Internal Revenue Service
DEPARTMENT OF THE TREASURY

LB&I Concept Unit
Knowledge Base – International

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Book	6	Income Shifting Inbound
Chapter		
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Subsection		

Unit Name	Common Ownership or Control Under IRC 482 - Inbound	
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General Overview

Common Ownership or Control Under IRC 482 - Inbound

Foreign multinational enterprises (MNEs) generally own one or more U.S. entities. The foreign parent is most often seen in the form of a corporation but could also be a partnership, trust, association or other hybrid entity. The U.S. entities may be corporations, partnerships, trusts, associations or hybrid entities. The members of a MNE group are often referred to as related parties in practice.

These related parties often may transact business with one another. For example, the foreign parent may perform services for one of its wholly owned U.S. subsidiaries or vice versa. In addition, one entity in the multinational structure may sell goods to a related entity. The most common types of related party transactions that you may see are the following:

- Loans
- Leases
- Sales
- Licenses
- Services

Transfer pricing relates to the pricing of transactions between such related parties. Generally, business transactions are entered into by unrelated parties, each of which is acting solely to increase its own economic goals. This concept is often referred to as an arm's length dealing resulting in an arm's length price.

When two related parties transact business with each other, the possibility exists that the price paid will be influenced by their related party status. Therefore, the price may not be an arm's length price. This could result in a U.S. taxpayer underreporting its U.S. taxable income, and consequently, its federal income taxes. Under IRC 482 and the related Treasury regulations, the IRS may reallocate income among related parties (as more precisely defined below) if that is necessary to reflect arm's length pricing. Note that the fact that two parties are related does not create any presumption that their pricing to each other is not arm's length. The parties might conscientiously determine an arm's length price, or might arrive at an arm's length price by chance. Only in the case of non-arm's-length pricing may the IRS reallocate income among related parties under IRC 482.

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Relevant Key Factors

Common Ownership or Control Under IRC 482 - Inbound
Key Factors
The purpose of IRC 482 is to ensure that taxpayers clearly reflect income from “controlled transactions” and to prevent a U.S. taxpayer from avoiding taxation by artificially shifting income. A transaction is a controlled transaction for IRC 482 purposes if the transaction is between two or more organizations, trades, or businesses that are either: (1) owned, or (2) controlled by the same interests. A controlled group of taxpayers is a group of taxpayers that are owned or controlled directly or indirectly by the same interests. Treas. Reg. 1.482-1(i)(6). A controlled transaction is any transaction or transfer between two or more members of the same group of controlled taxpayers. An uncontrolled transaction is any transaction between two or more taxpayers that are not members of the same controlled group. Treas. Reg. 1.482-1(i)(8). Thus, the term “controlled” in the Treasury Regulations is a shorthand that generally refers to the concepts of both common ownership and common control, except where it is necessary to distinguish between the concepts of “control” and “ownership,” as those two concepts are distinct. Further, the term “controlled” is defined in the Treasury Regulations (Treas. Reg. 1.482-1(i)(4)) as any kind of control to include : ▪ Direct or indirect; ▪ Whether legally enforceable or not; ▪ However exercisable or exercised; ▪ Including control through acting in concert or with a common goal or purpose. The Treasury Regulations also provide that it is “the reality of control” which is the decisive factor and not its form or the mode through which the control is exercised. Control is presumed to exist if income or deductions have been arbitrarily shifted between related parties. *Id*. Common ownership or control is determined as of when the parties agree to perform a transaction, even if the parties perform the transaction later.

Detailed Explanation of the Concept

Common Ownership or Control Under IRC 482 - Inbound
Common ownership means greater than 50% ownership by the same related party interests.

Analysis	Resources
<u>Common Ownership</u> The first step is to determine whether the “ownership” test is satisfied. While the term “owned” is not defined in the Code, it is the Service’s position that the common ownership under IRC 482 is satisfied if there is a greater than 50% ownership by the same related party interests. Ownership can be direct or indirect. Direct ownership occurs when one party directly owns stock or another ownership interest in its name. Indirect ownership occurs when one party owns the stock or other ownership interest of another party indirectly through ownership of one or more other, intervening parties. Importantly, even though greater than 50% ownership is enough to satisfy the ownership test and establish common ownership or control for purposes of IRC 482, the transfer price at issue may still be an arm’s length price. For example, in a joint venture where one shareholder owns a 51% share and the other shareholder owns a 49% share, the 49% shareholder may exert actual control over pricing or otherwise prevent the majority shareholder from setting non-arm’s length prices between itself and the joint venture entity. In such a situation, even though IRC 482 applies due to common ownership, the transfer price at issue may nonetheless be an arm’s length price.	▪ IRC 482 ▪ Treas. Reg. 1.482-1(i)(5) and (6)

Detailed Explanation of the Concept (cont'd)

Common Ownership or Control Under IRC 482 - Inbound	
Analysis	**Resources**
Common Ownership (cont'd) While majority ownership (or lack thereof) is generally easily identifiable, in some cases the inquiry may be complicated by additional considerations such as differing ownership interests (e.g., stock classes with different rights), aggregate majorities consisting of overlapping minority owners (e.g., two shareholders each hold 33% of the stock of two different corporations resulting in a common 66% majority), and similar issues. In cases where common ownership is not present, additional analysis will be needed to determine whether IRC 482 still applies on other grounds.	▪ IRC 482 ▪ Treas. Reg. 1.482-1(i)(5) and (6)

Detailed Explanation of the Concept (cont'd)

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<tr><td><u>Common Control</u>

As in the case of common ownership, even if it is determined that the parties are commonly controlled (and that IRC 482 therefore applies), that does not necessarily mean that the pricing between the parties is not arm's length. For example, it may be the case that the controlled taxpayers conscientiously determine arm's length transfer prices under the IRC 482 regulations.

<u>Factors of Control</u>

In a situation where IRC 482 can apply only if there is common control (due to the absence of common ownership by a majority of the same interests), common control might result in any number of ways depending on the facts of the case.

The courts have found common control present in a variety of situations. This unit discusses common control through factors such as (1) voting control, (2) management control, and (3) acting in concert.

In addition, the timing of control and the relevance of the presence of indifferent uncontrolled parties is set forth in the following slides.</td><td>▪ IRC 482
▪ Treas. Reg. 1.482-1(i)(5) and (6)
▪ Treas. Reg. 1.482-1(a)(1)
▪ Diefenthal v. U.S. - 367 F. Supp. 506, 511 (E.D. La. 1973)
▪ Charles Town, Inc. v. Commissioner - 372 F.2d 415 (4th Cir. 1967) aff'g, T.C. Memo 1966-15, cert. denied 389 U. S. 841
▪ W.L. Gore v. Commissioner - T.C. Memo 1995-96
▪ B. Forman Co. v. Commissioner - 453 F.2d 1144, 1155 (2d Cir. 1972), cert. denied, 407 U.S. 934 (1972)
▪ South Texas Rice Warehouse Co. v Commissioner - 43 T.C. 540 (1965) aff'd, 366 F.2d 890 (5th Cir. 1966), cert. denied, 386 U.S. 1016, (1967)</td></tr>
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Detailed Explanation of the Concept (cont'd)

Common Ownership or Control Under IRC 482 - Inbound	
Analysis	**Resources**
<u>Voting Control</u> Where a taxpayer has legal voting control over another entity, the control element will usually be met for purposes of IRC 482. This may be true even when a taxpayer owns less than 50% of the value of the stock, yet holds a majority of the voting stock, of a corporation. In this situation, the control element of IRC 482 will usually be met. This scenario is illustrated in *Diefenthal v. U.S.,* 367 F. Supp. 506, 511 (E.D. La. 1973). In *Diefenthal,* a corporation called Scrapco, was wholly owned by a grandfather. Upon the grandfather's death, one third of the stock was passed to his son ("Son"), and the other two-thirds were split between his two grandsons. The stock of the two grandsons was held in trust and Son was named as the trustee of the trusts. Therefore, Son had the power to vote 100% of the shares. The IRC 482 issue in *Diefenthal,* was whether Scrapco engaged in arm's length transactions with a corporation owned wholly by Son, called Fukaya. The district court held that common control was present for IRC 482 purposes since Son had power to vote 100% of Scrapco's stock and also owned 100% of Fukaya. (The court reasoned on the basis of voting control rather than common ownership, even though the Son as trustee also was the legal owner of 100% of Scrapco.)	▪ *Brittingham v. Commissioner* - 66 T.C. 373 (1976), *aff'd* 598 F.2d 1375 (5th Cir. 1979) ▪ Notice 95-53 - Lease Stripping ▪ Rev. Rul. 2003-96 - Lease Stripping ▪ *DHL Corp. & Subsidiaries v. Commissioner* - T.C. Memo 1998-461, *aff'd* in part and *rev'd* in part, 285 F.3d 1210 (9th Cir. 2002) ▪ *GAC Produce Co. v. Commissioner* - 77 T.C. Memo 1999-134 ▪ *Diefenthal v. U.S.* - 367 F. Supp. 506, 511 (E.D. La. 1973)

Detailed Explanation of the Concept (cont'd)

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<tr><td>Voting Control Considered on a Practical Basis

Even if a taxpayer does not have absolute voting control, there are scenarios where the taxpayer on a practical level has sufficient voting control so that common control is met. The following circumstances (which are not all-inclusive) illustrate such situations.

▪ De facto or practical control over the entity generally. For example, a situation where 49% of a corporation's stock is owned by a single entity and the other 51% is widely dispersed among many other shareholders, none of which owns more than 1%.

▪ Influence created by particular economic relationships. A non-majority owner of a joint venture entity might have sufficient influence over the other owners to exercise practical voting control, based on an economic relationship with the joint venture. This might occur, for example, if a 50% owner provides all the debt financing to the joint venture. Another example is where a 50% owner supplies the joint venture with essential components with an exclusive supply agreement. The presence or absence of control would depend upon the degree of ownership and the significance and size of the particular transaction relative to the joint venture business.</td><td>▪ Charles Town, Inc. v. Commissioner - 372 F.2d 415 (4th Cir. 1967), aff'g T.C. Memo 1966-15, cert. denied 389 U. S. 841
▪ W.L. Gore v. Commissioner - T.C. Memo 1995-96
▪ B. Forman Co. v. Commissioner - 453 F.2d 1144, 1155 (2d Cir. 1972), cert. denied, 407 U.S. 934 (1972)
▪ South Texas Rice Warehouse Co. v Commissioner - 43 T.C. 540 (1965) aff'd, 366 F.2d 890 (5th Cir. 1966), cert. denied, 386 U.S. 1016
▪ Brittingham v. Commissioner - 66 T.C. 373 (1976), aff'd 598 F.2d 1375 (5th Cir. 1979)
▪ Notice 95-53 – Lease Stripping
▪ Rev. Rul. 2003-96 – Lease Stripping</td></tr>
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<tr><td><u>Management Control</u>

Common control for purposes of IRC 482 may be established based on one party's management control of another entity. For example, in Charles Town, Inc. v. Commissioner, 372 F.2d 415 (4th Cir. 1967), aff'g T.C. Memo 1966-15, the court held that common control existed where there was only 2% common ownership.

In Charles Town, two brothers owned all of the stock of Fairmount Steel Corporation ("Fairmount"). The brothers formed a new corporation ("Charles Town"), which they used to acquire a race track. The brothers owned only 2% of the outstanding stock in Charles Town, while their cousin owned the other 98%. However, the brothers served as the president, secretary-treasurer, and directors of Charles Town. Fairmount advanced funds to Charles Town for operations at the race track. Charles Town operated the track and retained ten percent of the net profits, while paying the remaining profits to Fairmount.

The Commissioner allocated income from Fairmount to Charles Town, which represented the 90 percent of net profits that had been reported by Fairmount. Charles Town contended that there was insufficient "control of both it and Fairmount by the 'same interests' to justify the Commissioner's application of section 482." Id. at 419.

Even though the brothers owned only 2% of Charles Town, the court found that they controlled Charles Town and the common ownership or control requirement of IRC 482 was met because they caused the corporation to be formed, constituted the majority of the board of directors, were principal officers of the corporation active in its management, and made all major decisions with respect to the allocation of income and expenses. Id. at 420-421.</td><td>▪ Charles Town, Inc. v. Commissioner - 372 F.2d 415 (4th Cir. 1967), aff'g T.C. Memo 1966-15, cert. denied 389 U. S. 841</td></tr>
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Detailed Explanation of the Concept (cont'd)

Common Ownership or Control Under IRC 482 - Inbound	
Analysis	**Resources**
Management Control (cont'd) In *W.L. Gore v. Commissioner*, T.C. Memo 1995-96, the U.S. taxpayer (Gore) owned 30% of a Japanese corporation. The taxpayer and Japanese corporation then entered into a 50/50 joint venture (JV) along with various intercompany agreements including royalty-free cross licenses. The IRS reallocated income pursuant to IRC 482, concluding that: ▪ The U.S. taxpayer owned more than 50% of the JV via its direct 50% ownership and its indirect 30% ownership. ▪ The U.S. taxpayer had managerial control of the use of new technology in Japan by the JV. ▪ The royalty-free cross-licensing arrangements between the JV and the taxpayer constituted an arbitrary shifting of income which indicates a presumption of control. The taxpayer filed a motion for summary judgment. Among other arguments, the taxpayer contended that there was no control because its 30% ownership of the Japanese corporation should not be taken into account, arguing that the attribution rules do not apply for purposes of IRC 482. The court denied the taxpayer's motion. While *W.L. Gore* could be viewed as a case that the Tax Court decided based on common ownership (i.e., taxpayer's 65% overall ownership interest in JV), the Tax Court also addressed common control factors such as managerial control in reaching its decision. Thus, the Tax Court in *W.L. Gore* addressed both common ownership and control for purposes of IRC 482.	▪ *Charles Town, Inc. v. Commissioner* - 372 F.2d 415 (4th Cir. 1967), *aff'g* T.C. Memo 1966-15, cert. denied 389 U. S. 841 ▪ *W.L. Gore v. Commissioner* - T.C. Memo 1995-96

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<u>Acting in Concert</u>

Another indicator of common control that courts have considered occurs when two or more entities "act in concert." Non-majority shareholders and owners can still have control over another entity if they act in concert as a majority with a common goal to shift income or expenses to or from the entity.

For example, in B. Forman Co. v. Commissioner, 453 F.2d 1144, 1155 (2d Cir. 1972), cert. denied, 407 U.S. 934 (1972), the court concluded that there was common control where two unrelated corporations equally owned (50/50) a third corporation because the owners "acted in concert" to direct its actions, and thus upheld the IRS determination imputing arm's length interest income to the two shareholders pursuant to IRC 482. The court found that the two unrelated corporations made equal interest-free loans to the third corporation, "all of whose stock they owned and all of whose directors and officers were their alter egos." Id. at 1155.

The court used a "realistic analysis" to find that the two unrelated corporations exerted control even though they had no common shareholders, directors, or officers. The court found that the two unrelated corporations acted with a common goal to shift income. Thus, the court upheld the Service's reallocations between the controlled corporation and its two corporate owners.

It is important to note that in B. Forman Co., both of the shareholders' economic and tax interests were in parallel with each other, which made the income shifting determination more obvious. However, if the two taxpayer/owners have clearly adverse interests, a finding of a common goal will be less likely. Id. at 1153.
</td><td>
▪ B. Forman Co. v. Commissioner - 453 F.2d 1144, 1155 (2d Cir. 1972), cert. denied, 407 U.S. 934 (1972)
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<tr><td><u>Acting in Concert (cont'd)</u>

Another consideration is the interdependence of the companies in question. If two corporations are examined for income shifting and the facts uncover that the two corporations are dependent on each other, then this may suggest that the two corporations have a common goal to act in concert with each other. This common goal could lead to the arbitrary shifting of income. As a result, the facts and circumstances of each case must be thoroughly examined.

In South Texas Rice Warehouse Co. v Commissioner, 43 T.C. 540 (1965) aff'd, 366 F.2d 890 (5th Cir. 1966), cert. denied, 386 U.S. 1016, 87 S.Ct. 1370, Taxpayer owned a rice-drying warehouse while Enterprises leased the warehouse from Taxpayer and operated the warehouse. Four families each owned 25% of both entities, and the only substantial difference of ownership within each family, as between the two entities, arose because two owners of Taxpayer gave their children their interests in Enterprise.

The appellate court found control to exist because of the "complete identity of control" by the four family units, and because "individuals owning 65% of Taxpayer's stock owned Enterprises." 366 F.2d at 896. The court also found both entities to be interdependent, with each requiring cooperation of the other. This case is an example of where both familial relationships and interdependence result in a finding of common control.</td><td>▪ B. Forman Co. v. Commissioner - 453 F.2d 1144, 1155 (2d Cir. 1972), cert. denied, 407 U.S. 934 (1972)
▪ South Texas Rice Warehouse Co. v Commissioner - 43 T.C. 540 (1965) aff'd, 366 F.2d 890 (5th Cir. 1966), cert. denied, 386 U.S. 1016</td></tr>
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<tr><td><u>Acting in Concert (cont'd)</u>

However, in Brittingham v. Commissioner, 66 T.C. 373 (1976), aff'd, 598 F.2d 1375 (5th Cir. 1979), the court also examined familial relations and held that common control was <u>not</u> present. Brittingham involved two brothers (the "Brothers") and their immediate families. Each Brother together with his immediate family, owned 37% of corporation D ("corp D"). Id. at 383. Each Brother usually had voting proxy for the his immediate family members. Id. at 397. The Brothers were on the Board of Directors of corp D. Id. at 384.

One brother ("Robert") was the president of corp D and controlled all the decisions of corp D, and the other brother ("Juan") was not an officer of corp D and did not hold a management position in corp D. Id.

Corp D purchased tile from C, a Mexican corporation, ("corp C") for resale in the U.S. Id. at 379. Juan, his wife, and his mother owned 100% of corp C, and Juan had total management and voting control of corp C. Id. at 397. The Service asserted that while Robert and Juan alone did not own or control the two corporations, the "family unit" of Robert, Juan, and Juan's mother "collectively owned or controlled both corporations" and constituted the "same interests" necessary for the application of IRC 482. Id.</td><td>▪ Brittingham v. Commissioner - 66 T.C. 373 (1976) aff'd, 598 F.2d 1375 (5th Cir. 1979)</td></tr>
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Detailed Explanation of the Concept (cont’d)

Common Ownership or Control Under IRC 482 - Inbound	
Analysis	**Resources**
<u>Acting in Concert (cont’d)</u> The Tax Court (whose discussion was adopted and reproduced by the appellate court) determined that corp C and corp D were owned and controlled by different related individuals and were not commonly controlled because there was no “common design” to shift income among the two businesses. *Id*. at 398. The court stated “that “Different persons with a common goal or purpose for artificially shifting income can constitute the ‘same interests’ for purposes of the statute.” *Id*. at 397-398. However, Robert and Juan, although brothers, each had his own family, and each was financially independent of the other. *Id*. at 398. Robert had no ownership in corp C and the court noted that it was not credible that Robert would shift income from a company he and his family owned 37% into a company that they did not own. *Id*. The court distinguished the fraternal relationship between Robert and Juan from the closer marital and paternal relationships in other cases. *Id*. at 399. In applying the common ownership or control tests for purposes of IRC 482, in *Brittingham* the critical facts were that: (1) neither Robert nor Juan owned a majority of D (and their fraternal relationship does not allow them to be treated as one person unlike in the case of a parent and a minor child); (2) Robert had 100% actual control over D; (3) Juan owned a majority of C; and (4) Juan had 100% actual control over C. Given these facts, neither the common ownership test nor the common control test was satisfied as required by IRC 482.	▪ *Brittingham v. Commissioner* - 66 T.C. 373 (1976) *aff’d*, 598 F.2d 1375 (5th Cir. 1979)

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<tr><td><u>Common Control re: Certain "Lease Stripping" Transactions</u>

In Chief Counsel Notice 2003-010, the Service announced a change in its litigating position concerning the application of IRC 482 to certain aspects of "lease stripping" transactions described in Notice 95-53.

Prior to the issuance of Chief Counsel Notice 2003-010, the Service had taken the position that parties to lease-stripping transactions were commonly controlled solely on the basis that the parties acted in concert pursuant to a common plan to shift income and deductions arbitrarily.

The Service no longer asserts that IRC 482 applies to treat parties to a lease-stripping transaction as commonly controlled at the time income is stripped from the lease solely on the basis that the parties acted pursuant to a common plan to shift income and deductions arbitrarily between or among themselves. See also Rev. Rul. 2003-96.

<u>Other Control Considerations</u>

In examining the indicators of control to determine whether common control can be established for purposes of IRC 482, certain limitations and timing issues should be considered.</td><td>▪ CC-2003-010 - Application of IRC 482 to Certain Aspects of Lease Stripping Transactions
▪ Notice 95-53 - Lease Stripping
▪ Rev. Rul. 2003-96 - Lease Stripping</td></tr>
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Detailed Explanation of the Concept (cont'd)

Common Ownership or Control Under IRC 482 - Inbound	
Analysis	**Resources**
Other Control Considerations (cont'd) Timing of Control In many cases, the timing of common ownership or control is not an issue because the relevant events all occurred at a single point in time. But in some cases, where relevant events occur over a period of time, then the timing of common ownership or control can be an issue. In such cases, a key question may be determining the appropriate point in time for determining whether the parties were commonly owned or controlled. For example, if a transaction occurs on a different date than when the price for that transaction was determined, then is the relevant point in time the date of the transaction or the date the price was determined? In *DHL Corp. & Subsidiaries v. Commissioner*, T.C. Memo 1998-461, *aff'd* in part and *rev'd* in part, 285 F.3d 1210, 1217 (9th Cir. 2002), the court found it appropriate to use a "transactional approach" when reviewing the substance and events of the entire transaction. Under this approach, the relevant point in time for purposes of meeting the common ownership or control test was the time of the trademark option agreement. DHL is a package delivery company located in the United States. *Id*. at 1213. DHLI is a Hong Kong based company. Independent local agents conducted DHL's international operations and paid a network fee to DHLI. From 1972 to 1992, DHL and DHLI were part of a global network in which DHL handled United States operations exclusively and DHLI handled foreign operations.	▪ *DHL Corp. & Subsidiaries v. Commissioner* - T.C. Memo 1998-461, *aff'd* in part and *rev'd* in part, 285 F.3d 1210, 1216 (9th Cir. 2002)

Detailed Explanation of the Concept (cont'd)

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Timing of Control (cont'd)

In 1974, DHL and DHLI entered into an agreement where DHL licensed the name "DHL" to DHLI through 1990. Id. at 1214.

In 1989, Japan Airlines and Nissho Iwai Corp. offered to purchase a 60% ownership stake in DHLI for $450 million and purchase the "DHL" trademark for $50 million. Id.

The parties reached a memorandum of understanding for the sale based on the $450 million value for the DHLI ownership share and the $50 million price for the trademark, "'subject to confirmation of the tax effect"' for the trademark." Id. In late 1989, Lufthansa joined Japan Airlines and Nissho Iwai Corp. (collectively, the "Consortium") to purchase DHLI. Id. at 1215.
During the course of the negotiations, different parties provided a number of different valuations for the "DHL" trademark ranging from $20 million to $200 million. Id. at 1214-1215.

DHL representatives expressed concern about the tax consequences of the sale of the trademark, and they therefore sought a lower value for the trademark. Id. at 1215. On July 9, 1990, DHL and DHLI executed an agreement granting DHLI an option to purchase the "DHL" trademark for $20 million. Id.</td><td>▪ DHL Corp. & Subsidiaries v. Commissioner - T.C. Memo 1998-461, aff'd in part and rev'd in part, 285 F.3d 1210 9th Cir. 2002)</td></tr>
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<u>Timing of Control (cont'd)</u>

On December 7, 1990, the Consortium reached agreement with DHL and DHLI to acquire: (1) a 12.5% stock interest in DHLI, with an option to purchase an additional 45% interest; (2) a 2.5% interest in DHL; and (3) an option to purchase the "DHL" trademark for $20 million. Id. at 1215. On June 7, 1992, the Consortium exercised its stock option, purchasing a majority stake in DHLI. On September 17, 1992, the Consortium, as majority owner of DHLI, caused DHLI to exercise its option to purchase the "DHL" trademark rights for $20 million.

In 1995, the Service issued a notice of deficiency to DHL making an IRC 482 adjustment based on the sale of the "DHL" trademark being undervalued. Id. at 1216. The taxpayer challenged the IRC 482 adjustment in the Tax Court. During the trial, DHL conceded that, because of overlapping stock ownership, common control existed among DHL and DHLI for all relevant times up to December 7, 1990. Id. at 1213.

Further, the Service argued that DHL and DHLI were commonly controlled until 1992. The Tax Court upheld an income allocation to DHL under IRC 482 based on a higher valuation of the "DHL" trademark than the valuation used by DHL for tax return purposes. One of the issues raised on appeal to the United States Court of Appeals for the Ninth Circuit was the appropriate time period for determining whether common control existed for purposes of IRC 482. Id. at 1217.</td><td>▪ DHL Corp. & Subsidiaries v. Commissioner - T.C. Memo 1998-461, aff'd in part and rev'd in part, 285 F.3d 1210 9th Cir. 2002)</td></tr>
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<u>Timing of Control (cont'd)</u>

As a result, common control may be measured at the date the parties arrange and agree to the transaction and not necessarily at the exact date the action contemplated by the agreement occurred (such as when the option was exercised).

The economic reality of the transaction was that the price of the trademark was established at the time DHLI obtained the option to buy it at the specified price. The ultimate purchase of the trademark at that price merely ratified the price that had been established at the earlier time. Id.

<u>Existence of Control May Be Moot with the Presence of a Third Party</u>

Another issue raised in the DHL case on appeal was whether the presence of an unrelated party in the negotiations with the two controlled taxpayers precludes an allocation under IRC 482. Id. at 1218.

DHL challenged the Service's allocation of income from DHLI to DHL by arguing that the presence of the Consortium on the other side of the negotiating table precludes a finding that income was shifted between DHL and DHLI. Id. DHL argued that unlike the usual case of two controlled taxpayers making a deal with each other, the deal in the DHL case was made between two controlled taxpayers and an entity not controlled by the taxpayers (i.e., the Consortium).</td><td>▪ DHL Corp. & Subsidiaries v. Commissioner - T.C. Memo 1998-461, aff'd in part and rev'd in part, 285 F.3d 1210 9th Cir. 2002)</td></tr>
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<u>Existence of Control May Be Moot with the Presence of a Third Party (cont'd)</u>

Further, DHL asserted that a third party's presence at the table ensures that the transaction is conducted at arm's length.

However, there was evidence that DHL and DHLI had flexibility in structuring how the trademark price would be reflected in the deal terms. Without objection from the Consortium, the trademark price was reduced from $50 million in the initial agreement to $20 million in the final agreement. This $30 million reduction was combined with other changes to the deal terms, so as to leave the deal's net value to the Consortium essentially unchanged. Id. This reduction appears to have been based on considerations of DHL's potential tax liability and post-takeover viability rather than the trademark's actual value. The Ninth Circuit held that the Consortium's presence was not sufficient to preclude an IRC 482 allocation because the Consortium was indifferent to the specific trademark price term. Id. Thus, where a third party is indifferent to the terms of the transaction affecting the allocated items, that party's involvement does not interfere with the application of IRC 482.</td><td>▪ DHL Corp. & Subsidiaries v. Commissioner - T.C. Memo 1998-461, aff'd in part and rev'd in part, 285 F.3d 1210 9th Cir. 2002)</td></tr>
</table>

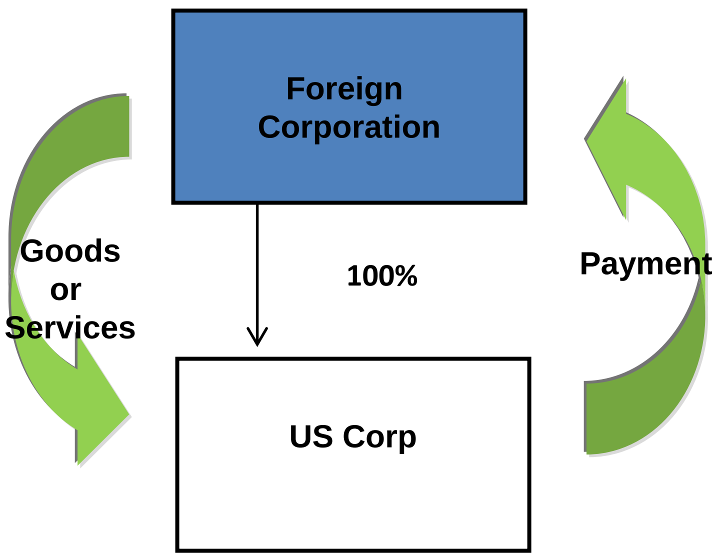
Common Ownership or Control Under IRC 482 - Inbound

Analysis	Resources
<u>Other Control Considerations (cont’d)</u> <u>Existence of Control May Be Moot with the Presence of a Third Party (cont’d)</u> The same point is made in *GAC Produce Co. v. Commissioner*, 77 T.C. Memo 1999-134. A Dole Food Co. subsidiary agreed to help market fresh produce grown and distributed by the Canelos group, a controlled group of entities. The agreement allocated the Canelos group’s income as between the Mexican growers and the U.S. distributor (GAC). *Id*. at 5-6. Dole did not care how the controlled group “internally allocated its share of the income,” so section 482 applied to that allocation despite Dole’s presence in the deal. *Id*. at 20. However, in certain cases where control clearly exists between two parties, the presence of an unrelated party may make an adjustment inappropriate because the unrelated party is not indifferent and keeps the controlled parties from shifting income. **CONSULTATION:** The Income Shifting Practice Network (PN) can provide resources to help identify control issues.	▪ *DHL Corp. & Subsidiaries v. Commissioner* - T.C. Memo 1998-461, *aff’d* in part and *rev’d* in part, 285 F.3d 1210 9th Cir. 2002) ▪ *GAC Produce Co. v. Commissioner* - 77 T.C. Memo 1999-134

Examples of the Concept

Common Ownership or Control Under IRC 482 - Inbound
Examples

Direct Ownership Example



This is an example demonstrating direct common ownership.

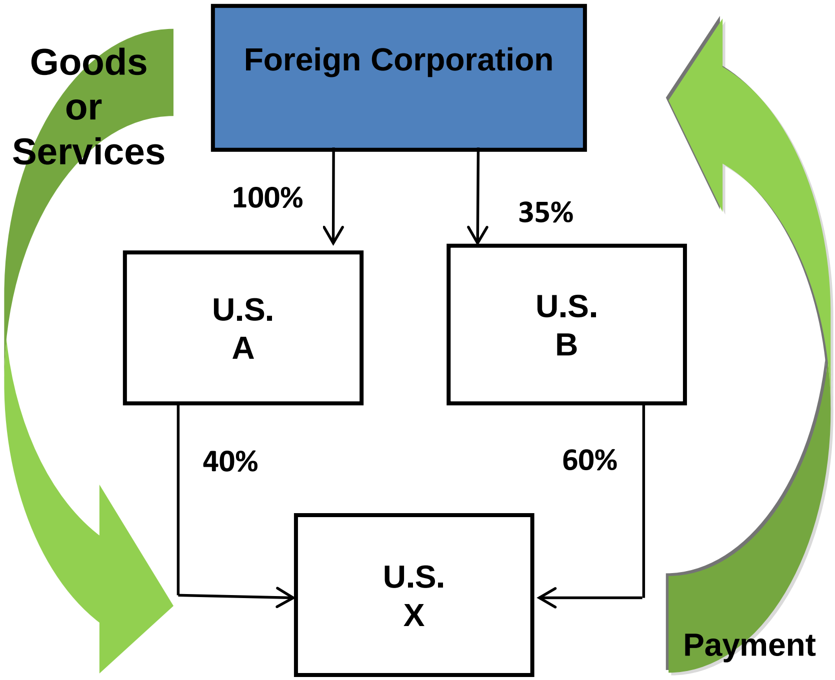
Foreign Corporation directly owns 100% of the stock of U.S. Corporation.

Examples of the Concept (cont'd)

Common Ownership or Control Under IRC 482 - Inbound

Examples

Indirect Ownership Example



This is an example demonstrating indirect possible common ownership.

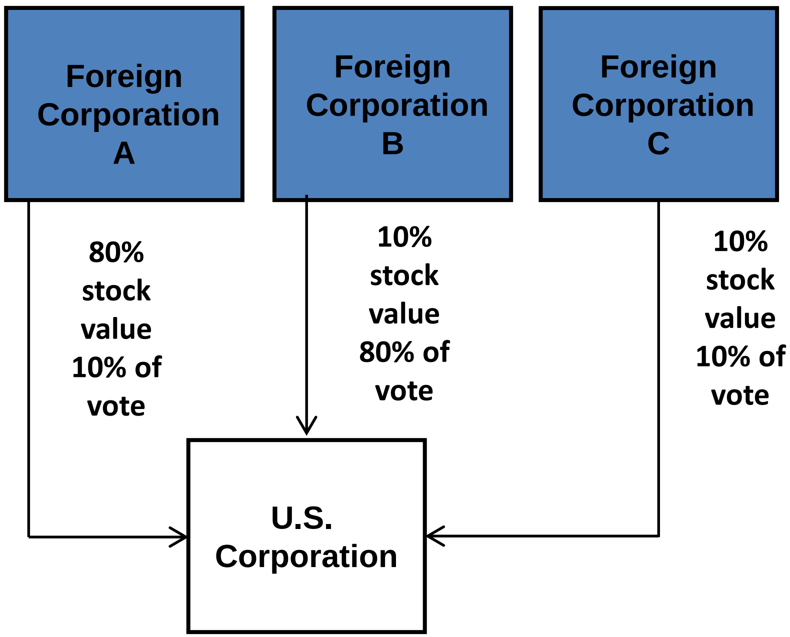
Foreign Corporation owns 100% of the stock of U.S. Corporation A and 35% of the stock of U.S. Corporation B. U.S. Corporation A owns 40% of the stock of U.S. Corporation X. U.S. Corporation B owns 60% of the stock of U.S. Corporation X. Foreign Corporation indirectly owns 61% of the stock of U.S. Corporation X. The facts and circumstances would need further development to determine if control exists.

Examples of the Concept (cont'd)

Common Ownership or Control Under IRC 482 - Inbound

Examples

Voting Control Example



This is an example demonstrating voting control. Unrelated Foreign Corporation A, Foreign Corporation B, and Foreign Corporation C all have ownership interests in U.S. Corp as follows:

	Stock %	Voting%
Foreign Corporation A	80	10
Foreign Corporation B	10	80
Foreign Corporation C	10	10

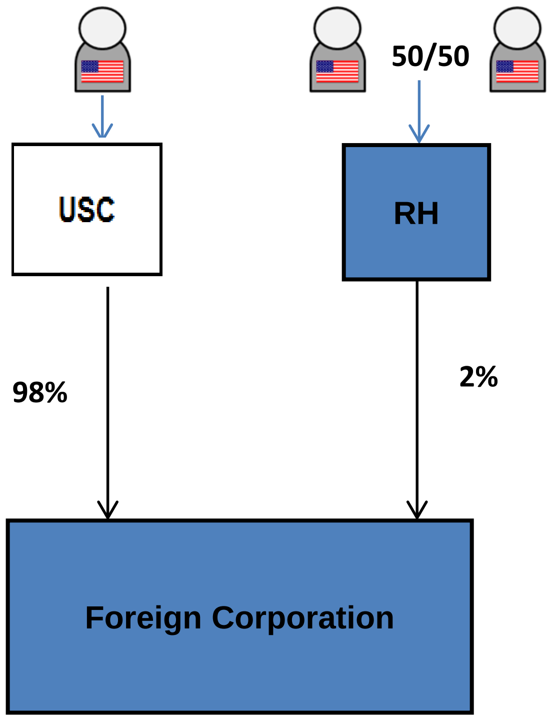
Assume U.S. Corporation's governing documents state that all material company decisions will be made by a majority vote of the shareholders of the voting stock. Foreign Corporation B clearly commonly controls U.S. Corporation. Is Foreign Corporation A simultaneously considered to commonly own U.S. Corporation? If so, what is the importance of the division of common ownership and common control between two unrelated parties?

Examples of the Concept (cont'd)

Common Ownership or Control Under IRC 482 - Inbound

Examples

Management Control Example



This is an example demonstrating management control and acting in concert. This is also an example of how control issues affect closely held privately controlled companies.

Assume two brothers, US citizens each own 50% of a foreign corporation (RH). Assume their father (US citizen) owns 100% of a US corporation (USC). Assume USC operates a retail business.

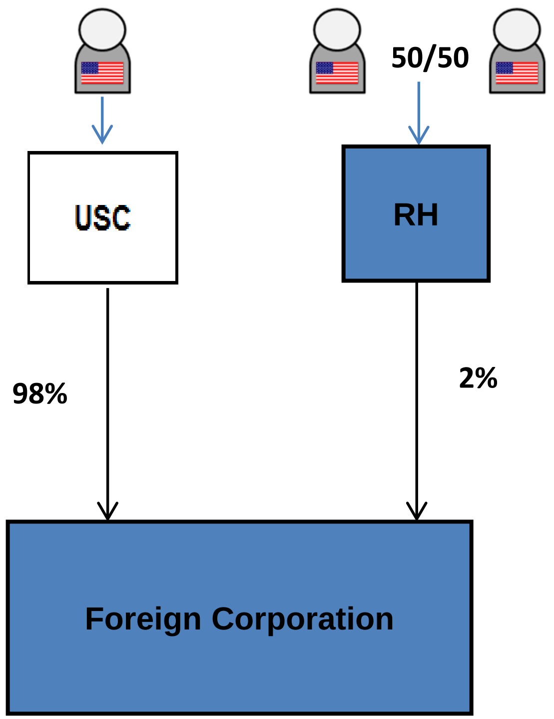
USC and RH form Foreign Corporation. USC owns 98% of the stock of Foreign Corporation and RH owns the other 2%. Foreign Corporation will be the management company for the retail business owned by USC. Foreign Corporation has a management agreement with USC that a majority of the three officers of Foreign Corporation will make all operating decisions for USC.

Examples of the Concept (cont'd)

Common Ownership or Control Under IRC 482 - Inbound

Examples

Management Control Example (cont'd)



The two brothers are the president and treasurer, respectively, as well as the directors. The father is vice president of Foreign Corporation. Therefore, the two brothers, acting in concert as a majority of the officers of Foreign Corporation, may have joint majority control over the operating decisions of Foreign Corporation as specified in the management agreement. Also, the two brothers, acting in concert as officers and directors of RH, may have joint management control over RH.

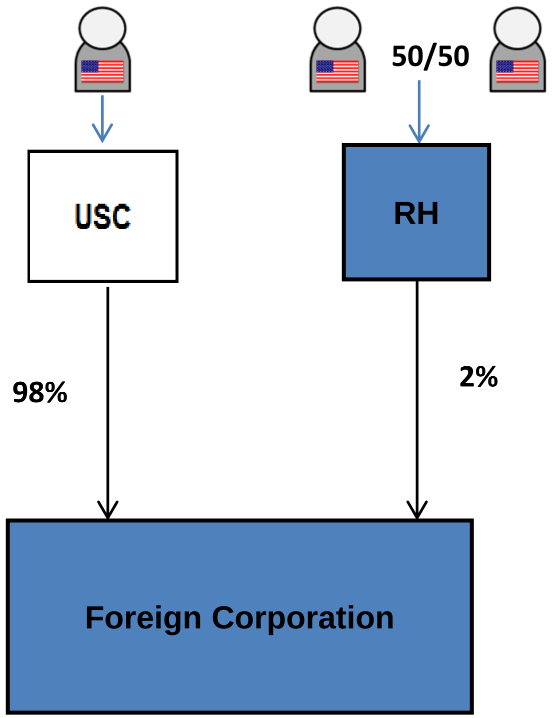
Through the management agreement the two brothers may have the ability to shift the U.S. taxable income that USC would have earned to Foreign Corporation. This might be accomplished by inflating the management fee to Foreign Corporation. This could transform the U.S. taxable income of USC to foreign income through income shifting.

Examples of the Concept (cont'd)

Common Ownership or Control Under IRC 482 - Inbound

Examples

Management Control Example (cont'd)



The brothers could possibly also approve loans from RH to USC at rates above arm's length interest rates, which would decrease USC's U.S. taxable income causing income shifting.

This shows a complicated scenario where multiple parties may lay claim to have control. The regulations do not address this type of situation. All the facts and circumstances must be gathered to make a control determination.

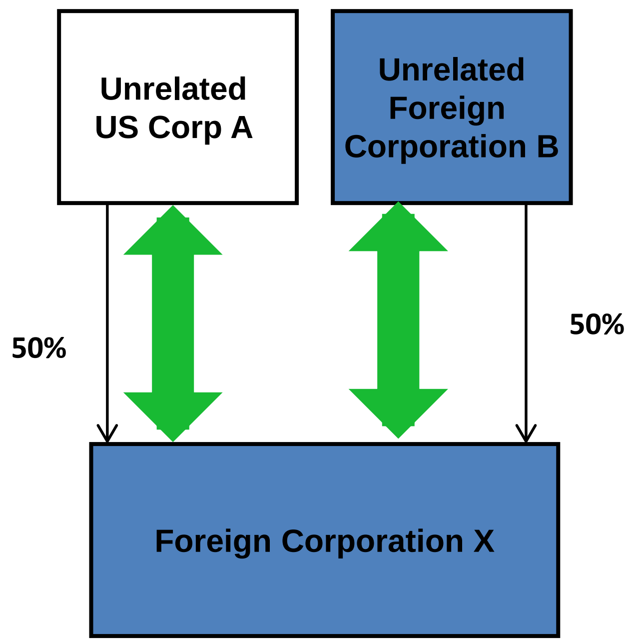
See *Charles Town, Inc. v Commissioner,* 372 F.2d 415 (4th Cir. 1967), *aff'g* T.C. Memo 1966-15, cert. denied 389 U. S. 841 for a case law example of management control.

Examples of the Concept (cont'd)

Common Ownership or Control Under IRC 482 - Inbound

Examples

Acting in Concert Example



This is an example demonstrating acting in concert.

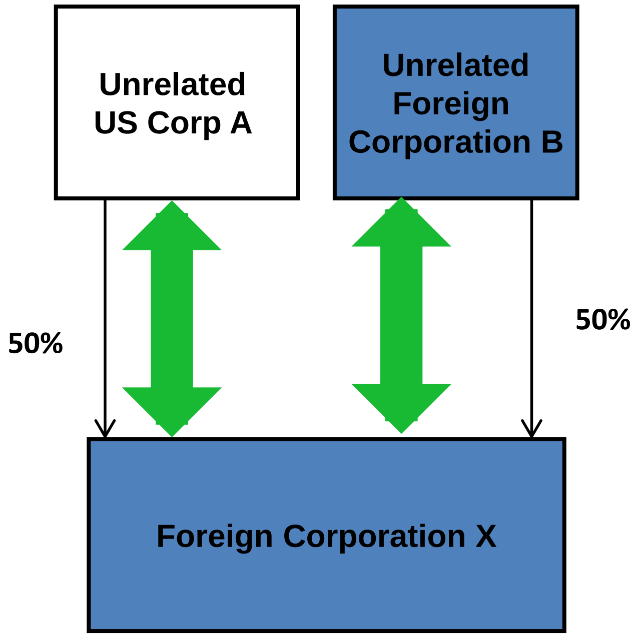
Assume US Corp A and Foreign Corporation B are unrelated and in fact competitors. The corporations share no common directors or officers and are both widely held public companies. The two corporations start a 50/50 joint venture, Foreign Corporation X. The goal of the joint venture is to increase sales by US Corp A and Foreign Corporation B. Assume that US Corp A and Foreign Corporation B each make a component part that goes into the product produced by Foreign Corporation X.

Examples of the Concept (cont'd)

Common Ownership or Control Under IRC 482 - Inbound

Examples

Acting in Concert Example (cont'd)



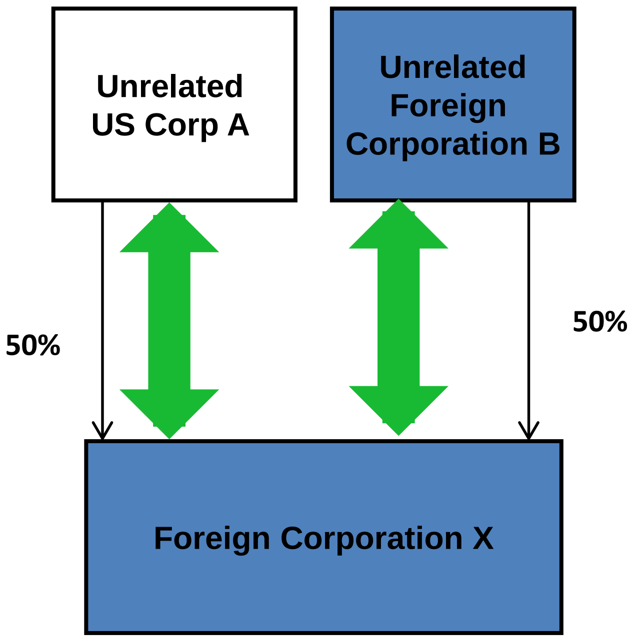
Generally, Foreign Corporation X would expect to earn a profit when it sells the manufactured product to third parties. With this structure, it is possible for USC A and Foreign Corporation B to manipulate the profits of Foreign Corporation X. This could be done through an agreed shifting of income by charging more or less than an arm's length amount for the parts that US Corp A and Foreign Corporation B sell to Foreign Corporation X.
Income shifting could also occur by having US Corp A and Foreign Corporation B loan money on non-arm's length terms to Foreign Corporation X, or by creating a non-arm's length management fee or licensing agreement.

Examples of the Concept (cont'd)

Common Ownership or Control Under IRC 482 - Inbound

Examples

Acting in Concert Example (cont'd)



An examination of all the facts is important in examining control to determine whether the parties are acting in concert to shift income. As a result, do not stop fact gathering based solely on percentage of ownership.

However, in order for control to exist for purposes of IRC 482, there must be factual evidence that US Corp A and Foreign Corporation B were motivated to act in concert with a common goal of shifting income or deductions from or to Foreign Corporation X.

Index of Referenced Resources

Common Ownership or Control Under IRC 482 - Inbound
IRC 482
Treas. Reg. 1.482-1
Notice 95-53 - Lease Stripping
Rev. Rul. 2003-96 - Lease Stripping
CC-2003-010 - Application of IRC 482 to Certain Aspects of Lease Stripping Transactions
Diefenthal v. U.S. - 367 F. Supp. 506, 511 (E.D. La. 1973)
Charles Town, Inc. v. Commissioner - 372 F.2d 415 (4th Cir. 1967) aff'g, T.C. Memo 1966-15, cert. denied 389 U. S. 841
W.L. Gore v. Commissioner - T.C. Memo 1995-96
B. Forman Co. v. Commissioner - 453 F.2d 1144, 1155 (2d Cir. 1972), cert. denied, 407 U.S. 934 (1972)
South Texas Rice Warehouse Co. v Commissioner - 43 T.C. 540 (1965) aff'd, 366 F.2d 890 (5th Cir. 1966), cert. denied, 386 U.S. 1016, (1967)
Brittingham v. Commissioner - 66 T.C. 373 (1976), aff'd 598 F.2d 1375 (5th Cir. 1979)
DHL Corp. & Subsidiaries v. Commissioner - T.C. Memo 1998-461, aff'd in part and rev'd in part, 285 F.3d 1210 (9th Cir. 2002)
GAC Produce Co. v. Commissioner - 77 T.C. Memo 1999-134

Training and Additional Resources

Common Ownership or Control Under IRC 482 - Inbound	
Type of Resource	**Description(s)**
Saba Meeting Sessions	▪ *Performing Functional Analysis* - 2012 Centra ▪ *Overview and Introduction to 482* – 2012 CENTRA ▪ *Comparable Profits Method* – 2012 CPE CENTRA ▪ *PLIs in a CPM World* - 2012 CPE CENTRA
Issue Toolkits	▪ Audit Tool - Transfer Pricing Development Tool ▪ Audit Tool - Transfer Pricing Road Map ▪ IRM 4.61.3-4 - Exhibit - *Transfer Pricing Functional Analysis Questionnaire* ▪ IRM 4.61.3 - *Development of IRC 482 Issues*
Other Training Materials	▪ *BNA Tax Management Int'l Portfolio* 890

Glossary of Terms and Acronyms

Term/Acronym	Definition
DCN	Document Control Number
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
ISI	Income Shifting Inbound
ISO	Income Shifting Outbound
JV	Joint Venture
MNE	Multinational Enterprises
PN	Practice Network
Rev. Rul.	Revenue Ruling
T.C.	Tax Court
TPO	Transfer Pricing Organization
Treas. Reg.	Treasury Regulation
UIL	Uniform Issue Listing
USC	United States Corporation

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Index of Related Practice Units

Associated UIL(s)	Related Practice Unit	DCN
9422	*Comparability Analysis for Tangible Goods Transactions Inbound*	ISO/P/01_05-01 (formerly ISI/PUO/V_6_01(2014))
9411	*Overview of IRC Section 482*	ISO/T/01-01 (formerly ISO/9411.07_01(2013))
9422	*Arm's Length Standard*	ISI/T/06-03 (formerly, ISI/9422.09_06(2013))
9422.09	*Best Method Determination for an Inbound Distributor*	ISI/T/06_07-03 (formerly, ISI/9422.09_04(2013))