

Section 925.—Transfer Pricing Rules

26 CFR 1.925(a)-1: Transfer pricing rules for FSCs.

T.D. 8944

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Grouping Rules for Foreign Sales Corporation Transfer Pricing

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations and amendments to temporary regulations that provide guidance to taxpayers that have made an election to be treated as a foreign sales corporation (FSC). These regulations permit the grouping of transactions for purposes of applying the administrative pricing (including marginal costing) rules to determine FSC transfer prices and provide a time for filing for the election to group transactions.

DATES: *Effective date:* These regulations are effective March 2, 2001.

Applicability: For dates of applicability, see §1.925(a)-1(c)(8)(i).

FOR FURTHER INFORMATION CONTACT: Christopher J. Bello (202) 874-1490 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On March 3, 1987, the IRS and Treasury published temporary regulations (T.D. 8126, 1987-1 C.B. 184) in the **Federal Register** (52 FR 6428) to provide (among other things) rules for grouping transactions for purposes of applying the FSC transfer pricing rules. A notice of proposed rulemaking (INTL-153-86, 1987-1 C.B. 799) cross-referencing the temporary regulations and inviting comments and requests for a public hearing was published on the same day in the

Federal Register (52 FR 6467). Written comments concerning the proposed regulations were received and a public hearing was held.

On March 3, 1998, the IRS and Treasury amended the above temporary regulations by publishing temporary regulations (T.D. 8764, 1998-1 C.B. 844) in the **Federal Register** (63 FR 10305) that (among other things) modified the time for filing the election to group transactions for purposes of applying the administrative pricing (including marginal costing) rules to determine FSC transfer prices. A notice of proposed rulemaking (REG-102144-98, 1998-1 C.B. 860) cross-referencing the temporary regulations and notice of public hearing was published on the same day in the **Federal Register** (63 FR 10351). Written comments concerning the proposed regulations were received and, on June 24, 1998, a public hearing was held.

After consideration of all the comments, certain proposed regulations relating to grouping of transactions for FSC transfer pricing are adopted as revised by this Treasury decision.

Explanation of Provisions

Section 927(d)(2)(B) of the Internal Revenue Code provides generally that FSCs and their related suppliers may, to the extent provided in regulations, elect to apply the FSC transfer pricing provisions under section 925 on the basis of groups of transactions based on product lines or recognized industry or trade usage, rather than on a transaction-by-transaction basis. Sections 1.925(a)-1T(c)(8)(i) and 1.925(b)-1T(b)(3)(i) of the temporary regulations permit taxpayers, at their annual choice, to group transactions in applying the administrative pricing (including marginal costing) rules to determine FSC transfer prices. Such grouping elections must be evidenced on a Schedule P of the FSC's timely filed (including extensions) U.S. income tax return for the taxable year. No untimely or amended returns are allowed to make a grouping election, change a grouping basis, or change from a grouping basis to a transaction-by-transaction basis (collectively "grouping redeterminations").

Section 1.925(a)-1T(c)(8)(i) of the temporary regulations also contains a transition rule that requires grouping redeterminations for any taxable year beginning before January 1, 1998, to be made no later than the due date of the FSC's timely filed (including extensions) U.S. income tax return for the FSC's first taxable year beginning after December 31, 1997 (transition rule).

Conforming changes are reflected in §§1.925(a)-1T(e)(4) and 1.925(b)-1T(b)(3)(i) of the temporary regulations.

Commentators requested that the rule limiting grouping elections to timely filed returns be removed to allow taxpayers to maximize FSC benefits and correct grouping errors. Other commentators requested that the time limit for grouping elections be replaced by a case-by-case analysis that would disallow only those grouping redeterminations that are abusive. Commentators also suggested alternative time limits that would allow taxpayers to file amended returns to reflect grouping redeterminations within a specified time limit (for example, one year from the extended due date of the original return). In response to these comments, the Treasury and the IRS have revised the time limits for filing grouping elections under §1.925(a)-1T(c)(8)(i). Accordingly, these regulations permit grouping redeterminations no later than one year after the due date of the FSC's timely filed (including extensions) U.S. income tax return for taxable years beginning after December 31, 1999. For any taxable year beginning before January 1, 2000, a grouping redetermination may be made no later than the due date of the FSC's timely filed (including extensions) U.S. income tax return for the FSC's first taxable year beginning on or after January 1, 2000.

Commentators also suggested that the transition rule be extended by two or more years to enable taxpayers to assemble data and determine the most advantageous groupings for taxable years beginning before January 1, 1998. In response, the IRS on May 17, 1999, published Notice 99-24 (1999-1 C.B. 1069). Notice 99-24 notified taxpayers that the IRS and Treasury intended to extend by one year the transition rule for such years. These

regulations provide a further extension of the transition rule time limit.

These regulations also provide an additional time period for certain taxpayers to make grouping redeterminations notwithstanding the time limits for filing grouping redeterminations otherwise specified in these regulations. In particular, a grouping redetermination may be made at any time during the one-year period commencing upon notification of the related supplier by the Internal Revenue Service of an examination, provided that both the FSC and the related supplier agree to extend their respective statutes of limitations for assessment by one year. The IRS and Treasury anticipate the IRS and taxpayers to plan and conduct examinations in a manner consistent with the foregoing provision so as to facilitate efficient and fair administration of the FSC grouping rules for transfer pricing.

Finally, these regulations provide that the requirements under §1.925(a)-1T(e)(4) with respect to redeterminations other than grouping also apply to grouping redeterminations.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the temporary regulations and notice of proposed rule-making preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Christopher J. Bello of the Office of the Associate Chief Counsel (International). Other personnel from the IRS and Treasury Department also participated in the development of these regulations.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order for section 1.925(a)-1 to read as follows:

Authority: 26 U.S.C. 7805 * * *

Section 1.925(a)-1 also issued under 26 U.S.C. 925(b)(1) and (2) and 927(d)(2)(B). * * *

Par. 2. Section 1.925(a)-1 is added to read as follows:

§1.925(a)-1 Transfer pricing rules for FSCs.

(a) through (c)(7) [Reserved] For further guidance, see §1.925(a)-1T(a) through (c)(7).

(c)(8) *Grouping transactions.* (i) The determinations under this section are to be made on a transaction-by-transaction basis. However, at the annual choice made by the related supplier if the administrative pricing methods are used, some or all of these determinations may be made on the basis of groups consisting of products or product lines. The election to group transactions shall be evidenced on Schedule P of the FSC's U.S. income tax return for the taxable year. No untimely or amended returns filed later than one year after the due date of the FSC's timely filed (including extensions) U.S. income tax return will be allowed to elect to group, to change a grouping basis, or to change from a grouping basis to a transaction-by-transaction basis (collectively "grouping redeterminations"). The rule of the previous sentence is applicable to taxable years beginning after December 31, 1999. For any taxable year beginning before January 1, 2000, a grouping redetermination may be made no later than the due date of the FSC's timely filed (including extensions) U.S. income tax return for the FSC's first taxable year beginning on or after January 1, 2000. Notwithstanding the time limits for filing grouping redeterminations otherwise specified in the previous three sentences, a grouping redetermination may be made at any time during the one-year period commencing upon notification of the related supplier by the

Internal Revenue Service of an examination, provided that both the FSC and the related supplier agree to extend their respective statutes of limitations for assessment by one year. In addition, any grouping redeterminations made under this paragraph must meet the requirements under §1.925(a)-1T(e)(4) with respect to redeterminations other than grouping. The language "or grouping of transactions" is removed from the fourth sentence of §1.925(a)-1T(e)(4), applicable to taxable years beginning after December 31, 1997. See also §1.925(b)-1T(b)(3)(i).

(c)(8)(ii) through (f) [Reserved] For further guidance, see §1.925(a)-1T(c)(8)(ii) through (f).

(g) *Effective date.* The provisions of this section apply on or after March 2, 2001.

Par. 3. Section 1.925(a)-1T is amended as follows:

1. Paragraph (c)(8)(i) is revised.

2. The last sentence of paragraph (e)(4) is removed.

The revision reads as follows:

§1.925(a)-1T Temporary regulations; transfer pricing rules for FSCs.

* * * * *

(c) * * *

(8) * * * (i) * * * [Reserved] For further guidance, see §1.925(a)-1(c)(8)(i).

§1.925(b)-1T [Amended]

Par. 4. Section 1.925(b)-1T is amended by removing the last sentence of paragraph (b)(3)(i).

Robert E. Wenzel,
Deputy Commissioner
of Internal Revenue.

Approved February 28, 2001.

Pamela F. Olson,
Acting Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on March 2, 2001, 8:45 a.m., and published in the issue of the Federal Register for March 6, 2001, 66 F.R. 13427)