taxnotes® federal

Volume 188, Number 4 ■ July 28, 2025

All In: The IRS's High-Stakes Bet on Periodic Adjustments

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Reprinted from *Tax Notes Federal*, July 28, 2025, p. 561

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In this article, Stevens and Armitage critique Treasury regulations and IRS guidance governing periodic adjustments to the pricing of transfers of intangible property, and they analyze ways for controlled taxpayers to adapt to and mitigate the risk of such adjustments.

The IRS has doubled down on the periodic adjustments rules in U.S. transfer pricing regulations. Generic Legal Advice Memorandum 2025-001 (GLAM), released January 17, 2025, adopts a muscular approach to application of periodic adjustments and likely heralds the next big wave of transfer pricing litigation.[1]

Congress enacted the commensurate with income (CWI) standard in 1986. In a 1988 white paper, Treasury and the IRS concluded that the CWI standard affords the IRS the power to make transfer pricing adjustments based on ex post results, even if the transaction was originally priced at arm's length.[2] The section 482 regulations authorize such periodic adjustments to transfers of intangible property, including for platform contribution transactions (PCTs) in connection with cost-sharing arrangements (CSAs), without regard to either the statute of limitations or the form of the transaction. The GLAM goes a step further, asserting that the periodic adjustments rules trump the arm's-length standard of section 482.

In the authors' view, the IRS has gone all in on a losing bet. Like the periodic adjustments regulations themselves, the GLAM rests upon a questionable interpretation of the statute and its legislative history. Nothing in the text or legislative history of section 482 suggests Congress intended for CWI to toll the limitations period, to allow the IRS to ignore arm's-length pricing when actual results differ from expected results, or to authorize recasting the form of transactions having economic substance. Further, in the wake of the Supreme Court decision in *Loper Bright Enterprises Inc. v. Raimondo*, which provides for less judicial deference to agency action, the IRS has raised the stakes when the odds have moved against it.[3] Finally, Congress's 2017 adoption of the third sentence of section 482 arguably precludes periodic adjustments when such adjustments would be inconsistent with the "realistic alternatives" of the taxpayers that are party to the transaction.

In this article the authors review the legislative history of periodic adjustments and promulgation

[1] IRS, AM 2025-001.

[2] IRS, Notice 88-123, 1988-2 C.B. 458.

[3] *Loper Bright Enterprises Inc. v. Raimondo*, 603 U.S. 369 (2024).

of the periodic adjustments regulations, discuss the GLAM's interpretation of the law, and identify shortcomings of the IRS's positions. We also identify practices controlled taxpayers might adopt to mitigate the risk of periodic adjustments.

Authority for Periodic Adjustments

The second sentence of section 482 provides: "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."[4]

Treasury and the IRS view this sentence as evidence of congressional intent that income from an intangibles transfer must reflect the "actual profit experience realized as a consequence of the transfer."[5] The "periodic adjustments" provisions of reg. sections 1.482-4 and -7 rely on that predicate. The regulations authorize the IRS to adjust income from controlled transfers of high-value intangibles, including PCTs, for tax years after the year of the transfer. Additionally, adjustments may be based on intangibles' actual, realized profitability in those later years.[6]

Legislative History

The CWI standard was added in 1986 to both sections 482 and 367(d) to address transfers of intangible property to foreign corporations. Congress expressed concern that taxpayers were using inappropriate comparables to price United States-to-foreign transfers of early-stage intangibles, resulting in inappropriate shifts of future profits offshore.[7] Congress observed that controlled taxpayers had a "powerful incentive" to establish low, fixed royalty rates and thereby achieve substantial deferral of U.S. taxes.[8] Congress said that taxpayers had been inappropriately relying on uncontrolled comparable transactions that involved risks not present in related party transfers, resulting in artificially low "safe harbor" pricing.[9]

Going forward, instead of limiting the transfer pricing inquiry to "facts in existence at the time of the transfer," the CWI standard would allow the IRS to consider "the actual profit experience realized as a consequence of the transfer."[10] More specifically, Congress intended "to require that the payments made for the intangible be adjusted over time to reflect changes in the income attributable to the intangible."[11]

Before 1986 Treasury and the IRS interpreted the first and original sentence of section 482, which allows the IRS to adjust pricing for controlled transactions "clearly to reflect . . . income," as contemplating "tax parity" between controlled taxpayers and uncontrolled taxpayers. Consideration of actual profits — information not available to the parties when they agreed to the transfer's terms — is plainly in tension with that standard.

When it enacted CWI, Congress did not explain whether it intended for CWI to serve as an alternative to the arm's-length standard or as a necessary and reconcilable extension of it. Further, neither the text of section 482 nor its legislative history authorizes the IRS to restructure a taxpayer's actual transaction. The legislative history discusses periodic adjustments in the context of royalty transactions, and Congress did not indicate that lump sum transactions could be recharacterized as royalty arrangements. Section 367(d), in contrast, expressly provides for recharacterizing a lump sum or other transfer of intangible property to a foreign corporation as a sale for a stream of contingent payments commensurate with the income attributable to the property over its useful

[4] IRC section 482.

[5] Notice 88-123, *supra* note 2 at 477 (citing H. Rep. 99-426).

[6] Reg. sections 1.482-4(f)(2) and 1.482-7(i)(6).

[7] *See* H. Rep. 99-426, at 425-426 (Oct. 22, 1986). Before 2017, deferral of U.S. tax on the profits of foreign subsidiaries was the norm, so the shift of valuable intangibles offshore at a discount produced far more significant erosion of the U.S. tax base than it would under the current GILTI regime.

[8] *See id.* at 425. *See also supra* note 2 at 477 (characterizing the CWI standard as in part a rejection of *R. T. French Co. v. Commissioner*, 60 T.C. 836, 837 (1973), which held that a long-term, fixed rate royalty agreement could not be adjusted under section 482 based on subsequent events that were not known to the parties at the original contract date).

[9] H. Rep. 99-426, *supra* note 7 at 425.

[10] *Id.*

[11] *Id.* at 425-426.

life.[12] Also, neither the text of section 482 nor the committee report expressly authorizes adjustments, regardless of the limitations period on assessment. These conceptual points, all of which are part of the IRS's contemporary position on periodic adjustments, instead emerged from the Treasury Department study commonly known as the white paper.[13]

The White Paper

Published in 1988, the white paper expresses the IRS and Treasury's view of the events that led to CWI's enactment and explores the underlying economic theories of section 482.[14] It concludes that CWI "is fully consistent with the arm's length principle"[15] and interprets CWI as authorizing periodic adjustments notwithstanding the statute of limitations.[16] The white paper reiterates Congress's concern about the lack of appropriate comparables for transfers of high-profit-potential intangibles.[17] It follows that CWI was intended to provide guidance for how to determine an arm's-length price when no reliable comparables are available.[18] In such cases the CWI standard would apply, and the section 482 analysis would use the amount of income derived from the transferred intangible as a starting point, giving it "primary weight."[19]

The white paper then seeks to reconcile CWI with the arm's-length standard, beginning with the 1979 OECD report on transfer pricing.[20] The white paper observes that the OECD report does not deem profits of related enterprises irrelevant when determining an arm's-length price, and it even refers to methods that look to comparable profits or returns on capital invested — that is, the transactional net margin method — as potentially appropriate ways to determine a transfer price for tangible goods.[21] It further notes the OECD report's allusion to the use of profit-based methods incorporating multiyear data when valuing transfers of intangible property.[22] The white paper reasons that, if consideration of multiyear data (necessarily including ex post information) is permissible, such an approach must not conflict with the arm's-length standard.[23]

Having laid this foundation, the white paper explains that periodic adjustments are the appropriate method for implementing CWI: "the commensurate with income language requires that changes be made to the transfer payments to reflect substantial changes in the income stream attributable to the intangible."[24] According to the white paper, uncontrolled parties often include mechanisms in their contracts for the transfer of intangible property that allow for renegotiation if the intangible property is more or less profitable than initially anticipated.[25] Indeed, the white paper claims — based on a review of 60 license agreements on file with the SEC — that such renegotiations occur even in the absence of

[12]IRC section 367(d)(1) and (d)(2) ("[I]f a United States person transfers any intangible property to a foreign corporation in an exchange described in section 351 or 361," then "the United States person transferring such property shall be treated as —

(i) having sold such property in exchange for payments which are contingent upon the productivity, use, or disposition of such property, and

(ii) receiving amounts which reasonably reflect the amounts which would have been received . . .

(I) annually in the form of such payments over the useful life of such property, or

(II) in the case of a disposition following such transfer (whether direct or indirect), at the time of the disposition.

The amounts taken into account under clause (ii) shall be commensurate with the income attributable to the intangible.").

[13]Notice 88-123, *supra* note 2, at 458. Congress requested the white paper. H. Rep. 99-841, at II-638 (Oct. 22, 1986) ("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.").

[14]Notice 88-123, *supra* note 2 at 458.

[15]*Id.*

[16]*Id.* at 479.

[17]*Id.* at 472.

[18]*Id.*

[19]*Id.*

[20]*Id.* at 476.

[21]*Id.* (citing OECD Committee on Fiscal Affairs, "Transfer Pricing and Multinational Enterprises" (1979)).

[22]*Id.*

[23]*Id.*

[24]*Id.* at 477 (internal quotations omitted).

[25]*Id.*

explicit contractual provisions.[26] Because periodic adjustments have the same effect as renegotiation, and such renegotiations occur at arm's length, the white paper reasons that CWI must be consistent with the arm's-length standard.[27]

Turning to the recharacterization of transactions, the white paper posits two potential methods for applying the CWI standard to lump sum payments made in the event of a sale: (1) recharacterize the sale as a license, or (2) recognize the transfer as a sale but make necessary allocations to increase the initial payment.[28] In contemplating the first option, the authors acknowledge that "parties dealing at arm's length occasionally sell intangibles. Thus, failure to recognize sale arrangements between related parties could be viewed as a deviation from the arm's length standard."[29] If the second option were adopted, the statute of limitations could apply to thwart periodic adjustments and congressional intent.[30] Keeping the statute of limitations open, however, would delay the closing of audits.[31] The white paper accordingly recommends treating a lump sum sale as an open transaction that is viewed by the IRS as a prepayment of the "commensurate with income amounts."[32] It points to no authority for such treatment.

Treasury Regulations

Reg. sections 1.482-4 and -7 were issued in 1994 and 2009, respectively, and generally follow the white paper.[33] The regulations authorize periodic adjustments to prices charged for the transfer of an intangible in an agreement that lasts more than one year to ensure the consideration is commensurate with the income attributable to the intangible.[34] In the cost-sharing context, the IRS may make periodic adjustments to platform contribution payments when the platform contribution payer realizes a return ratio that is outside a range defined by the parties' original projections.[35] In all cases, adjustments to open tax years may be computed to address deficiencies in previous — potentially closed — tax years so that the entire transaction reflects the CWI standard.[36]

The regulations expressly authorize periodic adjustments in which the taxpayers' actual arrangement involves a lump sum payment.[37] The white paper describes a method that could be employed in such circumstances: The IRS would first compute a fictious royalty stream ("commensurate with income amounts"), the lump sum sale price would then be applied against these amounts chronologically, with annual compounding of the remaining (declining) balance until wholly exhausted, after which annual periodic adjustments would be made based on the deemed royalties computed in the first step.[38] The regulations adopt a similar method: Periodic adjustments based on actual profits are made to a deemed royalty stream having equivalent present value to the lump sum payment.[39]

The regulations governing intangibles transferred outside the cost-sharing context provide only limited exceptions to the application

[26] *Id.* at 477, 524. Appendix D of the white paper discusses these agreements, none of which involved a lump sum sale. As evidence for the existence of contractual renegotiation provisions, the appendix cites only two examples: one in which the parties agreed to renegotiate a royalty rate after three years, and another in which the parties agreed to renegotiate if certain contingencies occurred. *Id.* at 527. Appendix D acknowledges that "it is not possible to make general statements about the overall frequency of renegotiations or terminations based on the sample of agreements . . . examined" and describes only one live example of such a renegotiation — a "license to manufacture and sell clothing under a trademark [that] was renegotiated in the second year of a six year term."

[27] *Id.* at 476.

[28] *Id.*

[29] *Id.*

[30] *Id.*

[31] *Id.*

[32] *Id.* at 479.

[33] Reg. sections 1.482-4(f)(2), 1.482-7(i)(6).

[34] *Id.*

[35] Reg. section 1.482-7(i)(6).

[36] Reg. sections 1.482-4(f)(2)(iii) *Example 2*, 1.482-7(i)(6)(v).

[37] Reg. sections 1.482-4(f)(6).

[38] Notice 88-123, *supra* note 2, at 479 ("Under this method, the lump sum is treated as invested on the date of the lump sum payment in a hypothetical certificate of deposit ('C.D.') maturing on the last day of taxpayer's current tax year bearing interest at the appropriate federal funds rate based on the anticipated life of the intangible (for U.S. developed intangibles) or the appropriate rate in the development country. At the end of year one the balance of the C.D. investment would be computed. From this amount, the amount of the commensurate with income amount would be subtracted. The remaining balance would then be treated as invested in a C.D. maturing at the end of year two. At the end of each tax year a computation similar to that done at the end of year one would be made. When the C.D. balance is exhausted, the taxpayer would be required thereafter to include the entire commensurate with income amount in income each year.").

[39] Reg. section 1.482-4(f)(6); reg. section 1.482-4(i)(6)(v)(A)(*1*), (*2*).

of periodic adjustments. First, no periodic adjustments may be made to a controlled transfer of intangible property if pricing is based on the price for an uncontrolled transfer of the same intangible under substantially the same circumstances — such as a same-intangible comparable uncontrolled transaction.[40] This exception is rare in practice because high-profit-potential intangibles are generally not transferred to uncontrolled parties, and it is available only for the first year in which substantial periodic consideration is required to be paid.

Other exceptions apply beyond the first year of the transaction when the difference between expected profits and actual profits remains within a specified margin of error. Specifically, the IRS may not make periodic adjustments to a controlled transaction priced using a CUT that is not a same intangible CUT if the following requirements are met:

1. The controlled parties maintain a written agreement that limits the use of the intangible to a specified field, and the amount payable is arm's length for the first year that substantial consideration is payable.
2. The parties to the CUT maintain a written agreement that does not expressly permit changes to the consideration, renegotiation, or termination of the agreement in circumstances comparable to those of the controlled transaction for the tax year under review.
3. The written agreements are substantially similar.
4. There are no substantial changes in the functions performed by the controlled transferee after the execution of the agreement, unless such changes are required by unforeseen events.
5. The total realized profits earned or costs saved are not less than 80 percent nor more than 120 percent of the projection in the agreement.[41]

For controlled transactions not priced using the CUT method, periodic adjustments are foreclosed under the same set of conditions, except that a requirement for contemporaneous documentation replaces the uncontrolled agreement requirement.[42] If either of the foregoing sets of conditions is satisfied for five uninterrupted years beginning with the first year in which substantial periodic consideration was required to be paid, the IRS is precluded from making periodic adjustments in later years.[43]

Finally, if a controlled transaction satisfies one of the foregoing sets of conditions (except that realized profits or savings are outside the 80 percent to 120 percent band), the IRS may not make periodic adjustments if the taxpayer can also demonstrate that the excess or deficit profits result from "extraordinary events" beyond the taxpayer's control, such as an earthquake that severely damages a U.S. licensee's manufacturing plant.[44]

The cost-sharing regulations provide a similarly narrow set of exceptions in the case of PCTs to a CSA. These exceptions become relevant only when a taxpayer has met the extensive requirements of a qualified cost-sharing arrangement and are considerably more complex than those for transferred intangibles. They include exceptions analogous to those under reg. section 1.482-4 for same intangible CUTs, extraordinary events, and transactions for which realized profits remain within a prescribed margin of error during a specified period.[45] They also contain exceptions allowing for alternative accounting that may be slightly more forgiving if a taxpayer falls outside the error margin.[46]

In sum, the regulations recognize broad authority for the IRS to make periodic adjustments, subject to only very narrow, multifaceted exceptions that may be difficult for taxpayers to satisfy. Even if a taxpayer demonstrates that its ex ante pricing considered all then-known or knowable information, it cannot avoid periodic adjustments unless it meets all elements of such an exception.

[40] Reg. section 1.482-4(f)(2)(ii)(A).

[41] Reg. section 1.482-4(f)(2)(ii)(B).

[42] Reg. section 1.482-4(f)(2)(ii)(C).

[43] Reg. section 1.482-4(f)(2)(ii)(E).

[44] Reg. section 1.482-4(f)(2)(ii)(D).

[45] Reg. section 1.482-7(i)(6)(ii), (vi)(A)(1)-(2), (B)(1)-(2).

[46] Reg. section 1.482-7(i)(6)(vi)(A)(3)-(4).

The GLAM

The GLAM stands in stark juxtaposition to its predecessor guidance, AM 2007-007, which presented a far less aggressive version of the IRS's periodic adjustments powers. Two aspects of that earlier guidance are notable. First, the IRS interpreted "income" in "commensurate with income" as generally referring to "operating profits attributable to the intangible the taxpayer would reasonably and conscientiously have projected at the time it entered into the controlled transaction."[47] In other words, CWI is applied based on good faith, reasonable expectations of future profits at the time of the transaction rather than profits that actually result. The IRS may use ex post information as evidence, but only to rebut a claim by the taxpayer that its initial pricing was made reasonably and conscientiously — that is, periodic adjustments correct for information asymmetry but nothing more.[48] Second, the IRS reserved itself the sole power to make periodic adjustments. Use of periodic adjustments is effectively a one-way street. If intangible profit underperforms projections, the transferor may not use periodic adjustments to reduce its income from that intangible.

In the GLAM, the IRS did not retreat from the one-way street principle, but it did reverse course on the more taxpayer-favorable aspect of its 2007 guidance. Dismissing its earlier interpretation of "income" as "just one application" of the IRS' CWI authority,[49] the GLAM reasons that, "properly construed," CWI includes "income actually received after the transfer of the intangible, as evaluated on an ongoing basis."[50] Thus, taxpayers are expected to set pricing ex ante not based on reasonable and conscientious projections, but rather based on perfect foresight of ex post outcomes or using a pricing mechanism that trues up pricing based on actual income.

The GLAM further asserts that the periodic adjustments rules trump the general arm's-length standard — but in the same breath reiterates the IRS's long-standing position that the CWI requirement is consistent with the arm's-length standard. One way or the other, according to the GLAM, a taxpayer may avoid periodic adjustments only by qualifying for one of the regulatory exceptions, not by relying on the general arm's-length standard or the best method rule.[51]

The GLAM illustrates these positions through two scenarios. In the first scenario, a taxpayer licenses an intangible to a controlled party for an annual fixed royalty over a 10-year period, determining the royalty using the CUT method. As its sole comparable, the taxpayer uses an uncontrolled license of a different intangible.[52] Although the uncontrolled transaction is like the taxpayer's transaction, the license agreements impose different use limitations, and the GLAM says the circumstances of the two licenses are different. Six years into the license agreement, the licensed intangible has proven substantially more profitable than anticipated, presumably yielding results outside the arithmetic range prescribed in the regulations. The IRS examines the taxpayer's tax years 6 and 7 and makes periodic adjustments based on actual profits.

According to the GLAM, the taxpayer cannot successfully rebut the adjustments on the premise that it complied with the best method rule when it initially determined the royalty because the taxpayer does not satisfy any of the exceptions under reg. section 1.482-4(f)(2)(ii). In particular, the taxpayer's CUT method involved intangible property that was not the same as the intangible property in the controlled transaction, and the circumstances of the transfers were not substantially the same. Additionally, the controlled license agreement did not limit the use of the intangible property in the same way as the uncontrolled transaction.[53]

In the second scenario, a taxpayer has entered into a CSA to which it makes a PCT of resources, capabilities, rights, or intangible property reasonably anticipated to contribute to the intangible development activity.[54] The taxpayer

[47] IRS, AM 2007-007.

[48] *Id.*

[49] AM 2025-001, *supra* note 1.

[50] *Id.*

[51] *See* reg. section 1.482-4(f)(2) or 1.482-7(i)(6).

[52] AM 2025-001, *supra* note 1.

[53] *See* reg. section 1.482-4(f)(2)(ii)(B).

[54] AM 2025-001, *supra* note 1; *see also* reg. section 1.482-7(b)(1)(ii).

uses the income method to price its PCT payments.[55] Six years into the CSA, the contributed and cost-shared intangibles have produced profits significantly exceeding the taxpayer's original projections. As in the first scenario, the taxpayer does not satisfy any of the applicable exceptions that would have prevented the IRS from making a periodic adjustment.[56] In particular, the GLAM recites that the taxpayer does not qualify for the "extraordinary events" exception, which requires events beyond the taxpayer's control that could not have been reasonably anticipated.[57] The IRS examines the taxpayer's tax years 6 and 7 and makes periodic adjustments.[58]

In the authors' view, the skeletal and somewhat contrived facts of these scenarios render them unhelpful as guidance to IRS examiners and taxpayers. In the first scenario, the taxpayer's ex ante methodology exhibits obvious flaws: Its supposed CUT involves a different intangible with different profit potential licensed under different conditions. Although the best method rule may, in practice, function as a least-worst method rule, it is unclear from the GLAM that (for example) a discounted cash flow approach would not have yielded a more reliable result than the selected CUT on an ex ante basis. In the second scenario, the GLAM implies that the taxpayer could (and should) have anticipated the results that ultimately ensued — in which case, again, the taxpayer's ex ante analysis would have been inherently flawed because it failed to consider the most reliable available data.

Whether or not the GLAM offers useful guidance, its publication delivers notice to taxpayers that the IRS will more assertively apply the periodic adjustments rules going forward, strongly suggesting that the next wave of high-dollar transfer pricing litigation will focus on periodic adjustments. The IRS's periodic adjustments power has yet to be litigated, implying that it has seldom been exercised.[59] Any hesitation on the IRS's part appears to have ended.

Shortcomings of Periodic Adjustments

The authors think the IRS's position on periodic adjustments is flawed. The regulations and the GLAM are internally inconsistent on crucial issues and appear to exceed the IRS's delegated authority under section 482 in multiple respects. The remainder of this article examines the technical shortcomings of the IRS's periodic adjustments guidance and lays out issues the authors believe taxpayers should (and will) raise in litigation.

Truly Arm's Length?

The GLAM's core position is that a taxpayer may not overcome periodic adjustments with the argument that such adjustments conflict with the general arm's-length standard. Yet it also doubles down on the IRS's historic view that periodic adjustments result in a truer expression of the arm's-length standard than arm's-length methods relying solely on ex ante information. The GLAM thus both asserts that periodic adjustments are fully consistent with the arm's-length standard, and that they trump the arm's-length standard. Asserting these inherently inconsistent propositions undermines the GLAM's core argument for regulatory authority.

Regarding the relationship between the arm's-length standard and the periodic adjustments provisions, the GLAM explains:

> 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 ALS. Treas. Reg.

[55] *See* reg. section 1.482-7(g)(4).

[56] Reg. section 1.482-7(i)(6)(vi).

[57] *Id.* at (A)(2).

[58] *See* reg. section 1.482-7(i)(6).

[59] Commentators have written extensively on this topic and speculated on the reasons as to why the IRS has, to date, demonstrated such uncharacteristic hesitation. *See, e.g.*, Reuven S. Avi-Yonah et al., "Commensurate With Income: IRS Nonenforcement Has Cost $1 Trillion," *Tax Notes Int'l*, May 22, 2023, p. 1017; Ryan Finley, "IRS Memo Marks a Major Shift in Transfer Pricing Approach," *Tax Notes Int'l*, Feb. 10, 2025, p. 917; Prita Subramanian and Thomas Zollo, "The Commensurate With Income Standard in Transfer Pricing," *Tax Notes Int'l*, Dec. 16, 2024, p. 1709; see also Finley, "*Perrigo* Reveals Confusion Over Commensurate With Income Standard," *Tax Notes Int'l*, Apr. 8, 2024, p. 241 (discussing how the IRS in *Perrigo Co. v. United States*, 294 F. Supp. 3d 740 (W.D. Mich. 2021), has seemingly avoided addressing section 482 periodic adjustments issues and instead lead with an economic substance argument).

> section 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. section 1.482-1, including the best method rule of Treas. Reg. section 1.482-1(c). But this limitation does not apply to periodic adjustments. 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. section 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.[60]

So periodic adjustments (and, presumably, the CWI standard upon which they rely) stand above the arm's-length standard. Anticipating taxpayer arguments to the contrary, the GLAM then explains that Treas. reg. section 1.482-4(f)(2)(i), which provides that "adjustments made pursuant to" the periodic adjustment rule in paragraph (f)(2) shall be "consistent with the arm's length standard and the provisions of section 1.482-1,"[61] does not alter the conclusion that such adjustments trump the arm's-length standard:

> 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. In addition, Treas. Reg. section 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. sections 1.482-4(a) and (f)(2)(i) amounts to an assumption that the results under Treas. Reg. section 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.[62]

In other words, periodic adjustments are inherently consistent with the general arm's-length standard. The GLAM nonetheless continues with: "That said, the specific rules of Treas. Reg. section 1.482-4(f)(2) prevail to the extent of a conflict with the more general rules of Treas. Reg. section 1.482-1."[63]

According to the GLAM, however one interprets the regulations, the IRS wins. Arguments in the alternative are a core tool in an advocate's kit, but each such argument should at least be in logical harmony with the others. Asserting that the IRS's own regulations can be interpreted in inconsistent ways does not strike the authors as a litigating position likely to prevail in a challenge to the regulations under *Loper Bright*.

The Tax Court's recent decision in *Facebook Inc. v. Commissioner*[64] illustrates the tension in this position and casts doubt on the utility of the regulatory exceptions to periodic adjustments for PCTs. Facebook challenged the IRS's adjustment to its PCT valuation on various bases, including that realized returns had not deviated sufficiently from anticipated returns to trigger a periodic adjustment under the cost-sharing regulations. If no periodic adjustment was appropriate, the taxpayer argued, then no adjustment was appropriate, period. Examining the regulatory text, the Tax Court concluded that the IRS's authority for periodic adjustments sits alongside its authority under the first sentence of section 482. That Facebook could have successfully rebutted a periodic adjustment did not shield it from an adjustment pursuant to the general arm's-length standard. Notably, because the IRS did not rely on the periodic adjustments rules in *Facebook*, the rules were not in scope for the taxpayer's *Loper*

[60] AM 2025-001, *supra* note 1.

[61] *Id.* at 15.

[62] *Id.*

[63] *Id.*

[64] *Facebook Inc. v. Commissioner*, 164 T.C. No. 9 (2025).

Bright challenge. There will almost surely be others.

The One-Way Street

Similarly mystifying is the IRS's position that periodic adjustments are a one-way street. Recall that AM 2007-007 takes the position that periodic adjustments may be made only by the IRS — presumably to increase U.S. gross income — and not by the taxpayer.[65] Taxpayers may not make downward adjustments based on actual profitability, except on an original return.[66] The IRS position thus can only be construed as heads the IRS wins, tails the taxpayer loses; a position which, applied prospectively, is inherently inconsistent with the arm's-length standard.[67]

The one-way street also is incompatible with the realistic alternatives principle long present in reg. section 1.482-1 and incorporated into section 482 itself in 2017.[68] That principle holds that arm's-length parties would consider realistically available alternative transactions and select the one that leaves them in the most advantageous risk-adjusted economic position. Thus, the economic consequences of such realistic alternative transactions are relevant to determining whether the undertaken transaction yields an arm's-length result.[69] Applied in the context of periodic adjustments, this principle would invariably counsel against acquiring an intangible from a related party. Since the rules restrict the transfer of upside risk, the transferee can never obtain the full benefit of its bargain.

This method may come back to bite the IRS. Congress intended for CWI to apply both to inbound and outbound transactions:

> 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.[70]

In a period when Congress is encouraging inbounding of intangibles through the foreign-derived deduction-eligible income regime, foreign tax authorities may seek to mimic the IRS's periodic adjustments position when it favors their fiscs.

Ignoring Substance

Another aspect of the periodic adjustments provisions conflicts with the realistic alternatives principle as articulated in the IRS's own regulations. Specifically, when an intangible is transferred under an arrangement that lasts more than one year, the periodic adjustments rules authorize disregarding the form of the transaction.[71]

Reg. section 1.482-4(f)(6) recasts a lump sum payment for the transfer or license of an intangible into a hypothetical stream of annual royalty payments over the estimated useful life of the intangible that have a present value equal to the original lump sum payment. These hypothetical payments or "equivalent royalty amounts" are then compared to arm's-length royalty amounts in their respective tax years to determine whether they satisfy the arm's-length principle. The arm's-length royalty amounts are determined from ex post results. If an "equivalent royalty amount" is found not to be arm's length, a periodic adjustment can be made such that the entire series of hypothetical payments are arm's length. In this manner, the taxpayer's choice of form for the transaction is disregarded. Reg. section 1.482-7(i)(6) works in essentially the same

[65] AM 2007-007, *supra* note 47.

[66] Reg. section 1.482-1(a)(3).

[67] The court's reading of the regulations in *Facebook* has a similar ring to it. *See Facebook*, 164 T.C. No. 9, fn. 64. Taxpayers entering into CSAs seemingly cannot price their PCTs in a manner that precludes adjustment.

[68] IRC section 482 ("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.").

[69] Reg. section 1.482-1(d)(3)(iv)(H). For additional arguments for taxpayers' authority to make affirmative CWI adjustments, see Thomas D. Bettge et al., "Dreaming of Infallibility: Periodic Adjustments Under Reg. Section 1.482-4," *Tax Notes Federal*, May 26, 2025, p. 1421.

[70] H.R. Rep. 99-841, *supra* note 13, at II-637.

[71] *See* reg. sections 1.482-4(f)(2), 1.482-7(i)(6)(v).

way for a PCT payment, converting it into a stream of contingent payments.

This is an extraordinary power. Nothing in the legislative history of CWI contemplates recharacterizing a lump sum payment, a contractual term agreed to by the parties in a closed and completed transaction, as a royalty stream reflecting ex post results to determine tax liability.[72] The white paper briefly posits the possibility of recasting a sale for a lump sum as a license but recognizes that unrelated parties sometimes sell intangibles.[73] As noted above, contemporaneously enacted section 367(d) expressly grants power to tax a one-time transfer as a license. Congress plainly knew how to grant the power to recharacterize transactions to the IRS. It did not do so in section 482.

The economic substance doctrine of section 7701(o) allows the IRS to disregard the form of a taxpayer's transaction under certain conditions — namely, if the transaction as structured by the taxpayer lacks a nontax business purpose or fails to change meaningfully the taxpayer's nontax economic position. The IRS has asserted the doctrine in at least one transfer pricing case currently pending in the courts.[74] The periodic adjustments regulations, however, impose no conditions comparable to the standard in section 7701(o) and thus ostensibly permit the recasting of transactions that meet the economic substance requirements of section 7701(o). The IRS may view such recharacterization as necessary to give effect to CWI, but an agency cannot make law. "[A] regulation may not serve to amend a statute . . . nor add to the statute something which is not there."[75]

Indeed, recharacterizing transactions having economic substance achieves the opposite of the realistic alternatives principle, which is an actual part of the statute. Controlled taxpayers that transfer intangibles must ignore the existence of more profitable realistic alternative transactions in favor of one that shifts no risk-adjusted profits at all, else the IRS will simply make the choice for them. Every transfer of intangibles thus becomes a mere financing transaction.

This practice flatly contradicts the IRS's self-imposed regulatory limitation on its powers. One could argue that the first sentence of section 482 grants the IRS sweeping authority, potentially including the authority to recharacterize transactions if needed "to prevent evasion of taxes or clearly to reflect the income of" controlled taxpayers. The regulations provide, however, that "the Commissioner will evaluate the results of a transaction as actually structured by the taxpayer unless its structure lacks economic substance. . . . The Commissioner may consider the alternatives available to the taxpayer . . . but will not restructure the transaction as if the alternative had been adopted by the taxpayer."[76] Having so defined the limits of its authority in one breath, the IRS attempts to sweep them away in the next — providing another basis on which taxpayers may argue that the periodic adjustments rules are *ultra vires*.

What Statute of Limitations?

Perhaps the most vulnerable aspect of the periodic adjustments rules is their end-run around the statute of limitations. IRC section 6501 provides for fixed limitations periods, generally beginning on the date when the return was filed, during which any income, employment, estate, or gift tax must be assessed, if at all. For a deficiency related to income from a closed and completed transaction, the statute of limitations begins to run when the taxpayer files the return for the tax year in which the income from that transaction was properly included.[77] The statute of limitations goes hand in hand with the annual accounting concept that is core to federal income taxation. Each tax year is a separate unit for tax accounting purposes, and transactions occurring during a specific year are evaluated and reported based on facts in existence at the end of that year.[78] The

[72] *See* H.R. Rep. 99-841, *supra* note 13.

[73] Notice 88-123, *supra* note 2, at 479.

[74] *See Perrigo Co. v. United States*, No. 1:17-cv-00737 (W.D. Mich).

[75] *California Cosmetology Coalition v. Riley*, 110 F.3d 1454, 1460 (9th Cir. 1997) (citing *Koshland v. Helvering*, 298 U.S. 441, 447 (1936); *United States v. Calamaro*, 354 U.S. 351, 359 (1957)) (citations and internal quotation marks omitted).

[76] Reg. section 1.482-1(f)(2)(ii).

[77] *Id.*

[78] *See Security Flour Mills Company v. Commissioner*, 321 U.S. 281 (1944); *see also* Rev. Rul. 80-58, 1980-1 C.B. 181 (Dec. 29, 1980).

annual accounting concept, along with the statute of limitations, provides certainty for taxpayers and enables them to assess risk and make informed decisions.

Periodic adjustments, as applied in the GLAM, vitiate that certainty. As described in the regulations, periodic adjustments to an open tax year may be used to address deficiencies in prior tax years so that the entire transaction reflects the CWI standard, regardless of whether those prior tax years are closed.[79] The GLAM alludes to this power in both scenarios, explaining: The year 7 adjustments are computed with reference to actual profits not only in year 7, but also in years 1-6, even when some or all of years 1-6 have been audited and closed without adjustments, and even if the limitations period on assessment is closed for one or more of those years. In short, periodic adjustments cast aside the annual accounting concept by packing multiple years' worth of adjustments into a single tax year, thereby eliminating all certainty that might have resulted from the lapse of the statute of limitations for one or more post-transaction years. For a transfer in perpetuity, the GLAM seemingly authorizes adjustments relating to profits earned in the year of transfer 10, 20, or more years later.

The IRS first asserted this authority to effectively disregard the statute of limitations on assessment in the white paper.[80] Treasury and the IRS argue in the white paper that the power to override the statute of limitations is necessary to enforce CWI, so Congress must have implicitly delegated this power.[81] But the white paper overlooks the constitutional requirements for delegations of legislative authority[82] and, in fact, cites no authority whatsoever for these claims.

In the wake of *Loper Bright*, the IRS's implied delegation theory for a statutory override is low-hanging fruit for regulatory challenge.[83] A merely permissible reading of the statute based on a broad, hand-waving reference to CWI will no longer suffice to support a regulation. Even when a statute delegates broad authority to an agency, the agency must demonstrate that its approach is within the delegation's scope. The Tax Court has already demonstrated its readiness to apply *Loper Bright* by invalidating regulations lacking any grounding in the text of the statute they purport to interpret.[84] That court, and others, may well find the IRS's *ipso facto* argument for overriding the statute of limitations in the periodic adjustments regulations unconvincing.

Further, arguments as to why this aspect of the regulations is *ultra vires* predate *Loper Bright*.[85] Courts heavily disfavor statutory nullification by implication, especially when the two statutes can be reconciled.[86] Here, CWI can easily be reconciled with the normal limitations periods on assessment: the IRS may adjust the income realized in any year from a controlled transfer of intangibles — within the prescribed limitations period for that year. The white paper says that it could be more difficult to make periodic adjustments if the statute of limitations applies.[87] That is undoubtedly true with respect to other adjustments under section 482 and other code provisions, but limitation periods on assessment reflect the balance Congress chose to strike between latitude for the IRS and certainty for taxpayers. Had it desired to strike a different balance in the context of CWI, it could have said so. It did not.

Practical Considerations

The above-described inconsistencies and shortcomings in the IRS's periodic adjustments guidance have real implications for taxpayers.

For example, the IRS's ambiguous position on whether periodic adjustments are arm's length

[79] Reg. sections 1.482-4(f)(2), 1.482-7(i)(6); IRC section 6501.

[80] *See* Notice 88-123, *supra* note 2, at 479.

[81] *Id.*

[82] *See* U.S. Const. Art. I, sec. 8, cl. 18.

[83] *See Loper Bright*, 603 U.S. at 2266, fn. 3.

[84] *See Varian Medical Systems Inc. v. Commissioner*, 163 T.C. No. 4 (2024).

[85] *See* Ken Brewer, "IRS Commensurate With Income Powers: Exploring Their Limits," *Tax Notes*, Dec. 7, 2015, p. 1281.

[86] *Watt v. Alaska*, 451 U.S. 259, 268 (1981), stating:

> Our examination of the legislative history is guided by another maxim: "repeals by implication are not favored." *Morton v. Mancari*, 417 U.S. 549, quoting *Posadas v. National City Bank*, 296 U.S. 497, 503 (1936). "The intention of the legislature to repeal must be 'clear and manifest.'" *United States v. Borden Co.*, 308 U.S. 188, 198 (1939), quoting *Red Rock v. Henry*, 106 U.S. 596, 602 (1883). We must read the statutes to give effect to each if we can do so while preserving their sense and purpose. *Mancari*, *supra*, at 551; see *Haggar Co. v. Helvering*, 308 U.S. 389, 394 (1940).

[87] Notice 88-123, *supra* note 2, at 479.

may impede resolution of cross-border transfer pricing disputes. U.S. periodic adjustments will result in economic double taxation unless the country on the other side of the transaction agrees to a correlative, downward adjustment to the income of its taxpayer. Absent an income tax treaty between the United States and the counterparty country, the probability of such a voluntary cession of tax revenue seems low. And even in the treaty context, achieving resolution of double taxation resulting from periodic adjustments through the mutual agreement procedure is hardly a slam dunk.

Article 9 of the model U.S. income tax treaty incorporates the arm's-length standard. Treasury's technical explanation of the 2006 U.S. model income tax convention, on which many current U.S. treaties are based, recites that CWI (and thus, presumably, periodic adjustments) is entirely consistent with that standard.[88] As explained above, the GLAM hedges on that issue, and in any event, Treasury's technical explanations are unilateral. Whether the counterparty country agrees that periodic adjustments based on ex post results are consistent with the arm's-length standard as articulated in the treaty is another matter.

The OECD transfer pricing guidelines, which typically provide the basis for negotiation in transfer pricing MAPs between the United States and its treaty partners, permit the use of ex post information only to determine the existence of uncertainty at the time a controlled transfer of an intangible was agreed, whether the taxpayer properly took into account reasonably foreseeable events in arriving at its valuation, and the reliability of the ex ante information used to determine the transfer price.[89] When the tax administration can confirm the reliability of the information on which the ex ante transfer price was based, an adjustment based on ex post profits must not be made.[90] As discussed above, the IRS claims the authority to make periodic adjustments based on ex post information regardless of whether any ex ante valuation made by the taxpayer satisfied the best method rule and the general arm's-length standard.[91] It's unclear whether the IRS will retreat from that dogmatic position in a MAP involving U.S.-initiated periodic adjustments and negotiate with treaty partners on the basis of the OECD guidelines. If not, economic double taxation seems an inevitable result. If so, the IRS will be applying different standards in treaty and non-treaty situations.

The IRS's position that periodic adjustments override the statute of limitations also has adverse practical implications for taxpayers. As other commentators have observed, at least some companies facing potential periodic adjustments exposure have explored the possibility of keeping a financial statement reserve for the contingent liability of periodic adjustments.[92]

The most salient consequence for taxpayers, however, is uncertainty. Even if profits remain within the 80 percent to 120 percent band specified in the regulations for 5 years, the IRS reserves the right to challenge the transfer pricing at some indefinite time in the future. And in the PCT context, at least per *Facebook*, safe harbors in the period adjustments rules do not protect the taxpayer from adjustments under the general arm's-length standard.

Concluding Thoughts on Taxpayer Best Practices

The GLAM puts taxpayers on the defensive. If they price based solely on ex ante projections, they face continued and indefinite uncertainty. If they address the GLAM by providing only a non-routine return to the transferee, they ensure that all upside or downside from exploitation of the intangibles must sit in the United States.

Taxpayers desiring to mitigate the effects of the periodic adjustments rules should review their pricing methods, projections, and profits connected with intangibles transfers, including in PCTs, annually. That will allow them to proactively document their satisfaction of any regulatory exceptions. Including price adjustment

[88] U.S. Treasury Department, "United States Model Technical Explanation Accompanying the United States Model Tax Convention," at 31 (Nov. 15, 2006).

[89] OECD, "Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations," at 6.188-6.90 (Jan. 20, 2022).

[90] *Id.* at 6.192-6.193.

[91] *See* AM 2025-001, *supra* note 1.

[92] *See* Subramanian and Zollo, *supra* note 59 (discussing the financial statement exposure caused by the CWI standard).

clauses or provisions for renegotiation in intercompany agreements should also increase certainty, albeit at the cost of limiting the possibility that entrepreneurial risk associated with the subject intangibles can be transferred. Given the IRS's position that periodic adjustments can be used to address implied underpayments in closed years, however, no transfer of an intangible can ever truly be closed.

The IRS has stacked the deck in its favor, but taxpayers need not fold. A taxpayer seeking to transfer intangibles or execute a PCT should consider structuring the transfer as a sale for a lump sum rather than a license for periodic royalty payments. So structured, the transaction would tee up the aforementioned arguments about the validity of the periodic adjustments regulations. If such arguments prevail in litigation, the statute of limitations would bar the IRS from including profits from closed tax years with those for open years when making periodic adjustments. Moreover, the rules are ripe for a regulatory validity challenge. Taxpayers at risk of periodic adjustments should study the GLAM carefully, marshal their facts, and prepare to argue the law. ■