IN-DEPTH

# Transfer Pricing

## USA



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# Transfer Pricing

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Contributing Editor

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In-Depth: Transfer Pricing (formerly The Transfer Pricing Law Review) provides a practical overview of the main transfer pricing rules in key jurisdictions worldwide. Each chapter summarises the relevant country's substantive transfer pricing rules, explains how a transfer pricing dispute is handled – from initial scrutiny through to litigation or settlement – and discusses the interaction between transfer pricing and other parts of the tax code (such as withholding taxes, customs duties and attempts to prevent double taxation).

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# USA

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# Introduction

The United States' transfer pricing regime consists of a single statute in the Internal Revenue Code (Code) and a large body of implementing regulations. The transfer pricing regime applies broadly in the federal income tax context in both purely domestic and cross-border settings (ie, the United States permits transfer pricing adjustments whether or not cross-border transactions are involved). In the event of a "controlled" transaction, the US Internal Revenue Service (IRS) can allocate income, deductions, credits, basis, or any other element that affects taxable income. US regulations define "controlled" broadly to include control resulting from the actions of two or more taxpayers acting in concert or with a common goal. There is no mechanical ownership or relationship test for the IRS to apply to establish that a transaction is "controlled". The regime applies broadly to any person, organisation, or trade or business, whether or not they are subject to any internal revenue tax.

Though most recent transfer pricing audits have concerned cross-border tangible and intangible transfers and financial transactions between related corporations and partnerships, the IRS has also historically applied the transfer pricing regime to transactions between shareholders and the corporations they own. Whether transactions between a shareholder and a corporation are at arm's length can have implications beyond the tax realm. US courts can look to the issue in deciding whether to pierce the corporate veil and strip corporate owners of their limited liability.

There are transfer pricing regulations that apply specifically to certain financial transactions (ie, loans). There are also other (non-transfer pricing) rules that apply to limit interest deductions under certain circumstances. There are special (non-transfer pricing) rules that apply in the case of outbound transfers of intangible property to foreign corporations that would have otherwise qualified for non-recognition treatment under specific rules (eg, in the case of a contribution of property to a controlled corporation in exchange for stock). These outbound transfer rules cross-reference or incorporate the transfer pricing regulations.

The Organisation for Economic Cooperation and Development (OECD) transfer pricing guidelines (the TP Guidelines) are not incorporated in the US transfer pricing statute or regulations. In the United States, the OECD TP Guidelines can apply under a treaty in the competent authority process alongside domestic law. In other contexts, the IRS and US courts apply solely domestic law but may look to the TP Guidelines as nonbinding but useful commentary. The IRS's position has historically been that the US transfer pricing regulations are consistent with the OECD TP Guidelines. While that position is questionable in all respects, it is certainly the case that the US Treasury and IRS have been actively involved with other OECD members in authoring changes to the TP Guidelines, which have been modified in recent years to better align with certain principles already reflected in the US statute and transfer pricing regulations.

In theory, the accounting treatment of uncertain tax positions attributable to transfer pricing could present a major IRS audit risk. However, given concerns under the work product doctrine, the IRS has exercised a policy of restraint in requesting work papers underlying the accounting treatment of uncertain tax positions. Certain corporate taxpayers are required to file a form with their returns that lists material uncertain tax

positions and contains a general description of the underlying issues. There is no penalty for failing to file such a form, but most taxpayers file them anyway. Because a fair number of transfer pricing issues will inevitably appear on the form, the maintenance of a tax reserve for a large, uncertain transfer pricing position is a factor that increases IRS audit risk.

## Year in review

Transfer pricing and cross-border taxation continued to be at the forefront of international tax. Numerous countries implemented statutory changes to incorporate aspects of the OECD's Two-Pillar Solution while continuing to aggressively implement and enforce the OECD's Base Erosion and Profit Shifting initiatives, but with continued headwinds from the United States, which successfully lobbied for a “side-by-side” package establishing a safe harbour exempting multinational groups with ultimate parent entities in qualifying jurisdictions from the Pillar Two income inclusion and under-taxed profits rules. To date, the United States is the only jurisdiction deemed qualified for this safe harbour

As of 2026, there is continued uncertainty about bilateral cooperation among countries with respect to trade and transfer pricing due to greater implementation of cross-border tariffs covering a wide variety of goods. Such tariffs may impact many multinationals' transfer pricing policies and prices, and is likely to be a source of conflict between taxpayers and tax authorities and between competent authorities in connection with Advance Pricing Agreements and under Mutual Agreement Procedures.

## Filing requirements

The US transfer pricing regulations do not require taxpayers to prepare written support for their transfer pricing positions. However, taxpayers must prepare contemporaneous transfer pricing documentation supporting the arm's-length results of their controlled transactions to avoid the substantial penalties that could apply to transfer pricing adjustments. As described below, certain taxpayers must file Form 8975 (country-by-country (CbC) report) and accompanying Schedules A with their tax returns, but those documents do not require explaining the bases for a company's transfer prices.

Code section 6662 imposes accuracy-related penalties on transfer pricing-related valuation misstatements resulting in underpayments of tax. The accuracy-related penalties are 20% (substantial valuation misstatement) or 40% (gross valuation misstatement) of the increased US tax liability, depending on the amount of the valuation misstatement for a given controlled transaction or the net adjustment amount of multiple controlled transactions. The applicable thresholds for which valuation misstatement penalties apply are low. Consequently, the vast majority of IRS adjustments result in underpayments above the penalty threshold.

Taxpayers can avoid penalties by preparing transfer pricing documentation that:

- establishes that the transfer price was reasonably and reliably determined, consistent with the transfer pricing regulations;

- was in existence when the taxpayer filed the relevant return; and
- is provided to the IRS within 30 days of a request.

Treasury Regulation section 1.6662-6 provides a list of required materials that the documentation must include and be supported by (principal documents and background documents). The IRS has also issued informal guidance to assist taxpayers and their advisers in preparing transfer pricing documentation that will provide protection from penalties and reduce inefficient audits. Whether transfer pricing documentation establishes that the transfer price was reasonably and reliably determined will ultimately depend on the specific facts and circumstances.

The principal documents "should accurately and completely describe the basic transfer pricing analysis conducted by the taxpayer" and must contain certain information, including:

- an "overview of the taxpayer's business";
- a "description of the taxpayer's organisation structure" (eg, an organisation chart), covering all related parties that are engaged in transactions potentially relevant under section 482;
- a "description of the [pricing] method selected and an explanation why that method was selected" and what alternative methods were considered but not selected (ie, the selected one is the best method); and
- a "description of the controlled transactions" (eg, the terms of sale) and "any internal data used to analyse those transactions".[1]

In its informal guidance, the IRS highlighted specific sections of transfer pricing documentation that could, generally, benefit from improvement, including:

- industry and company context and analysis;
- functional and risk analyses; and
- support for the best method.

Beyond the required materials, whether the taxpayer's transfer pricing conclusions were reasonable is determined by objective factors, including:

- the "experience and knowledge of the taxpayer, including all members of the taxpayer's controlled group";
- the "extent to which reliable data was available";
- the "extent to which the taxpayer followed" the transfer pricing regulations;
- the "extent to which the taxpayer reasonably relied on a study or other analysis performed by a professional qualified to conduct such a study or analysis, including an attorney, accountant, or economist";
- the "extent to which the taxpayer relied on a transfer pricing methodology developed and applied pursuant to an Advance Pricing Agreement for a prior taxable year"; and
- the "size of the net transfer pricing adjustment in relation to the size of the controlled transaction on which the adjustment arose".[2]

The regulations do not require that a taxpayer prepare new transfer pricing documentation each year for ongoing transactions as long as the relevant facts and circumstances have not changed. Because businesses and business environments are dynamic, to ensure adequate documentation, taxpayers must review the relevant facts and circumstances annually – at a minimum to incorporate new financial or other data that may affect pricing.

In addition, the ultimate parent entity of a US multinational enterprise with annual revenue for the preceding reporting period of at least US$850 million is required to file Form 8975 (CbC report) and accompanying Schedule A. Consistent with the OECD final report on country-by-country reporting (CbCR), Form 8975 and accompanying Schedule A require the disclosure of financial and similar data for each constituent entity of the multinational group by jurisdiction. This information may then be shared, confidentially, among tax authorities pursuant to competent authority arrangements. There is currently no indication that the United States intends to require public disclosure of CbC reports. The United States does not require preparation or filing of the master and local files because substantially the same information is required under the aforementioned transfer pricing documentation requirements. However, the CbCR requirements create further incentives for large multinationals to properly document their transfer prices due to an increased potential for audit.

## Presenting the case

The transfer pricing regulations found in Treasury Regulation sections 1.482-1 to 1.482-9 provide specified methods for pricing a variety of types of transactions (eg, tangible goods, intangibles, cost-sharing and services) and permit the use of unspecified methods. There is no hierarchy of methods; the touchstone is the best method rule, which provides that "The arm's length result of a controlled transaction must be determined under the method that, under the facts and circumstances, provides the most reliable measure of an arm's length result."[3]

The determination of the best method is case specific. However, the regulations state that the two primary factors to take into account in making a best method determination between two or more available methods (or the applications of a single method) are:

- "the degree of comparability between the controlled transaction (or taxpayer) and any uncontrolled comparables"; and
- "the quality of the data and assumptions used in the analysis".[4]

The principal types of specified methods can be categorised as either:

- transactional methods, which rely on third-party transaction data (price, gross margin or markups) to determine a transfer price for a controlled transaction; or
- profit-based methods, which use operating profit and often rely on profitability metrics to compare a controlled taxpayer to a third-party company.

The transactional methods include the comparable uncontrolled price (CUP) method for tangible goods transactions (the method has slightly modified names when applied to intangibles or services transactions), the resale price method, and the cost plus method.

The profit-based methods include the comparable profits method (CPM) and the profit split method. Regarding cost-sharing arrangements, the regulations provide for additional specified methods, such as the income method and acquisition price method.[5]

Although best-method selection is case specific, taxpayers and courts historically preferred transactional methods. The CPM and profit split method are commonly used, particularly when reliable transactional data is unavailable. Because perfect or identical transactional or CPM comparables are often not available, adjustments should be made for differences to improve the reliability of the results; however, the number, magnitude and reliability of those adjustments will affect the reliability of the results.[6] Therefore, a transactional method requiring multiple adjustments or adjustments based on questionable assumptions may be less reliable than a profit-based method requiring fewer adjustments or based on sounder assumptions.

Transfer pricing compliance continues to be a primary focus of the IRS and a multinational's greatest US audit risk. A transfer pricing audit can take years and involve hundreds of information requests. It sometimes also includes site visits and numerous transcribed interviews. Publication 5300, the "Transfer Pricing Examination Process", provides the IRS and taxpayers a guide to best practices and processes for a transfer pricing audit. To identify potential taxpayers with non-compliant transfer pricing, the IRS uses data analytics and will review the tax return, including Form 8975 (CbC report) and accompanying Schedule A. With this information, as well as publicly available information about the taxpayer, the IRS will develop an initial transfer pricing risk assessment.

For transfer pricing audits, the IRS examination team (Exam) generally includes one or more economists employed by the IRS. In fact, they tend to drive the audits. Although the IRS can also hire outside economists, that is not typical (particularly early in an audit). If it appears that a transfer pricing issue will not likely be resolved and that litigation is likely, the IRS sometimes engages an outside economist later in an audit.

The IRS has a variety of tools for requesting and collecting information from a taxpayer. The IRS's principal tool is the information document request (IDR), and the IRS's first transfer pricing IDR is generally a request for the taxpayer's transfer pricing documentation. As noted above, the taxpayer must provide that documentation within 30 days of the IRS's request to avoid potential valuation misstatement penalties.

In general, the IRS will request relevant financial and organisational data (eg, a walk-through of the geographic, legal-entity, tax, and functional organisational charts and numerous financial statements, including reconciliations to the audited financial statements) and an orientation meeting on the taxpayer's transfer pricing and supply chain. In addition to the taxpayer's US transfer pricing documentation, the IRS may request other transfer pricing documentation (eg, the master file or local files, if applicable) to better understand the taxpayer's global operations and transfer pricing positions.

The IRS may have further questions and will request additional information through IDRs. IDRs are not enforceable. If the taxpayer does not sufficiently comply with an IDR, then the IRS must issue either a summons, which is judicially enforceable and may subject the summonsed party to criminal liabilities for failure to obey the summons, or a formal document request (FDR). Where foreign-based information is not subject to the control of the US taxpayer, the IRS may issue an FDR. If the taxpayer fails to comply with the FDR, then the foreign-based documentation requested may not be admissible in a

subsequent court proceeding.[7] If the US taxpayer is a subsidiary of a foreign entity with at least 25% ownership of the US taxpayer, then the IRS may request that the US taxpayer sign an authorisation of agent (AOA), such that the US taxpayer is subject to summons enforcement for information held by the foreign entity. If the US taxpayer does not agree to the AOA or does not substantially comply with a valid summons after signing an AOA, then the IRS, in its sole discretion, can determine the amount of deduction permitted in a controlled transaction between the US taxpayer and the foreign entity.[8] AOA requests are becoming increasingly common.

Criminal tax cases are rarer than civil ones. That is especially true with respect to multinational enterprises. In the unlikely event the IRS has probable cause to believe that a crime was committed (eg, tax fraud), then the IRS can ask a judge for a search warrant to search the taxpayer's premises and seize items connected to the alleged crime.

## Intangible assets

Intangible property is referenced in Code section 482 itself and addressed more extensively in Treasury Regulation section 1.482-4. Intangible property is defined in Code section 482 by reference to Code section 367(d)(4), which lists specific types of intangible property (eg, patents, copyrights, trademarks, licences, and goodwill) and contains a catch-all provision for "other item[s] the value or potential value of which is not attributable to tangible property or the services of any individual". Treasury Regulation section 1.482-4 addresses ownership of intangible property, provides four methods to price transfers of intangible property, and implements the second sentence of Code section 482, which states that when intangibles are transferred or licensed "the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible".

Two standards apply to determine ownership of intangible property. For legally protected intangible property (eg, patents, trademarks and licence rights), the legal holder of the rights is considered the owner for US transfer pricing purposes unless the ownership is inconsistent with economic substance. For other intangible property (ie, where no owner is determined by intangible property law or contract), the owner of the intangible property will be the entity in control of the intangible property based on all the facts and circumstances. Although development, enhancement, maintenance, protection and exploitation (DEMPE) functions are not specifically referenced in the US transfer pricing regulations for purposes of identifying the owner of intangible property, they may be relevant to demonstrating that legal ownership is consistent or inconsistent with economic substance and in instances where no legal owner is identified. Even in cases where legal ownership governs, DEMPE functions of non-owners can affect the arm's-length compensation that those entities receive for intangible development activities.

The transfer pricing regulations identify four transfer pricing methods for pricing transfers and licences of intangible property:

- the comparable uncontrolled transaction (CUT) method;
- the CPM;
- the profit split method; and
- unspecified methods.

When the CUT method is used by reference to intangible property that is not the same intangible property that is the subject of the controlled transaction, the referenced intangible property must have similar profit potential to the intangible property involved in the controlled transaction and must be used in connection with similar products or processes within the same general industry or market as the intangible property used in the controlled transaction. Profit potential is most reliably calculated by determining the net present value of the benefits realised from exploiting the intangible property, but this is often not possible and alternative means of comparing profit potential are required. Cost-sharing arrangements for the development of intangible property are subject to a specific set of rules provided in Treasury Regulation section 1.482-7.

The second sentence of Code section 482 – commonly referred to as the "commensurate with income" provision – is implemented through periodic adjustments described in Treasury Regulation section1.482-4(f)(2). The IRS may apply periodic adjustments to any year of a lump sum or multi-year transfer of intangible property if it determines that the income received by the intangible property owner was not commensurate with the income attributable to the subject intangible property. Treasury Regulation section 1.482-4(f)(2)(ii) provides certain exceptions where the IRS will not make a commensurate with income adjustment. Treasury Regulation section 1.482-7(i)(6) has its own periodic adjustment rules and exceptions for cost-sharing arrangements. For intangibles transactions other than cost sharing, the exceptions are based on various factors that can generally be categorised as instances:

- when a taxpayer priced the inter-company transaction using a price determined in an uncontrolled transaction involving the same intangible property;
- when the transfer involves a comparable intangible and the actual income earned is within a 20% range of projected income;
- when the divergence between projected and actual income is due to extraordinary events; and
- when projected and actual income do not diverge too greatly for the first five years after the intangible property transaction occurred.

## Settlements

IRS enforcement of US transfer pricing rules can be resolved in various ways. The IRS can agree to leave a taxpayer's transfer pricing unadjusted at the end of an examination. The IRS and taxpayer can also agree to an adjustment at the end of an examination. Settlements at the examination level are limited by the fact that Exam is not authorised to settle based on hazards of litigation and is bound by IRS National Office positions on regulations, best-method directives and economics.

If the taxpayer does not settle a transfer pricing dispute with Exam, the taxpayer typically receives a 30-day letter, which entitles the taxpayer to protest Exam's proposed adjustment to the IRS Independent Office of Appeals (Appeals). Unlike Exam, Appeals is permitted to consider hazards of litigation, which sometimes leads to material reductions in the size of Exam's proposed adjustments.

Absent allegations of fraud or a misrepresentation of material facts, settlements with Exam and Appeals are final. Those settlements are usually reflected on Form 906, Closing Agreement on Final Determination Covering Specific Matters. However, other forms are sometimes also used.

If taxpayers are unable to settle with Appeals, they can still pursue settlement during litigation. Litigation settlements are negotiated with the IRS Office of Chief Counsel or US Department of Justice Tax Division, depending on the litigation forum. Once a settlement has been reached, the US competent authority is bound by the results for US tax purposes for the years covered by the settlement. In that case, any mutual agreement procedure will be limited to obtaining correlative relief from the non-US jurisdiction.

Settlements with Exam, Appeals, or in litigation are limited to the particular years in dispute. A taxpayer would need an Advance Pricing Agreement or Accelerated Issue Resolution (AIR) agreement in order to obtain a binding resolution regarding the pricing of inter-company transactions in future years. However, the taxpayer's adoption of a settlement methodology previously accepted by the IRS in its transfer pricing documentation covering subsequent periods can indicate that the transfer pricing approach is reasonable for penalty protection purposes.

## Investigations

A large IRS transfer pricing investigation (typically referred to as an "audit" or "examination") is conducted by the IRS's large business and international division and involves three phases: a planning phase, an execution phase and a resolution phase. A typical large transfer pricing investigation lasts at least two or three years.

In the planning phase of the investigation, the IRS reviews taxpayer documents and prepares an internal risk analysis to determine how to proceed. The execution phase composes most of the IRS investigation. During the execution phase, the IRS issues information requests (ie, IDRs). The IDRs are often extensive and voluminous, sometimes numbering in the hundreds. The IRS has increasingly been requesting recorded interviews of taxpayers' current and former employees during the examination phase. If a taxpayer refuses to provide information (whether documents or interviews) voluntarily, then the IRS has methods by which to compel the taxpayer to provide the requested information. One reason a taxpayer might resist production of certain materials is because it fears violating foreign privacy laws, although in a recent case a court enforced an IRS summons of overseas performance evaluations, notwithstanding that disclosure may violate European privacy laws.[9] But taxpayers typically provide the requested information voluntarily, in part because it is very difficult to successfully resist IRS attempts to compel disclosure. The IRS's ability to compel disclosure extends to third parties. Additional notification requirements apply in that setting.

In unagreed cases, the resolution phase involves the issuance of an economist report, a notice of proposed adjustment and a document that affords the taxpayer the right to protest the IRS's adjustments in order to pursue an administrative appeal. A taxpayer has 30 days to file an administrative appeal, but the IRS frequently agrees to extend that deadline another 30 or 60 days. The administrative appeals process can last two years or more, depending on backlogs and how long settlement negotiations last.

The default rule is that the IRS has three years from when a return is filed to assess tax. There are a variety of exceptions that lengthen the limitations period. Because transfer pricing examinations often do not begin until three years or more have passed from when the taxpayer filed the relevant return, the IRS will typically request an extension of the limitations period on assessment in order to conduct its examination. It is common for the IRS to request additional extensions of the limitations period on assessment throughout the examination and administrative appeals processes. The IRS does not have to provide a reason or justification for requesting an extension, though the IRS will typically explain that it requires the extension in order to provide it sufficient time to complete the administrative process. A taxpayer is free to refuse to extend the period of limitations on assessment, in which case the IRS will typically issue a notice of deficiency. This suspends the limitations period on assessment and affords the taxpayer the right to file a petition contesting the deficiency in the US Tax Court. The IRS has a few other options to protect against the running of the limitations period on assessment, but such measures are drastic and rarely used.

## Litigation

### Procedure

In the non-bankruptcy context, a taxpayer facing transfer pricing adjustments has a choice of litigating forum. The US Tax Court is the sole prepayment forum, ie, the only court in which the taxpayer can litigate IRS transfer pricing adjustments before paying the related tax. If the taxpayer decides to pay the tax attributable to the transfer pricing adjustment, then the taxpayer can file suit to recover the tax in one of two forums, the appropriate federal district court or the US Court of Federal Claims. The pre-litigation procedure and relevant timelines differ substantially depending on which route the taxpayer pursues. Once in litigation, there are some differences between the litigating forums but the general procedures and timeline are fairly similar.

In the pre-litigation context, absent a rare exception, the IRS must issue a notice of deficiency reflecting tax owed as a result of transfer pricing (or any other) adjustments before the limitations period on assessment runs. The taxpayer then has 90 days to file a petition in the US Tax Court. That 90-day period is extended to 150 days in the case of a foreign taxpayer. If the taxpayer does not file a Tax Court petition within the requisite time frame, then the taxpayer will likely lose the right to contest the transfer pricing adjustments before paying the additional tax reflected in the notice of deficiency.

If the taxpayer forgoes a Tax Court petition, then the taxpayer must pay the tax attributable to the transfer pricing adjustments in full before contesting the adjustments. Once the taxpayer has paid the tax, the taxpayer must file an administrative refund claim for the tax. The period for filing an administrative refund claim is either three years from when the relevant return was filed or two years from when the tax was paid, whichever is later. It is only after the IRS has denied the taxpayer's administrative refund claim or has failed to act on it for six months that a taxpayer can initiate a refund suit for the tax. The taxpayer

has two years from the denial of its refund claim to initiate a refund suit. The taxpayer has longer if the IRS fails to act on the refund claim.

Once in litigation, the process is generally similar regardless of the forum. There is a lengthy pretrial period that includes discovery. Then, there is a trial, post-trial briefing, and an opinion. The trial-court process in a large transfer pricing case typically takes at least three to five years from beginning to end, but it can take even longer depending on the complexity of the case and how long it takes the court to decide the case after trial. There are some differences between the forums. For example, the Tax Court has its own rules and relies heavily on a more informal pretrial discovery process and stipulations. The refund forums follow the same general processes that they follow in other civil litigation. Jury trials are available only in federal district court. A taxpayer contesting transfer pricing adjustments in the US Tax Court or Court of Federal Claims is limited to a bench trial. Different groups of lawyers represent the government in the different trial-court forums. IRS lawyers represent the government in Tax Court. Lawyers in the US Department of Justice Tax Division represent the government in the refund forums.

Taxpayers and the government both rely heavily on expert witnesses in transfer pricing litigation. It is not uncommon for each side to have experts in a variety of disciplines, including transfer pricing economics, licensing, forensic accounting, manufacturing, and sales and marketing. Courts are willing to reject expert evidence and fashion their own views, though they tend to borrow from different experts when they do so. They sometimes have difficulty deciding between conflicting expert testimony, and how they decide often comes down to which side's arguments they find more persuasive.

The initial litigation tribunal (ie, the trial court) is the only fact-finding forum. The losing party has the right to appeal to a federal appellate court. The losing party there can also seek Supreme Court review, but such review is discretionary, rare in general, and even rarer in tax cases. The Supreme Court has decided only one transfer pricing case, and that was more than 50 years ago.

The losing party can appeal a trial court decision based on factual or legal error. Because the appellate courts defer to the trial courts on issues of fact but not on issues of law, the losing party stands a better chance on appeal if the question presented to the appellate court is one of law (or one that the appellate court reviews as a question of law even if it is a mixed question of law and fact). A typical appeal of a trial-court decision can take two or three years. Supreme Court review could add another year or more.

## Recent cases

Transfer pricing remains one of the IRS's main enforcement priorities. A number of transfer pricing cases have been litigated in recent years. Some of those settled before trial. The results have been mixed in cases that went through trial and opinion, with wins and losses for the government and taxpayers. In recent years, Medtronic and Coca-Cola have had outbound licensing cases in which the IRS applied the CPM to benchmark the licensee and assigned all residual profit to the US licensor. The Tax Court rejected the CPM in *Medtronic* in favour of its own application of the CUT method based on a litigation settlement agreement. After the US Court of Appeals for the Eighth Circuit reversed and remanded the Tax Court decision, the Tax Court again rejected the CPM. This time it acknowledged that the CUT method was not the best method and fashioned an unspecified method that

borrowed from both CUT and CPM analyses, imposing a larger adjustment on Medtronic than it had after the original trial. The appellate court again reversed and remanded, holding that the Tax Court improperly relied on a non-comparable uncontrolled licensing transaction and applied incorrect legal standards in rejecting the IRS's CPM. The appellate court ordered further factual findings and analysis under section 482. In *Coca-Cola*, the Tax Court adopted the IRS's bottler-based CPM, which was peculiar to Coca-Cola's system. The taxpayer has appealed the Tax Court's decision to the US Court of Appeals for the Eleventh Circuit.

The US District Court for the Western District of Michigan recently issued its long-awaited opinion in *Perrigo*. A US affiliate in the Perrigo group assigned to an Israeli affiliate the exclusive contractual rights to sell the first-to-market generic version of Omeprazole in the United States. The IRS asserted that the assignment should not be given effect under the economic substance doctrine (and related anti-abuse doctrines) and, alternatively, that a section 482 "commensurate with income" (CWI) adjustment (as discussed in the "Intangible assets" section above) was warranted based on the income method using *ex-post* actual operating income. This is the first known instance of the IRS asserting a CWI adjustment in this manner. The District Court rejected the IRS's economic-substance theories and its use of the CWI rules in favour of an income method based on contemporaneous projections, which Perrigo presented at trial. The government has appealed the District Court's decision to the US Court of Appeals for the Sixth Circuit.

Cost-sharing is another area that has been heavily litigated. After taxpayer wins in *Veritas* and *Amazon*, in which the Tax Court rejected the income method, Congress amended the definition of intangible property referenced in section 482. In *Facebook*, the Tax Court upheld the validity of the income method under the revised cost-sharing regulations and agreed with the IRS's use of that method to value Facebook's platform contribution, but it corrected various inputs into that method (projections and discount rates) to reach an arm's-length result much closer to the taxpayer's reported position than to the IRS's adjustment. In a case involving Facebook's successor Meta Platforms, Inc., the IRS has asserted roughly US$54 billion in periodic adjustments, effectively extending its challenge to the earlier platform contribution transaction (PCT) in *Facebook*. This is the first known instance of the IRS asserting periodic adjustments in the cost-sharing context.

Challenges to regulations' validity have also arisen in the transfer pricing context. Altera challenged the validity of a regulation that requires taxpayers to share stock-based compensation costs under a cost-sharing agreement. After a taxpayer win in the Tax Court, the US Court of Appeals for the Ninth Circuit reversed the decision and found the regulation valid. McKesson Corporation and Abbott Laboratories are raising the same issue in District Court and Tax Court, respectively, in cases appealable to the US Court of Appeals for the Fifth Circuit and US Court of Appeals for the Seventh Circuit, respectively. Meta Platforms, Inc. has raised this same issue once again in its pending Tax Court case, with hopes that the US Supreme Court's recent abandonment of the *Chevron* doctrine of administrative deference in the *Loper Bright* case will ultimately lead the US Court of Appeals for the Ninth Circuit court to reconsider *Altera* (which was decided in part under *Chevron*) assuming the case is eventually appealed. Challenges to regulatory validity have also arisen in the blocked-income context. Both 3M and Coca-Cola challenged the regulation that governs when the IRS will respect a foreign legal restriction in the transfer pricing context. In *3M*, a divided Tax Court upheld the regulation in part based on *Chevron*. The Tax Court then followed that holding in *Coca-Cola*. The US Court of Appeals for the Eighth Circuit reversed

the Tax Court's holding in *3M,* and Coca-Cola has appealed the Tax Court's decision on the issue to the US Court of Appeals for the Eleventh Circuit.

## Secondary adjustment and penalties

Treasury Regulation section 1.482-1(g)(3) authorises the IRS to impose necessary adjustments that reflect the deemed consequences of a primary transfer pricing allocation. A primary transfer pricing allocation occurs when the IRS adjusts the pricing of a controlled transaction (typically by increasing the income of a US taxpayer in the cross-border setting); a correlative or corresponding adjustment increases or reduces income of the related party by the same amount as the primary allocation (this is typically a decrease to foreign earnings and profits of the counterparty to the controlled transaction in the cross-border setting); a conforming adjustment treats the movement of the adjusted amount as a distribution or a capital contribution (or some combination of the two).

Instead of having to conform their accounts through a secondary adjustment, taxpayers may elect to apply the provisions of Revenue Procedure 99-32 and treat the adjustments as interest-bearing accounts receivable or accounts payable. Revenue Procedure 99-32 is available for both IRS-initiated and taxpayer-initiated adjustments. In addition, Revenue Procedure 2015-40 provides rules for taxpayers to request assistance from the US competent authority in obtaining relief from double taxation.

As noted above in "Filing requirements", the Code authorises the IRS to impose a 20 or 40% penalty on underpayments attributable to a valuation misstatement, depending on the magnitude of the misstatement. The penalties are based on either the net transfer pricing adjustment or the transactional valuation misstatement giving rise to the adjustment.

As also noted in "Filing requirements", the Code provides a defence against such penalties for taxpayers that:

- reasonably use a specified method as provided by the section 482 regulations in determining a transfer price (or uses an unspecified method having reasonably concluded that none of the specified methods were as likely to provide a reliable measure of an arm's length result);
- have documentation establishing the determination and reasonableness of the price that was in existence when the taxpayer filed the relevant return; and
- provide the documentation to the IRS within 30 days of a request.

As a technical matter, the Code authorises the IRS to assert other penalties in all contexts, including transfer pricing cases (eg, for negligence, disregard of rules or regulations, and substantial understatements of income tax). Because there is no stacking of penalties, the transfer pricing-specific penalties are generally the most relevant ones when the IRS makes transfer pricing adjustments.

Taxpayers against which the IRS has asserted penalties as a result of transfer pricing adjustments may choose to seek to settle the dispute with IRS appeals. Alternatively, taxpayers may seek to resolve the matter through the courts, either before or after paying the penalties.

## Broader taxation issues

In 2017, Congress enacted the Tax Cuts and Jobs Act (TCJA), which included several provisions aimed at discouraging the shifting of profits to lower-tax jurisdictions. Specifically, the TCJA included the Base Erosion and Anti-Abuse Tax (BEAT) to reduce the shifting of profits out of the US taxing jurisdiction by imposing an additional 10.5% tax on certain payments made by corporations in the United States to related foreign recipients. The tax only applies to US corporations with average annual gross receipts for the prior three-year taxable period of at least US$500 million and a base erosion percentage of 3% or higher.

In 2025, Congress enacted the One Big Beautiful Bill Act (OBBBA), which further modified the US international taxation regime. Other reforms aimed at reducing profit-shifting incentives, as modified by the OBBBA, include a tax on Net CFC Tested Income (NCTI) and another on foreign-derived deduction eligible income (FDDEI). The tax rates applicable to NCTI and FDDEI, respectively, were designed to incentivise US corporations not to move their assets and activities to lower-tax countries and, correspondingly, to locate those assets and activities in the United States. NCTI applies to all US corporations with controlled foreign subsidiaries, while FDDEI may potentially apply to certain US corporations based on sales and services activities in foreign markets. The NCTI and FDDEI provisions can apply to the same taxpayer in the same tax year, and are, at least to some extent, intended to supplement the traditional transfer pricing rules. Formal guidance implementing these changes is still awaited.

On 5 January 2026 the OECD released a “side-by-side” package establishing a safe harbour exempting multinational groups with ultimate parent entities in qualifying jurisdictions from the Pillar Two income inclusion and undertaxed profits rules. To date, the United States is the only jurisdiction deemed qualified for this safe harbour. However, qualified domestic minimum top-up taxes (QDMTTs) will continue to apply, which could potentially lead to an increase in double income taxation. Likewise, more extensive utilisation of tariffs on the cross-border sale or exchange of goods in and out of the United States and around the world remains, although the landscape remains in flux following a recent US Supreme Court decision striking down the key tariffs imposed by the administration. There is some overlap but also material differences between pricing for Customs purposes and transfer pricing within and outside the United States generally. Navigating the complexities of both regimes will be a significant issue for cross-border-related party trade, and there may be greater US Customs and Border Patrol and IRS enforcement on the cross-border pricing of goods. The IRS and US Customs and Border Patrol may share certain information for enforcement purposes upon request and in the context of specific determinations.

Taxpayers facing double income taxation involving a treaty partner may seek relief through the mutual agreement process. Taxpayers can also apply for an advance pricing agreement, which may help avoid or relieve double income taxation as well as more strongly support the proper pricing of goods for US and foreign Customs purposes. But it is yet to be seen how competent authorities will accommodate tariffs in their negotiations.

## Special considerations

With the expectation of greater unilateral action by taxing authorities, including the greater use of tariffs, taxpayers are in the unenviable position of increased uncertainty and navigating even more complexity centred around the determination of arm's length prices. Although related-party pricing for Customs and tariff purposes have previously applied, the magnitude and scope may become substantially broader – which may necessitate substantial changes in supply-chains and inter-company pricing for many multinationals.

## Outlook and conclusions

Transfer pricing is still a primary area of IRS enforcement focus. Large audits continue. Cases will continue to wind their way through the administrative process and litigation in the coming years. The IRS is likewise increasing its use of anti-abuse rules such as the economic substance doctrine with respect to inter-company agreements. Recent staff departures and budget cuts could affect IRS enforcement, IRS dispute resolution opportunities and pending litigation at least temporarily. Taxpayers should continue to pay close attention to their inter-company transactions and pricing and should view audits as potential preludes to litigation. Moreover, the enhanced application of tariffs on the cross-border sale and exchange of goods will place a spotlight on related-party pricing for Customs purposes, adding greater complexity as taxpayers do their best to support transfer prices that satisfy Customs and income-tax authorities around the world.

The implementation of the OBBBA of 2025, including the modification of key TCJA provisions, and the uncertain futures of Pillars One and Two will further complicate matters. Taxpayers should also continue to consider using the mutual agreement process and advance pricing agreements to avoid double income taxation and enhance the likelihood that such pricing will satisfy Customs authorities and to monitor changes to the wider international taxation regime, both domestically and globally, to ensure that their behaviour is both tax efficient and in line with dynamic domestic and applicable foreign standards.

## Endnotes

1 Treasury Regulation Section 1.6662-6(d)(2)(iii)(B). ^ Back to section

2 Treasury Regulation Section 1.6662-6(d)(2)(ii)(A) ^ Back to section

3 Treasury Regulation Section 1.482-1(c)(1). ^ Back to section

4 Treasury Regulation Section 1.482-1(c)(2). ^ Back to section

5 Treasury Regulation Section 1.482-7. ^ Back to section

6 Treasury Regulation Section 1.482-1(c)(2)(i). ^ Back to section

7 Internal Revenue Code Section 982. ^ Back to section

8 Treasury Regulation Section 1.6038A-7. ^ Back to section

9 *United States v Eaton Corporation*, No. 24-3732 (6th Cir. Aug. 8, 2025). ^ Back to section

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