Key to Abbreviations

CFC	controlled foreign corporation
CPM	comparable profits method
CUP	comparable uncontrolled price
CUT	comparable uncontrolled transaction
FCC	foreign controlled corporation
RPM	resale price method

APPENDIX: COMPANY 1

Background

Company 1 engages in manufacturing, research and development, and distribution. It operates through a network of controlled parties, including CFCs.

Company 1 and its controlled parties conduct research and development that benefit all members of the controlled group. Company 1 owns software, know-how and trade secrets, as well as valuable patents, trademarks, and other intangible property. Company 1 makes its intangible property available to controlled parties and also engages in significant controlled transfers of tangible property. Each entity in the controlled group generally performs a discrete function, e.g., manufacturing, distribution.

Company 1 also provides intercompany services. It has cost sharing arrangements with several CFCs.

Overview of the Documentation Submitted

Company 1 submitted two studies. The first study dealt with a single category of transactions with one CFC. The second study consisted of multiple subsections, each of which pertained to a specific set of controlled transactions, such as transfers of tangible property or services.

The documentation appeared to have been prepared contemporaneously with the taxable year in question. In some cases, the documentation referred to a study for a previous year, which contained additional detail regarding the history of the company and the controlled transactions. This information was updated to refer to subsequent developments.

The overview section provided an organization chart for those segments of the company relevant to the controlled transactions analyzed in the study. Company 1 also provided a description of its overall corporate structure, in the form of an affiliation schedule.

Company 1 had cost sharing arrangements with several controlled parties but did not provide copies of the agreements. Thus, little information was available regarding the agreements or associated controlled transactions.

Company 1 applied various transfer pricing methods, depending on the particular transaction. Generally, the description of the method selected was cursory. The documentation did not discuss other methods that were considered but not selected.

The documentation described the controlled transactions. This description consisted of an overview, as well as a schematic that showed the controlled parties and their ownership and affiliation, as well as the risks assumed by each controlled party.

The documentation used a summary format to describe the comparable data. The company performed a survey in 1994 to identify comparables. This survey was not updated on an annual basis. The narrative, together with the background documents, provided a good explanation of the comparable selection process. Company 1 did not identify any economic analysis relied upon in developing the transfer pricing method.

Company 1 stated that it obtained no information after the end of the tax year and before the tax return was filed, which was relevant to the transfer pricing analysis.

Company 1 submitted an index of the documents contained in the first study. The second study was divided into chapters, each of which was a study for a particular category of controlled transaction. Each chapter had a detailed index.

Overall Quality

Overall, the quality of the documentation was good. However, the documentation could have provided more detail concerning economic analysis and other aspects of application of the transfer pricing method.

Overall Utility

Although the two studies submitted addressed only certain controlled transactions, they were useful to the examination team. Overall, the studies provided a reasonable understanding of the company's operations and its method of establishing transfer prices with CFCs.

APPENDIX: COMPANY 2

Background

Company 2 designs, manufactures, and sells a consumer product. The product is associated with certain valuable intangibles that are owned by Company 2. Product design is performed in the United States. Manufacturing takes place both in the United States and abroad.

Overview of the Documentation Submitted

Company 2 submitted documentation for the taxable year 1995, but not for 1996 or 1997, which were also under examination. The documentation consisted of an update of a study prepared for the taxable year 1994. In 1995, the company formed a CFC that assumed responsibility for sales to a particular geographic region. In 1996, the company formed another CFC, and entered into a cost sharing arrangement with that corporation. The documentation did not discuss these new entities or other changes in Company 2's organizational structure that took place after 1994.

The documentation contained a brief overview of the company. The overview discussed manufacturing in foreign countries, as well as domestic and foreign marketing and distribution. Other functions, including product design, were not discussed.

The organization chart showed the flow of products between controlled parties and, in later years, royalties and other intra-company income and expense items.

Company 2 did not provide copies of a cost sharing arrangement that took effect in 1996 and 1997, as the documentation provided was limited to the 1995 taxable year.

Company 2 did not explain the basis for selecting the transfer pricing method or the controlled transactions that it addressed. The company explained alternative pricing methods that it considered, and briefly described why those methods were not selected as the best method.

Company 2 briefly described the comparables, but more information would have been helpful, particularly regarding comparables that were eliminated. The documentation also briefly explained the economic analysis and projections relied upon in developing the transfer pricing method.

The documentation did not identify any information obtained after the end of the tax year, and before the tax return was filed, which was relevant to the transfer pricing analysis. An index of the principal and background documents was included.

Overall Quality

The overall quality of the documentation was moderate.

Because the studies were updates of documentation prepared before the effective date of the section 6662(e) regulations, they did not include certain items specified in those regulations. No documentation was provided for 1996 or 1997. As a result, the documentation only partially described the conditions in the years subject to examination.

Analysis of the documentation would have been easier if it separately addressed inbound and outbound transactions with controlled parties. Instead, the documentation discussed transactions between the parent and several small-size CFCs. Controlled transactions with another, larger CFC were not addressed. Similarly, the documentation covered fairly insignificant marketing transactions, but omitted controlled transactions involving manufacturing and transfers of tangible property.

Overall Utility

Company 2 did not provide the documentation within the time limits specified in the section 6662(e) regulations. The documentation would have been more useful if it had been submitted within those time limits.

Company 2's documentation saved the examination team substantial time, as it contained information that often took lengthy periods to obtain prior to enactment of the section 6662(e) regulations.

APPENDIX: COMPANY 3

Background

Company 3 designs and develops products for business applications. Company 3 sells its products through subsidiaries and other controlled parties. It performs research and development and obtains technology by acquiring existing companies. The parent company has cost sharing arrangements with several of its foreign subsidiaries.

Overview of the Documentation Submitted

The documentation provided was an update of a study prepared for a previous taxable year. Despite a formal request by the IRS, Company 3 declined to give the current examination team a copy of the initial study. The update was generally limited to information concerning corporate and technology acquisitions that took place after the study for the previous taxable year was completed.

Company 3 provided an overview of its business, but did not describe its customers or the geographic areas in which it conducted business. The documentation did not include a description of the company's organization or organization chart.

Company 3 had several cost sharing arrangements with CFCs and lower-tier foreign subsidiaries. Under these arrangements, the parties share the costs of technology development and acquired technology in proportion to expected benefits. The documentation primarily addressed controlled transactions that pertained to cost sharing arrangements. The documentation included an update of a single cost sharing arrangement. No copy of this agreement (or others) was provided.

The documentation described the transfer pricing method selected and indicated why the taxpayer selected that method. It did not explain why other transfer pricing methods were not appropriate. The documentation did not fully describe the controlled transactions, or provide information on comparables. No economic analysis was provided. The documentation identified information received after the end of the tax year and before the tax return was filed, which was relevant to the transfer pricing analysis. No index of documents was included.

Overall Quality

The overall quality of the documentation was poor. The documentation applied a transfer pricing method on an entity-level basis, but did not fully describe the controlled transactions or the application of the transfer pricing method to those transactions. In addition, the documentation provided little information regarding the buy-ins or other amounts determined under the cost sharing arrangements.

Of the ten principal documents specified in the section 6662(e) regulations, only one was provided in full. Partial versions of two other principal documents were provided.

Overall Utility

The usefulness of the documentation was limited. Although it highlighted the potential importance of cost sharing issues, it did not provide the information necessary to analyze those issues.

APPENDIX: COMPANY 4

Background

Company 4 designs and develops products for business applications. It also performs research and development. The company sells products through a network of subsidiaries and other controlled parties of which it is the ultimate parent.

Overview of the Documentation Submitted

The documentation appeared to have been prepared contemporaneously with the taxable year in question.

The documentation contained an overview of the company. Much of the information provided appeared to be derived from documents prepared for other purposes, e.g., financial accounting. The overview included a written description of the organization and an organization chart, which appeared to address the entire structure of Company 4.

Company 4 used a CUT method to analyze its transfer prices. The documentation described this transfer pricing method and explained why it was selected. The documentation also described other methods considered and briefly described why they were not selected.

The documentation described some controlled transactions, but did not address certain other transactions with CFCs. It also described several comparables for a minor product line. For transactions involving that product line, Company 4 concluded that the CPM was the best method. Although the documentation identified the comparables, it did not show adjustments to the data. The documentation provided a relatively brief economic analysis of the differences between the comparables.

The documentation did not identify any information obtained after the end of the tax year and before the return was filed, which was relevant to the transfer pricing analysis. Company 4 provided an index of the principal and background documents.

Overall Quality

The overall quality of the documentation was good. The documentation included most of the principal documents specified in the section 6662(e) regulations, but certain of these documents were abbreviated or limited in scope. The documentation did not address a potentially significant aspect of the controlled transactions.

Overall Utility

The documentation gave the examination team a good understanding of the company and its methods of doing business with controlled parties. It also provided detailed information concerning a CUT that the taxpayer applied to one product and CPM comparables that were used to analyze another group of controlled transactions.

The documentation served to highlight several potential examination issues, and allowed the examination team to develop issues that required additional analysis.

APPENDIX: COMPANY 5

Background

Company 5 manufactures and sells tangible property. The company owns all patents and other intellectual property rights associated with the property. Research and development, as well as manufacturing, take place in the United States. The CFCs distribute products abroad and pay royalties to Company 5.

Overview of the Documentation Submitted

Company 5 prepared two distinct sets of documentation for the period 1995-1997. One set of documentation summarized the other set, which was finished in December 1997. Consequently, neither set of documentation appeared to have been prepared contemporaneously with the controlled transactions in 1995 or 1996.

The documentation presented a comprehensive overview of the company, including a discussion of manufacturing, sales, and service operations. An organization chart, updated to reflect changes in each year, was also provided. The chart identified all CFCs and indicated the parent's ownership in each CFC or other controlled party.

The documentation covered controlled transactions involving both tangible and intangible property. The documentation described the transfer pricing method selected and explained why the method was selected. Where distinct methods applied to individual products, Company 5 explained why the particular method was chosen. Company 5 did not explain, however, why it did not consider potential CUTs, despite apparently similar transactions with both controlled and uncontrolled parties.

Additional discussion of other transfer pricing methods that the company considered and rejected would have been useful. Although the documentation described alternative methods, the analysis and conclusions were often ambiguous. Moreover, although Company 5 used internal comparable transactions in prior years, it did not consider using these transactions as the basis for alternative or confirming methods in the years under examination.

The documentation described some but not all of the company's controlled transactions. Controlled transactions involving manufacturing and royalties for intangible property were not addressed in depth.

The documentation referred to comparables, but provided little information regarding comparable companies or the process used to identify them.

The documentation briefly addressed controlled transactions involving a royalty paid by CFCs for use of intangible property owned by Company 5. The documentation provided information on comparables used to analyze the royalty transactions, but this analysis was abbreviated.

The documentation also contained a brief economic analysis, consisting of an overview of the economic environment in which Company 5 operates. The documentation stated that no other economic analysis was relied upon in developing the transfer pricing method.

The documentation did not discuss information developed in prior examinations that was potentially relevant to the transfer prices for the tax year at issue. No information was obtained after the end of the tax year, and before the tax return was filed, which was relevant to the transfer pricing analysis. No index of background documents was provided.

Overall Quality

The overall quality of the documentation was poor. In many cases, the documentation appeared intended to support the income reported on Company 5's tax returns. In particular, the analysis of alternative transfer pricing methods was ambiguous and little information was provided regarding comparables.

Many of the principal documents specified in the section 6662(e) regulations were either missing or incomplete. The documents failed to indicate that the transfer pricing methods applied conflicted with the methods used to make agreed transfer pricing adjustments in prior audit cycles, and failed to consider potential CUTs.

Overall Utility

Although the documentation was of poor quality, the overview of the company and its organization provided a good starting point for the transfer pricing examination. Although the documentation disregarded prior-year transfer pricing adjustments, this led the examination team to consider whether similar adjustments might apply in the cycle under examination.

APPENDIX: COMPANY 6

Background

Company 6 is a FCC. The foreign parent, which owns Company 6, manufactures and distributes various products, engages in research and development activities and owns valuable patents and trademarks. Company 6 markets and distributes products manufactured by controlled parties. Company 6 also performs processing prior to re-sale, and conducts contract research and development on behalf of the foreign parent.

Overview of the Documentation Submitted

The documentation appeared to have been prepared contemporaneously with the taxable year in question.

Company 6 provided a brief overview of the business. Rather than provide a broad view of company operations, the overview described one particular function and considered controlled transfers of tangible property in a single product line. No organization chart was provided. Certain controlled parties were identified, but the documentation did not describe the organization as a whole or the flow of products between controlled parties.

Company 6 briefly described certain controlled transfers of tangible property. It did not address controlled transactions involving intangibles, distribution, or further manufacturing, even though these activities were more significant elements of the business.

Company 6 described the transfer pricing method selected and explained why it chose that method. Company 6 considered each of the specified methods and determined that only the profit-split method or CPM were appropriate. The documentation did not fully explain why the CPM was selected and why other methods were not selected. Also, the documentation identified certain transactions with uncontrolled parties that might have been used as CUPs, but did not explain why those transactions were not considered for that purpose.

Company 6 described the companies whose transactions were used as comparables, but provided little information concerning the comparables selection process. For example, Company 6 did not indicate why particular comparables were rejected.

Company 6 briefly described the economic analysis and projections relied upon in developing the transfer pricing method. No information was obtained after the end of the tax year, and before the tax return was filed, which was relevant to the transfer pricing analysis. No index of the background documents was provided.

Overall Quality

The overall quality of the documentation was moderate. Most of the principal documents specified in the regulations were included, but several appeared to be abbreviated or incomplete. The documentation did not thoroughly explain the transfer pricing analysis applied to the controlled transactions. In addition, it addressed only transfers of tangible property, when controlled transactions involving intangibles appeared to be more significant.

Overall Utility

Although overall quality was moderate, the documentation helped the examination team to analyze the relevant transfer pricing issues.

The documentation provided a good explanation of the controlled transfers of tangible property. It also identified certain other controlled transactions that potentially affected the transfer pricing analysis, and pointed out an uncontrolled transaction that might be used as the basis for a CUP. The examination team identified several aspects of the comparable selection process for further inquiry.

The documentation expedited the examination by allowing early identification of potential issues. Substantially fewer IRS requests for information were necessary, compared to prior years in which no documentation was submitted.

APPENDIX: COMPANY 7

Background

Company 7 designs, manufactures, and markets a consumer product. The company owns a valuable marketing intangible. Company 7 sells its products in the United States and in many foreign countries. The company performs manufacturing and research and development in the United States, and has overseas manufacturing and distribution CFCs.

Overview of the Documentation Submitted

Company 7 submitted two studies. The first study addressed certain marketing functions. The second described transactions with a controlled foreign manufacturer.

The documentation, which consisted of updates of studies prepared for previous taxable years, appeared to have been prepared contemporaneously with the taxable year in question. Some sections of both updates referenced a prior-year study, which evidently contained more detailed information.

An accounting firm prepared the documentation and provided it to the company after the end of its taxable year and before the income tax return for that year was filed. In some cases, the company adjusted its income on the timely-filed income tax return for the year in question, based on the analysis in the documentation.

Company 7 provided organization charts and a listing of all controlled parties. It also provided copies of purchasing services agreements with controlled parties.

Company 7 applied a cost-plus method to its transactions with CFCs. The documentation discussed the method and its application, as well as other transfer pricing methods that were considered but not selected.

Company 7 submitted a description of the controlled transactions. The documentation described the transactions with the controlled manufacturer. However, this description was general in nature, and did not indicate, for example, the products at issue or the total output of the facility.

Company 7 described the comparables in detail, including companies that it considered and rejected. For each comparable that was rejected, a short description indicated the reason. The overall explanation, viewed together with the background documents provided with the study, fully explained the comparables selection process.

Company 7 described the economic analysis relied upon in developing the transfer pricing method. The description was detailed, and the information provided a basis for evaluating the role of the economic analysis in the transfer pricing methodology.

No information was obtained after the end of the tax year, and before the tax return was filed, which was relevant to the transfer pricing analysis.

A document index was provided, which consisted of a table of contents. Individual sections of the update corresponded to the principal documents in the section 6662(e) regulations. No index was provided for the background documents.

Overall Quality

The first update, which dealt with certain marketing transactions, was of good quality, but it largely incorporated by reference more detailed information contained in a prior-year study.

The second update, which dealt with manufacturing, was comprehensive and included most of the principal documents specified in the section 6662(e) regulations. However, it dealt with a single country and one category of controlled transactions. Other controlled transactions were not addressed.

Overall, the quality of both studies was good to excellent. Although the updates covered only a portion of Company 7's business, they addressed those aspects of the business deemed to present the most significant transfer pricing issues.

Overall Utility

The examination team believed that the documentation covered the areas most likely to present transfer pricing issues, although it did not provide a complete picture of the company's business. The first study allowed the examination team to determine that no potential transfer pricing adjustment was present with respect to marketing transactions. This saved substantial time and resources.

The second study gave the examination team a good understanding of the controlled transactions involving manufacturing and the transfer pricing analysis applied to those transactions. Although the examination team did not necessarily agree with the analysis, the documentation provided a good starting-point for an in-depth examination of foreign manufacturing.

APPENDIX: COMPANY 8

Background

Company 8 designs and develops products for business applications. Company 8 performs research and development to improve existing products and to develop new products. It sells products in many countries, through subsidiaries and other controlled organizations, of which it is the ultimate parent or owner. Company 8 owns valuable patents, trademarks, and copyrights, and other intangible property.

Company 8 entered into a cost sharing arrangement with one of its foreign subsidiaries. Under the agreement, the foreign subsidiary shared the costs of intangible development in proportion to its expected benefits from the exploitation of the intangible.

Overview of the Documentation Submitted

Company 8 submitted a study prepared for a previous tax year, and an updated study dated September 1996, for the taxable year ending December 31, 1995. The documentation appeared to have been prepared contemporaneously with the taxable year in question.

Company 8's documentation primarily addressed controlled transactions related to the cost sharing arrangement.

Each study contained a comprehensive overview of the business, which covered all CFCs and other controlled parties. No organization chart was provided as part of the documentation, but one was submitted later in response to a specific request. That chart appeared to list all controlled parties.

Company 8 had a cost sharing arrangement, but the documentation did not contain a copy of the agreement. In response to a specific request, the company submitted a copy, but that copy did not contain information regarding cost pools. The taxpayer later provided that information, in response to another supplemental request.

Substantially all controlled transactions reviewed in the documentation took place under the cost sharing arrangement. Company 8 used a CUT to determine the buy-in payment for existing technology that was contributed to the cost sharing arrangement. The documentation discussed other transfer pricing methods considered for this purpose, and indicated why they were not selected. The company also applied the CPM to confirm the reliability of the results under the CUT method.

The documentation fully described the controlled transactions subject to the cost sharing arrangement. The agreement (not provided in the initial documentation) also discussed the controlled transactions and how the buy-in was calculated.

Company 8 described in detail the CPM comparables used in the confirming analysis. The comparables were derived from an initial listing of all companies in the industry, which was narrowed down to those companies that performed functions comparable to Company 8. Company 8 reviewed each company on the initial list and explained why it was or was not deemed to be comparable.

Company 8 also discussed, in general terms, the general market in which the company operated and discussed industry trends.

No information was received between the end of the end of the tax year and the date the tax return was filed, which was relevant to the transfer pricing analysis. The documentation included a comprehensive index.

Overall Quality

The overall quality of the documentation was good. The documentation contained most of the principal documents specified in the section 6662(e) regulations, and these documents were comprehensive. At the same time, the documentation did not address substantial issues concerning payments for existing technology under the cost sharing arrangement (buy-in payments).

Overall Utility

The documentation fully described the company and the controlled transactions. In several specific areas, the documentation allowed the examination team to determine that no potential adjustment was likely and that no additional resources should be expended in that area. However, the documentation was not provided promptly in response to the initial IRS request, and numerous follow-up requests were necessary to obtain some items.

The documentation led the examination team to focus on whether the buy-in payments under the cost sharing arrangements were arm's length. It significantly reduced the time needed to complete the examination by limiting the number of information document requests, and by narrowing the issues at the outset of the process.

APPENDIX: COMPANY 9

Background

Company 9 provides services through a network of CFCs in various countries. Company 9 and one or more CFCs may participate in a transaction with an uncontrolled customer.

Overview of the Documentation Submitted

Company 9 submitted separate studies for 1997 and 1998. The documentation appeared to have been prepared contemporaneously with the taxable year in question.

Each study contained a general description of the business. Only the major CFCs were discussed in the overview.

Although it described the controlled transactions, the overview focused on industry practices, as opposed to the specific activities of Company 9. The documentation did not include an organization chart. In response to follow-up requests by the IRS, the company submitted an organization chart that showed the functions performed by the controlled parties.

Company 9 changed its transfer pricing methodology from 1997 to 1998. In 1997, the company used a CUT to develop a profit-split method, but in 1998 the company instead applied a cost-plus method. The 1998 study considered the CUT method, but concluded that the cost-plus method was more appropriate, on account of changes in the business. The two methods did not appear to reach materially different results in terms of the income derived from the controlled transactions.

Both studies described the transfer pricing method selected and how the method applied in year at issue. The documentation also discussed other transfer pricing methods, and briefly stated why they were not selected.

The documentation did not fully describe the controlled transactions. Rather, it described individual segments of the transactions. No description was provided of the functions performed or the risks assumed by the controlled parties.

The documentation described the method used to select comparables for 1998, and provided a short business description was provided for each company.

Company 9 did not identify any economic analysis relied upon in developing the transfer pricing method. Although the company stated that the adoption of a new transfer pricing method was supported by economic analysis, that analysis was not provided as part of the documentation.

No information was obtained after the end of the tax year, and before the tax return was filed, which was relevant to the transfer pricing analysis. Company 9 provided an index for the principal documents, but not for the background documents.

Overall Quality

The overall quality of the documentation was moderate.

The 1997 study applied a profit-split method, based on a CUT. However, the uncontrolled transaction was at a different market level than the controlled transaction. The transfer pricing analysis did not take this into account.

The 1998 study applied a cost-plus method. The examination team could not discern any change in the company's operating structure that would warrant adoption of a new transfer pricing method. In addition, the examination team identified certain factual inconsistencies that called into question the taxpayer's transfer pricing analysis for both years.

The data submitted with respect to comparables for 1998 were incomplete and appeared to contain errors. For example, the comparable data in some cases were derived from incorrect years, and the derivation of the interquartile range contained mathematical errors.

In determining the appropriate return to the tested party under the cost-plus method, Company 9 selected a point that was outside the interquartile range of returns of the comparables, but provided no explanation for this approach.

Overall Utility

The studies were somewhat useful to the examination team. They clearly showed that the company had changed its transfer pricing method, although its operations had apparently not changed from one year to the next. This focused the examination team's attention on the selection of the best method. Substantive errors and inconsistencies in the taxpayer's analysis also provided starting-points for additional inquiry.

APPENDIX: COMPANY 10

Background

Company 10 is a U.S.-based retailer. The company operates in foreign countries through CFCs.

Overview of the Documentation Submitted

Company 10 submitted six distinct studies. Three studies pertained to specific countries, and three others pertained to specific functions. The following analysis concentrates on one study that dealt with a specific country and that failed to support the transfer pricing method chosen. The other five studies, which generally supported the taxpayer's transfer pricing method, are not discussed in detail herein.

The documentation appeared to have been prepared contemporaneously with the taxable year in question. An accounting firm prepared the study and provided it to Company 10 after the end of the taxable year, and before the tax return was filed.

Company 10 provided an overview that included a complete history of the company. The documentation also contained an organization chart that listed all controlled parties.

Company 10 submitted a description of the controlled transactions, which consisted of services for a CFC, for which the company received a management fee.

The documentation addressed two distinct controlled transactions, both of which involved payment of a management fee to Company 10. Company 10 in effect aggregated these transactions and treated them as a single transaction. The study concluded that the CPM was the best method. It discussed other transfer pricing methods and stated why these other methods did not apply.

Company 10 described the comparables and provided a list of companies in the industry and an explanation of the functions performed and business operations. A short business description and basic financial data were provided for each comparable that was selected.

Company 10 stated that it did not rely on any economic analysis in developing the transfer pricing method for the years covered by the study.

The study did not identify any information obtained after the end of the tax year and before the tax return was filed, which was relevant to the transfer pricing analysis. No index was provided for the study or the background documents.

Overall Quality

The company submitted six studies, five of which fully supported the transfer pricing method and analysis. Accordingly, the overall quality of the documentation was excellent.

The specific study discussed above included each of the principal documents specified in the section 6662(e) regulations. However, the company did not appear to choose the best method or appropriate comparables.

Overall Utility

The study presented a great deal of factual information and provided a good understanding of the company and its controlled transactions. It enabled the examination team to narrow its inquiries. For example, the examination team concluded that other comparables might have been more appropriate, and that the taxpayer's decision to aggregate the controlled transactions warranted further analysis.

The study highlighted the key transfer pricing issues at a very early stage of the examination, thus resulting in savings of time and resources.

APPENDIX: COMPANY 11

Background

Company 11 is an FCC that owns a valuable marketing intangible and substantial capital assets. The company's management is located in the United States, but a substantial portion of its business activities takes place abroad.

Company 11 produces, purchases, transports, and sells products in many countries, including the United States. Controlled transactions include transfers of tangible property, services (including transportation, insurance, logistics, management and ministerial functions), and use of intangible property.

Overview of the Documentation Submitted

An accounting firm prepared the documentation, which consisted of an initial study and three updates. The documentation for each year appeared to have been prepared contemporaneously with the taxable year in question.

Although the annual updates appeared to be contemporaneous with the taxable year in question, they did not describe intervening, material changes in the business or the company's ownership structure, and they contained substantially less information than the initial study. In addition, they indicates that the taxpayer did not revisit the selection of the transfer pricing method under the final section 482 regulations (adopted in 1994).

The overview covered some but not all of Company 11's controlled transactions. The overview pertained primarily to U.S. operations, as opposed to overall company operations. Certain facts were not disclosed. For example, Company 11 is owned by a foreign corporation, domiciled in a low-tax jurisdiction. Another corporation, domiciled in another low-tax jurisdiction, in turn owns the immediate parent of Company 11.

The initial documentation included an organization chart. However, this chart was out of date, as it was prepared in 1993. Also, the chart showed only direct owners of Company 11, and did not include other controlled parties or CFCs. In the current examination, in response to a request by the examination team for an up-to-date organization chart, the company provided a chart for a small portion of the corporate structure. Multiple requests were made for a complete organization chart, but each time only a portion of the chart was provided.

The initial documentation and updates concluded that the CPM was the best method, and they described the reasons for this conclusion. Company 11 discussed the transfer pricing methods and explained why methods other than the CPM were not selected. The company also identified a transaction with an uncontrolled party that might constitute a CUP, but it explained in detail why this transaction was not a valid basis for application of the CUP method.

The initial documentation fully described the controlled transactions, which consisted primarily of controlled transfers of inventory property.

Other controlled transactions involved services on behalf of controlled parties. These services and the fees charged were discussed in detail. Controlled transactions involving services were also discussed briefly, but the company took the position that these transactions had no U.S. tax consequences and were not subject to analysis under section 482.

The initial documentation described a group of potential comparables and provided financial data and in-depth analysis of each company. The updates provided new lists of comparables, but the descriptions were not as detailed as in the initial documentation. For example, financial data in the updates were provided in a summary format, and the company descriptions were very brief.

Each of the updates showed revised calculations of the interquartile range of CPM returns, based on the comparables for the specific period. Company 11 did not identify any other economic analysis relied upon in developing the transfer pricing method.

The updates identified no information obtained after the end of the tax year, and prior to the filing of the tax return, which was relevant to the transfer pricing analysis. Company 11 did not provide an index for the principal or background documents.

Overall Quality

The overall quality of the documentation was moderate. As of the most recent taxable year under examination, virtually all information, including the data regarding comparables, was five years old. Most of the principal documents were provided, but the information in those documents was not contemporaneous with the taxable years in question.

The information contained in the documentation was not updated systematically. The statement that that the company's business structure -- in particular its ownership -- had not changed since the initial documentation was prepared was contradicted by information in Securities and Exchange Commission filings.

The functional analysis contained in the initial study was comprehensive, but the updates did not indicate whether that analysis remained accurate in the taxable years under examination.

Overall Utility

The documentation helped the examination team to identify areas of potential inquiry. However, it provided little specific information regarding the taxable years under examination. The documentation provided a starting point, by explaining the transfer pricing analysis used by the taxpayer.

APPENDIX: COMPANY 12

Background

Company 12 manufactures and sells products for business applications. It sells its primary product to CFCs and to uncontrolled parties in the U.S. and abroad. This product is a component that is incorporated into an end-product. The company also performs contract manufacturing for uncontrolled parties. This activity accounts for a substantial portion of the company's revenues.

The company's headquarters are in the United States. The company has many domestic subsidiaries and CFCs, some of which operate assembly facilities in major markets outside of North America. Other controlled parties resell items produced in these foreign countries.

Overview of the Documentation Submitted

Company 12 prepared two studies. The first study, dated Summer 1995, covered the taxable years ending 1995, 1996 and 1997. The second study, dated Spring 1997, pertained to 1992, 1993, and 1994. This documentation did not appear to be contemporaneous, as it was prepared well after the filing of the tax returns for the taxable years in question.

The documentation focused primarily on purchases of inventory property by a CFC.

The studies provided an overview of the company's operations. However, this overview was very general and provided no details about the company or the controlled transactions. In response to a request for additional information, an Annual Report was provided. The information contained in the Annual Report was also of a general nature.

The studies contained an abbreviated organization chart, which included only the U.S. parent and a single CFC. In response to a request for a complete organization chart, the company provided two charts, one for domestic companies and another for foreign affiliates. These charts listed all CFCs.

The documentation applied the RPM. Although the documentation pertained to a single category of controlled transactions involving tangible property, many other types of controlled transactions also took place. The documentation did not address controlled transactions involving management fees, services, or interest on loans.

Company 12 discussed the other transfer pricing methods and explained why those methods were not selected as the best method. The company identified certain transactions with uncontrolled parties that could have been used as CUPs. The company explained why, notwithstanding these potential CUPs, the RPM constituted the best method.

The initial documentation identified a group of potential comparables. The initial documentation briefly described each comparable and provided financial data. The update identified different comparables, and briefly explained why a particular company was or was not selected as a comparable. The update also provided other information, such as financial data and adjustments for functional differences between the comparables and the tested party.

Company 12 did not describe the market in which it operated or trends in the industry. Company 12 identified no economic analysis, other than calculation of the interquartile range under the RPM, which was relied upon in developing the transfer pricing method.

Company 12 identified no information obtained after the end of the tax year and before the tax return was filed, which was relevant to the transfer pricing analysis. An index was provided for the initial documentation and the updates, but not for the background documents.

Overall Quality

The overall quality of the documentation was poor. It was not contemporaneous within the meaning of the section 6662(e) regulations. Several of the principal documents were missing or incomplete, and they provided little information concerning the transfer pricing analysis.

Overall Utility

Due to its numerous deficiencies, the documentation had limited utility. It provided some general information concerning intercompany transactions with one CFC. In other respects, the documentation was narrow in scope and did not significantly aid the examination of transfer pricing issues. In this case, the examination team obtained most information concerning transfer pricing issues via specific requests, rather than from the documentation.

APPENDIX: COMPANY 13

Background

Company 13 designs, manufactures, and markets products for sale at retail. The company possesses valuable marketing and manufacturing intangibles.

Company 13's products are sold in the United States and many foreign countries. Manufacturing takes place both in the United States and overseas. Research and design take place in the United States. In the second year for which documentation was prepared, the company entered into cost sharing arrangements with CFCs concerning intangible assets that Company 13 developed.

Overview of the Documentation Submitted

Company 13 provided documentation for the taxable years 1997 and 1998.   The documentation appeared to have been prepared contemporaneously with the taxable years in question.

Company personnel prepared documentation for controlled transactions involving tangible property, e.g., sales of products to CFCs, and outside representatives prepared documentation for controlled transactions involving intangibles, e.g., licensing of marketing intangible to CFCs. Except as noted, these comments apply to the documentation for both years.

Company 13 did not provide a current organization chart for the company as a whole.

Both sets of documentation applied the CPM as the best method. In most cases, the documentation described the basis for selection of the CPM as the best method, and also provided information concerning the selection and screening of comparables under that method. Company 13 also did not provide any economic analysis relied upon in developing the transfer pricing method.

Because the documentation provided for tangible and intangible property transactions differed to some extent, each is discussed separately.

Tangible Property Transactions

The documentation covered all CFCs. It discussed the pricing methods and stated why methods other than CPM were not selected as the best method.

The documentation also contained comprehensive descriptions of companies whose transactions were identified as comparables.

Intangible Property Transactions

The 1997 documentation did not specify the exact nature of the controlled transactions. The 1998 documentation relied on the descriptions provided in the documentation for 1997.

The 1998 documentation dealt with only one controlled party, and it applied the CPM without any consideration of potential alternative methods under the best-method rule.

The documentation contained little information regarding cost sharing arrangements or the buy-in payments under those agreements. Because the cost sharing arrangements affected the ownership of the intangibles for section 482 purposes, execution of the agreements affected the transfer pricing analysis applied in 1998, as compared to 1997.

Overall Quality

The overall quality of the documentation was moderate for the tangible property study and poor for the intangible property study. The documentation for tangible-property transactions contained substantial background information concerning the company and the industry in which it operates. Certain principal documents identified in the section 6662(e) regulations, however, were not provided (e.g., organization chart, economic analysis).

Company 13 could have provided more support for its conclusion that the CPM constituted the best method. The documentation for intangible property transactions did not explain why transactions with uncontrolled third parties that involved similar intangibles were not considered as potential CUTs.

Several comparables identified by Company 13 appeared to operate at market levels or in geographic markets distinct from those of the tested party, or performed functions different from those of than the tested party. Some comparables owned valuable intangibles – a factor for which adjustment may have been appropriate.

The documentation for intangibles was difficult to understand, in part because the description of the controlled transactions was incomplete (1997) or missing (1998).

The documentation for intangibles failed to explain the impact of the cost sharing arrangements. In particular, the taxpayer did not explain the buy-in amounts under the cost sharing arrangements. No copies of the cost sharing arrangements were provided. Rather, only exemplars were provided that showed the general format of the agreement, without numerical or product information.

Overall Utility

The documentation concerning tangible-property transactions allowed the examination team to conclude efficiently that potential section 482 adjustments on these transactions were unlikely.

The documentation for intangibles highlighted several potential issues. For example, the examination team explored the taxpayer's rejection of potential CUTs in favor of the CPM. In addition, it considered whether certain comparables were appropriate, and whether comparability adjustments were necessary. Finally, the information about cost sharing arrangements indicated that the arm's length nature of buy-in payments should be analyzed. A change in the tested party under the CPM in 1998, purportedly on account of the execution of the cost sharing arrangements, was identified as an examination issue for that taxable year.

Overall, the documentation reduced the amount of time that the examination team spent identifying issues, and it provided a starting point for more detailed analysis of those issues.

APPENDIX: COMPANY 14

Background

Company 14 has many wholly-owned U.S. subsidiaries and CFCs. Company 14 performs some functions directly through U.S. operating divisions, and others through U.S. subsidiaries or CFCs. Primary functions include manufacturing, marketing and sale of raw materials to controlled and uncontrolled parties. In addition, Company 14 provides technical support, management, marketing, engineering, and other services to its CFCs.

Overview of the Documentation Submitted

Company 14 presented two transfer pricing studies. The first study addressed the functions performed by one of Company 14's operating divisions (Study 1). The second study addressed operations of a CFC that resold products to other CFCs in a specific geographic region (Study 2).

Both studies appeared to have been prepared contemporaneously with the first taxable year in question. These studies, which were also provided as documentation for several subsequent years, were not contemporaneous with those years because they were not updated to take into account material changes that took place.

Study 1 discussed certain management services provided by one of Company 14's U.S. operating divisions to foreign manufacturing affiliates. Compensation for these services was paid in the form of commissions based on net sales of each affiliate whether or not each affiliate benefited from the specific services. Study 2 analyzed transactions between a U.S. subsidiary and a CFC. The controlled transactions covered by the Study 2 included the manufacture and sale of products and royalty payments for the use of manufacturing technology developed and owned by the U.S. division.

Neither study described Company 14's overall operations. Each study included a brief overview that was limited to the particular segment of the business covered by the study.

Company 14 submitted multiple organization charts that identified all affiliated companies, and listed each company's location and ownership percentage by upper-tier entities.

Both studies provided basic information about the controlled transactions identified. Neither study, however, identified or discussed controlled transactions involving the use of Company 14's intangible. For example, neither study addressed the association of

Company 14's trade name with many products manufactured by CFCs, or the fact that CFCs use Company 14's trade name in conjunction with their own names.

The documentation described the companies selected as comparables, but neither study provided information regarding companies that were identified in the initial comparables search but subsequently eliminated.

Neither study contained a statement concerning information received after the end of the tax year and before the tax return was filed, which was relevant to the transfer pricing analysis. Each study included a comprehensive index.

To the extent that the documentation for the Study 1 and Study 2 differed, each study is discussed separately.

Study 1

Study 1 addressed commissions for intercompany management services. During the taxable year covered by the documentation, Company 14 charged its CFCs commissions, calculated as a fixed percentage of net sales of each affiliate, whether or not each affiliate benefited from the specific services. The study concluded that the commissions should be determined on a cost-plus basis. The study included an analysis of other transfer pricing methods and a discussion of reasons why they were not the best method.

To determine the appropriate profit attributed to the U.S. operating division, Study 1 identified the CFC as the tested party and provided a three-year weighted average of overall percentage of profit based on two years of financial and economic data available for comparable companies. The companies in the divisional study did not appear to be comparable to the CFC because they performed different functions, sold dissimilar products, or sold products in markets different than those of the CFC.

Study 2

Study 2 dealt with several controlled transactions between Company 14 and a CFC. The CFC purchased materials from Company 14 and resold them to other CFCs. The CFC received a flat fee for this service, regardless of the costs incurred. Company 14 applied an unspecified transfer pricing method to this transaction, based on data from independent service-providers. Company 14 discussed other transfer pricing methods, but concluded that the unspecified method was the best method.

The description of the economic analysis was very brief. Study 2 discussed foreign currency risk and stated that that risk was borne by the CFC. No other economic analysis was provided.

Overall Quality

The overall quality of the documentation was poor. It contained little information about the controlled transactions. There were a number of mathematical and other methodological errors in the analysis. In addition, the documentation did not address certain developments that potentially affected the quality and reliability of the analysis, including the acquisition of a major competitor and changes in the trade names used by the CFCs.

Overall Utility

The two studies provided basic descriptions of the company's operations, and identified sources of additional information regarding key issues. The studies helped the team to identify what information was important to the transfer pricing analysis, and indicated which CFC likely had control of that information. In other respects, the documentation was not useful.

APPENDIX: COMPANY 15

Background

Company 15 provides services and intangible-based products. Company 15 has CFCs that conduct business with controlled and uncontrolled parties. In general, Company 15 operates in the United States and the CFCs operate in individual countries on its behalf. Intercompany services are reimbursed on various bases, depending on the nature of the specific service.

Overview of the Documentation Submitted

Company 15 submitted an initial study for the 1994 taxable year and updates for 1995 and 1996. The study and the updates were prepared by two different outside advisors. The initial study was divided into six sections, including an overall background-type section and five sections that dealt with major categories of controlled transactions.

The 1995 update addressed one specific controlled transaction. One update for 1996 addressed the same controlled transaction, but included additional data that became available for that year. A separate update for 1996 analyzed activities that were performed jointly by a U.S. subsidiary and a CFC.

In each case, the documentation appeared to have been prepared contemporaneously with the taxable year in question.

The initial study provided an overview of the business and a short history of the company. The overview provided background information for each of the controlled transactions discussed in the study.

None of the studies contained an organization chart. However, charts were provided for specific controlled transactions, which showed the companies involved and their locations. Partial listings of other CFCs were also provided. Only after multiple requests by the examination team, however, did the company provide a comprehensive organization chart that included all CFCs.

Company 15 described the transfer pricing method applied to each of the six controlled transactions. For each transaction, Company 15 identified the transfer pricing method and stated why that method was the best method.

Company 15 did not completely describe all aspects of the controlled transactions. In some cases, the examination team needed to request additional descriptions of the transaction.

Company 15 applied the cost-plus method, but it did not describe the composition of the tested party's costs. Analysis suggested that these cost pools changed from one year to the next, but no in-depth information was provided on this issue.

The initial, background-type study provided considerable information regarding comparables. Each section of that study described selection of comparables for the specific controlled transactions at issue. The company initially identified a large set of potentially-comparable companies. After excluding various companies, the remaining database contained companies whose transactions were deemed comparable to those of the tested party. Certain comparables in this final group, however, appeared to perform different functions than the tested party. Company 15 did not identify any economic analysis relied upon to develop the transfer pricing method, or economic factors that affected pricing.

No information was reported as having been obtained after the end of the tax year and before the tax return was filed, which was relevant to the transfer pricing analysis. Company 15 submitted indexes for the study and the background information.

Overall Quality

The overall quality of the documentation was good. The initial, background-type study provided detailed information regarding the controlled transactions and explained the company's background and operations. However, the specific studies and the updates failed to specify the tested party's costs used in the cost-plus method, and they did not fully describe the controlled transactions. The IRS found it necessary to request additional information on both topics.

Overall Utility

The documentation provided a good explanation of Company 15's overall operations and enabled the examination team to formulate specific inquiries about the controlled transactions and the company's operations. In particular, the overview of the company provided a general understanding of the controlled transactions and the history of the company. The documentation also helped the examination team to identify supplemental information that was needed, and where that information could be obtained. In addition, it identified issues concerning assistance provided by a CFC in developing a product used by other members of the group.

APPENDIX: COMPANY 16

Background

Company 16 is primarily a service-provider. The company is organized in operating divisions, each of which deals with a particular category of products, transactions, or services. Company 16 also develops intangible assets that it licenses to CFCs.

Overview of the Documentation Submitted

The documentation appeared to have been prepared contemporaneously with the taxable year in question.

For the taxable year 1994, Company 16 submitted an industry-wide study that analyzed fees charged for transactions in the U.S. market that were potentially analogous to a certain controlled transactions that took place between Company 16 and its CFCs.

The study did not contain any analysis specifically addressed to the facts and circumstances of the controlled transactions in which Company 16 engaged.   Rather, the study was an industry-wide survey of certain transactions in the U.S. market.

The study did not describe or apply any transfer pricing method, nor did it contain any of the principal documents specified in the section 6662(e) regulations.

Company 16 submitted separately annual reports, organization charts, and other background information. Some of this information corresponded to the principal documents in the section 6662(e) regulations. However, none was provided in response to the examination team's request for transfer pricing documentation.

Overall Quality

The study did not constitute transfer pricing documentation within the meaning of section 6662(e). It was not addressed to Company 16's particular facts and circumstances.

Overall Utility

Because the study did not pertain specifically to Company 16, it was not useful to the examination team.

APPENDIX: COMPANY 17

Background

Company 17 manufactures and sells tangible property. Company 17 and its affiliates perform a range of functions, including research, production, processing, and retail and wholesale distribution. Company 17's operating divisions include domestic and foreign branches, subsidiaries, partnerships, and other entities.

Overview of the Documentation Submitted

The documentation appeared to have been prepared contemporaneously with the taxable year in question.

Company 17 provided individual studies, each of which dealt with a major business division or with a specific category of controlled transactions. Any documentation provided for the company as a whole was very general in nature.

The documentation did not contain a comprehensive organization chart For certain divisions, charts were provided that showed the legal structure, and others showed personnel structure. The organization charts provided in the individual studies, considered together, were not equivalent to an organization chart for the company's global operations.

For purposes of the transfer pricing analysis, many of the controlled parties restated their income, based on various accounting assumptions. In addition, Company 17 excluded controlled transactions involving products that originated outside the United States, and it aggregated other transactions based on geographic regions. The stated goal was to identify controlled transactions that would affect the company's U.S. tax liability.

Company 17 generally treated each operating division as functionally independent. With several exceptions (e.g., intercompany services, loans, tangible-property transfers), the company provided limited information about controlled transactions between divisions, or between foreign affiliates.

For many controlled transactions, Company 17 concluded that because it lacked data necessary to apply the CUP or other methods, the CPM was the best method. Company 17 identified comparables for manufacturers, manufacturer/marketers, and pure distributors, and applied distinct profit level indicators to each category of transaction. Analysis of functions performed and risks assumed was in a checklist format, without any narrative description.

Company 17's documentation for some categories of intercompany services was abbreviated. In some cases, the documentation simply identified the services in question and briefly stated how they were treated under the section 482 regulations.

For certain tangible-property transactions, Company 17 applied the CUP method. Where Company 17 applied the CUP (tangible-property transfers) or cost or cost-plus (intercompany services), it generally did not discuss other methods. Where the CPM was used, Company 17 indicated why other methods were not selected (e.g., because necessary information was not available).

Company 17 described the controlled transactions covered by each set of documentation.

The description of the comparables varied, depending on the transfer pricing method applied. Descriptions of CPM comparables were generally brief and did not contain functional analysis. Where a CUP was used, the description provided a general understanding of the transactions. In some cases, Company 17 provided copies of contracts with uncontrolled parties, but it did not describe differences between the terms of the contracts and the controlled transactions.

Company 17 had several cost sharing arrangements. A copy of each agreement was provided.

No information was provided that was received after the end of the tax year and before the tax return was filed, which was relevant to the transfer pricing analysis. Each of the studies contained an index. Indexes were also provided for the background documents, where appropriate.

Overall Quality

Although the quality of the individual transfer pricing studies varied, the overall quality of the documentation was moderate.

Considered individually, the studies provided a good deal of information concerning complex transactions. However, they did not explain how the selected transfer pricing method applied to particular transactions. The documentation also lacked a complete corporate overview, and did not state how Company 17 restated its income from certain controlled transactions, or how it aggregated other controlled transactions. These deficiencies made it difficult to assess the overall reliability of the transfer pricing methods and conclusions.

Company 17 restated the data for many of its controlled transactions, and excluded an unspecified percentage of those transactions. It failed to describe the accounting conventions, allocation methodologies, and other economic assumptions used in this process.

Overall Utility

The documentation assisted the analysis of specific divisions of the company and particular categories of controlled transactions. It also described the controlled transactions and the transfer pricing methods applied, and thus provided a starting point for subsequent, in-depth examination of transfer pricing issues. However, the documentation provided little information about specific controlled transactions. The examination team obtained such information through information document requests, interviews, and other examination techniques. The inability to link the documentation to the company's financial statements or tax accounting records also reduced the usefulness of the documentation.

APPENDIX: COMPANY 18

Background

Company 18 and its affiliates perform a range of functions, including research, production, manufacturing, and retail and wholesale distribution.

Overview of the Documentation Submitted

The documentation appeared to have been prepared contemporaneously with the taxable years in question. Each set of documentation covered a specific taxable year.

Company 18 provided documentation for controlled transfers of tangible property. No documentation was provided for other controlled transactions (e.g., loans, services, transfers of intangible property).

Company 18 provided a comprehensive overview of its operations and organizational structure. This discussion also described the company's history, its current operations, and major economic conditions that affect pricing in the industry.

No organization chart was provided for the company or the controlled party considered in the study. A schematic diagram showed the parties that engaged in specific transactions and indicated whether these parties were controlled or uncontrolled. In response to a request for an organization chart, the company submitted a list of controlled parties. However, this list was not contained in the initial documentation, and it did not appear to be comprehensive.

Company 18 applied the CUP method. Prices in controlled transactions were compared to: (1) prices for similar products in uncontrolled transactions, or (2) indirect evidence of prices for similar products. Company 18 provided detailed narrative descriptions of the CUP method and the controlled transactions. The description referred to a schedule of controlled transactions and listed the comparables for each transaction.

The CUP analysis suggested that prices of the controlled transactions were within the arm's length range as determined by the taxpayer. Where the prices of controlled transactions were outside the arm's length range as determined by the taxpayer, Company 18 identified unusual market conditions in effect at the time of the transaction, or other adjustments to the comparables that might explain the deviation. If the prices could not be explained by such factors, Company 18 made adjustments to the price of the controlled transaction. Such adjustments were clearly identified in the documentation, and were reflected on the timely-filed income tax return for the period in question.

Company 18 discussed several factors that could affect the reliability of the CUP analysis. For example, the terms of sale of a specific transaction might result in material differences in price. Other factors that might be relevant were not addressed.

Company 18 considered transfer pricing methods other than the CUP. However, Company 18 concluded that, because extensive data were available regarding prices in uncontrolled transactions, the CUP was the best method.

No information was provided that was received after the end of the tax year and before the tax return was filed, which was relevant to the transfer pricing analysis. Each of the studies contained an index.

Overall Quality

The overall quality of the documentation was moderate. The documentation did not discuss certain assumptions about the CUPs. For example, some uncontrolled transactions were remote in time (many months in some cases) from the controlled transactions. To the extent that prices of the uncontrolled transactions were volatile, reliance on such CUPs may not be appropriate. In addition, CUPs applicable to a particular date were often compared to controlled transactions under extended supply contracts.

Overall Utility

The study’s usefulness was limited to a specific category of controlled transactions. Detailed information for those transactions allowed the team to identify sub-categories of transactions (or particular transactions) for closer scrutiny. In addition, the documentation enabled the team to understand controlled transactions that were complex and voluminous, and reduced the number of subsequent requests for information.

APPENDIX: COMPANY 19

Background

Company 19 and its affiliates perform a range of functions, including research, production, manufacturing, and retail and wholesale distribution.

Overview of the Documentation Submitted

The documentation appeared to have been prepared contemporaneously with the taxable years in question.

Company 19 prepared documentation for almost 100% of its controlled transactions. Transfers of tangible property, services, loans, and royalties for use of intangibles were all addressed. The documentation also addressed transactions with related entities that might not be viewed as controlled parties under the section 482 regulations.

An overview section summarized the company's operations and the organization of its controlled parties and affiliates. Also provided were the total value of controlled transactions in individual categories, ownership percentages in various affiliates, and a comprehensive organization chart for Company 19.

The documentation consisted of several sections, each of which dealt with a particular product line or a category of transactions. For one category of tangible property, Company 19 applied the CUP method, comparing prices of controlled transactions to: (1) prices for similar products in uncontrolled transactions, or (2) indirect evidence of prices for similar products. Company 19 described the CUP method and stated why it constituted the best method. Company 19 also provided detailed documentation that permitted these transactions to be traced to the company's books and records.

The documentation also addressed controlled transfers of other types of tangible property. Transfer pricing methods applied included CUP (based on direct and indirect measures), the resale price method, cost-plus method, and, in some cases, unspecified methods. Where an unspecified method was used, Company 19 explained why the method was appropriate, by reference to industry practices, specific characteristics of the transaction, or other factors. In several cases, Company 19 applied the CUT method to royalties charged in controlled transactions.

The documentation explained why the transfer pricing method selected was the best method, and other methods were not appropriate. Company 19 described the controlled parties and changes in ownership, as well as the total value of controlled transactions in the particular category. In most cases, Company 19 also showed application of the transfer pricing method on an individual transaction basis.

The documentation also addressed services. In some cases, foreign revenue authorities required that a CFC service-provider be compensated at a particular cost-plus margin. Each such instance was documented in the report.

Company 19 also provided documentation for intercompany loans, intended to show compliance with the arm's length interest provisions in the section 482 regulations.

Several cost sharing arrangements were in effect. Company 19 provided copies of these arrangements as background documents.

Company 19 made some year-end or post-year end adjustments to the income of controlled parties, in order to reflect what Company 19 concluded was the arm's length price. In each case, specific information was provided regarding the nature and amount of the adjustment. Indexes were provided for the documents.

Overall Quality

The overall quality of the documentation was excellent. The information was extensive and well organized. Company 19 occasionally selected indirect evidence of CUPs that tended to show that the prices of controlled transactions were arm's length, but did not state why a particular indirect measure was chosen over others. In addition, the CUP analysis made certain assumptions about the reliability of the CUPs (or indirect evidence of such prices), which were not fully explained. Aside from some minor omissions, the documentation was detailed and comprehensive.

Overall Utility

The documentation enabled the examination team to review a large number of controlled transactions relatively quickly and without the need to request additional information. Based on the detailed information, the examination team was able to identify controlled transactions or categories of transactions that warranted additional scrutiny. In addition, the documentation provided the examination team with a good understanding of the overall organization of Company 19 and the company's methods of establishing and monitoring prices of controlled transactions.

APPENDIX: COMPANY 20

Background

Company 20 sells products to consumers. Substantially all of the company's products are manufactured abroad by controlled and uncontrolled parties, under contracts negotiated on behalf of Company 20.

Overview of the Documentation Submitted

The documentation appeared to have been prepared contemporaneously with the taxable years in question.

Company 20 provided documentation for three aspects of its business: two categories of services, and royalties for intangibles paid by CFCs.

Each study contained introductory material, such as the history of the company and its operations in various countries, including the United States. Also included was a discussion of major competitors and economic factors in the industry, net sales data for each operating group, and functional and risk analysis of major divisions of the company.

The first set of documentation applied a cost-plus methodology to services performed by controlled parties on behalf of Company 20. Company 20 concluded that cost-plus was the best method for these transactions. The mark-up was determined by reference to internal comparables that performed similar functions, and the results under this approach were corroborated by analysis of external comparables. Company 20 did not fully describe the criteria used to select comparables, or show how the cost-plus method applied to specific transactions.

The second set of documentation applied a cost-plus methodology to services on behalf of CFCs (other than services valued at cost). The mark-up was determined by reference to the operating profits of uncontrolled service providers. Company 20 generally described its comparables search methodology, but did not show the application of the cost-plus method, except to state that the operating profit on these transactions was within the arm's length range.

The third set of documentation applied the CUT method to royalties paid by certain CFCs for use of intangible assets. Company 20 first searched industry databases for royalty agreements deemed comparable to the agreements with the CFCs. It then eliminated comparables in different geographical markets or in distinct segments of the market. Company 20 also made various adjustments to state the comparable royalties on an accounting basis equivalent to that used by Company 20. Based on the CUT analysis, Company 20 concluded that royalties from CFCs were within the arm's length range, on a country-by-country basis.

For a subsequent tax year, Company 20 submitted documentation to show that the royalties satisfied the commensurate with income standard of section 482. Company 20 evaluated the previously-determined royalty rates based on the actual results of the individual CFCs in the subsequent year. It also analyzed the economic conditions and operating results in each national market. Company 20 discussed certain economic theories that it claimed supported a gradual reduction of the royalties over time. The documentation provided a useful analysis of the controlled transactions and subsequent developments in the individual foreign markets.

No information was provided that was received after the end of the tax year and before the tax return was filed, which was relevant to the transfer pricing analysis. Each of the studies contained an index.

Overall Quality

The overall quality of the documentation was good. It covered all major categories of controlled transactions, and it applied the section 482 regulations in a thorough manner. In several cases, Company 20 analyzed two distinct sets of comparables, or applied an alternative transfer pricing method, to confirm the reliability of the results under the primary method.

The background information provided a good understanding of the company's history and organization. Because the studies for services relied extensively on comparables, additional discussion of the selection and screening criteria would have been useful. The documentation with respect to royalties and the commensurate with income standard was comprehensive and well-organized.

Overall Utility

The documentation enabled the examination team to analyze the controlled transactions without the need for in-depth consideration of alternative transfer pricing methods or review of comparables. The documentation contained sufficient detail to eliminate most potential concerns about the arm's length nature of intercompany prices for the years under examination. Most areas that required additional analysis were resolved quickly, based on targeted requests for additional information.

APPENDIX: COMPANY 21

Background

Company 21 manufactures and distributes tangible property. Its functions include manufacturing, research and development, and distribution. Each of the various controlled parties generally performs a specific function or several closely related functions. For example, some parties are manufacturers, others are distributors, and others perform research and development.

Overview of the Documentation Submitted

The documentation appeared to have been prepared contemporaneously with the taxable years in question.

The documentation addressed controlled transactions involving tangible and intangible property. Each study gave an overview of the business segment covered in the study, and a general overview of the company was also provided as part of the documentation.

A comprehensive organization chart was provided. Each study contained a listing of the parties that took part in the controlled transactions at issue. Some studies contained charts that showed the functions performed by individual CFCs.

Each study described the transfer pricing method applied. In some cases, the results under the selected method were corroborated by another method. The documentation discussed methods that were not selected and stated why they were not selected.

The studies provided complete descriptions of the controlled transactions.

The studies discussed the comparables and the selection methodology. The process was explained step-by-step, as were the adjustments to the comparables and the reasons for eliminating companies from the comparables database. The economic analysis and projections were provided in the discussion of the selection of the best method or the selection of comparables. Some studies stated that exhibits showing economic analysis were available upon request.

The studies identified certain data received after the end of the tax year and before the tax return was filed, which was relevant to the transfer pricing analysis. Indexes were provided for the principal and background documents.

Overall Quality

The overall quality of the documentation was excellent. It provided a good understanding of the company’s business and the controlled transactions. The analysis of transfer prices was logical and clearly explained. All assumptions relied upon were described in detail. Each item specified in the section 6662(e) regulations was considered and noted.

Overall Utility

The documentation was very useful to the examination team. Because the company described each step of its transfer pricing analysis, the examination team was able to test the accuracy and reliability of the analysis. The documentation contained an exceptional amount of detail, particularly regarding the selection of comparables. The examination team was able to follow each step of the taxpayer's transfer pricing analysis, including the preparation and refinement of the database of comparables.

APPENDIX: COMPANY 22

Background

Company 22 produces equipment for industrial and commercial applications, in two primary business segments. The first segment has manufacturing facilities throughout the world. Its output consists of three major product lines. The second segment provides engineering, installation, and other services through foreign subsidiaries and branches located in many foreign countries. This segment has two major product lines.

Company 22 has a large number of CFCs. The company owns numerous U.S. patents and foreign counterpart patents, and also holds numerous registered trademarks in the U.S. and in many foreign countries.

Overview of the Documentation Submitted

Company 22 submitted five separate studies for the period 1997-98. The first three studies pertained to the first business segment and dealt with tangible property, intangible property, and original equipment manufacturer (OEM) sales. The study for intangible property was dated Fall 1994, and the study for tangible property was dated Fall 1998. Although the intangible study was apparently not contemporaneous because it failed to reflect material changes that took place since the initial study was prepared, the background documents for that study were contemporaneous. The fourth study dealt with the company's second business segment. The fifth study was a general or background study. The company also submitted several volumes of background documents. These documents appeared to have been prepared contemporaneously with the years in question.

The documentation contained an in-depth company history. The overview identified the division to which each CFC belonged and the CFC's officers. It described the two major segments of the company and identified products, major customers, and revenues from each major customer. The overview also discussed certain joint ventures.

The documentation included organization charts in several formats, based on legal entity, country of incorporation, voting stock, reporting system, etc. The charts appeared to address all controlled parties. The charts also identified the owner for each CFC and the respective ownership percentage.

Company 22 did not provide documentation relating to market-penetration strategies, but it noted that certain CFCs paid reduced royalties because their operations were in a start-up phase, and fully explained this phenomenon.

The studies described the transfer pricing methods applied and the controlled transactions. The services were provided pursuant to written agreements. In some cases, Company 22 performed similar services for both controlled and uncontrolled parties. It appeared that the agreements with controlled and uncontrolled parties had equivalent terms.

For tangible property transfers, the transfer pricing method was discussed and the results were confirmed by application of an alternative method. The company described other transfer pricing methods and indicated why they were not selected as the best method.

The studies discussed the controlled transactions for each product line. However, the discussion appeared to omit some important factors, such as currency risk and financing that Company 22 provided to controlled parties.

The study briefly described the comparables and the selection process. The search methodology, however, was not described in depth. Also, the study did not describe adjustments (if any) for differences such as level of market.

The studies did not identify any economic analysis relied upon to develop the transfer pricing method, or economic factors that affected pricing. One study contained projected sales, but no support for these projections was provided.

The documentation discussed royalty computations performed after the end of the tax year but before the income tax return was filed. Under this process, the base royalty was adjusted to reflect a particular percentage of net sales, after elimination of intercompany transactions. The royalty rate might also be adjusted based on the CFC's net profits. In one year, the royalty rate for one CFC was adjusted upward after the tax year ended and before the income tax return was filed. The documentation fully described these post-year-end adjustments. No other year-end adjustments were noted.

The company provided an index for the principal and background documents.

Overall Quality

The overall quality of the documentation was good. The company made a substantial effort to determine the best method and in some cases confirmed the reliability of the results under that method by applying an alternative method.

The documentation should have been updated more extensively to incorporate information for the particular taxable years under examination. In addition, more information could have been provided about the comparables selection process.

Overall Utility

Based on its review of the documentation, the examination team accepted most of the transfer prices that were analyzed in the documentation. The examination team concluded that in-depth analysis of transfer pricing issues was not warranted.

APPENDIX: COMPANY 23

Background

Company 23 is an FCC that manufactures and sells products for use in a particular industry. Company 23 licenses from a foreign affiliate intangible property, including formulas, patents and marketing intangibles. It also purchases components from a foreign affiliate. Although foreign affiliates perform most research and development, Company 23 performs limited research-type functions in the United States.

Overview of the Documentation Submitted

Company 23 provided four separate studies. Study 1 and Study 2 addressed two specific products. These studies focused on specific controlled transactions: use of foreign affiliates' product formulas and marketing intangibles, and purchases of a component for a specific product from a controlled party. These studies did not appear to have been prepared contemporaneously with the taxable years in question. For one year, the study was provided to the company by an accounting firm one year after the tax return for the year in question had been filed.

Study 3 pertained to services provided by a foreign affiliate. Study 4 dealt with royalties paid to a controlled party for use of marketing intangibles. These studies appeared to have been prepared contemporaneously with the taxable years in question.

Each of the studies contained an overview of the business sector that it covered. The documentation briefly described the ownership of the company and gave basic information on controlled parties. The overviews focused on Company 23 and provided little information about the company's role in the corporate group.

No organization chart was provided for Company 23 or other controlled parties. The studies identified Company 23's ownership interests in lower-tier U.S. FCCs, and identified Company 23's foreign parent. However, no organization chart was provided for any of these controlled parties.

Study 1 dealt with transfer prices and royalties in connection with a product introduced in the U.S. market during the year covered by the study. This study also dealt with royalties to a controlled party for a formula and marketing intangible for the same product. Some aspects of the controlled transaction were not described, such as a mark-up for a product component purchased from a controlled party.

Study 2 covered royalties to a controlled party for the product patent and marketing intangibles.

Study 3 dealt with services performed by the foreign parent for Company 23. The study concluded that these services were not stewardship or duplicative of functions performed by Company 23. Company 23 did not provide copies of the agreements that governed these services.

Study 4 covered royalties to a controlled party for a marketing intangibles. These intangibles replaced existing intangibles that Company 23 had used for many years. The study did not state whether the new marketing intangibles were recognized at the time of introduction in the U.S., or whether Company 23 incurred (or was reimbursed for) expenses associated with introducing the new marketing intangibles.

In each study, Company 23 applied the CPM. The nature of the application differed, depending on the specific controlled transactions.

In the updated studies, it appeared that CUPs might have been available for purchases of a product component from a controlled party.

The comparables used to analyze royalties did not appear to perform functions similar to Company 23, but the documentation did not provide sufficient information on which to evaluate the comparables selection process. The application of the CPM appeared to contain other irregularities. For example, in one case, two-year average data were compared to three-year average data. None of the studies identified any economic analysis relied upon in developing the transfer pricing method.

No information was reported as received after the end of the tax year and before the tax return was filed, which was relevant to the transfer pricing analysis. Each study each contained an index. No index of background documents was provided.

Overall Quality

The overall quality of the documentation was moderate. Although the studies contained most of the principal documents specified in the section 6662(e) regulations, the documents appeared to overlook material considerations. For example, one study did not consider contributions that Company 23 may have made to the value of an intangible. In another case, a foreign controlled party was the tested party, when it appeared that Company 23 should have been the tested party.

Overall Utility

Although the quality of the studies was only moderate, they provided useful information. They gave the examination team background information at an early stage of the examination. Several errors were identified in the taxpayer's analysis, some of which led to changes in transfer prices. In some cases, the documentation raised factual or legal issues that were pursued in the examination, such as a royalty to a foreign affiliate for which the documentation provided no analysis.

APPENDIX: COMPANY 24

Background

Company 24 is a U.S. corporation that operates through a network of controlled parties, including CFCs. Company 24 and its affiliates produce, purchase, transport and distribute products in the United States and abroad. The company owns a valuable marketing intangible, as well as substantial physical assets and real property. Company 24's management is located in the United States, but much of its business activity takes place abroad.

Overview of the Documentation Submitted

The documentation appeared to have been prepared contemporaneously with the taxable year in question.

The company submitted one study that addressed the primary product of the company's largest division. This product accounted for a majority of the division's total sales.

The study contained an overview of the division. Because the overview covered only one division, it did not address the company's overall operations. No organization chart was provided. The documentation did not describe the ownership of the company or identify divisions within the U.S. entity. It provided no information on foreign or domestic affiliates. In response to an IRS request for a comprehensive organization chart, the company stated that such a chart did not exist.

The description of the controlled transaction was relatively complete, but did not address two controlled parties companies that participated in the transaction.

The company bought certain products from foreign controlled parties. Those parties in turn purchased the product from other controlled parties or from uncontrolled suppliers pursuant to long-term contracts. Company 24 applied an unspecified transfer pricing method that combined elements of the CPM and the residual profit-split method. The documentation considered other transfer pricing methods and explained why these methods were not selected as the best method.

The study briefly described the comparables. However, more information could have been provided. The discussion of the comparables search process was highly abbreviated. It was not clear, for example, whether the comparables performed similar functions, operated at the same level of market, or dealt with similar products. The study did not explain adjustments, if any, to the comparables to account for differences such as level of the market, different geographic markets, or differences in products.

The study concluded that the marketing intangibles owned by Company 24 generated a price premium at the wholesale level of trade, but not at the retail level. No explanation of this phenomenon was provided.

The documentation included economic analysis that discussed the overall market and the basis for certain sales projections in the study.

An outside economist prepared the study. No information was identified that was obtained after the end of the tax year, but before the tax return was filed, which was relevant to the transfer pricing analysis.

No index was provided for the study or the background documents.

Overall Quality

The overall quality of the documentation was moderate. The documentation omitted several of the principal documents specified in the section 6662(e) regulations. It also omitted material facts concerning the controlled transactions. In applying the unspecified transfer pricing method, Company 24 appeared to select a profit-split ratio without any substantive analysis. In addition, the description of the comparables selection process contained little information.

Overall Utility

The documentation was useful to the examination team. The functional analysis contained in the documentation provided a basis for a more detailed examination. The unspecified transfer pricing method applied by the taxpayer provided the examination team with a starting point for independent analysis of the transfer pricing method.

APPENDIX: COMPANY 25

Background

Company 25 manufactures, markets, and distributes an industrial product. Company 25 consists of several operational groups, one of which encompasses the manufacturing operations of a wholly-owned subsidiary.

Overview of the Documentation Submitted

As discussed below, only one of the studies provided appeared to have been prepared contemporaneously with the taxable year in question.

The documentation pertained to controlled transactions with a single subsidiary that manufactures products to Company 25's specifications.

Company 25 provided three separate sets of documentation, each of which discussed a specific category of controlled transactions with the subsidiary. An outside firm prepared the first set of documentation, dated March 1995. This documentation was submitted for the years 1994 through 1997. This study determined that a cost plus method was the preferred method.

Another outside firm prepared another set of documentation for subsequent years. In March 2000, yet another study was prepared by a third outside firm. This study, which Company 25 submitted for the years 1995 to present, applied the CUP method. The discussion below focuses on the March 1995 study, the only study that appeared to have been prepared contemporaneously with the 1994 taxable year.

Company 25 provided an overview that was limited to the subsidiary but also gave some information concerning the company's overall operations. The overview described the subsidiary's projected sales, the items manufactured, and factory locations. The study did not address other company operations, such as marketing and product distribution by the subsidiary after it was acquired from an unrelated party.

The documentation did not include an organization chart and did not discuss changes in Company 25's organizational structure after the production subsidiary was acquired.

The documentation described each of the transfer pricing methods and indicated why the transfer pricing method selected was the best method. This section included brief functional analyses of Company 25 and the subsidiary. The documentation concluded that the cost-plus method applied to the controlled transactions, and explained why other transfer pricing methods were not selected.

The description of the controlled transactions was general, and did not indicate, for example, the value of sales from the subsidiary to Company 25 or to uncontrolled parties.

The study stated that the search for comparables identified several companies. The study did not fully describe the search methodology, the basis for exclusion of potential comparables, or adjustments to the comparable data.

The documentation did not include any economic analysis relied upon in developing the transfer pricing method.

The study did not refer to information obtained after the end of the tax year and before the tax return was filed, which was relevant to the transfer pricing method. No index was provided for the study or the background documents.

Overall Quality

The overall quality of the documentation was poor. Because the study was dated March 1995, it was contemporaneous only for the 1994 year. Although Company 25 stated that no changes took place since the initial study was prepared, the examination team was aware of certain material changes. The study applied the cost-plus method, but the company itself subsequently determined (based on a new study) that a CUP might be more appropriate.

Overall Utility

The documentation provided some useful information, in particular concerning the comparables. The documentation allowed the examination team to quickly identify several issues for in-depth analysis.