

# Dreaming of Infallibility: Periodic Adjustments Under Reg. Section 1.482-4

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In this article, the authors analyze the IRS's apparent change of position on the commensurate with income statute and its implementing regulations, and they consider possible defenses for taxpayers if the IRS chooses to exercise its authority to impose periodic adjustments.

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## I. Introduction

For over three decades, the IRS has had periodic adjustment rules on the books — transfer pricing regulations that allow it to revisit transfers of intangible property and make adjustments based on the profitability of the IP. And for over three decades, those rules have been little more than a curiosity. Although the IRS regularly invokes the principle behind periodic adjustments

— the commensurate with income (CWI) standard — in other contexts, periodic adjustments themselves have seldom, if ever, been deployed.<sup>1</sup> Ultimately, the IRS developed other ways, such as the use of the comparable profits

<sup>1</sup>For discussion of the CWI standard, see Prita Subramanian and Thomas Zollo, "The Commensurate With Income Standard in Transfer Pricing," *Tax Notes Federal*, Dec. 16, 2024, p. 2149.

method, to address the challenging problem that spurred the introduction of the CWI standard: the difficulty of locating high-quality comparables for transfers of unique IP.

Avoiding periodic adjustments was good tax policy. The periodic adjustment regulations are difficult to use and present an examiner with too many opportunities to veer into arbitrariness. The very concept of periodic adjustments and the use of ex post information to price a transaction are difficult to square with the government's commitment to the arm's-length standard — a commitment reflected in both the transfer pricing regulations and U.S. tax treaties.

Presumably for this reason, the IRS long took a circumspect view of periodic adjustments. AM 2007-007, a chief counsel memo that is approaching two decades of age, espoused the view that actual ex post profit data merely supplied provisional evidence of CWI outcomes, with the taxpayer's ex ante anticipation remaining the touchstone. This position was consistent with both the legislative history of section 482 and Treasury's 1988 white paper,<sup>2</sup> which underscored that the CWI standard should operate within the arm's-length framework rather than override it.

AM 2007-007 thus sought to balance enforcement concerns with the need for ex ante certainty. About a decade later, when the OECD published guidance on hard-to-value intangibles (HTVI) in 2018,<sup>3</sup> that guidance continued in the spirit of balance, espousing the view that ex post results should only serve as presumptive — and therefore rebuttable — evidence rather than definitive proof.<sup>4</sup>

In January 2025, however, IRS chief counsel discarded these established views on the application of CWI with AM 2025-001, a memo that repudiates much of the 2007 IRS guidance (along with core principles of the OECD's HTVI guidance) and replaces it with some surprising conclusions. The gist of the memorandum is that unless one of the regulatory exceptions to

periodic adjustments applies, periodic adjustments will invariably be correct, no matter what an arm's-length analysis might show. This about-face suggests that, for the first time, periodic adjustments are coming into focus as an enforcement item.<sup>5</sup>

As we discuss below, AM 2025-001's logic is fundamentally flawed. Although it is helpful to bear in mind that AM 2025-001 amounts to no more than an explanation of the IRS's enforcement position, the renewed IRS focus comes as a reminder that the periodic adjustment regulations — and the underlying statutory language — are out there. This article provides an overview of the periodic adjustment rules under reg. section 1.482-4,<sup>6</sup> discusses a few of the memorandum's flaws, and explores what this all means for taxpayers.

## II. How to Adjust

Reg. section 1.482-4(f)(2) provides the framework for periodic adjustments in the context of transfers of IP. The regulation permits the IRS to impose ex post adjustments. It does not, however, provide any mechanism or economic framework for making these adjustments.<sup>7</sup> That is left to the IRS's discretion after it weighs "all relevant facts and circumstances throughout the period the intangible is used."<sup>8</sup> The discretion contemplated by the regulation is very broad — periodic adjustments are not foreclosed by an earlier determination that the consideration charged was arm's length. Interestingly, while three examples are provided under reg. section 1.482-4(f)(2),<sup>9</sup> they all relate to whether adjustments may be made; there is no example illustrating what an

<sup>5</sup> For discussion of the IRS's reversal of position, see Michael McDonald, "IRS Memo on CWI: Moving Away From the Arm's-Length Standard?" *Tax Notes Federal*, Mar. 24, 2025, p. 2227.

<sup>6</sup> For reasons of space, we forgo discussion of their more byzantine counterparts under reg. section 1.482-7 but note that many of the same issues (as well as other, novel ones) arise in that context.

<sup>7</sup> For a discussion of shortcomings in the regulations, see Ryan Finley, "Periodic Adjustment Enforcement May Require Clearer Guidance," *Tax Notes Federal*, Mar. 31, 2025, p. 2342 ("nothing in reg. section 1.482-4(f)(2) provides much guidance on the actual calculation of the periodic adjustment after it's been established that no exceptions apply").

<sup>8</sup> Reg. section 1.482-4(f)(2)(i). The regulation does, however, provide direction on the treatment of lump sum consideration for periodic adjustment purposes. Reg. section 1.482-4(f)(6).

<sup>9</sup> Reg. section 1.482-4(f)(2)(iii).

<sup>2</sup> Notice 88-123, 1988-2 C.B. 458.

<sup>3</sup> OECD, "Guidance for Tax Administrations on the Application of the Approach to Hard-to-Value Intangibles, BEPS Action 8" (2018). The HTVI guidance is now included in chapter 6 of OECD, "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations" (2022).

<sup>4</sup> OECD, "Transfer Pricing Guidelines," *supra* note 3, at para. 6.188.

adjustment should look like or how it should be made.

A reader of the regulation's plain language might at least draw comfort from what appears to be a limiting principle: "Adjustments made pursuant to this paragraph (f)(2) shall be consistent with the arm's length standard and the provisions of [reg.] section 1.482-1."<sup>10</sup> Broad as periodic adjustment discretion may be, this language would seem to suggest that any adjustment remains fettered by the arm's-length standard and the overarching framework imposed in reg. section 1.482-1. That interpretation makes sense against the backdrop of reg. section 1.482-4(f)(2); the otherwise complete absence of substantive guidance on how periodic adjustments should be made makes sense only if the overarching principles of reg. section 1.482-1 apply to govern these adjustments.

Not according to AM 2025-001, however, which glosses this provision as "most naturally read to mean that because periodic adjustments are consistent with the [arm's-length standard] they are *deemed consistent* with Treas. Reg. section 1.482-1" (emphasis added).<sup>11</sup> Concerningly, chief counsel seems to believe periodic adjustments are invested with some sort of infallibility: "Treas. Reg. section 1.482-4 recognizes that periodic adjustments made under Treas. Reg. section 1.482-4(f)(2) are *necessarily consistent* with the [arm's-length standard]. . . . [Reg. section 1.482-4(a)] explicitly requires any valuation of intangibles to comply with the commensurate with income standard, *a requirement that is always satisfied by periodic adjustments*" (emphasis added).<sup>12</sup>

### III. Constraints

One could be forgiven for wondering how periodic adjustments under reg. section 1.482-4 could always be consistent with the CWI standard, and thus apparently also with the arm's-length standard and the provisions of reg. section 1.482-1, when reg. section 1.482-4 provides no substantive economic guidance on how to

apply such an adjustment. At least part of the answer, according to the memorandum, lies in guardrails: "The constraints imposed on periodic adjustments, by limiting their use to high-profit-potential intangibles, ensure that periodic adjustments do not supplant a more reliable method and are consistent with the arm's length standard."<sup>13</sup>

What are those constraints? The memorandum offers:

Specifically, periodic adjustments are triggered by return ratios contained in Treas. Reg. sections 1.482-4(f)(2)(ii)(B)(6), (C)(4), and (D)(1) (aggregate profits are not less than 80 percent nor more than 120 percent of the prospective profits or cost savings for purposes of various exceptions) and the parallel Periodic Return Ratio Range (PRRR) in Treas. Reg. section 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.<sup>14</sup>

That is simply incorrect. Although the periodic adjustment mechanism for cost-sharing arrangements uses a trigger,<sup>15</sup> there is no trigger for periodic adjustments under reg. section 1.482-4. To be sure, there is a range of 80 to 120 percent of prospective profits or cost savings,<sup>16</sup> but that range is an exception, not a trigger — and crucially, it is only one component of the exceptions provided. Similarly, despite the assurance offered in the memorandum, periodic adjustments are not "prevented" in cases in which "factors extrinsic to the intangible property's value" cause profits or savings to diverge from expectations. Reg. section 1.482-4 does

<sup>10</sup> *Id.*

<sup>11</sup> AM 2025-001, at 15.

<sup>12</sup> *Id.* at 14.

<sup>13</sup> *Id.* at 15.

<sup>14</sup> *Id.* at 13, n.49.

<sup>15</sup> Reg. section 1.482-7(i)(6)(i).

<sup>16</sup> For ease of reference, we generally refer to the range as applying to profits in the following discussion.



contemplate extraordinary events,<sup>17</sup> but only as an exception to an exception.

These distinctions are significant. There will be many circumstances in which the profits realized fall within the 80 to 120 percent range and periodic adjustments can nonetheless be made under reg. section 1.482-4(f)(2)(i) because none of the exceptions in reg. section 1.482-4(f)(2)(ii) apply. By the same token, there will be many circumstances in which the profits diverge from the 80 to 120 percent range solely because of extraordinary events and yet a periodic adjustment can be made. As far as reg. section 1.482-4 is concerned, the constraints on which the memorandum rests its conclusions do not exist.

#### IV. Exceptions

In light of this confusion, a more systematic breakdown of how reg. section 1.482-4(f)(2)(ii) works may be helpful. This provision subjects periodic adjustments under reg. section 1.482-4 to three basic exceptions. First, periodic adjustments will not apply if the same intangible is licensed to a third party under substantially the same circumstances, the comparable uncontrolled transaction method is applied on this basis in the first year during which substantial consideration was paid, and an arm's-length amount (that is, an amount consistent with the application of the internal CUT method) was paid in that year.<sup>18</sup> If this exception applies, no periodic adjustments can be made in any subsequent year. The fact that reg. section 1.482-4 views a CUT with the same intangible as prevailing over periodic adjustments in all cases is difficult to square with AM 2025-001's conclusion that periodic adjustments are untrammelled by best method considerations.

Cases not involving a CUT with the same intangible are subject to evaluation under two other exceptions: one for the CUT method (that is, for CUTs other than transfers of the same IP),<sup>19</sup> and one for all other methods.<sup>20</sup> The requirements

to qualify for one of these exceptions are summarized in the table.

#### Exception Requirements

Exception for CUT Method	Exception for Other Methods
Written intercompany agreement specifying consideration (reg. section 1.482-4(f)(2)(ii)(B)(1))	Written intercompany agreement specifying consideration (reg. section 1.482-4(f)(2)(ii)(C)(1))
Arm's-length consideration in the first year substantial consideration is paid (reg. section 1.482-4(f)(2)(ii)(B)(1))	Arm's-length consideration in the first year substantial consideration is paid (reg. section 1.482-4(f)(2)(ii)(C)(2))
	Supporting documentation contemporaneous with agreement (reg. section 1.482-4(f)(2)(ii)(C)(2))
Intercompany agreement remains in effect for audit year (reg. section 1.482-4(f)(2)(ii)(B)(1))	Intercompany agreement remains in effect for audit year (reg. section 1.482-4(f)(2)(ii)(C)(1))
CUT agreement does not permit changes in consideration (except for specified, noncontingent, periodic changes), renegotiation, or termination under comparable circumstances (reg. section 1.482-4(f)(2)(ii)(B)(2))	
Substantial similarity between intercompany agreement and CUT agreement regarding the period for which they are effective (reg. section 1.482-4(f)(2)(ii)(B)(3))	
Substantial similarity between intercompany agreement and CUT agreement regarding consideration, renegotiation, and termination provisions (reg. section 1.482-4(f)(2)(ii)(B)(3))	

<sup>17</sup> Reg. section 1.482-4(f)(2)(ii)(D).

<sup>18</sup> Reg. section 1.482-4(f)(2)(ii)(A).

<sup>19</sup> Reg. section 1.482-4(f)(2)(ii)(B).

<sup>20</sup> Reg. section 1.482-4(f)(2)(ii)(C).

**Exception Requirements (Continued)**

Exception for CUT Method	Exception for Other Methods
Limitation on use of IP is consistent with industry practice and with CUT agreement (reg. section 1.482-4(f)(2)(ii)(B)(4))	
Functions performed by the controlled transferee have not substantially changed (except to the extent required by unforeseeable events) (reg. section 1.482-4(f)(2)(ii)(B)(5))	Functions performed by the controlled transferee have not substantially changed (except to the extent required by unforeseeable events) (reg. section 1.482-4(f)(2)(ii)(C)(3))
Aggregate profits realized from the IP during the audit year and all prior years are between 80 and 120 percent, inclusive of the prospective profits foreseeable at the time of the agreement, subject to the extraordinary events exception (reg. section 1.482-4(f)(2)(ii)(B)(6))	Aggregate profits realized from the IP during the audit year and all prior years are between 80 and 120 percent, inclusive of the prospective profits foreseeable at the time of the agreement, subject to the extraordinary events exception (reg. section 1.482-4(f)(2)(ii)(C)(4))

If the taxpayer meets all the requirements of either exception apart from the 80 to 120 percent range, the taxpayer may still qualify under the extraordinary events rule, which is a sort of exception to the exceptions' normal requirements. This rule provides that profits outside the set range shall not cause a taxpayer to fail to qualify if profits fell below 80 percent or above 120 percent of what was projected "due to extraordinary events that were beyond the control of the controlled taxpayers and that could not reasonably have been anticipated at the time the controlled agreement was entered into."<sup>21</sup>

While the exceptions in the table operate annually, if the taxpayer satisfies all applicable requirements for five consecutive years beginning with the first year in which substantial consideration was required, the exceptions become permanent, and no periodic adjustments can be applied in future years.<sup>22</sup> To qualify for this

permanent safe harbor, the actual results must fall within the 80 to 120 percent range for each of the five years; extraordinary events can provide protection only on an annual basis.

**V. Glossing the Exceptions**

AM 2025-001 is not simply wrong in treating the 80 to 120 percent range as a constraint sufficient to ensure that periodic adjustments under reg. section 1.482-4 are "limit[ed] . . . to high-profit-potential intangibles";<sup>23</sup> it is internally inconsistent. In the first scenario that the memorandum lays out, the taxpayer licenses IP and applies the CUT method using an uncontrolled license of comparable IP that is subject to different limitations on use than the controlled IP. In subsequent years, the market share for the product using the IP grows, and the IRS makes periodic adjustments.<sup>24</sup>

When convenient for its purposes, the memorandum casts the 80 to 120 percent requirement as a "trigger";<sup>25</sup> however, when walking through the scenario at issue, it does not. There is no mention of 80 percent, 120 percent, or any other value — simply an unquantified assertion that "the market share of the product," which will not necessarily correlate to profit or cost savings, "has grown significantly." We are told nothing about the actual profits that are experienced.

Nonetheless, in this scenario, the IRS concludes that a periodic adjustment is appropriate. The memorandum posits that while the CUT method was the best "of the methods available to the Taxpayer," the taxpayer "does not establish to the satisfaction of the IRS that [the taxpayer] satisfied any of the exceptions to periodic adjustments under Treas. Reg. section 1.482-4(f)(2)(ii), including because . . . the controlled license agreement did not limit the use of the intangible property consistently with the uncontrolled license agreement."<sup>26</sup> This time, the memorandum gets the regulation right: The 80 to 120 percent range is irrelevant unless the other

<sup>21</sup> Reg. section 1.482-4(f)(2)(ii)(D).

<sup>22</sup> Reg. section 1.482-4(f)(2)(ii)(E).

<sup>23</sup> AM 2025-001, at 15.

<sup>24</sup> *Id.* at 4-5.

<sup>25</sup> *Id.* at 13.

<sup>26</sup> *Id.* at 4.

requirements outlined above are met, including the requirement that the CUT and the controlled transaction involve consistent limitations on use. For all the importance it ascribes to constraints on the periodic adjustment power, AM 2025-001 ultimately displays an inclination to apply the exceptions of reg. section 1.482-4(f)(2)(ii) narrowly and disqualify taxpayers based on the details of their CUTs rather than any analysis of how far profits diverged from expectations and why.

This can also be seen in the handling of extraordinary events: AM 2025-001 adopts a restrictive reading of the foreseeability standard. While the regulations acknowledge that extraordinary events can justify deviations from projected results, the IRS now takes the position that “revenues considered possible . . . by the taxpayer group but not considered sufficiently likely to be reflected in financial projections” do not qualify for the extraordinary events exception.<sup>27</sup> Under the IRS’s interpretation, market shifts, regulatory changes, or economic disruptions that were considered unlikely — but not impossible — at the time of the transaction are likely to be met with skepticism.

To recap: Not only is there no direction in reg. section 1.482-4(f)(2) on how periodic adjustments should be made, but there is also no direction on when they should be made. There are only exceptions and an IRS seemingly bent on reading them as narrowly as possible.

## VI. Disputes

In AM 2007-007, the IRS endorsed the OECD transfer pricing guidelines as “wholly consistent” with the U.S. regulations<sup>28</sup> — and as noted above, when the guidelines were updated to address HTVI, they continued in the vein of consistency. Chief counsel has now reversed its position and fully embraced the use of ex post basis as definitive rather than presumptive evidence, subject to the limited exceptions the regulations provide. This has required a corresponding but subtler reversal of the IRS’s position regarding consistency with the OECD guidelines: According

to AM 2025-001, “the section 482 regulations (including the periodic adjustment rules) are consistent with the principles of the US’s treaty obligations” (but not necessarily with the OECD guidelines themselves).<sup>29</sup>

As AM 2007-007 explained, the U.S. competent authority relies on the OECD guidelines when negotiating transfer pricing cases with treaty partners: “The purpose of the Guidelines is to provide a common reference point for resolution of transfer pricing disputes between treaty partners within the context of the competent authority process.”<sup>30</sup> AM 2025-001 rather opaquely directs the U.S. competent authority to “take into account the section 482 regulations (including the periodic adjustment rules) as well as the OECD [transfer pricing guidelines] (including the HTVI guidance)” when negotiating mutual agreement procedure cases under bilateral tax treaties.<sup>31</sup> Its failure to acknowledge head-on the inconsistency that its interpretation creates between the OECD guidelines and the section 482 regulations makes this direction unhelpful.

The competent authority should continue to rely on the OECD guidelines for the reasons laid out in AM 2007-007. To do less would be to fall short of the United States’ treaty commitments — and, after all, it is important to bear in mind that the competent authority falls under the control of the IRS commissioner, not chief counsel. It is therefore hoped that the competent authority will continue to fulfill the United States’ treaty obligations and negotiate cases on the basis of the OECD guidelines, rather than insist on a novel interpretation of domestic regulations that does not accord with international consensus.

Still, difficulties may arise from other sources. The periodic adjustment rules are unusual in that the adjustment would typically fall into a year later — sometimes, much later — than that in which the transaction occurred. In many cases, intangibles have been transferred to entities that did not originally qualify for treaty relief, and even if the entity qualifies for the adjustment year,

<sup>27</sup> *Id.* at 5, n.13.

<sup>28</sup> AM 2007-007, at 13.

<sup>29</sup> AM 2025-001, at 12, n.45.

<sup>30</sup> AM 2007-007, at 3-4.

<sup>31</sup> AM 2025-001, at 12, n.45.

obtaining practicable relief may be difficult in these circumstances.

While AM 2025-001 takes the position that periodic adjustments can be applied even if taxpayers do everything correctly, there is one thing that taxpayers can do to definitively preclude periodic adjustments: obtain an advance pricing agreement that provides certainty for the transfer, license, or platform contribution transaction. While APAs typically provide coverage only for years that are formally subject to the agreement, they can also provide ongoing certainty that no periodic adjustment can be made. Rev. Proc. 2015-41, 2015-35 IRB 263, provides:

If a covered issue is the transfer of intangible property (which does not constitute a platform contribution transaction as defined in Treas. Reg. section 1.482-7(b)(1)(ii)) within the meaning of Treas. Reg. section 1.482-4, the APA may provide that such transfer will not be subject to periodic adjustments, during or after the APA term, under Treas. Reg. section 1.482-4(f)(2) or (6). If a covered issue is a platform contribution transaction, the APA may provide that such transaction will not be treated as a Trigger [platform contribution transaction] within the meaning of Treas. Reg. section 1.482-7(i)(6)(i) for purposes of making periodic adjustments, during or after the APA term, under Treas. Reg. section 1.482-7(i)(6).<sup>32</sup>

In other words, for periodic adjustments under reg. sections 1.482-4 and 1.482-7, an APA can contractually eliminate the potential for periodic adjustments for any future period. Taxpayers concerned about periodic adjustment exposure — especially in cases in which extreme profitability results are foreseeable, however unlikely they may be — should consider seeking certainty through the APA program.

<sup>32</sup> Rev. Proc. 2015-41, section 6.03.

## VII. Self-Help

The IRS's evolving position on the application of the CWI standard raises the question of whether taxpayers can invoke CWI affirmatively to support their own transfer pricing positions. Historically, the IRS has treated CWI as an enforcement mechanism, allowing it to impose upward adjustments when intangibles outperform ex ante projections without permitting taxpayer-initiated downward adjustments when they underperform. This asymmetry was evident in AM 2007-007, which sought to address it by arguing that while ex post results could serve as presumptive evidence of an arm's-length outcome, taxpayers retained the ability to rebut periodic adjustments by demonstrating that deviations from projections resulted from factors beyond their control.

AM 2025-001 departs from this framework by treating ex post results as definitive rather than presumptive evidence of an arm's-length price. Under this reasoning, the IRS views periodic adjustments as per se arm's length and not rebuttable simply because the taxpayer correctly and conscientiously selected and applied the best method. This stance fundamentally alters the balance of transfer pricing disputes because it not only undermines the taxpayer's ability to rely on the best method rule but also raises the question of whether taxpayers should be afforded reciprocal treatment when ex post results diverge in their favor.

If periodic adjustments are inherently arm's length, as AM 2025-001 asserts, the logical corollary is that downward adjustments are equally valid in cases in which an intangible generates lower-than-expected returns. A taxpayer that transfers an intangible to a foreign affiliate under an arrangement governed by reg. section 1.482-4(f)(2) might wish to argue that if ex post data justify upward adjustments, they must also justify downward adjustments when actual profits fall below projections.

### A. True-Ups

Taxpayers entering into agreements governing the transfer or license of IP can include in those agreements a true-up mechanism, but they should be cautious when evaluating whether it would be helpful to do so. Including a true-up



mechanism allows the taxpayer to benefit from downward adjustments if projected revenues fail to materialize. However, to reflect arm's-length behavior, the true-up mechanism would generally be expected to operate in both directions, and to be invoked by either party when it is in that party's interest to do so. Thus, taxpayers that include such a provision in their agreements should monitor how their actual results differ from their projections and be prepared to make periodic adjustments, when warranted, in either direction.

If a taxpayer's agreement contains a true-up mechanism, the IRS could assert a true-up adjustment without invoking its periodic adjustment authority as such, on the grounds that at arm's length a taxpayer that has a contractual entitlement to a favorable price alteration would be expected to act on that entitlement. This distinction is important: If the IRS were to pursue a contractual true-up adjustment, it might not be bound by the regulatory exceptions to periodic adjustments. Taxpayers should therefore think carefully about whether to adopt true-up mechanisms and how to design them.

Taxpayers contemplating true-up mechanisms should also carefully consider the contours of reg. section 1.482-4(f)(2)(ii)(B)'s CUT exception to periodic adjustments. Any true-up provision in the contract between the related parties must be substantially similar to the true-up provision (if any) in the CUT,<sup>33</sup> and the CUT's true-up provision (if any) must be inapplicable under circumstances comparable to those of the taxpayer seeking the shelter of the exception. To the extent that the taxpayer relies on a CUT based on comparable IP, including a meaningful true-up provision in the controlled agreement might preclude the taxpayer from successfully invoking the exception. Because periodic adjustments are not restricted to cases in which results fall outside the 80 to 120 percent range, taxpayers that apply a CUT analysis and wish to include a true-up mechanism in the controlled agreement should carefully consider what divergence from expected

results should qualify for a true-up and design the mechanism accordingly.

On the other hand, when applying a method other than the CUT, the presence or absence of a true-up provision in the controlled agreement is irrelevant to qualification for the exception. Taxpayers applying non-CUT methods may therefore wish to include true-up mechanisms that kick in only at the 80 and 120 percent thresholds specified in the regulation — and taxpayers may, to the extent consistent with the arm's-length principle, wish to limit any such mechanism to the first five years of the agreement. The 80 to 120 percent safe harbor is framed in terms of "the total profits actually earned or the total cost savings realized," which would include profits or costs realized through the operation of a true-up mechanism during the year at issue.<sup>34</sup> In situations in which a method other than the CUT is the best method, a well-crafted true-up mechanism can therefore preclude periodic adjustments for future years by triggering the five-year safe harbor in reg. section 1.482-4(f)(2)(ii)(E).

## B. Amended Returns

Reg. section 1.482-1(a)(3), which provides that taxpayers cannot use untimely or amended returns to report transfer pricing adjustments decreasing U.S. taxable income, prevents a taxpayer from making CWI adjustments for prior years. In general, this rule makes sense; after all, the first sentence of section 482 speaks solely in terms of when the IRS may make adjustments.

Yet the second sentence is framed not as a grant of enforcement authority to the IRS, but rather as a statement of general applicability: "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." In a different context, four Tax Court judges have indicated a willingness to interpret this sentence

<sup>33</sup> Reg. section 1.482-4(f)(2)(ii)(B)(3).

<sup>34</sup> Reg. section 1.482-4(f)(2)(ii)(C)(4).

as imposing an affirmative requirement independent of the section 482 regulations.<sup>35</sup> “Shall be” is a command that is not directed exclusively at the IRS.<sup>36</sup>

The friction this creates with reg. section 1.482-1(a)(3) is detectible in AM 2007-007. There, the IRS laid out clearly its position that taxpayers cannot affirmatively make CWI adjustments, but it grounded that position in the broader view that periodic adjustments were subject to the arm’s-length standard and thus avoidable by a taxpayer that correctly priced its transaction at the outset: “A taxpayer may achieve CWI results through the structure, risk allocation, and fixed or contingent form of payment that it adopts upfront for its controlled transaction, so long as that comports with economic substance.”<sup>37</sup>

AM 2025-001 abandoned the underpinnings of the 2007 position, and its own attempt to reconcile reg. section 1.482-1(a)(3) with its expansive view of ex post results rings false. First, the memo seeks to read into the second sentence of section 482 language that Congress did not provide: “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.”<sup>38</sup> While transfers and licenses of IP are indeed subject to both sentences, nothing on the face of the second sentence imports the limitations of the first.

The memorandum also points to legislative history indicating a desire to authorize the IRS to make CWI adjustments,<sup>39</sup> but that history does nothing to preclude the taxpayer from making adjustments. Indeed, the history suggests something quite different: While the House had

originally drafted the CWI amendment as applicable only to outbound transfers,<sup>40</sup> the conference committee took issue with and deleted this limitation. In doing so, it espoused a different, and broader, purpose for the provision:

The concerns addressed in the House bill originated in connection with transfers of intangibles from U.S. parties to foreign affiliates, particularly those operating in low-tax foreign countries. Consequently, the provisions of the House bill only were applied to transfers of intangibles from U.S. persons to their foreign affiliates. In view of the fact that *the objective of these provisions — that the division of income between related parties reasonably reflect the relative economic activity undertaken by each — applies equally to inbound transfers*, the conferees concluded that it would be appropriate for these principles to apply to transfers between related parties generally if income must otherwise be taken into account. [Emphasis added.]<sup>41</sup>

In short, AM 2025-001 gets it wrong for the reasons outlined above. The better view of periodic adjustments is the one taken in AM 2007-007 and more easily reconciled with reg. section 1.482-1(a)(3). But the difficulty of squaring the new IRS position with this regulation makes the position all the more surprising. Preventing taxpayers’ affirmative use of CWI to make otherwise barred adjustments has long been an important IRS priority — and in taking the aggressive position laid out in AM 2025-001, the IRS may have weakened its own hand.

### C. Economic Analysis

It is important not to lose sight of the fact that section 482 only provides that the income with respect to the transferred IP be commensurate with the income *attributable to the IP*. Reg. section 1.482-4 provides no guidance at all on how to determine what is CWI, thereby ceding an

<sup>35</sup> 3M Co. v. Commissioner, 160 T.C. 50, 304-309 (2023) (Copeland, J., concurring in the result, joined by Kerrian, Gale, and Paris, JJ.) (“In my view, the result of this case is dictated by the plain text of section 482. . . . The Court views the IRS’s allocation . . . as ‘consistent with the 1986 statutory amendment’ and ‘supported by the language of the 1986 amendment.’ Such allocation is in fact required by the amended statute, with or without the clarifications of Treasury Regulation section 1.482-1(h)(2).”).

<sup>36</sup> Cf. *id.* at 307-308 (Copeland, J., concurring in the result) (quoting the second sentence of section 482 and adding emphasis to the words “shall be”).

<sup>37</sup> AM 2007-007, at 9.

<sup>38</sup> AM 2025-001, at 3, n.8.

<sup>39</sup> *Id.*

<sup>40</sup> See H.R. Rep. No. 99-426, at 425 (“The basic requirement of the bill is that payments with respect to intangibles that a U.S. person transfers to a related foreign corporation or possessions corporation must be commensurate with the income attributable to the intangible.”).

<sup>41</sup> H.R. Rep. No. 99-841, at II-638 (Conf. Rep.).

opportunity to taxpayers to establish this through economic analysis. While an IRS examination team can always conduct its own analysis, a taxpayer that can affirmatively explain why its reported results are consistent with the CWI standard may forestall or cut short examination of the issue.

In a typical income method or discounted cash flow analysis, the transferee's projected profits are split between the contributions expected to be made by the transferee (for example, ongoing development and sales and marketing activities) and the value of the IP that was transferred. Depending on how the transferee's projected contributions are measured, even if actual results are higher than projections, it will often be the case that some of that increase should be attributed to the transferee (that is, assuming that the transferee is performing value-added functions such as developing the market, it should be entitled to some of the upside if profits do end up higher than expected). Creating a robust factual and economic analysis before an IRS audit can allow the taxpayer to reliably quantify how the difference between actuals and projections should be allocated.

### VIII. Conclusion

Even as an announcement of the IRS's litigating position, AM 2025-001 makes little sense. If the IRS wishes to pursue periodic

adjustments in earnest, it would do better to issue guidance that provides, well, guidance. Reg. section 1.482-4(f)(2) gives an examiner a single piece of substantive economic direction for making periodic adjustments: They "shall be consistent with the arm's length standard and the provisions of section 1.482-1." By recasting that limiting principle as a cloak of infallibility, AM 2025-001 leaves an examiner with nothing whatsoever by way of guidance. That is hardly a recipe for adjustments that can withstand judicial scrutiny. The difficulty of squaring AM 2025-001 with section 482, the regulations thereunder, and the interests of sound tax administration gives the IRS ideal reasons to withdraw the memorandum.<sup>42</sup> An advice memorandum that provided real economic advice would have better served both the IRS and the taxpayer community.<sup>43</sup> ■

<sup>42</sup> See Notice 2025-19, 2025-17 IRB 1418; and Executive Order 14219 (Feb. 19, 2025).

<sup>43</sup> The information in this article is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the authors only and does not necessarily represent the views or professional advice of KPMG LLP. KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee.