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to: Nicole L. Welch
(Director, Treaty & Transfer Pricing Operations)

from: Peter H. Blessing
(Associate Chief Counsel (International))

subject: Periodic Adjustments and the Arm's Length Standard

Section 482 authorizes the IRS to allocate tax items, including income, between commonly controlled taxpayers, to clearly reflect their respective incomes. Its general purpose is to place controlled taxpayers on parity with uncontrolled taxpayers. Regulations under section 482 further elaborate on the IRS's adjustment authority and dictate how taxpayers can report transactions between entities on a timely filed initial return to clearly reflect income. This memorandum addresses the relationship between several of the regulations' provisions: the general arm's length standard ("ALS") in Treas. Reg. § 1.482-1(b)(1) and the specific periodic adjustment rules in Treas. Reg. §§ 1.482-4(f)(2) and 1.482-7(i)(6).[1] This advice may not be used or cited as precedent.

ISSUE AND SUMMARY ANALYSIS

[1] This memorandum clarifies and updates advice provided in Generic Legal Advice Memorandum AM 2007-007 (AM 2007-007), which was issued by the Office of Associate Chief Counsel, International (INTL) in 2007, as described *infra* notes 4, 9, and 45.

If the IRS makes a periodic adjustment under Treas. Reg. § 1.482-4(f)(2) or 1.482-7(i)(6)[2] with respect to high-profit-potential intangible property transferred[3] or contributed to a cost sharing arrangement ("CSA"), and none of the specific exceptions in Treas. Reg. §§ 1.482-4(f)(2)(ii) or 1.482-7(i)(6)(vi), respectively, applies, may the taxpayer nevertheless overcome the periodic adjustment by invoking the general ALS under Treas. Reg. § 1.482-1(b)(1) or the best method rule of Treas. Reg. § 1.482-1(c)?

An adjustment based on the income anticipated at the time of the transfer of an intangible to be realized after the transaction (i.e., projected profits) is just one application of the IRS's authority under section 482 to clearly reflect income attributable to controlled transactions of taxpayers. Section 482 — in particular, its commensurate with income standard — also authorizes the IRS, in appropriate circumstances, to make an adjustment to the income of the transferor of intangible property based on the income actually received by the transferee after the transfer (i.e., actual profits) by making periodic adjustments under Treas. Reg. § 1.482-4(f)(2). Similarly, in the context of cost sharing under Treas. Reg. § 1.482-7, the commensurate with income standard authorizes the IRS to make adjustments with respect to platform contribution transaction ("PCTs") payments based on actual profits by making periodic adjustments under Treas. Reg. § 1.482-7(i)(6). The commensurate with income standard, implemented through the mechanics of the periodic adjustment rules, achieves a result consistent with the general ALS.

The term "income" in the phrase "commensurate with the income attributable to the intangible" in section 482 is properly construed, consistent with its plain meaning and the legislative history of the section, to include income actually received after the transfer of an intangible, as evaluated on an ongoing basis.[4] The sentence lacks any temporal limitation[5] and refers to the "attribut[ion]" of income, which can be done most accurately as that income arises. In enacting the sentence, Congress intended that the IRS, when

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[2] For CSAs entered into before January 5, 2009 that were qualified CSAs under the provisions of the former Treas. Reg. § 1.482-7 (1995) and remained in effect on January 5, 2009, PCTs will continue to be subject to the periodic adjustment rules of Treas. Reg. § 1.482-4(f)(2) rather than Treas. Reg. § 1.482-7(i)(6) unless there has been a material change in the scope of the CSA from its scope as of January 5, 2009. *See* Treas. Reg. §§ 1.482-7(m)(2)(ii) and (m)(3).

[3] The second sentence of section 482 refers to a "transfer (or license) of intangible property." For simplicity, this memorandum refers to "transfers" of intangibles, but the analysis would be the same for any controlled transaction in which intangibles are licensed, sold, or otherwise transferred in any way. While the second sentence refers to and thus applies to transactions involving any intangible property, this memorandum concerns transactions involving high-profit-potential intangibles. Periodic adjustments are limited in scope to such transactions by virtue of the regulations' mechanics, including the threshold return ratios and the exceptions. *See infra* note 49.

[4] AM 2007-007 advised that "[t]he word 'income'" in this context "should generally be construed as operating profits attributable to the intangible the taxpayer would reasonably and conscientiously have projected at the time it entered into the controlled transaction." (Emphasis added). This memorandum clarifies that "income" in the second sentence of section 482 is not always construed in that manner, and, in the context of periodic adjustments, includes actual profits.

[5] *Compare* section 482, *with*, *e.g.*, section 1223(1) ("at the time of such exchange"), section 83(b)(1)(A) ("at the time of [the] transfer"), *and* section 864(c)(8)(C) ("at the time of the sale or exchange").

making section 482 adjustments with respect to the transfer of high-profit-potential intangible property, "consider[] … the actual profit experience realized as a consequence of the transfer."[6] It did this in part to address the IRS's inherent problem of information asymmetry vis-à-vis the taxpayer in evaluating whether the taxpayer's pricing was adequately supported by a reliable estimate of projected profits when the taxpayer originally priced the controlled transaction. Further, as Congress and the Treasury Department recognized, it is inherently difficult for any party to reliably estimate profits attributable to the unique, high-profit-potential intangible property that could be subject to periodic adjustments, because such intangibles "derive their high value from their ability to exclude comparable external transactions."[7]

Consequently, the regulations allow the IRS, in its discretion,[8] to use the actual profits from a transferred intangible or PCT in making periodic adjustments. The profit thresholds prerequisite to making such adjustments, and exceptions preventing their use in certain situations, limit their reach to high-profit-potential intangible property. The enumerated exceptions also ensure consistency with the general ALS by prohibiting periodic adjustments in specific fact patterns. If, however, none of the regulations' exceptions to periodic adjustments is satisfied, a taxpayer cannot overcome the IRS's consideration of actual profits via periodic adjustment by invoking the general ALS in Treas. Reg. § 1.482-1(b)(1).[9]

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[6] H.R. REP. NO. 99-426, at 425–26 (1985).

[7] *Coca-Cola Co. & Subs. v. Comm'r*, 155 T.C. 145, 218 (2020) (determining comparable profits method was more reliable than "direct valuation" of taxpayer's core intangible property using comparable uncontrolled transaction method).

[8] Although Treas. Reg. §§ 1.482-4(f)(2) and 1.482-7(i)(6) both allow the IRS, in its discretion, to use actual income as the basis for periodic adjustments, neither these regulatory provisions nor the commensurate with income standard allow a taxpayer to use actual income to defend its pricing upon later review by the IRS (nor, for the same reasons, do the regulations' exceptions to periodic adjustments serve as a standalone basis for a taxpayer to establish an arm's length price). The second sentence of section 482 applies only "in the case of" certain transactions subject to the first sentence, and the first sentence authorizes only the Secretary to "distribute, apportion, or allocate" tax items. *Accord* Treas. Reg. § 1.482-1(a)(3) (taxpayer-initiated section 482 adjustments limited to timely filed returns). Moreover, as discussed *infra*, the legislative history of the second sentence accords with this plain language and further evidences Congress's clear intent that the phrase "shall be commensurate with income" would empower the IRS to make adjustments based on actual results. In particular, the provision was intended to help the IRS to combat taxpayer misuse of comparables in transfer pricing to undervalue unique and high-profit intangibles. *See*, *e.g.*, *infra* note 21.

[9] AM 2007-007 advised that "consistent with [section 482's] legislative history, the regulations allow the IRS, in its discretion, provisionally to treat the income actually resulting from the transferred intangible as evidence of what should have been projected at the time of the transfer," and that "[t]he regulations then allow taxpayers the ability to rebut such presumption, e.g., by showing that such results were beyond the control of the taxpayer and could not reasonably have been anticipated at the time of the transaction." AM 2007-007's example of evidence that might rebut a periodic adjustment — unanticipated results beyond the control of the taxpayer — is an enumerated exception in the regulations. *See* Treas. Reg. § 1.482-7(i)(6)(vi)(A)*(2)*. This memorandum clarifies that, as a matter of the IRS's authority, when no

STATEMENT OF FACTS

Scenario 1: Periodic adjustment for license of intangible property

In Taxable Year 1, Taxpayer 1 licenses unique, high-profit-potential intangible property to a controlled party in exchange for a fixed annual royalty over ten years. Taxpayer 1 determines the amount of the royalty by applying the comparable uncontrolled transaction ("CUT") method under Treas. Reg. § 1.482-4(c), based on the terms of a license agreement between two unrelated parties involving a different intangible that Taxpayer 1 maintains is comparable to its licensed intangible and was licensed between the unrelated parties under circumstances comparable to that of the controlled license. Both the controlled license and the uncontrolled license involved limitations on the use of the respective intangible property, but the controlled license agreement did not limit the use of the intangible in the same way that the uncontrolled license agreement was limited.[10] In addition, the circumstances of the two licenses were different. Taxpayer 1's license remains in place through at least Taxable Year 7 with Taxpayer 1 continuing to determine the royalty amount using the same CUT method.

By Taxable Year 6, the market share of the product that the licensee manufactures and sells using the licensed intangible property has grown significantly. In an examination of Taxpayer 1's Taxable Years 6 and 7, the IRS uses the actual profits from the licensed intangible property as the basis for a periodic adjustment under Treas. Reg. § 1.482-4(f)(2) ("Periodic Adjustment 1"). Taxpayer 1 contests whether Periodic Adjustment 1 is appropriate based on the general ALS in Treas. Reg. § 1.482-1(b)(1). Specifically, Taxpayer 1 contends that its use of the CUT method overcomes the application of periodic adjustments based on actual profits.

Taxpayer 1 does not establish to the satisfaction of the IRS that Taxpayer 1 satisfied any of the exceptions to periodic adjustments under Treas. Reg. § 1.482-4(f)(2)(ii), including because (i) Taxpayer 1's CUT method was based on an uncontrolled transaction involving intangible property that was not the same as that licensed in the controlled transaction and was not transferred under substantially the same circumstances,[11] and (ii) the controlled license agreement did not limit the use of the intangible property consistently with the uncontrolled license agreement.[12] Of the methods available to the Taxpayer, Taxpayer 1's CUT method would be the best method for pricing the license in a best method analysis under Treas. Reg. § 1.482-1(c).

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enumerated exception applies, the arm's length price determined by the periodic adjustment rules is not merely presumptive evidence but is determinative. The IRS will determine in its discretion whether it is appropriate to assert periodic adjustments in a particular case.

[10] *See* Treas. Reg. § 1.482-4(f)(2)(ii)(B)*(4)*.

[11] *See* Treas. Reg. § 1.482-4(f)(2)(ii)(A).

[12] *See* Treas. Reg. § 1.482-4(f)(2)(ii)(B)*(4).*

The analysis and conclusion that follows, at the end of this memorandum, regarding Scenario 1 would be the same if, instead, only Taxpayer 1's Taxable Year 7 was examined and adjusted, and Taxpayer 1's Taxable Year 6 was, for example: (i) previously examined and closed without adjustment; (ii) previously examined and resolved by an agreement that did not cover Taxable Year 7; or (iii) not examined for this issue, and the statute of limitations on assessment precluded an adjustment to Taxable Year 6.

Scenario 2: Periodic adjustment for platform contribution

In Taxable Year 1, Taxpayer 2 enters into a CSA with another controlled participant. At the time of entry into the CSA, Taxpayer 2 has developed and contributes to the CSA resources, capabilities, or rights — including intangible property — reasonably anticipated to contribute to the intangible development activity (platform contribution) that therefore are required to be the subject of a PCT under Treas. Reg. § 1.482-7(b)(1)(ii). Taxpayer 2 prices its PCT payments using the income method under Treas. Reg. § 1.482-7(g)(4) based on projecting future profits from the cost shared intangibles reasonably anticipated to be developed under the CSA. The CSA remains in place through at least Taxable Year 7.

By Taxable Year 6, the actual profits attributable to the contributed and cost shared intangibles are significantly greater than the profits that Taxpayer 2 had projected as of the time of the PCT in Taxable Year 1. In an examination of Taxable Years 6 and 7, the IRS uses actual profits as the basis for a periodic adjustment under Treas. Reg. § 1.482-7(i)(6) ("Periodic Adjustment 2"). Taxpayer 2 contests Periodic Adjustment 2 under the general ALS in Treas. Reg. § 1.482-1(b)(1), and contends that its income method based on ex-ante projections overcomes the application of periodic adjustments because the latter is based on actual results.

Taxpayer 2 does not establish to the satisfaction of the IRS that Taxpayer 2 satisfied any of the exceptions under Treas. Reg. § 1.482-7(i)(6)(vi). In particular, the IRS determines that the exception in Treas. Reg. § 1.482-7(i)(6)(vi)(A)*(2)* ("Results not reasonably anticipated") does not apply because Taxpayer 2 has not established that the actual profits in excess of those projected both (i) were due to events beyond Taxpayer 2's control and (ii) could not reasonably have been anticipated.[13]

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[13] This exception would not be satisfied if the higher actual profits resulted from, for example, (i) a new indication, approval, or off-label use of a drug that was viewed as possible at the time the CSA was entered into; (ii) exploitation of a new market for any product; or (iii) revenues considered possible (or indicated to potential investors to be possible) by the taxpayer group but not considered sufficiently likely to be reflected in financial projections. *Accord* OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD TPGs") Appendix II to Chapter VI, ¶ 23–25 (analogous exception in OECD TPGs does not apply where drug trials are completed and commercialization begins earlier than projected, where taxpayer "cannot demonstrate" either that "its original valuation took into account the possibility" of such earlier sales nor "that such development was unforeseeable"). The exception in Treas. Reg. § 1.482-7(i)(6)(vi)(A)*(2)* would apply if, for example, the higher actual profit

The analysis and conclusion that follows regarding Scenario 2 would be the same if, instead, only Taxpayer 2's Taxable Year 7 was examined and adjusted and Taxpayer 2's Taxable Year 6 was, for example: (i) previously examined and closed without adjustment, (ii) previously examined and resolved by an agreement that did not cover Taxable Year 7, or (iii) not examined for this issue, and the statute of limitations on assessment precluded an adjustment to Taxable Year 6.

LAW AND ANALYSIS

I. Background

Section 482 provides:

> In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses. In the case of any transfer (or license) of intangible property (within the meaning of section 367(d)(4)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible. For purposes of this section, the Secretary shall require the valuation of transfers of intangible property (including intangible property transferred with other property or services) on an aggregate basis or the valuation of such a transfer on the basis of the realistic alternatives to such a transfer, if the Secretary determines that such basis is the most reliable means of valuation of such transfers.

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resulted from demand caused by an unforeseeable natural disaster's impact on a competitor. *See, e.g.*, Treas. Reg. § 1.482-7(i)(6)(vii), *Example 2*.

The direct predecessor to section 482, section 45 of the Revenue Act of 1928,[14] was substantially the same as the current first sentence of section 482.[15] Congress replaced that predecessor with section 482 in 1954.[16]

The language of section 482 — e.g., "to prevent evasion of taxes," "clearly to reflect…income," and "commensurate with the income attributable to the intangible" — grants broad authority to the Secretary to make adjustments. The Treasury Department, invoking its rulemaking authority, has articulated one way in which the IRS may exercise this authority: Treas. Reg. § 1.482-1(b)(1) (captioned "In General") provides that "the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer," and describes that standard. The ALS as described in Treas. Reg. § 1.482-1(b)(1) is generally consistent with regulatory language that has existed under section 482 and its predecessor since 1935.[17]

Since section 45's enactment, courts have collectively articulated a broad scope of the IRS's authority to make adjustments under the section. This includes adjustments to achieve an arm's length result, i.e., transfer pricing consistent with the ALS.[18] Courts have recognized the IRS's authority is broader than adjusting prices for consistency with the result of arm's length bargaining in transactions between uncontrolled parties, sometimes adjusting a transaction price to reflect a "fair price" or "reasonable return,"[19] or making adjustments to clearly reflect income more broadly.[20] In 1968, in response to a request

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[14] Pub. L. 70-562, 45 Stat. 791 (1928).

[15] In 1934, Congress revised former section 45 to include "organizations," which was intended "to remove any doubt as to the application of this section to all kinds of business activity." H.R. REP. NO. 73-704, at 24 (1934). In 1943, Congress modified former section 45 to include a reference to the allocation of "credits, or allowances" in addition to income or deductions, which was labeled as a technical amendment to conform the provision with the enactment of the predecessor to section 269. H.R. REP. NO. 78-871, at 49–50 (1943); S. REP. NO. 78-627, at 61 (1943).

[16] Internal Revenue Code of 1954, Pub. L. 83-591, 68A Stat. 3 (1954).

[17] Treas. Reg. 86, art. 45-1(b) (1935) ("The standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm's length with another uncontrolled taxpayer.").

[18] *See, e.g.*, *Altera Corp. & Subs. v. Comm'r*, 926 F.3d 1061, 1068–73 (9th Cir. 2019) (collecting cases).

[19] *See id.* at 1068–69; *see, e.g.*, *Frank v. Int'l Canadian Corp.*, 308 F.2d 520, 528–29 (9th Cir. 1962) (affirming the district court's "reasonable return" standard and finding that "[m]any decisions have been reached under § 45 without reference to the phrase 'arm's length bargaining' and without reference to Treasury Department Regulations and Rulings which state that the talismanic combination of words—'arm's length'—is the 'standard to be applied in every case.'"); *Gren. Indus., Inc. v. Comm'r*, 17 T.C. 231, 260 (1951) (emphasizing the disputed transaction's "fair price [and resulting] reasonable profit" without reference to ALS); *Polak's Frutal Works, Inc. v. Comm'r*, 21 T.C. 953, 975–76 (1954) (citing *Gren. Indus.* to look to whether "fair and reasonable prices" were charged between related parties without reference to ALS).

[20] *See, e.g.*, *Foster v. Comm'r*, 756 F.2d 1430, 1433–34 (9th Cir. 1985) (upholding allocation where a partnership transferred appreciated real property to a controlled corporation under section 351 to use the corporation's carryover losses), *aff'g in relevant part and rev'g in part* 80 T.C. 34 (1983); *Nw. Nat'l Bank of Minneapolis v. United States*, 556 F.2d 889, 890–92 (8th Cir. 1977) (upholding allocation of a

from Congress to consider regulatory responses addressing abusive transfer pricing practices,[21] the Treasury Department and the IRS issued section 482 regulations, which retained the ALS "in every case" language,[22] and added methods based on CUTs.[23]

Section 482 then remained substantively unchanged until Congress added an additional directive with the second sentence in the Tax Reform Act of 1986,[24] which provides that the income with respect to the transfer of intangible property shall be commensurate with the income attributable to the intangible.[25] Transaction-based methods prescribed in the 1968 regulations had proven unreliable and subject to abuse in valuing unique, high-profit-potential intangibles.[26] Specifically, Congress observed:

> Transfers between related parties do not involve the same risks as transfers to unrelated parties. There is thus a powerful incentive to establish a relatively low royalty without adequate provisions for adjustment as the revenues of the intangible vary. There are extreme difficulties in determining

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corporation's charitable deduction to its subsidiary, where the subsidiary distributed appreciated property as a dividend to be donated because the parent "was in a better position to enjoy the deduction"); *Cent. Cuba Sugar Co. v. Comm'r*, 198 F.2d 214 (2d Cir. 1952) (upholding section 45 allocation where a parent corporation deducted expenses related to agricultural assets it had transferred to a foreign subsidiary, while the subsidiary reported income from the assets related to those expenses), *aff'g in part and rev'g in part* 16 T.C. 882 (1952); *Nat'l Sec. Corp. v. Comm'r*, 137 F.2d 600, 600–03 (3d Cir. 1943) (upholding section 45 allocation to deny loss to subsidiary, where parent corporation transferred built-in loss property to the subsidiary, which sold it), *aff'g* 46 B.T.A. 562 (1942); *Asiatic Petrol. Co. v. Comm'r*, 79 F.2d 234, 235–36 (2d Cir. 1935) (upholding section 45 allocation where a domestic corporation sold property with built-in gain to a related foreign corporation at cost basis and the foreign corporation sold it immediately thereafter for gain), *aff'g* 31 B.T.A. 1152 (1935); *S. Bancorporation v. Comm'r*, 67 T.C. 1022, 1025–27 (1977) (upholding income allocation to a bank that had distributed appreciated bonds as a dividend to its parent corporation to obtain capital gain treatment, which, under section 582(c), is unavailable to banks for a sale or exchange of debt).

[21] H.R. REP. NO. 87-2508, at 19 (1962) (Conf. Rep.) (asking the Treasury Department to "explore the possibility of developing and promulgating regulations under [section 482] which would provide additional guidelines and formulas for the allocation of income and deductions"); *see also Altera*, 926 F.3d at 1069 (discussing *id.*).

[22] Treas. Reg. § 1.482-1(a) (1969).

[23] Treas. Reg. § 1.482-2 (1969).

[24] Tax Reform Act of 1986, Pub. L. 99-514, title XII, § 1231(e)(1), 100 Stat. 2085, 2562–63.

[25] Subsequently, in 2017, Congress added the third sentence, confirming that section 482 authorizes the Secretary to require valuation of transfers of intangible property on an aggregate basis (including with transfers of tangible property or services) or on the basis of realistic alternatives. Tax Cuts and Jobs Act of 2017, Pub. L. No. 115-97, § 14221(b)(2), 131 Stat. 2054, 2219; *see* H.R. REP. NO. 115-466, at 661–62 (2017) (Conf. Rep.) ("[The amendment] confirms the [IRS's] authority to require certain valuation methods. It does not modify the basic approach of the existing transfer pricing rules with regard to income from intangible property."). In 2018, section 482 was updated to reference section 367(d)(4) instead of section 936(h)(3)(B). Consolidated Appropriations Act, 2018, Pub. L. No. 115-141, division U, title IV, § 401(d)(1)(D)(viii)(III), 132 Stat. 348, 1207.

[26] Joint Committee on Tax'n, *Gen'l Explanation of the Tax Reform Act of 1986*, JCS-10-87, at 1014–16 (1987).

> whether the arm's length transfers between unrelated parties are comparable.[27]

To address this concern, Congress added the commensurate with income standard. In doing so, Congress "intend[ed] to make it clear that industry norms or other unrelated party transactions do not provide a safe-harbor minimum payment for related party intangibles transfers."[28] In other words, in performing a transfer pricing analysis it is neither necessary nor appropriate for the IRS to be limited to relying on ex-ante market information when that information (if it exists at all) is an unreliable means of determining an arm's length result in a particular situation. Congress instead emphasized the use of actual profits to price transfers of unique, high-profit-potential intangibles, rather than transaction-based methods, stating in particular that "the profit or income stream generated by or associated with [such] intangible property is to be given primary weight."[29]

Congress described adjustments under the commensurate with income standard as based on "actual profit experience" and not only ex-ante information:

> The committee does not intend…that the inquiry as to the appropriate compensation for the intangible be limited to the question of whether it was appropriate considering only the facts in existence at the time of the transfer. The committee intends that consideration also be given the actual profit experience realized as a consequence of the transfer*.* Thus, the committee intends to require that the payments made for the intangible be adjusted over time to reflect changes in the income attributable to the intangible.[30]

Subsequently, Congress directed the Treasury Department and the IRS to study the section 482 regulations and whether to change the regulations to conform with this statutory amendment.[31] In response, the Treasury Department and the IRS issued Notice 88-123, 1988-2 C.B. 458, which came to be known colloquially as the White Paper, and then promulgated regulations in 1994.[32] The White Paper observed that controlled

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[27] H.R. REP. NO. 99-426, at 425 (1985).

[28] *Id.*

[29] *Id.* at 425–26 (emphasis added).

[30] *Id.* (emphasis added).

[31] H.R. REP. NO. 99-841, at II-638 (1986) (Conf. Rep.) ("The conferees are also aware that many important and difficult issues under section 482 are left unresolved by this legislation. The conferees believe that a comprehensive study of intercompany pricing rules by the Internal Revenue Service should be conducted and that careful consideration should be given to whether the existing regulations could be modified in any respect.").

[32] After receiving comments on the White Paper, the Treasury Department and the IRS issued a proposed regulation. *See* Intercompany Transfer Pricing and Cost Sharing Regulations Under Section 482, 57 Fed. Reg. 3571 (Jan. 30, 1992). Subsequently, after receiving comments on the 1992 proposed regulations, the Treasury Department and the IRS issued simultaneous temporary and proposed

taxpayers often "looked solely at the purportedly limited facts" known at the time of transfers of intangible property to justify inappropriately low pricing, and that "[p]eriodic adjustments will … obviate the need for the often fruitless inquiry into the state of mind of the taxpayer and its affiliate at the outset."[33] The IRS's ability to make periodic adjustments based on actual profits helps to address the information asymmetry problem that can be especially acute in the case of intangibles, because a controlled taxpayer is intimately familiar with its own business (including the profit potential of its intangibles and in-process intangibles) and the IRS's understanding of that information is generally limited to that shared with the IRS by the taxpayer.

The White Paper "conclude[d] that the commensurate with income standard is fully consistent with the arm's length principle."[34] It described the use of actual profits to determine the arm's length price:

> [T]he enactment of the commensurate with income standard reflects the recognition that, for certain classes of intangibles (notably high profit potential intangibles for which comparables do not exist), the use of inappropriate comparables had failed to produce results consistent with the arm's length standard. Enactment of the commensurate with income standard was thus a directive to promulgate rules that would give primary weight to the income attributable to a transferred intangible in determining the proper division of that income among related parties. In the rare instance in which there is a true comparable for a high profit intangible, the royalty rate must be set on the basis of the comparable because that remains the best measure of how third parties would allocate intangible income.[35]

The 1994 regulations retained the general rule that the ALS applies "in every case," but added that "[s]ections 1.482-2 through 1.482-7 and 1.482-9 provide specific methods to be used to evaluate whether transactions between or among members of the controlled group satisfy the arm's length standard, and if they do not, to determine the arm's length result."[36] Among these "specific methods," the regulations added methods for intangibles

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regulations that replaced most of the provisions in the 1992 proposed regulations except the cost sharing rules. *See* Intercompany Transfer Pricing Regulations Under Section 482, 58 Fed. Reg. 5263 (Jan. 21, 1993) (temporary); Intercompany Transfer Pricing Regulations Under Section 482, 58 Fed. Reg. 5310 (Jan. 21, 1993) (proposed). Finally, after receiving comments on the 1993 temporary and proposed regulations, the Treasury Department and the IRS issued final regulations. *See* Intercompany Transfer Pricing Regulations Under Section 482, 59 Fed. Reg. 34971 (July 8, 1994); Section 482 Cost Sharing Regulations, 60 Fed. Reg. 65553 (December 20, 1995); *see also 3M Co. & Subs. v. Comm'r*, 160 T.C. 50, 306 (2023) (Copeland, J., concurring) ("The new regulations [i.e., the 1994 regulations], which have remained in place for over 24 years, put logical concrete parameters on the concept of 'commensurate with income' as it relates to intangibles."), *argued*, No. 23-3772 (8th Cir. Oct. 22, 2024).

[33] Notice 88-123 at 472, 477 n.173.

[34] *Id.* at 458.

[35] *Id.* at 473.

[36] Treas. Reg. § 1.482-1(b).

that did not rely on CUTs.[37] For example, the comparable profits method evaluates whether the amount charged in a controlled transaction is arm's length based on objective measures of profitability (profit level indicators) derived by uncontrolled taxpayers that engage in similar business activities under similar circumstances.[38] And the profit split method evaluates whether the allocation of the combined operating profit or loss attributable to a controlled transaction is arm's length by reference to the relative value of each controlled taxpayer's contribution to the combined operating profit or loss.[39] Notably, both the comparable profits method described in Treas. Reg. § 1.482-5 and the profit split method described in Treas. Reg. § 1.482-6 determine prices by allocating the actual profits among the parties to the controlled transaction.[40]

The 1994 regulations also provide that the IRS, in its discretion, may use the income actually attributable to the transferred intangible as the basis for periodic adjustments[41] in determining the "arm's length consideration for the transfer of an intangible."[42] And in 2005, when the Treasury Department and the IRS proposed updates to the CSA regulations under section 482, those proposed regulations included rules for periodic adjustments analogous to those already in Treas. Reg. § 1.482-4(f)(2).[43] The Treasury

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[37] *See generally* Treas. Reg. § 1.482-4. Further, the 1994 regulations impose strict comparability requirements as a predicate for applying a CUT method for intangibles under Treas. Reg. § 1.482-4(c), which address the concerns Congress expressed specifically with regard to intangibles. *See* Treas. Reg. § 1.482-4(c)(2)(iii)(A) ("the application of [the CUT] method <u>requires</u> that the controlled and uncontrolled transactions involve either <u>the same</u> intangible property or <u>comparable</u> intangible property, <u>as defined in paragraph (c)(2)(iii)(B)(1)</u> of this section [requiring intangibles to be used in connection with similar products or processes in the same general industry or market and to have similar profit potential]") (emphases added). Similarly, the White Paper had noted that "[i]n the case of a high profit intangible . . . a third party transaction <u>generally must be an exact comparable</u> in order for the transaction to constitute a valid comparable." Notice 88-123 at 478 (emphasis added).

[38] Treas. Reg. § 1.482-5(a).

[39] Treas. Reg. § 1.482-6(a).

[40] Under the comparable profits method, after an arm's length return has been allocated to the tested party, all of the actual profits net of such return are allocated to the other party. The profit split method under Treas. Reg. § 1.482-6 allocates the actual profits (whether or not net of returns for routine contributions) between the parties.

[41] *See* Treas. Reg. § 1.482-4(f)(2)(i) ("If an intangible is transferred under an arrangement that covers more than one year, the consideration charged in each taxable year may be adjusted to ensure that it is commensurate with the income attributable to the intangible."); *see also* Treas. Reg. § 1.482-4(f)(6) ("A lump sum is commensurate with income in a taxable year if the equivalent royalty amount for that taxable year is equal to an arm's length royalty. The equivalent royalty amount is subject to periodic adjustments under § 1.482-4(f)(2)(i) to the same extent as an actual royalty payment pursuant to a license agreement."). The example that follows Treas. Reg.§ 1.482-4(f)(6) describes a potential periodic adjustment despite an initial lump sum payment based on ex-ante projections, the reasonableness of which is not questioned. Treas. Reg. § 1.482-4(f)(6)(iii).

[42] Treas. Reg. § 1.482-4(a) (third sentence).

[43] *See* Section 482: Methods To Determine Taxable Income in Connection With a Cost Sharing Arrangement, 70 Fed. Reg. 51116 (Aug. 29, 2005). The NPRM states that the proposed regulations apply

Department and the IRS also included periodic adjustment rules in temporary CSA regulations issued in 2009 and final CSA regulations promulgated in 2011.[44] These final rules, found in Treas. Reg. § 1.482-7(i)(6),[45] determine "[t]he arm's length amount charged in a [CSA]."[46]

II. Analysis

In the context of controlled intangible property transactions, neither section 482 nor Treas. Reg. § 1.482-1(b)(1) limits adjustments under section 482 to arm's length results based on information contemporaneous with the controlled transaction to be priced.[47] Rather, the authority of the IRS under section 482, as interpreted by the courts and consistent with the sections's legislative history, permits a capacious ALS that extends to adjustments based on actual profits. Methods based solely on information available at the time of the transaction, including those that rely on comparable transactions, cannot be the most reliable measure of an arm's length result if they fail to account for the full value of intangibles, and comparables involving unique, high-profit-potential intangibles are

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the commensurate with income provision to frame CSAs in terms of an "investor model," by which controlled participants are viewed as making contributions to achieve an anticipated return appropriate to the risks of the CSA over the term of the development and exploitation of the intangibles resulting from the arrangement. *Id.* at 51117. Periodic adjustments may apply when the actually experienced results of the investment diverge widely from expectations at the time of the investment. *Id.* at 51118. The NPRM states that the investor model derives from the legislative history of the 1986 amendment, specifically H.R. REP. NO. 99-841, at II-638 (1986) (Conf. Rep.). *Id.* at 51117.

[44] Section 482: Methods To Determine Taxable Income in Connection With a Cost Sharing Arrangement, 74 Fed. Reg. 340 (Jan. 5, 2009); Section 482: Methods To Determine Taxable Income in Connection With a Cost Sharing Arrangement, 76 Fed. Reg. 80082 (Dec. 22, 2011).

[45] The OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD TPGs"), which are not binding on the IRS (including the Independent Office of Appeals) or courts, also contain guidance permitting the use of information about actual outcomes with respect to a transferred intangible in determining whether the price charged between controlled taxpayers is arm's length. *See generally* OECD TPGs ¶ 6.186 *et seq.* (January 2022) (special guidance for "hard-to-value intangibles (HTVI)"). The HTVI guidance, included in the TPGs since 2018, recognizes that for certain intangibles, at the time of their transfer no reliable comparables may exist and the projections of future income may be highly uncertain. *Id.* ¶ 6.189; *see also* OECD TPGs Annex II to Chapter VI at 637 ("Since hard to value intangibles are intangibles for which no reliable comparables exist, tax administrations cannot be expected to substantiate adjustments to the pricing structure by referring to uncontrolled transactions involving comparable intangibles."). In resolving transfer pricing disputes with OECD member treaty partners in the competent authority process, negotiations should take into account the section 482 regulations (including the periodic adjustment rules) as well as the OECD TPGs (including the HTVI guidance). This advice updates AM 2007-007 by reaffirming that the section 482 regulations (including the periodic adjustment rules) are consistent with the principles of the U.S.'s treaty obligations.

[46] Treas. Reg. § 1.482-7(a) (first sentence).

[47] *See Altera Corp. & Subs. v. Comm'r*, 926 F.3d 1061, 1067 (9th Cir. 2019) (upholding a section 482 adjustment based not on "a comparability analysis using comparable transactions between unrelated business entities," but "a purely internal method of allocation").

extremely rare.[48] As such, in cases involving the transfer of high-profit-potential intangible property — the kind of intangible property that would trigger a periodic adjustment[49] — the IRS may determine an arm's length result based on the contingent consideration, commensurate with the income actually realized with respect to the intangible, that would be charged at arm's length. Such an adjustment, if warranted under the regulations, would yield to a method based solely on contemporaneous information (e.g., a CUT) only in the limited circumstances prescribed in the regulations.[50]

As relevant here, section 482 — in particular, its commensurate with income standard — and the regulations thereunder authorize the IRS to achieve an arm's length result by applying periodic adjustments under Treas. Reg. §§ 1.482-4(f)(2) and (6)[51] and 1.482-7(i)(6) determined by reference to ex-post information rather than ex-ante information, except insofar as ex-ante information is relevant to the limited exceptions in those provisions. The Treasury Department and the IRS promulgated the periodic adjustment rules after Congress, as well as the Treasury Department, expressed concern about the inherent problem of information asymmetry and absence of reliable comparable transactions in evaluating whether taxpayers' pricing and forward-looking profit projections were adequately supported by information contemporaneous with the controlled transactions.[52] Based on these concerns, Congress added the commensurate

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[48] *See Coca-Cola Co. & Subs. v. Comm'r*, 155 T.C. 145, 218 (2020) (stating that unique intangibles derive value from "their ability to exclude comparable external transactions"); Notice 88-123 at 473 (describing as "rare" an "instance in which there is a true comparable for a high profit intangible").

[49] Specifically, periodic adjustments are triggered by return ratios contained in Treas. Reg. §§ 1.482-4(f)(2)(ii)(B)*(6)*, (C)*(4),* and (D)*(1)* (aggregate profits are not less than 80% nor more than 120% of the prospective profits or cost savings for purposes of various exceptions) and the parallel Periodic Return Ratio Range (PRRR) in Treas. Reg. § 1.482-7(i)(6)(ii). These ratios generally ensure the intangible property transferred or contributed is high-profit-potential intangible property. Although it is possible that factors extrinsic to the intangible property's value result in the return ratios being triggered, periodic adjustments are prevented in specifically enumerated exceptions to address this situation. *See, e.g.,* Treas. Reg. § 1.482-4(f)(2)(ii)(D) (limited exception for "extraordinary events … beyond the control of the controlled taxpayers and that could not reasonably have been anticipated at the time the controlled agreement was entered into"); Treas. Reg. § 1.482-7(i)(6)(vi)(A)*(2)* (limited exception where result "is due to extraordinary events beyond the control of the controlled participants that could not reasonably have been anticipated as of the date of the Trigger PCT"). *See generally* Treas. Reg. §§ 1.482-4(f)(2)(ii) and 1.482-7(i)(6)(vi).

[50] Treas. Reg. §§ 1.482-4(f)(2)(ii)(A)–(B), 1.482-7(i)(6)(vi)(A)*(1)*; *accord* Notice 88-123 at 473 ("In the rare instance in which there is a true comparable for a high profit intangible, the royalty rate must be set on the basis of the comparable because that remains the best measure of how third parties would allocate intangible income.") (emphases added).

[51] In general, Treas. Reg. § 1.482-4(f)(2) provides periodic adjustment rules with respect to payments for intangible property that are made over a period of time. Treas. Reg. § 1.482-4(f)(6) then explains how to adapt those rules to cases in which a single lump sum has been paid. Throughout this memo, references to Treas. Reg. § 1.482-4(f)(2) include Treas. Reg. § 1.482-4(f)(6) where the context warrants it.

[52] *See* H.R. REP. NO. 99-426, at 423–24 (1985):

with income standard in the second sentence of the statute to, "[i]n the case of any transfer (or license) of intangible property," enlarge the Secretary's allocation authority conferred in the first sentence. The term "income" in the phrase "commensurate with the income attributable to the intangible" includes income actually received by the transferee following the transfer of a high-profit-potential intangible, as evaluated on an ongoing basis.[53] Effectuating that statutory language, Treas. Reg. §§ 1.482-4(f)(2) and 1.482-7(i)(6) allow the IRS, in its discretion, to use the income actually generated by the transferred intangible as the basis for periodic adjustments. Treas. Reg. §§ 1.482-4(f)(2)(ii) and 1.482-7(i)(6)(vi) allow taxpayers to overcome periodic adjustments only in limited circumstances termed "exceptions."

Treas. Reg. § 1.482-4 recognizes that periodic adjustments made under Treas. Reg. § 1.482-4(f)(2) are necessarily consistent with the ALS. Treas. Reg. § 1.482-4(a) states that the specified and unspecified methods provided in that section must be applied consistently with all the provisions of Treas. Reg. § 1.482-1, including the best method rule of Treas. Reg. § 1.482-1(c). But this limitation does not apply to periodic adjustments.[54] Conversely, that same paragraph explicitly requires any valuation of intangibles to comply with the commensurate with income standard, a requirement that is always satisfied by periodic adjustments. Treas. Reg. § 1.482-4(a) thus clarifies that the Commissioner's authority to make periodic adjustments exists alongside the general best method rule, and periodic adjustments override the methods to the extent of a conflict.[55]

> Many observers have questioned the effectiveness of the "arm's length" approach of the regulations under section 482. A recurrent problem is the absence of comparable arm's length transactions between unrelated parties, and the inconsistent results of attempting to impose an arm's length concept in the absence of comparables.
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> The problems are particularly acute in the case of transfers of high-profit potential intangibles. Taxpayers may transfer such intangibles to foreign related corporations or to possession corporations at an early stage, for a relatively low royalty, and take the position that it was not possible at the time of the transfers to predict the subsequent success of the product. Even in the case of a proven high-profit intangible, taxpayers frequently take the position that intercompany royalty rates may appropriately be set on the basis of industry norms for transfers of much less profitable items.

See also H.R. REP. NO. 99-841, at II-638 (1986) (Conf. Rep.); Notice 88-123 at 472, 477 n.173.

[53] The first two examples in Treas. Reg. § 1.482-4(f)(2)(iii) illustrate how periodic adjustments are determined based on actual revenues regardless of whether the initial royalty rate was properly determined using a comparable profits method.

[54] The four methods listed are (1) CUT, (2) CPM, (3) the profit split method, and (4) unspecified methods. Treas. Reg. § 1.482-4(a).

[55] *Id.* ("The arm's length consideration for the transfer of an intangible determined under this section must be commensurate with the income attributable to the intangible") (emphasis added) (citing § 1.482-4(f)(2)); Treas. Reg. § 1.482-4(c)(1) ("The amount determined under this [CUT] method may be adjusted

This conclusion is not altered by Treas. Reg. § 1.482-4(f)(2)(i), which provides that "[a]djustments made pursuant to the periodic adjustment paragraph (f)(2) shall be consistent with the arm's length standard and the provisions of § 1.482-1." The constraints imposed on periodic adjustments, by limiting their use to high-profit-potential intangibles,[56] ensure that periodic adjustments do not supplant a more reliable method and are consistent with the arm's length standard.[57] In addition, Treas. Reg. § 1.482-4(a) states that "[t]he arm's length consideration … determined under this section must be commensurate with the income attributable to the intangible," and cross-references the periodic adjustment rules. When read together, this language in Treas. Reg. §§ 1.482-4(a) and (f)(2)(i) amounts to an assumption that the results under Treas. Reg. § 1.482-1 and the periodic adjustment rules will converge, which is supported by the observation that the commensurate with income standard is consistent with the ALS.[58]

That said, the specific rules of Treas. Reg. § 1.482-4(f)(2) prevail to the extent of a conflict with the more general rules of Treas. Reg. § 1.482-1.[59] To the same effect, the command that the "arm's length consideration … under [Treas. Reg. § 1.482-4] <u>must be commensurate</u> with income" articulates a quantifiable requirement and so in that context Treas. Reg. § 1.482-4(f)(2)'s statement that "periodic adjustments … <u>shall</u> be consistent with the arm's length standard and the provisions of § 1.482-1" is most naturally read to mean that because periodic adjustments are consistent with the ALS they are deemed consistent with Treas. Reg. § 1.482-1. Moreover, allowing a result based solely on the general rules of Treas. Reg. § 1.482-1 and ex-ante information to override a periodic adjustment (relying, for example, on the theory that determination of arm's length results based on ex-ante information is always preferred to determination of arm's length results based on ex-post information) would disregard the clear legislative intent to permit reference to ex-post information and nullify the specifically delineated exceptions, which identify the limited instances in which upfront pricing using comparables or other ex-ante information can overcome a periodic adjustment.[60] Those exceptions strike an

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as required by paragraph (f)(2) of this section (Periodic adjustments)."). Treas. Reg. § 1.482-4(f)(2)(i) similarly resolves any conflict between the periodic adjustment rules and the comparable analysis approach of Treas. Reg. § 1.482-1(b) in favor of periodic adjustments by describing the adjustments made pursuant to Treas. Reg. § 1.482-4(f)(2) as "consistent with the arm's length standard and the provisions of § 1.482-1."

[56] *See supra* note 49.

[57] *See* Notice 88-123 at 473 ("commensurate with income standard reflects … that, for certain classes of intangibles (notably high profit potential intangibles for which comparables do not exist), the use of inappropriate comparables had failed to produce results consistent with the arm's length standard.").

[58] *See, e.g.*, Notice 88-123 at 476.

[59] *See, e.g.*, *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 566 U.S. 639, 645 (2012) ("[I]t is a commonplace of statutory construction that the specific governs the general." (quoting *Morales v. Trans World Airlines, Inc.*, 504 U.S. 374, 384 (1992))).

[60] *See* Treas. Reg. §§ 1.482-4(f)(2)(ii) and 1.482-7(i)(6)(vi)(A). We note that such views are similar to common taxpayer assertions that the CUT method is favored over other methods and that the comparable profits method is disfavored—views that are clearly unsupported by the plain language of the regulations.

appropriate balance: they are necessary and sufficient to ensure consistency with the ALS but allow the IRS to determine an arm's length price without giving undue weight to or requiring evaluation of asserted comparables and ex-ante information—the exact problem the commensurate with income standard was enacted to address in 1986.

Treas. Reg. § 1.482-7 similarly allows the IRS to make periodic adjustments as an overlay to the transfer pricing methods or any analysis based on comparables or other ex-ante information, except in the case of the transactions identified in the exceptions.[61] The prefatory language of Treas. Reg. § 1.482-7(a) specifies that "[e]ach method must be applied in accordance with the provisions of § 1.482-1, <u>except as those provisions are modified in this section</u>." (emphasis added). The periodic adjustment rules of Treas. Reg. § 1.482-7(i)(6) are such a modification. That is why Treas. Reg. § 1.482-7(i), which provides for the various allocations the Commissioner may make to ensure the results of a controlled transaction in connection with a CSA are consistent with an arm's length result,[62] allows the Commissioner to make <u>either</u> a PCT allocation under paragraph (i)(3) <u>or</u> a periodic adjustment under paragraph (i)(6). A contention that a periodic adjustment is precluded because a PCT allocation cannot be made (based on, *inter alia*, an arm's length result analysis under one of the methods in Treas. Reg. § 1.482-7(g) or a prior resolution of the year of the PCT), would thus be contrary to the plain language of Treas. Reg. § 1.482-7(i).[63]

Therefore, in Scenario 1, Taxpayer 1 cannot overcome Periodic Adjustment 1 on the basis that its use of a CUT method overcomes periodic adjustments.[64] And in Scenario 2, Taxpayer 2 cannot overcome Periodic Adjustment 2 on the basis that its income method overcomes periodic adjustments because it relies on ex-ante projections. In both scenarios, under the facts stated above, the taxpayer's focus solely on comparables or other ex-ante information, while ignoring actual profit performance, would be contrary to the statute, would disregard the legislative intent, and would impermissibly make

[61] As under Treas. Reg. § 1.482-4(f)(2)(ii), the enumerated exceptions in Treas. Reg. § 1.482-7(i)(6)(vi) are a taxpayer's only opportunity to "demonstrate" that, notwithstanding that the periodic adjustment conditions are otherwise triggered, such an adjustment is not warranted because "its deal was nevertheless arm's length." Section 482: Methods To Determine Taxable Income in Connection With a Cost Sharing Arrangement, 70 Fed. Reg. 51116, 51129 (Aug. 29, 2005).

[62] Treas. Reg. § 1.482-7(i)(1). Treas. Reg. § 1.482-7(i)(6)(i) further states that "[i]n determining whether to make such adjustments, the Commissioner may consider whether the outcome as adjusted more reliably reflects an arm's length result under all the relevant facts and circumstances, including any information known as of the Determination Date." The Commissioner's consideration here explicitly incorporates the actual profit experience as of the Determination Date and, by design, is not required to be tethered to the purported comparables or other ex-ante information underlying the pricing as of the date of the trigger PCT.

[63] This is the context for the confirmation in Treas. Reg. § 1.482-7(g)(2)(ix)(A) that "[t]he rules provided in §1.482-1(e) and this section for determining an arm's length range shall not override the rules provided in paragraph (i)(6) of this section for periodic adjustments by the Commissioner."

[64] *See* Treas. Reg. § 1.482-4(c)(1) ("The amount determined under this [CUT] method may be adjusted as required by paragraph (f)(2) of this section (Periodic adjustments).").

surplusage of the exceptions in Treas. Reg. §§ 1.482-4(f)(2)(ii) and 1.482-7(i)(6)(vi) and, in the case of Treas. Reg. § 1.482-4(f)(2)(ii), of the provisions withdrawing those exceptions when actual profits fall outside of the prescribed range.[65] To overcome periodic adjustments, the taxpayer in each scenario must establish to the satisfaction of the IRS that it has satisfied one or more of the exceptions, which neither taxpayer did for Periodic Adjustment 1 or Periodic Adjustment 2.

III. Conclusion

In Scenario 1, under the facts set forth above, Taxpayer 1 may not overcome Periodic Adjustment 1 by invoking the general ALS as that term is used in Treas. Reg. § 1.482-1(b)(1) or contending that the transfer pricing method it selected and applied satisfies the best method rule of Treas. Reg. § 1.482-1(c).

In Scenario 2, under the facts set forth above, Taxpayer 2 may not overcome Periodic Adjustment 2 by invoking the general ALS as that term is used in Treas. Reg. § 1.482-1(b)(1) or contending that the transfer pricing method it selected and applied satisfies the best method rule of Treas. Reg. § 1.482-1(c).[66]

Please call Jacob H. Larson at (202) 317-6478 if you have any further questions.

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[65] *See*, *e.g.*, *Ark. Best Corp. v. Comm'r*, 485 U.S. 212, 218 (1988) ("we are unwilling to read § 1221 in a manner that makes surplusage of these statutory exclusions."); *15 W. 17th St. LLC v. Comm'r*, 147 T.C. 557, 586 (2016) ("When construing a statute, '[i]t is our duty 'to give effect, if possible, to every clause and word' so as to avoid rendering any part … meaningless surplusage." (quoting *United States v. Menasche*, 348 U.S. 428, 538 (1955))); *Abbott Lab'ys v. United States*, 84 Fed. Cl. 96, 106 (2008) (rejecting construction of regulation that renders a portion surplusage). Moreover, resort to the arm's length standard to override the exclusions would violate the canon that "[g]enerally a more specific provision … prevails, in the sense of making an exception to, a more general provision." *Sec. Pac. Nat'l Bank v. Resol. Tr. Corp.*, 63 F.3d 900, 904 (9th Cir. 1995).

[66] Importantly, the commensurate with income standard permits reference to actual profits in a variety of ways—not just by calculating the difference between the price paid and actual profits. The full array of ways in which the standard can impact the IRS's transfer pricing analysis and resulting adjustments is outside the scope of this memorandum.