similar risks. The district director determines that the price that ManuCo charged to MarkCo for the htw's is an arm's length price under § 1.482–3T(b). No information on uncontrolled taxpayers in country H that perform similar functions is available. The search is broadened for companies performing the most similar functions in the most similar markets. The district director determines that data available in countries M and N provides the best match of companies in a similar market performing similar functions and assuming similar risks.

(iv) Applying the provisions of paragraph (e) of this section to financial information from the set of country M and N companies provides an interquartile range of constructive operating profits from $3,000 to $4,500, with a median of $3,750. ManuCo's average reported operating profit for the years 992 through 1994 of $21,500 falls outside he arm's length range, and an adjustment to increase the royalties that ManuCo paid is made equal to $17,800 (the difference between $21,500 and the median of the arm's length range $3,700).

§ 1.482–6T Profit split method. [Reserved]

§ 1.482–7T Cost sharing. [Reserved]

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par 4. Section 602.101(c) is amended by adding the following citations to the table to read as follows:

§ 602.101 OMB Control Numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control number
* * * *	*
1.482–1T	1545–1298
* * * *	*
1.482–3T	1545–1298
1.482–4T	1545–1298

* * * * *

Shirley D. Peterson,

Commissioner of Internal Revenue.

Approved: January 11, 1993.

Alan J. Wilensky,

Acting Assistant Secretary of the Treasury.

[FR Doc. 93–1109 Filed 1–13–93; 2:10 pm]

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DEPARTMENT OF DEFENSE

Office of the Secretary

32 CFR Part 397

[DoD Directive 5330.3]

Defense Printing Service (DPS)

AGENCY: Office of the Secretary, DoD.

ACTION: Final rule.

SUMMARY: This part establishes the Defense Printing Service (DPS) within the Department of the Navy as the consolidated organization for printing and duplicating activities in the Department of Defense, excluding intelligence and tactical activities and National Guard and Reserve organizations. It also designates the Secretary of the Navy as the single manager for the operation of the DPS and assigns responsibilities, functions, and relationships relating thereto.

EFFECTIVE DATE: January 7, 1993.

FOR FURTHER INFORMATION CONTACT: Mr. H. Gioia, 703–695–4281.

SUPPLEMENTARY INFORMATION:

List of Subjects in 32 CFR Part 397

Organization and functions (Government agencies).

Accordingly, title 32, chapter I, subchapter R is amended to add part 397 to read as follows:

PART 397—DEFENSE PRINTING SERVICE (DPS)

Sec.

Authority: 10 U.S.C. 131.

§ 397.1 Purpose.

Pursuant to the authority vested in the Secretary of Defense under 10 U.S.C., this part:

(a) Establishes the DPS within the Department of the Navy as the consolidated organization for printing and duplicating activities in the Department of Defense, excluding intelligence and tactical activities and National Guard and Reserve organizations.

(b) Designates the Secretary of the Navy as the single manager for the operation of the DPS and assigns responsibilities, functions, and relationships, as prescribed herein.

§ 397.2 Applicability.

This part applies to the Office of the Secretary of Defense (OSD), the Military Departments, the Chairman of the Joint Chiefs of Staff and the Joint Staff, the Unified and Specified Commands, the Inspector General of the Department of Defense, the Defense Agencies, and the DoD Field Activities (hereafter referred to collectively as "the DoD Components").

§ 397.3 Responsibilities and functions.

(a) The Director of Administration and Management, Office of the Secretary of Defense, shall:

(1) Have principal OSD staff responsibility for the activities of the DPS and provide policy guidance regarding the operation and management of printing and duplicating services in the Department of Defense.

(2) Chair the DoD Printing and Duplicating Services Oversight Group, composed of senior-level representatives of the Secretaries of the Military Departments; Assistant Secretary of Defense for Command, Control, Communications, and Intelligence; and Comptroller of the Department of Defense. Other DoD officials may be invited to participate, as required.

(3) Represent the Department of Defense on printing and duplicating policy matters with the Joint Committee on Printing (JCP), Government Printing Office (GPO), Office of Management and Budget (OMB), and other Government Agencies.

(b) The Secretary of the Navy is designated as the single manager for all DoD printing, both for the operation of DoD in-house printing and duplicating facilities and for the departmental printing procurement functions. In this capacity, the Secretary of the Navy shall:

(1) Appoint a Director of the DPS to manage and operate the DPS and all assigned resources, who shall be under the Secretary of the Navy's authority, direction, and control.

(2) Provide guidance to the Director of the DPS regarding the management of the DPS and its relationships with other commands, organizations, and activities within the Navy, as well as with other DoD Components and Government Agencies.

(3) Finance the operations of the DPS under the Printing and Publications

Services business area of the Defense Business Operations Fund.

(4) Ensure that the Director, DPS, shall:

(i) Organize, direct, and manage the DPS and all its assigned resources; produce or procure printing services; and administer, supervise, and control all assigned programs, services, and functions.

(ii) Provide effective and efficient printing support to DoD Components.

(iii) Conduct a coordinated DoD printing program covering the production, procurement, and distribution of publications through conventional or alternative methods.

(iv) Administer Department-wide printing management systems, programs, and activities, including technical assistance, support services, and information.

(v) Provide advice and assistance on printing matters to the DoD Components and other organizations, as appropriate.

(vi) Act as DoD representative for technical printing and duplicating matters under DPS cognizance with the JCP, GPO, OMB, and other Government Agencies.

(vii) Supports the Director of Administration and Management, OSD, in the performance of his duties under this part.

(c) The Comptroller of the Department of Defense shall advise, and provide policy guidance to, the DPS on the functioning of the Defense Business Operations Fund and other financial management matters.

(d) The Heads of the DoD Components shall cooperate with, and provide necessary information and assistance to, the DPS in setting requirements, arranging for and executing inter-Service support agreements, and enabling the DPS to carry out day-to-day operations in an effective and efficient manner.

§ 397.4 Relationships.

(a) In the performance of assigned responsibilities and functions, the Director, DPS, shall:

(1) Maintain liaison with DoD Components, other Government Agencies, and private sector organizations for the exchange of information concerning assigned programs, activities, and responsibilities.

(2) Use established facilities and services of the Department of Defense and other Government Agencies, whenever practicable, to avoid duplication and to achieve modernization, efficiency, economy, and user satisfaction.

(b) The heads of DoD Components shall coordinate with the Director, DPS, on all matters related to the responsibilities and functions listed in § 397.3(b)(4).

Dated: January 13, 1993.

L.M. Bynum,

Alternate OSD Federal Register Liaison Officer, Department of Defense.

[FR Doc. 93–1324 Filed 1–19–93; 8:45 am]

BILLING CODE 3810–01–M

ENVIRONMENTAL PROTECTION AGENCY

40 CFR Parts 52, 60, and 61

[MT4–1–5449, ND2–2–5619, SD1–2–5620, SD3–1–5496; FRL–4541–7]

Approval and Promulgation of Implementation Plans; Montana, North Dakota, South Dakota; Delegation of Authority; Wyoming

AGENCY: Environmental Protection Agency (EPA).

ACTION: Final rulemaking and delegation of authority.

SUMMARY: In this action, EPA is approving revisions to the State Implementation Plans (SIPs) for the states of Montana, North Dakota, and South Dakota, which pertain to the states' regulations for New Source Performance Standards (NSPS) and National Emission Standards for Hazardous Air Pollutants (NESHAPs). Specifically, EPA is approving the following submittals: The August 20, 1991 submittal of NSPS and NESHAP revisions from the Governor of Montana; the June 30, 1992 submittal of NSPS and NESHAP revisions, excluding the asbestos NESHAP regulations, from the Governor of North Dakota; and the September 25, 1991 and the February 24, 1992 submittals of revised NSPS and asbestos NESHAP regulations from the designee of the Governor of South Dakota. These revisions are being approved because they provide for consistency with Federal regulations.

In addition to approving the above-listed SIP revisions, EPA is also providing notice that it granted delegation of authority to the State of Wyoming on July 29, 1992 to implement and enforce several NSPS which were adopted by the State. This is a result of an April 13, 1992 request for delegation from the State.

EFFECTIVE DATES: The amendments to §§ 52.1370(c), 52.1820(c), 52.2170(c), 60.04(c), and 61.04(c) will become effective on March 22, 1993 unless notice is received by February 22, 1993 that someone wishes to submit adverse or critical comments. If the effective date is delayed, timely notice will be published in the **Federal Register.**

The delegation of authority to the State of Wyoming became effective on July 29, 1992.

ADDRESSES: Copies of the revisions are available for public inspection between 8 a.m. and 4 p.m. Monday through Friday at the following offices:

Environmental Protection Agency, Region VIII, Air Programs Branch, 999 18th Street, suite 500, Denver, CO 80202–2466.

Air Quality Bureau, Department of Health and Environmental Sciences, Cogswell Building, Helena, Montana 59620.

Division of Environmental Engineering, State Department of Health and Consolidated Laboratories, 1200 Missouri Avenue, Bismarck, North Dakota 58502–5520.

Division of Environmental Regulation, Department of Environment and Natural Resources, Joe Foss Building, Pierre, South Dakota 57501.

Public Information Reference Unit, Environmental Protection Agency, 401 M Street, SW., Washington, DC 20460.

FOR FURTHER INFORMATION CONTACT: Vicki Stamper, Environmental Protection Agency, Region VIII, Air Programs Branch, suite 500, Denver, CO 80202–2466, (303) 293–1765.

SUPPLEMENTARY INFORMATION: EPA has two options for the approval of a state's NSPS and NESHAPs regulations. Sections 111(c) and 112(1) of the amended Clean Air Act (CAA) permit EPA to delegate to the states authority to implement and enforce standards set forth in 40 CFR parts 60 and 61, NSPS and NESHAPs. EPA also has the option of approving state NSPS and NESHAPs regulations as part of the SIP. The main difference between these two options is in the processing of the State submittal. EPA's enforcement ability generally remains consistent. In either case, as provided for in the CAA, EPA has the authority to take enforcement action for a violation of a NSPS or NESHAP without providing notice of violation or waiting 30 days to take action. However, if the NSPS or NESHAP regulations are approved in the SIP, EPA has responsibility for enforcing the state regulation; whereas, if a state is delegated the authority for NSPS or NESHAP, EPA is only responsible for enforcing the Federal regulation. In either case, EPA can only approve a state regulation that is no less stringent than the respective Federal regulation.

EPA believes that, with respect to NSPS and NESHAPs established under section 111 and 112 of the CAA,

Congress intended for EPA to set the "standard," rather than including such standards in section 110 implementation plans (which allows states to set nonattainment area "standards.") EPA's Region VIII has found that many of its states wished to compile all of their air quality regulations into their respective SIPs to improve clarity and coordination of their air program. EPA believes that it does have the authority to approve state NSPS and NESHAP programs in the SIP. However, given the Congressional intent of the NSPS and NESHAP programs, EPA believes it can only approve in the SIP those state regulations that are equivalent to the corresponding Federal regulations, and such approval will be given with the understanding that EPA will retain concurrent enforcement authority for the NSPS and NESHAPs programs as outlined in the CAA.

On October 9, 1991, EPA Region VIII sent a letter to each of its states explaining the differences between SIP approval and delegation of authority for NSPS/NESHAP programs and offering each state the opportunity to change the processing of their NSPS and NESHAP programs. Pursuant to those letters, the States of Montana, North Dakota, and South Dakota decided to have their NSPS and NESHAPs approved in their respective SIPs. The State of Wyoming chose to continue with delegation of authority for its NSPS and NESHAPs. Thus, in this notice, EPA is clarifying those decisions concurrent with its action on the submittals of revised NSPS and NESHAPs from those four states.

Montana

On August 20, 1991, the Governor of Montana requested approval of revisions to the Montana SIP. The revisions consisted of amendments to ARM 16.8.1423, NSPS, and 16.8.1424, NESHAPs. The amendments update the State's NSPS and NESHAPs regulations to incorporate new Federal regulations promulgated between July 1, 1987 and July 1, 1990. On October 2, 1991, EPA notified the State that the SIP submittal was administratively and technically complete, and that the submittal would be approved. In this notice, EPA is approving the State's revisions to the SIP, providing the State with authority to implement and enforce the Federal NSPS in 40 CFR part 60 and the Federal NESHAPs in 40 CFR part 61, as in effect on July 1, 1990, with the exception of 40 CFR 61 subparts B, H, I, K, T, and W, which pertain to radionuclides.

In a March 23, 1992 letter to the State, EPA identified concerns with the State's interpretation of the term "administrator" as it applied to its NSPS and NESHAPs regulations. Some confusion had arisen because the State incorporated by reference the Federal NSPS and NESHAPs regulations, in which "administrator" is defined as the Administrator of EPA, and the State regulations did not specifically redefine "administrator" to be the appropriate State official. On April 20, 1992, the State responded with its interpretation of the term "administrator" in its NSPS and NESHAPs regulations to mean the administrator of the Montana Department of Health and Environmental Sciences or his designee (Bureau Chief of the Montana Air Quality Bureau), except for those authorities that cannot be delegated by the EPA, in which case "administrator" means Administrator of EPA. EPA concurs with the State's interpretation and is clarifying that interpretation in this notice. Also in that letter, the State committed to incorporate a definition of the term "administrator" consistent with its interpretation in the next revisions to its NSPS and NESHAPs regulations.

North Dakota

On June 30, 1992, the Governor of North Dakota submitted a request for approval of revisions to the SIP. The submittal consisted of revisions to the following sections in the State's Air Pollution Control Rules: 33–15–01 General Provisions, 33–15–05 Emissions of Particulate Matter Restricted, 33–15–06 Emissions of Sulfur Compounds Restricted, 33–15–07 Control of Organic Compound Emissions, 33–15–12 Standards of Performance for New Stationary Sources, 33–15–13 Emission Standards for Hazardous Air Pollutants, 33–15–15 Prevention of Significant Deterioration of Air Quality, and 33–15–20 Control of Emissions from Oil and Gas Well Production Facilities.

On August 27, 1992, EPA notified the State that the submittal was administratively and technically complete. In this notice, EPA is approving only the revisions to Chapter 33–15–12, NSPS, and Chapter 33/15/13, NESHAPs, of the North Dakota Administrative Code, with the exception of the State's asbestos regulations in Section 33–15–13–02. EPA will act on the remainder of the SIP submittal, including the asbestos regulations, in a separate notice. The revisions to Chapters 33–15–12 and 33–15–13 incorporate by reference the Federal NSPS in 40 CFR part 60 and the Federal NESHAPs in 40 CFR part 61, as in effect on May 1, 1991, with the exception of 40 CFR part 61, subparts B, H, I, K, M, T, and W (radionuclides and asbestos). EPA has reviewed the revised regulations and determined that they are consistent with the Federal regulations. Therefore, in this notice, EPA is approving the revisions to the State's NSPS and NESHAP regulations.

South Dakota

On September 25, 1991, the Governor's designee submitted revisions to the South Dakota SIP. The submittal consisted of revisions to the State's Air Pollution Control in Article 74:26 of the Administrative Rules of South Dakota. Specifically, revisions were made to the State's regulations for new source review (NSR) permitting, emergency episode plans for PM–10, PM–10 ambient standards and methods of measurement, operation permits, NSPS, and asbestos. The State also submitted regulations for the disposal of medical waste in Article 74:35.

On December 2, 1991, EPA notified the State that the submittal of the revisions to Article 74:26 was administratively and technically complete. In that letter, EPA returned Article 74:35 as incomplete because the State had not provided any response to the numerous public comments received.

On February 10, 1992, the State withdrew Section 74:26:26, Standards of Performance for Municipal Waste Combustors, and Section 74:26:22, Emission Standards for Asbestos Air Pollutants, so that revised regulations for these sections could be submitted for SIP approval.

On February 24, 1992, the State submitted the revised asbestos and municipal waste combustor regulations, along with its Asbestos Control Program in Article 74:31, for approval in the SIP. On April 28, 1992, EPA notified the State that the submittal was administratively and technically complete. In that letter, EPA also explained that it could not take action on the asbestos control program in Article 74:31 because those provisions were mandated by the Toxics Substances Control Act (TSCA), and EPA did not have the authority to approve such a regulation in a SIP required by section 110 of the CAA. Although EPA acknowledges receipt of these regulations, no action will be taken on the regulations.

In this notice, EPA is only taking action on the State's NSPS and asbestos regulations in Sections 74:26:8 through 74:26:26 of the Administrative Rules of South Dakota. The remainder of the SIP submittal will be acted on in a separate notice. EPA has reviewed the State's revisions to its NSPS and asbestos regulations and has found them to be

consistent with the respective Federal requirements. Specifically, EPA is approving the NSPS revisions submitted on September 25, 1991 that include the following: Sections 74:26:08–74:26:21 and 74:26:23–74:26:25 of the State's regulations which incorporate by reference 40 CFR part 60, subparts D, Da, Db, E, F, I, K, Ka, Kb, O, Y, DD, GG, HH, LL, and OOO, as in effect on July 1, 1989. EPA is also approving the revisions submitted on February 24, 1992 that include Section 74:26:26 of the State regulations, which incorporates by reference 40 CFR part 60, subpart Ea, as published in the **Federal Register** on February 11, 1991 (56 FR 5506), and Section 74:26:22 of the State's regulations, which incorporates by reference 40 CFR part 61, subpart M, as in effect on July 1, 1991.

Wyoming

On April 13, 1992, the State of Wyoming submitted revisions to its NSPS regulations. The submittal included the addition of the following NSPS categories: Small industrial-commercial-institutional steam generating units, municipal waste combustors, volatile organic compound (VOC) emissions from the polymer manufacturing industry, VOC emissions from the synthetic organic chemical manufacturing industry air oxidation unit processes, VOC emissions from synthetic organic chemical manufacturing industry distillation operations, VOC emissions from petroleum refinery wastewater systems, magnetic tape coating facilities, and polymeric coating of supporting substrates facilities (40 CFR part 60, subparts Dc, Ea, DDD, III, NNN, QQQ, SSS, and VVV). Pursuant to such submittal, on July 29, 1992, delegation was given with the following letter:

Hon. Mike Sullivan,
Governor of Wyoming, State Capitol, Cheyenne, Wyoming 82002

Dear Governor Sullivan: On April 13, 1992, you requested delegation of authority for revisions to the New Source Performance Standards (NSPS) in Section 22 of the Wyoming Air Quality Standards and Regulations (WAQSR). These revisions brought the State's NSPS up to date with the Federal NSPS in effect as of July 1, 1991.

Subsequent to states adopting NSPS regulations, the EPA delegates the authority for the implementation and enforcement of those NSPS, so long as those regulations are equivalent to the Federal regulations. EPA, therefore, is acting on the delegation of authority to Wyoming for implementation and enforcement of eight NSPS.

EPA has reviewed the pertinent statutes and regulations of the State of Wyoming and has determined that they provide an adequate and effective procedure for the implementation and enforcement of the NSPS, including the source applicability dates, by the State of Wyoming. Therefore, pursuant to section 111(c) of the Clean Air Act (CAA), as amended, and 40 CFR part 60, EPA hereby delegates its authority for the implementation and enforcement of the NSPS to the State of Wyoming as follows:

(A) Responsibility for all sources located, or to be located in the State of Wyoming subject to the standards of performance for new stationary sources promulgated in 40 CFR part 60. The categories of new stationary sources covered by this delegation are as follows: Small industrial-commercial-institutional steam generating units (subpart Dc), municipal waste combustors (subpart Ea), volatile organic compound emissions from the polymer manufacturing industry (subpart DDD), volatile organic compound emissions from the synthetic organic chemical manufacturing industry air oxidation unit processes (subpart III), volatile organic compound emissions from synthetic organic chemical manufacturing industry distillation operations (subpart NNN), VOC emissions from petroleum refinery wastewater systems (subpart QQQ), magnetic tape coating facilities (subpart SSS), and polymeric coating of supporting substrates facilities (subpart VVV).

(B) Not all authorities of NSPS can be delegated to states under section 111(c) of the CAA, as amended. The EPA Administrator retains authority to implement those sections of the NSPS that require: (1) Approving equivalency determinations and alternative test methods, (2) decision making to ensure national consistency, and (3) EPA rulemaking to implement. The following are the authorities in the applicable subparts of 40 CFR part 60 that are being delegated in this letter which EPA cannot delegate: (i) 40 CFR part 60.562–2(c), which pertains to equivalency determinations in subpart DDD, Volatile Organic Compound Emissions from the Polymer Manufacturing Industry; (ii) 40 CFR part 60.613(e), which pertains to alternative test methods in Subpart III, Volatile Organic Compound Emissions from the Synthetic Organic Chemical Manufacturing Industry Air Oxidation Unit Processes; (iii) 40 CFR part 60.663(e), which pertains to alternative test methods in subpart NNN, Volatile Organic Compound Emissions from Synthetic Organic Chemical Manufacturing Industry Distillation Operations; (iv) 40 CFR parts 60.711(a)(16), 60.713(b)(1)(i), 60.713(b)(1)(ii), 60.713(b)(5)(i), 60.713(d), 60.715(a), and 60.716, which pertain to equivalency determinations, alternative test methods, and EPA rulemakings in subpart SSS, Magnetic Tape Coating Facilities; and (v) 40 CFR parts 60.743(a)(3)(v) (A) and (B), 60.743(e), 60.745(a), and 60.746, which pertain to alternative test methods, equivalency determinations, and EPA rulemakings in subpart VVV, Polymeric Coating of Supporting Substrates Facilities.

(C) As 40 CFR part 60 is updated, Wyoming should revise its rules and regulations accordingly and in a timely manner.

This delegation is based upon and is a continuation of the same conditions as those stated in EPA's original delegation letter of August 2, 1977, except that condition 6, relating to Federal facilities, has been voided by the Clean Air Act Amendments of 1977. It is also important to note that EPA retains concurrent enforcement authority as stated in condition 3. If at any time there is a conflict between a State and Federal regulation (40 CFR part 60), the Federal regulation must be applied if it is more stringent than that of the State, as stated in condition 9 of our August 2, 1977 letter. A copy of this letter was published in the notices section of the **Federal Register** of September 15, 1977 (42 FR 46386), along with an associated rulemaking notifying the public that certain reports and applications required from operators of new or modified sources shall be submitted to the State of Wyoming (42 FR 46304). Copies of the **Federal Register** are enclosed for your convenience.

Since this delegation is effective immediately, there is no need for the State to notify the EPA of its acceptance. Unless we receive written notice of objections from you within ten days of the date on which you receive this letter, the State of Wyoming will be deemed to have accepted all the terms of this delegation. An information notice will be published in the **Federal Register** in the near future informing the public of this delegation. This letter will appear in such notice in its entirety.

In previous letters dated October 9, 1991 and February 6, 1992, EPA expressed concerns with the State's acceptance and enforcement of the Federal NSPS applicability dates. In this submittal, the State has revised the effective dates of its NSPS to be equivalent to the effective dates of the Federal NSPS, and has provided an Attorney General's opinion verifying the State's authority to implement and enforce the Federal NSPS. Therefore, EPA believes that this submittal has adequately addressed our concerns.

If you have any questions on this matter, please call me, or have your staff contact Doug Skie, Chief of our Air Programs Branch, at 293–1750.

Sincerely,
Jack W. McGraw,
Acting Regional Administrator.

Final Action

EPA is approving the revisions to Montana's NSPS and NESHAPs regulations in ARM 16.8.1423 and 16.8.1424, respectively, which were submitted by the Governor for SIP approval on August 20, 1991. This action provides the State with the authority for implementation and enforcement of all Federal NSPS and NESHAPs (except 40 CFR part 61, subparts B, H, I, K, Q, R, T, and W, pertaining to radionuclides) promulgated as of July 1, 1990. However, the State's NSPS and NESHAP authorities do not include those authorities which cannot be delegated to the states, as defined in 40 CFR parts 60 and 61.

EPA is also approving the revisions to the North Dakota SIP submitted on June 30, 1992, which include Chapters 33–15–12 (NSPS) and 33–15–13 (NESHAPs) of the State's Air Pollution Control Rules, with the exception of the asbestos regulations in Section 33–15–13–02. This action provides the State with the authority for implementation and enforcement of all Federal NSPS and NESHAPs (except 40 CFR part 61, subparts B, H, I, K, M, Q, R, T, and W, pertaining to radionuclides and asbestos) promulgated as of May 1, 1991. However, the State's NSPS and NESHAP authorities do not include those authorities which cannot be delegated to the states, as defined in 40 CFR parts 60 and 61.

Lastly, EPA is approving the revisions to the South Dakota SIP, Sections 74:26:08 through 74:26:26 of the Administrative Rules of South Dakota, NSPS and asbestos, which were submitted by the State on September 25, 1991 and February 24, 1992. This action provides the State with the authority for implementation and enforcement of the following subparts of 40 CFR part 60: D, Da, Db, E, F, I, K, Ka, Kb, O, Y, DD, GG, HH, LL, and OOO (as in effect on July 1, 1989); and Ea (as in effect on February 11, 1991). Also, this action provides the State with authority to implement and enforce 40 CFR part 61, subpart M, as in effect on July 1, 1991. However, the State's NSPS and asbestos NESHAP authorities do not include those authorities which cannot be delegated to the states, as defined in 40 CFR parts 60 and 61.

Nothing in this action should be construed as permitting or allowing or establishing a precedent for any future request for revision to any SIP. Each request for revision to the SIP shall be considered separately in light of specific technical, economic, and environmental factors and in relation to relevant statutory and regulatory requirements.

Under 5 U.S.C. 605(b), I certify that this SIP revision will not have a significant economic impact on a substantial number of small entities (See 46 FR 8709).

This action has been classified as a Table 3 action by the Regional Administrator under the procedures published in the **Federal Register** on January 19, 1989 (54 FR 2214–2225). On January 6, 1989, the Office of Management and Budget (OMB) waived Table 2 and 3 SIP revisions (54 FR 2222) from the requirements of Section 3 of Executive Order 12291 for a period of two years. EPA has submitted a request for a permanent waiver for Table 2 and 3 SIP revisions. OMB has agreed to continue the temporary waiver until such time as it rules on EPA's request.

Under section 307(b)(1) of the CAA, petitions for judicial review of this section must be filed in the United States Court of Appeals for the appropriate circuit by March 22, 1993. Filing a petition for reconsideration by the Administrator of this final rule does not affect the finality of this rule for the purposes of judicial review nor does it extend the time within which a petition for judicial review must be filed, and shall not postpone the effectiveness of such rule or action. This action may not be challenged later in proceedings to enforce its requirements (see section 307(b)(2)).

List of Subjects

40 CFR Part 52

Air pollution control, Incorporation by reference.

40 CFR Part 60

Air pollution control, Aluminum, Ammonium sulfate plants, Beverages, Carbon monoxide, Cement industry, Coal, Copper, Dry cleaners, Electric power plants, Fertilizers, Fluoride, Gasoline, Glass and glass products, Grains, Graphic arts industry, Household appliances, Insulation, Intergovernmental relations, Iron, Lead, Lime, Metallic and nonmetallic mineral processing plants, Metals, Motor vehicles, Natural gas, Nitric acid plants, Nitrogen dioxide, Paper and paper products industry, Particulate matter, Paving and roofing materials, Petroleum, Phosphate, Plastics materials and synthetics, Reporting and recordkeeping requirements, Sewage disposal, Steel, Sulfur oxides, Tires, Urethane, Vinyl, Waste treatment and disposal, Wool, Zinc.

40 CFR Part 61

Air Pollution Control, Arsenic, Asbestos, Benzene, Beryllium, Hazardous substances, Mercury, Vinyl chloride.

Dated: November 13, 1992.

Jack W. McGraw,

Acting Regional Administrator.

Title 40, chapter I of the Code of Federal Regulations is amended as follows:

PART 52—[AMENDED]

1. The authority citation for part 52 continues to read as follows:

Authority: 42 U.S.C. 7401–7671q.

Subpart BB—Montana

2. Section 52.1370 is amended by adding paragraph (c)(25) to read as follows:

§ 52.1370 Identification of plan.

* * * * *

(c) * * *

(25) On August 20, 1991, the Governor of Montana submitted revisions to the plan for new source performance standards and national emission standards for hazardous air pollutants.

(i) *Incorporation by reference.*

(A) Revisions to the Administrative Rules of Montana 16.8.1423, Standards of Performance of New Stationary Sources, and 16.8.1424, Emission Standards for Hazardous Air Pollutants, adopted July 1, 1991, effective July 12, 1991.

(ii) *Additional material.*

(A) Letter dated April 20, 1992 from Jeffrey T. Chaffee, Chief of the Montana Air Quality Bureau, to Doug Skie, Chief of Air Programs Branch, EPA Region VIII.

Subpart JJ—North Dakota

3. Section 52.1820 is amended by adding paragraph (c)(23) to read as follows:

§ 52.1820 Identification of plan.

* * * * *

(c) * * *

(23) On June 30, 1992, the Governor of North Dakota submitted revisions to the plan for new source performance standards and national emission standards for hazardous air pollutants.

(i) *Incorporation by reference.*

(A) Revisions to the Air Pollution Control Rules, Chapter 33–15–12, Standards of Performance for New Stationary Sources, and Chapter 33–15–13, excluding Section 33–15–13–02, Emission Standards for Hazardous Air Pollutants, effective June 1, 1992.

Subpart QQ—South Dakota

4. Section 52.2170 is amended by adding paragraph (c)(13) to read as follows:

§ 52.2170 Identification of plan.

* * * * *

(c) * * *

(13) On September 25, 1992 and February 24, 1992, the Governor of South Dakota submitted revisions to the plan for new source performance standards and asbestos.

(i) *Incorporation by reference.*

(A) Revisions to the Air Pollution Control Program, Sections 74:26:08–74:26:21 and 74:26:23–74:26:25, New

Source Performance Standards, effective May 13, 1991, Section 74:26:26, Standards of Performance for Municipal Waste Combustors, effective November 24, 1991, and Section 74:26:22, Emission Standards for Asbestos Air Pollutants, effective December 2, 1991.

PART 60—[AMENDED]

1. The authority citation for part 60 continues to read as follows:

Authority: 42 U.S.C. 7401, 7411, 7414, 7416, and 7601 as amended by the Clean Air Act Amendments of 1990, Pub. L. 101–549, 104 Stat. 2399 (November 15, 1990; 402, 409, 415 of the Clean Air Act as amended, 104 Stat. 2399, unless otherwise noted).

Subpart A—General Provisions

2. Section 60.4(c) is amended by revising the table to read as follows:

§ 60.04 Address.

* * * * *

(c) * * *

DELEGATION STATUS OF NEW SOURCE PERFORMANCE STANDARDS

[(NSPS) for Region VIII]

Subpart	State					
	CO	MT[1]	ND[1]	SD[1]	UT[1]	WY
A General Provisions	(*)	(*)	(*)	(*)	(*)	(*)
D Fossil Fuel Fired Steam Generators	(*)	(*)	(*)	(*)	(*)	(*)
Da Electric Utility Steam Generators	(*)	(*)	(*)	(*)	(*)	(*)
Db Industrial-Commercial Institutional Steam Generators	(*)	(*)	(*)	(*)	(*)	(*)
Dc Industrial-Commercial Institutional Steam Generators			(*)		(*)	(*)
E Incinerator	(*)	(*)	(*)	(*)	(*)	(*)
Ea Municipal Waste Combustors			(*)	(*)	(*)	(*)
F Portland Cement Plants	(*)	(*)	(*)	(*)	(*)	(*)
G Nitric Acid Plants	(*)	(*)	(*)		(*)	(*)
H Sulfuric Acid Plant	(*)	(*)	(*)	(*)	(*)	(*)
I Asphalt Concrete Plants	(*)	(*)	(*)		(*)	(*)
J Petroleum Refineries	(*)	(*)	(*)	(*)	(*)	(*)
K Petroleum Storage Vessels (6/11/73–5/19/78)	(*)	(*)	(*)	(*)	(*)	(*)
Ka Petroleum Storage Vessels (5/18/78–7/23/84)	(*)	(*)	(*)	(*)	(*)	(*)
Kb Petroleum Storage Vessels (after (7/23/84)		(*)	(*)	(*)	(*)	(*)
L Secondary Lead Smelters	(*)	(*)	(*)		(*)	(*)
M Secondary Brass & Bronze Production Plants	(*)	(*)	(*)		(*)	(*)
N Primary Emissions from Basix Oxygen Process Furnaces (after 6/11/73).	(*)	(*)	(*)		(*)	(*)
Na Secondary Emissions from Basic Oxygen Process Furnaces (after 1/20/83).	(*)	(*)	(*)		(*)	(*)
O Sewage Treatment Plants	(*)	(*)	(*)	(*)	(*)	(*)
P Primary Copper Smelters	(*)	(*)	(*)		(*)	(*)
Q Primary Zinc Smelters	(*)	(*)	(*)		(*)	(*)
R Primary Lead Smelters	(*)	(*)	(*)		(*)	(*)
S Primary Aluminum Reduction Plants	(*)	(*)	(*)		(*)	(*)
T Phosphate Fertilizer Industry: Wet Process Phosphoric Plants	(*)	(*)	(*)		(*)	(*)
U Phosphate Fertilizer Industry: Superphosphoric Acid Plants	(*)	(*)	(*)		(*)	(*)
V Phosphate Fertilizer Industry: Diammonium Phosphate Plants	(*)	(*)	(*)		(*)	(*)
W Phosphate Fertilizer Industry: Triple Super-Phosphate Plants	(*)	(*)	(*)		(*)	(*)
X Phosphate Fertilizer Industry: Granular Triple Superphosphate Storage Facilities.	(*)	(*)	(*)		(*)	(*)
Y Coal Preparation Plants	(*)	(*)	(*)	(*)	(*)	(*)
Z Ferroalloy Production Facilities	(*)	(*)	(*)		(*)	(*)
AA Steel Plants: Electric Arc Furnaces (10/21/74–8/17/83)	(*)	(*)	(*)		(*)	(*)
AAa Steel Plants: Electric Arc Furnaces and Argon-Oxygen Decarburization Vessels (after 8/7/83).		(*)	(*)		(*)	(*)
BB Kraft Pulp Mills	(*)	(*)	(*)		(*)	(*)
CC Glass Manufacturing Plants	(*)	(*)	(*)		(*)	(*)
DD Grain Elevator	(*)	(*)	(*)	(*)	(*)	(*)
EE Surface Coating of Metal Furniture	(*)	(*)	(*)		(*)	(*)
GG Stationary Gas Turbines	(*)	(*)	(*)	(*)	(*)	(*)
HH Lime Manufacturing Plants	(*)	(*)	(*)	(*)	(*)	(*)
KK Lead-Acid Battery Manufacturing Plants	(*)	(*)	(*)		(*)	(*)
LL Metallic Mineral Processing Plants	(*)	(*)	(*)	(*)	(*)	(*)
MM Automobile & Light Duty Truck Surface Coating Operations	(*)	(*)	(*)		(*)	(*)
NN Phosphate Rock Plants	(*)	(*)	(*)		(*)	(*)
PP Ammonium Sulfate Manufacturing	(*)	(*)	(*)		(*)	(*)
QQ Graphic Arts Industry: Publication Rotogravure Printing	(*)	(*)	(*)		(*)	(*)
RR Pressure Sensitive Tape & Label Surface Coating	(*)	(*)	(*)		(*)	(*)
SS Industrial Surface Coating: Large Appliances	(*)	(*)	(*)		(*)	(*)
TT Metal Coil Surface Coating	(*)	(*)	(*)		(*)	(*)
UU Asphalt Processing & Asphalt Roofing Manufacture	(*)	(*)	(*)		(*)	(*)
VV Synthetic Organix Chemicals Manufacturing: Equipment Leaks of VOC.	(*)	(*)	(*)		(*)	(*)
WW Beverage Can Surface Coating Industry	(*)	(*)	(*)		(*)	(*)
XX Bulk Gasoline Terminals	(*)	(*)	(*)		(*)	(*)
AAA Residential Wood Heaters		(*)	(*)		(*)	(*)
BBB Rubber Tires		(*)	(*)		(*)	(*)
DDD VOC Emissions from Polymer Manufacturing Industry					(*)	(*)
FFF Flexible Vinyl & Urethane Coating & Printing	(*)	(*)	(*)		(*)	(*)
GGG Equipment Leaks of VOC in Petroleum Refineries	(*)	(*)	(*)		(*)	(*)
HHH Synthetic Fiber Production	(*)	(*)	(*)		(*)	(*)
III VOC Emission from the Synthetic Organic Chemical Manufacturing Industry Air Oxidation Unit processes.		(*)	(*)		(*)	(*)

DELEGATION STATUS OF NEW SOURCE PERFORMANCE STANDARDS—Continued
[(NSPS) for Region VIII]

Subpart	State					
	CO	MT[1]	ND[1]	SD[1]	UT[1]	WY
JJJ Petroleum Dry Cleaners	(*)	(*)	(*)		(*)	(*)
KKK Equipment Leaks of VOC from Onshore Natural Gas Processing Plants.	(*)	(*)	(*)		(*)	(*)
LLL Onshore Natural Gas Processing: SO_2 Emissions	(*)	(*)	(*)		(*)	(*)
NNN VOC Emissions from the Synthetic Organic Chemical Manufacturing Industry Distillation Operations.		(*)	(*)		(*)	(*)
OOO Nonmetallic Mineral Processing Plants	(*)	(*)	(*)	(*)	(*)	(*)
PPP Wool Fiberglass Insulation Manufacturing Plants	(*)	(*)	(*)		(*)	(*)
QQQ VOC Emission from Petroleum Refinery Wastewater Systems		(*)	(*)		(*)	(*)
SSS Magnetic Tape Industry		(*)	(*)		(*)	(*)
TTT Plastic Parts for Business Machines Coatings		(*)	(*)		(*)	(*)
VVV Polymeric Coating of Supporting Substrates		(*)	(*)		(*)	(*)

*Indicates approval of state regulation.
[1]Indicates approval of New Source Performance Standards as part of the State Implementation Plan (SIP).

PART 61—[AMENDED]

1. The authority citation for part 61 continues to read as follows:

Authority: Secs. 101, 112, 114, 116, 301, Clean Air Act as amended (42 U.S.C. 7401, 7412, 7414, 7416, 7601).

Subpart A—General Provisions

2. Section 61.04(c) is amended by revising the table to read as follows:

§ 61.04 address

* * * * *

(c) * * *

DELEGATION STATUS OF NATIONAL EMISSION STANDARDS FOR HAZARDOUS AIR POLLUTANTS
[(NESHAPs) for Region VIII]

Subpart	State					
	CO	MT[1]	ND[1]	SD[1]	UT[1]	WY
A General Provisions	(*)	(*)	(*)	(*)	(*)	.....
C Beryllium	(*)	(*)	(*)	.....	(*)	.....
D Beryllium Rocket Motor Firing	(*)	(*)	(*)	.....	(*)	.....
E Mercury	(*)	(*)	(*)	.....	(*)	.....
F Vinyl Chloride	(*)	(*)	(*)	.....	(*)	.....
J Equipment Leaks (Fugitive Emission Sources) of Benzene	(*)	(*)	(*)	.....	(*)	.....
L Benzene Emission from Coke By-Product Recovery Plants	.....	(*)	(*)	.....	(*)	.....
M Asbestos	(*)	(*)	(*)	(*)	(*)	(*)[2]
N Inorganic Arsenic Emissions from Glass Manufacturing Plants	.....	(*)	(*)	.....	(*)	.....
O Inorganic Arsenic Emissions from Primary Copper Smelters	.....	(*)	(*)	.....	(*)	.....
P Inorganic Arsenic Emissions from Arsenic Trioxide and Metallic Arsenic Production Facilities	.....	(*)	(*)	.....	(*)	.....
V Equipment Leaks (Fugitive Emission Sources)	.....	(*)	(*)	.....	(*)	.....
Y Benzene Emissions from Benzene Storage Vessels	.....	(*)	(*)	.....	(*)	.....
BB Benzene Emissions from Benzene Transfer Operations	.....	(*)	(*)	.....	(*)	.....
FF Benzene Waste Operations	.....	(*)	.....	.....	(*)	.....

*Indicates approval of state regulations.
[1]Indicates approval of state regulation. Indicates approval of National Emission Standards for Hazardous Air Pollutants as part of the State Implementation Plan (SIP).
[2]Delegation for asbestos demolition, renovation and spraying operations, and waste disposal for demolition, renovation and spraying operations only.

[FR Doc. 93–1389 Filed 1–19–93; 8:45 am]
BILLING CODE 6560–50–M

FEDERAL COMMUNICATIONS COMMISSION

47 CFR Part 73
[MM Docket No. 92–129; RM–8006]

Radio Broadcasting Services; Grundy Center, IA

AGENCY: Federal Communications Commission.
ACTION: Final rule.

SUMMARY: The Commission, at the request of Grundy Broadcasting Company, substitutes Channel 249C3 for Channel 249A at Grundy Center, Iowa, and modifies the license of Station KGCI–FM to specify operation on the higher powered channel. See 57 FR 28163, June 24, 1992. Channel 249C3 can be allotted to Grundy Center in compliance with the Commission's minimum distance separation requirements with a site restriction of 18.2 kilometers (11.3 miles) east to avoid a short-spacing to Station KHBT, Channel 249A, Humboldt, Iowa, and to accommodate petitioner's desired transmitter site. The coordinates for Channel 249C3 at Grundy Center are North Latitude 42–21–25 and West Longitude 92–33–14. With this action, this proceeding is terminated.

EFFECTIVE DATE: February 26, 1993.

FOR FURTHER INFORMATION CONTACT: Leslie K. Shapiro, Mass Media Bureau, (202) 634–6530.

SUPPLEMENTARY INFORMATION: This is a synopsis of the Commission's Report and Order, MM Docket No. 92–129, adopted December 22, 1992, and released January 13, 1993. The full text of this Commission decision is available for inspection and copying during normal business hours in the FCC Dockets Branch (room 230), 1919 M Street, NW., Washington, DC. The complete text of this decision may also be purchased from the Commission's copy contractor, Downtown Copy Center, (202) 452–1422, 1990 M Street, NW., suite 640, Washington, DC 20036.

List of Subjects in 47 CFR Part 73

Radio broadcasting.

PART 73—[AMENDED]

1. The authority citation for part 73 continues to read as follows:

Authority: 47 U.S.C. 154, 303.

§ 73.202 [Amended]

2. Section 73.202(b), the Table of FM Allotments under Iowa, is amended by removing Channel 249A and adding Channel 249C3 at Grundy Center.

Federal Communications Commission.

Michael C. Ruger,

Chief, Allocations Branch, Policy and Rules Division, Mass Media Bureau.

[FR Doc. 93–1287 Filed 1–19–93; 8:45 am]

BILLING CODE 6712–01–M

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47 CFR Part 73

[MM Docket No. 92–131; RM–8005]

Radio Broadcasting Services; Copenhagen, NY

AGENCY: Federal Communications Commission.

ACTION: Final rule.

SUMMARY: The commission, at the request of Tia A. Soliday, substitutes Channel 294C3 for Channel 294A at Copenhagen, New York, and modifies Station WWLF–FM's construction permit to specify operation on the higher class channel. See 57 FR 28163, June 24, 1992. Channel 294C3 can be allotted to Copenhagen in compliance with the Commission's minimum distance separation requirements with a site restriction of 11.3 kilometers (7 miles) northeast to avoid a short-spacing to Station WPCX, Channel 295B, Auburn, New York, at coordinates North Latitude 43–56–30 and West Longitude 75–33–00. While the allotment is short-spaced to Station CKO–1, Channel 295C1, Ottawa, Ontario, and vacant Channel 293A at Brockville, Ontario, Canada, we find that the use of Channel 294C3 at Copenhagen will not result in any prohibited interference. Canadian concurrence in the allotment as a specially negotiated allotment has been received because Copenhagen is located within 320 kilometers (200 miles) of the U.S.-Canadian border. With this action, this proceeding is terminated.

EFFECTIVE DATE: February 26, 1993.

FOR FURTHER INFORMATION CONTACT: Leslie K. Shapiro, Mass Media Bureau, (202) 634–6530.

SUPPLEMENTARY INFORMATION: This is a synopsis of the Commission's Report and Order, MM Docket No. 92–131, adopted December 22, 1992, and released January 13, 1993. The full text of this Commission decision is available for inspection and copying during normal business hours in the FCC Dockets Branch (room 230), 1919 M Street, NW., Washington, DC. The complete text of this decision may also be purchased from the Commission's copy contractor, Downtown Copy Center, (202) 452–1422, 1990 M Street, NW., suite 640, Washington, DC 20036.

List of Subjects in 47 CFR Part 73

Radio broadcasting.

PART 73—[AMENDED]

1. The authority citation for part 73 continues to read as follows:

Authority: 47 U.S.C. 154, 303.

§ 73.202 [Amended]

2. Section 73.202(b), the Table of FM Allotments under New York, is amended by removing Channel 294A and adding Channel 294C3 at Copenhagen.

Federal Communications Commission.

Michael C. Ruger,

Chief, Allocations Branch, Policy and Rules Division, Mass Media Bureau.

[FR Doc. 93–1288 Filed 1–19–93; 8:45 am]

BILLING CODE 6712–01–M

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47 CFR Part 73

[MM Docket No. 92–130; RM–8007]

Radio Broadcasting Services; Canyon City, OR

AGENCY: Federal Communications Commission.

ACTION: Final rule.

SUMMARY: The Commission, at the request of Blue Mountain Broadcasting, allots Channel 233A to Canyon City, Oregon, as the community's first local aural broadcast service. See 57 FR 28162, June 24, 1992. Channel 233A can be allotted to Canyon City without the imposition of a site restriction, at coordinates North Latitude 44–23–18 and West Longitude 118–56–54. With this action, this proceeding is terminated.

DATES: Effective February 26, 1993. The window period for filing applications will open on March 1, 1993, and close on March 31, 1993.

FOR FURTHER INFORMATION CONTACT: Leslie K. Shapiro, Mass Media Bureau, (202) 634–6530.

SUPPLEMENTARY INFORMATION: This is a synopsis of the Commission's Report and Order, MM Docket No. 92–130, adopted December 22, 1992, and released January 13, 1993. The full text of this Commission decision is available for inspection and copying during normal business hours in the FCC Dockets Branch (room 230), 1919 M Street, NW., Washington, DC. The complete text of this decision may also be purchased from the Commission's copy contractor, Downtown Copy Center, (202) 452–1422, 1990 M Street, NW., suite 640, Washington, DC 20036.

List of Subjects in 47 CFR Part 73

Radio broadcasting.

PART 73—[AMENDED]

1. The authority citation for part 73 continues to read as follows:

Authority: 47 U.S.C. 154, 303.

§ 73.202 [Amended]

2. Section 73.202(b), the Table of FM Allotments under Oregon, is amended by adding Canyon City, Channel 233A.

Federal Communications Commission.

Michael C. Ruger,

Chief, Allocations Branch, Policy and Rules Division, Mass Media Bureau.

[FR Doc. 93–1284 Filed 1–19–93; 8:45 am]

BILLING CODE 6712–01–M