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Section 482 contra adjustments in 27 countries

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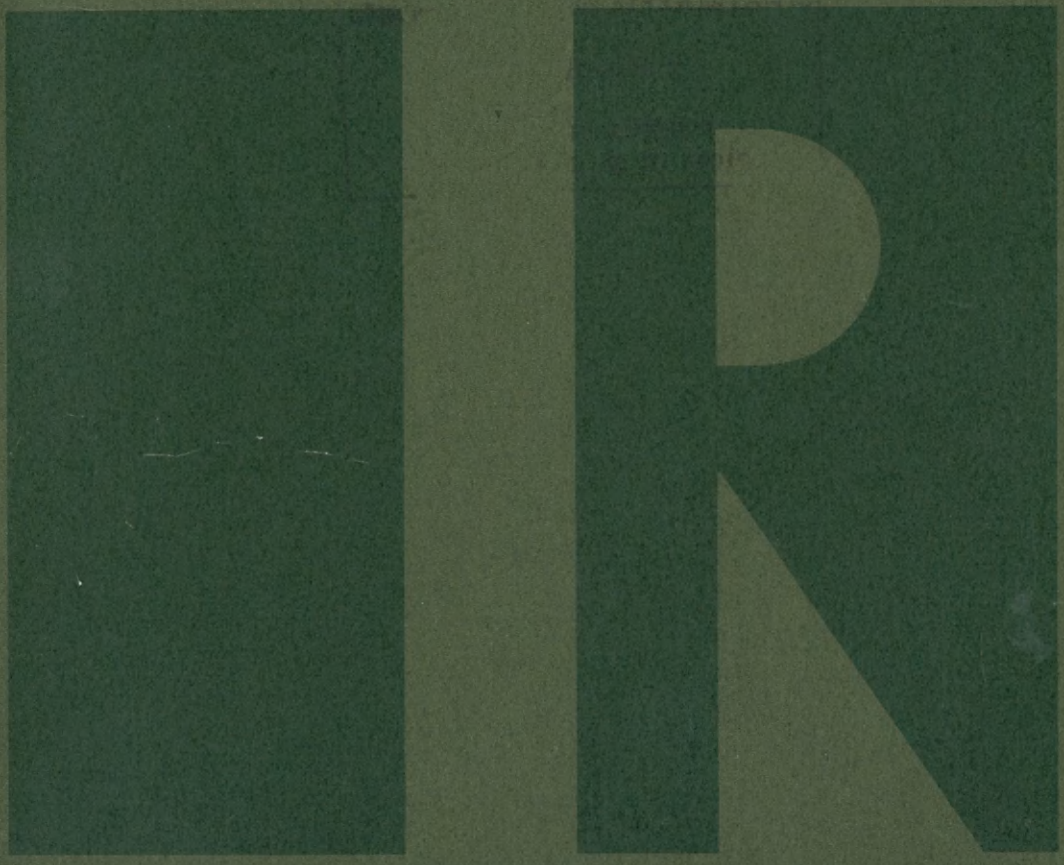
Business Study | Section 482
Contra Adjustments in 27 Countries



SECTION 482

CONTRA ADJUSTMENTS IN 27 COUNTRIES

PREFACE

This is one of a series of Business Studies designed for the use of the Touche Ross professional staff in all countries and for interested clients. Users of this Study should ascertain that the information contained here has not been superseded by later developments. Specific business questions or problems may have legal and tax ramifications that are beyond the scope of this Business Study and the assistance of professional advisors is recommended. Suggestions for revisions should be sent to the Touche Ross International Executive Office in New York City.

November, 1968

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INTRODUCTION

Section 482 of the Internal Revenue Code is a feature of U.S. tax law. Although its use and application are entirely within the responsibility of examining agents of the Internal Revenue Service, Section 482 cannot be considered adequately from the standpoint solely of the United States. In the foreign area almost every adjustment to a domestic taxpayer's income has an effect upon the related foreign entity which was a party to the transaction. Ever-increasing evidence exists that foreign taxing authorities are considering the effects on their own tax revenues and structures of the U.S. Internal Revenue Service's crusade against tax manipulation. They too are changing long established rules governing intercompany transactions – perhaps a more realistic description is that the foreign tax administrations are awakening to the challenge.

Effective tax planning within the framework of Section 482 is twofold – an understanding of and familiarity with the Section 482 regulations and a knowledge of how the transaction will be viewed from the other side. In certain areas the relatively new regulations establish rather specific limits into which intercompany transactions must fall if they are to escape adjustment, while in other areas the guidelines are not so precise or capable of exact application. Efforts to comply with these Section 482 regulations will naturally be guided and influenced by the effect on the tax liability of the related foreign company in the event of an adjustment by the U.S. Internal Revenue Service. If the foreign country will permit the related taxpayer to give full effect to and reflect completely the correlative effect of any Section 482 adjustment to the U.S. company, the failure to anticipate correctly any such adjustment may not be significant if the tax rates in the two countries are comparable. On the other hand, if the foreign country does not permit retroactive adjustments once a tax return has been filed, a Section 482 adjustment by the U.S. Internal Revenue Service could be expensive. For example, imputing interest on intercompany indebtedness is of little consequence if both the debtor and creditor are to be treated alike and are subject to roughly the same tax rates, but if only one party to the transaction will have its tax liability adjusted, with the other party unable to effect a comparable adjustment, the imputed interest could become quite expensive.

Accordingly, we have included in this survey a review and explanation of the Section 482 regulations and an analysis of the position taken by 27

foreign countries with respect to the existence and treatment of equivalent tax provisions. The countries included are:

Argentina	Costa Rica	Japan	South Africa
Australia	Denmark	Mauritius	Sweden
Belgium	France	Mexico	Switzerland
Brazil	Germany	Netherlands	United Kingdom
Canada	India	Panama	Venezuela
Chile	Italy	Philippines	Zambia
Colombia	Jamaica	Rhodesia	

The contents of each of the analyses include:

Section 482 Allocations by IRS – whether the foreign subsidiary can adjust its prior years' tax returns to reflect a Section 482 adjustment to its U.S. parent; what is the statute of limitations on such adjustment; and the treaty provisions that apply, if any.

Allocations Under the Tax Laws of the Foreign Country – whether a provision similar to U.S. Section 482 exists; the extent to which it is enforced; and the treaty provisions that apply, if any.

Interest, Royalty and Rental Charges – the approval of agreements for payment of interest, royalties, etc. by foreign tax and/or other authorities; the deductibility of such payments; and the extent of review and the penalities on disallowance.

Service Charges – the foreign tax law relating to intercompany service charges; the documentation required to support such charges; and the extent of review.

Pricings – the foreign tax law relating to intercompany pricing; and the extent of review and adjustment.

FINAL REGULATIONS OF SECTION 482

REVIEW AND EXPLANATION

> "In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary or his delegate may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses."

These 94 words, Section 482 of the Internal Revenue Code, comprise the statutory authority for the thorough examination the Internal Revenue Service is now giving transactions between related parties. Although Section 482 has been around since the early twenties only this year have detailed final regulations been promulgated setting forth guidelines as to its administration and interpretation. Although Section 482 applies equally to transactions in the domestic and foreign areas, it is in connection with transactions with foreign entities that it has its greatest impact. An allocation between domestic companies will, in the absence of unusual circumstances, not result in a significant amount of additional tax since both entities are subject to the same rates of tax. However, a Section 482 allocation between a domestic company and its related foreign entity will usually result in increased U.S. taxes. The effects of a Section 482 allocation on the income of the related foreign company and upon its income tax liability are of no particular consequence to the IRS.

The effects of a typical Section 482 allocation may be illustrated by the following example. Assume that a U.S. parent and its foreign subsidiary had taxable incomes of $800,000 and $200,000 respectively and paid income taxes of $377,500 and $60,000 respectively. The IRS in its examination of the parent's return determines that its taxable income was understated by $100,000 because of its failure to charge a royalty for intangibles. The results of such allocation are illustrated on the following page.

	U.S. Parent		Foreign Subsidiary	
	Before	After	Before	After
Taxable income	$800,000	$900,000	$200,000	$100,000
Tax	377,500	425,500	60,000	30,000
Additional Tax		48,000		(30,000)

The net additional tax due by the corporate group is $18,000, the difference between $48,000 and $30,000. This assumes that the foreign subsidiary will be allowed to adjust its taxable income, that the underlying transaction giving rise to the allocation is deductible in computing its taxable income, and that the foreign tax authorities will consider that the allocation is reasonable. Since a number of "ifs" to tax relief exist at the other end of the allocation, Section 482 must be considered carefully before a transaction between related domestic and foreign entities takes place.

Control must exist before an allocation may be made – one company must be either controlled by another or be a member of a group controlled by the same interests as the other. For this purpose, control is not measured solely by a stock ownership test. The criteria is whether there is actual control regardless of whether such control is legally enforceable. If there is a shifting of income between companies, the Regulations state that a presumption of control exists.

The Regulations have adopted an arm's length standard for measuring dealings between related parties. That is, the charge between related parties must be the same as it would have been between unrelated parties in a similar transaction under similar circumstances. Guidelines are set forth as to what constitutes an arm's length price if a true arm's length price cannot be established. These Regulations, issued in proposed form on August 2, 1966, became final on April 15, 1968. They provide guidelines in five major areas – interest on loans and advances, performance of services, the use of tangible and intangible property, and the sale of tangible property.

INTEREST ON LOANS AND ADVANCES

Interest at an arm's length rate must be charged on loans or advances between related parties or where one party becomes a creditor of the other as in the case of open accounts arising in the ordinary course of business.

If the party making the loan is in the business of making loans, the arm's length rate is the usual rate charged considering such factors as the amount and term of the loan, the security involved, the credit standing of the borrower, and the prevailing interest rates for comparable loans.

If the lender is not in the business of making loans, the arm's length rate is determined as follows:

1. If no interest was charged – 5%;
2. If interest at a rate of 4 to 6% was charged, the arm's length rate is the rate charged. [this range of 4 – 6% is the safe haven range];
3. If the interest rate charged was between the safe haven range (4 – 6%) and the true arm's length rate, the rate charged is deemed to be the arm's length rate;

   Example: Assume that a U.S. parent loans funds to a foreign subsidiary at 8%. The foreign subsidiary could have borrowed from a local bank at 10%. Since the 8% rate charged falls between the top of the safe haven range (6%) and the true arm's length rate (10%), the 8% actually charged will be accepted and no allocation will be made.

4. If the interest rate cannot be determined under the rules of 2 or 3 above, the rate is 5% unless a more appropriate rate is established by the taxpayer.

If the loan to one related party is from another related party's borrowings, made at the situs of the former, the arm's length rate is the sum of the interest paid by the original borrower plus an amount to cover the cost of the borrowing and loaning. The interplay of this rule and those stated earlier result in an opportunity for tax planning. A U.S. parent may borrow in one country at say 9% and in turn loan the proceeds to a foreign subsidiary located in another country. Under the rules determining an arm's length interest charge now in effect, the parent may charge a rate of only 4% without question since this is in the safe haven range. The 5% difference between the rates is apparently a good deduction for the U.S. parent.

Open accounts which arise in the ordinary course of business and which do not in writing require the payment of interest are treated in the same manner as loans except that interest begins to run 6 months after the transaction giving rise to the open account takes place unless it can be

established that trade practice permits a longer period to pass without charging interest. The period a debt is outstanding is determined under the FIFO method unless an agreement requiring that another method be used exists and it is trade practice to enter into such agreements.

PERFORMANCE OF SERVICE

Charges for services rendered between one related party and another must be at arm's length. Regardless of which party performs the service, if either renders such services as an integral part of its business activity the charge must be that which would have been charged an unrelated party for similar services under similar circumstances.

If the services are not an integral part of the business activities of either party, the arm's length charge is deemed equal to the costs incurred. Costs incurred for this purpose include both direct costs such as the salaries of personnel performing the service, the materials and supplies consumed, etc., and all indirect costs. Indirect costs include the overhead of the department rendering the service plus its share of the overhead of supporting departments such as personnel, accounting, payroll, maintenance and executive management. Costs for this purpose, however, do not include interest not incurred specifically for another member of the group, expenses connected with the issuance of stock and the maintenance of shareholder relations, and expenses of complying with governmental regulations not directly related to the services performed.

The Regulations provide that the allocation of the overhead of supporting departments may be based on reasonable estimates or on established departmental overhead rates. If costs are consistently allocated through the use of a method in keeping with good accounting practice, the method will not be disturbed. Consideration will be given to methods actually used to allocate costs in connection with the preparation of statements for the use of management, creditors, investors, etc. or among domestic members of the group.

All allocations must be made on the basis of full costs and not on an incremental cost basis.

If incidental services are rendered in connection with the transfer of property, a separate allocation will not be made for the services. Whether the

services are incidental is a question of fact. Start-up assistance is considered to be incidental.

In addition to the final Regulations, new proposed regulations have been issued which state the conditions under which services are deemed to be an integral part of a company's activities. These conditions are:

1. Where either party is in the business of rendering similar services to unrelated parties;
2. Where the principal activity of the party rendering the service is to perform such services for other related parties;
3. Where the party rendering the service is in a special position to furnish the service which is a principal element in the operations of the recipient.
4. Where the party receiving the services has received substantial services from related parties during the year. Services are substantial if the cost of the services exceeds 25% of the total cost of the recipient, excluding both its cost of sales and the amounts paid to related parties for the services rendered and including the costs incurred by the related parties in performing such service.

> Example: Assume that a subsidiary had cost of sales of $750,000 and general and administrative expenses of $170,000. Included in its general and administrative expenses are charges for advertising services from its parent of $75,000. The costs of the parent to perform these services was $45,000. The numerator in the formula is $45,000 and the denominator is $140,000 [750,000 + 170,000 + 45,000 - 750,000 - 75,000]. Since $45,000 is more than 25% of the total costs of $140,000, the advertising services are deemed to be an integral part of the activities of the subsidiary. Therefore, the charges from the parent to the subsidiary may not be based on the parent's costs.

The proposed regulations of August 2, 1966 provided that if a party was in the business or was deemed to be in the business of performing services, its charge for services performed for a related party must include a profit factor and could not be based solely on its costs. The proposed regulations set forth the circumstances under which a party was deemed to be in the

business of rendering services. These rules of the proposed regulations are of continuing importance because the IRS has announced that they will be applied at a taxpayer's request to years beginning prior to May 1, 1968. The newly proposed regulations of April 15, 1968 continue to require a profit factor but set forth the above mentioned "integral part" test for its application.

No allocations will be made for services when the benefit to the recipient is so incidental that an unrelated party would not be charged for them or when the services are merely a duplication of services which the recipient has itself performed. The qualifications and availability of a party's personnel will be considered here.

> Example: If a foreign subsidiary asked its U.S. parent to analyze its borrowing needs because the subsidiary did not have qualified personnel, a charge must be made. If the foreign subsidiary had a financial staff which analyzed its borrowing needs and then submitted its report to its U.S. parent for review and comment, no charge need be made for services performed by the U.S. parent.

USE OF TANGIBLE PROPERTY

An allocation will be made if one related party transfers tangible property to another at other than an arm's length charge. If neither party is in the business of renting such property and an appropriate arm's length charge is not otherwise established such charge shall be the sum of the following:

1. Straight line depreciation of the property transferred (for this purpose the useful life, and salvage value are estimated on the basis of the facts known at the time of transfer with no adjustment for exhaustion, wear and tear, obsolescence, etc.);
2. Three percent of the depreciable base used to compute the straight line depreciation;
3. All expenses of the owner in connection with the property (this includes property taxes and repair and maintenance expenses, etc. but excludes interest expense); and
4. All expenses connected with the transfer of the property (this includes services rendered in connection with the start-up of the property).

If the property is owned for less than the full year or is used by more than one party during the year an allocation on a daily basis must be made.

> Example: Assume that in 1968 a U.S. parent leased a machine to its foreign subsidiary. The machine had been purchased in 1963 for $100,000 and was being depreciated over a 10 year life under the double declining balance method. On the date of transfer the machine had been used for five years, and it was estimated that it had a remaining useful life of 7 years and a salvage value of $10,000. During the year the U.S. parent paid $1,500 for property taxes and $1,200 for start-up assistance. The machine was used for 120 days by the U.S. parent, 200 days by the foreign subsidiary and was not used the balance of the year. The deemed arm's length charge is:

1. Depreciation [(100,000 - 10,000) ÷ 12]	$ 7,500
2. 3% of depreciable base	2,700
3. Property taxes	1,500
	$11,700
Allocation of expense to period of use by the foreign subsidiary	
$\frac{200}{320}$ x $11,700	$ 7,312
Start-up assistance	1,200
Deemed Arm's Length Charge	$ 8,512

The method of computing an arm's length charge set forth in the Regulations provides a level rental charge from year to year. This differs from the method of the proposed regulations which was based on actual tax depreciation and, therefore, may have resulted in a decreasing charge.

The rules outlined above are not applicable, however, to those cases in which one related party acquires rented property from an unrelated party and then transfers it to a related party. Here the arm's length charge is the rent paid by the intermediate party plus its deductible expenses incurred in connection with the property.

TRANSFERS OF INTANGIBLE PROPERTY

The Regulations which deal with this area of transactions between related parties do not provide any safe haven areas as are furnished in the three areas previously discussed. Instead they provide a method by which the use of intangibles may be transferred without a resulting Section 482 allocation. This method, the cost sharing agreement, provides that if the risks and expenses of developing intangible property are borne by the members of a related group at the time the intangible property is developed, all such members may use the property in accordance with their interests.

It is interesting to note that the provisions of the proposed regulations set out several pages of rules and conditions under which a cost sharing agreement would be determined to exist. The Regulations, however, require only that the agreement setting forth the parties' interests be in writing, that it represent a good faith attempt by the parties to bear their respective shares of all of the costs and risks, and that its terms and conditions are those that would have been adopted by unrelated parties in similar circumstances.

If a cost sharing agreement does not exist, the arm's length charge for the transfer and use of intangible property is that which an unrelated party would have been charged. If the party transferring the property has similar transactions with unrelated parties, the arm's length charge for transactions with related parties must be substantially the same. If no unrelated party transactions exist the arm's length charge is determined on the basis of 12 enumerated factors which include prevailing rates in the same industry for similar property, the offers of competing transferors or the bids of competing transferees, the prospective profits of the transferee to be realized, and conclude with "any other fact or circumstance which unrelated parties would have been likely to consider in determining the amount of an arm's length consideration for the property."

No charge need be made until such time as the intangible property is transferred or made available to the related party. The expenses of developing an intangible may therefore be deducted in computing current taxable income without, in the absence of a cost sharing agreement, recognition of the possibility that related parties may later also benefit from such research activities. The charge, when required to be made, may take the form of a royalty, a lump sum payment, or any other reasonable form that might have been adopted by unrelated parties so long as it can be established that such agreement did in fact exist.

As an exception to the general rule that Section 482 is the weapon of the IRS, where an allocation is required involving the transfer of an intangible and the taxpayer can establish that he benefited from assistance furnished by the party to whom the intangible was transferred, the taxpayer can insist that offsetting allocations be made.

SALE OF TANGIBLE PROPERTY

Where tangible property is sold by one related party to another an allocation will be made if the sale is at other than an arm's length price. The arm's length price will be determined under one of the following:

1. Comparable Uncontrolled Price Method;
2. Resale Price Method;
3. Cost Plus Method; or
4. Another Appropriate Method.

These methods must be used in the order indicated. If the standards for the Comparable Uncontrolled Price method are met, that method must be used. Only if its standards are not met may the Resale Price method be used. If the standards for the Resale Price method are not met, the Cost Plus method must be used unless the Resale Price method is more feasible and is likely to result in a more accurate arm's length price than would the use of the Cost Plus method. Another method may be used where none of the above three methods can be applied or where another method is clearly more appropriate considering the facts and circumstances.

Comparable Uncontrolled Price Method. Here the arm's length price is determined by reference to the price paid in comparable sales between unrelated parties. Uncontrolled sales are comparable to controlled sales if the physical properties and circumstances in both cases are identical or so nearly identical that any differences either have no effect on price or can be reflected by reasonably ascertainable adjustments to the price. Thus the sale to an unrelated party of a small quantity of goods would not be comparable to the sale of a large quantity of the same goods to related parties.

Differences which could affect price include differences in quality, terms of sale, intangible property such as trademarks or brand names, time of the sale, level of the market, and the geographic market. Whether these differences render a sale noncomparable depends on the facts in each case. Differences such as freight and insurance terms or minor modifications to

the property have an ascertainable value and do not keep a sale from being classified as comparable. However, differences such as the use of a trademark would normally render a sale non-comparable.

A seller may reduce his price to enter or maintain a market. This can be done only if the price would have been so reduced in a sale to an unrelated party under comparable circumstances. This could be demonstrated by showing that the buyer had reduced his resale price to unrelated parties or had incurred extraordinary sales promotion expenses. The arm's length price may be below the cost of manufacture in these cases.

Resale Price Method. The arm's length price under the Resale Price method is determined by reference to the applicable resale price reduced by an appropriate mark-up based on the gross profit percentage of the buyer on sales of goods both purchased from and resold to unrelated parties. The applicable resale price is the price for which the property purchased from a related party will be sold in an uncontrolled sale. In determining whether transactions are similar, the following will be considered – the type of property (tools, furnishings, appliances,etc.), the functions performed by the seller (labelling, servicing, advertising, etc.), the intangible property used (trade marks, brand names, etc.), and the geographic market.

The Resale Price method must be used if there are no comparable uncontrolled sales, an applicable resale price is available, and the related party vendor/vendee has not added more than insubstantial value by physical alteration of the goods or use of intangible property. Physical alteration does not include packaging, repacking, labelling or minor assembly. If substantial value is added, the Resale Price method is preferable to the Cost Plus method if the substantial value added can easily be reflected in a price adjustment.

Appropriate adjustments must be made to reflect material differences between the resale of the property purchased from a related party and the property purchased from an unrelated party. The resale of these later purchases of course establish the appropriate gross profit percentage. For example, if the reseller gives a warranty on his sale of property purchased from related parties and does not give such warranty on the property purchased from unrelated parties, the value of the warranty must be considered in determining the price of the goods transferred between the related parties. If no uncontrolled purchases and resales exist, consideration may be given to the markup percentages of other persons selling in the same or similar markets, to markup percentages of U.S. sellers performing com-

parable functions, or to the markup percentage appropriate to the particular industry.

Cost Plus Method. The arm's length price here is the sum of the cost of producing the property plus the applicable gross profit determined by using the gross profit percentage from similar uncontrolled sales by the seller or others. The similarity of uncontrolled sales depends upon the type of property sold, the functions of the seller, the effects of intangible property used by the seller, and the geographic market in which the functions are performed by the seller. Close physical similarity of the property sold is not required under this method since its lack does not necessarily mean that profit margins will differ. The experience of other sellers or the gross profit percentage prevailing in the particular industry may be used in the absence of uncontrolled sales by the particular taxpayer.

MISCELLANEOUS PROVISIONS

Whenever an adjustment is made under Section 482, a correlative adjustment must be made. That is, when the income of a related party is increased, the income of the other related party is correspondingly decreased. At the time the adjustment is made the district director will furnish a written statement of the amount and nature of the correlative adjustment which is deemed to be made.

In making allocations, the Service will consider arrangements made between the related parties for reimbursements or payments to be made within a reasonable time if it can be established that the agreement actually existed in the year in question. For example, if in 1966 one party performs services for a related party and their agreement calls for reasonable payment for the services to be made during the period 1966–1970, no allocation will be made with respect to the services.

A taxpayer may claim an offset to a proposed allocation if he can establish that other transactions existed which were not handled at arm's length and can establish the amount of the appropriate arm's length price. For this purpose, the arm's length value of the offsetting transactions cannot be determined by referring to the guidelines under which certain charges are deemed to be arm's length charges.

> Example: Assume that a U.S. parent rented property to its foreign subsidiary without charge. The arm's length

charge would be $100,000 and the IRS proposes an allocation for this amount. However, during the same year, the foreign subsidiary had performed services for the U.S. parent for which no charge was made. The arm's length charge for these services would be $25,000. The U.S. parent may offset one transaction against the other so that the net allocation would be $75.00.

Example: Assume that a U.S. parent rented property to its foreign subsidiary for which the arm's length charge would be $100,000. The U.S. parent also rendered technical services to the foreign subsidiary for which the arm's length charge would be $25,000. The U.S. parent billed the foreign subsidiary $125,000 for rent and nothing for the services. If the IRS proposed an allocation for the charge for services, the U.S. parent could show that it had already received such amount through the increased rental charge.

To claim the benefit of these offset provisions, the district director must be notified of the basis for the offset within 30 days from the date of the letter of transmittal for the examination report notifying the taxpayer of the proposed adjustments.

If reimbursement was prevented or would have been prevented at the time of the transaction by restrictions imposed by foreign law – for example currency restrictions – the allocation may be treated as deferrable income if the taxpayer had elected to use the deferred income method or makes such election with respect to the allocations before the earliest of the following events: (1) execution of Form 870; (2) execution of a closing agreement or offer-in-compromise; or (3) 30 days after the date of the letter of transmittal for the examination report notifying the taxpayer of the adjustments.

The final regulations apply to all years except as provided in Revenue Procedures 64-54, 66-33 and 68-22. Revenue Procedures 64-54 and 66-33 apply to years beginning prior to January 1, 1965 and deal with the offset of the foreign taxes paid on the amount of the Section 482 allocation against the U.S. tax payable. Revenue Procedure 68-22 provides that Revenue Procedure 63-10, (providing guidelines for transactions with Puerto Rican affiliates) will continue to be followed and that those provisions of the proposed regulations of August 2, 1966 dealing with the circumstances

under which related parties are deemed to be in the business of rendering services may be applied at a taxpayer's request to years beginning before May 1, 1968 instead of the comparable provisions of the final Regulations. The application of the final Regulations to prior years results from the Treasury's insistence that the arm's length standard has been the standard used for many years and that the final Regulations make no basic change from this standard.

The announced policy of the IRS is to make adjustments only where there has been a significant deviation from arm's length dealing or where there has been a significant shifting of income, and to administer Section 482 in a spirit of reasonableness. Whether this policy will be followed in practice remains to be seen.

ARGENTINA

SECTION 482 ALLOCATIONS BY IRS

It is very doubtful if the Argentine tax authorities will allow a controlled subsidiary of a U.S. corporation to reflect Section 482 adjustments in tax returns of prior years. For such adjustments to be at all possible, it must be shown that the charge resulted from an actual prior agreement between the parties, and was not a Section 482 adjustment. The statutory limitation on such adjustments is five years.

An Argentine company on a cash basis may be able to deduct in its current tax return an amount equal to the adjustments for prior years, but in no case may an accrual basis taxpayer make such a deduction.

No tax treaty presently exists between the U.S. and Argentina.

ALLOCATIONS UNDER TAX LAWS OF ARGENTINA

Although Argentina has no specific provision similar to Section 482, it does have general provisions which are applied on a basis similar to Section 482. Enforcement of such provisions generally depends on the local tax inspectors.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payments of interest, royalty, rent, etc. need not be approved by the Argentine government and, in fact, it is not possible to obtain prior approval. Payments made pursuant to agreements are deductible for tax purposes, but they may be adjusted if considered excessive or unreasonable. Such adjustments do not give rise to penalties unless fraud is proven.

SERVICE CHARGES

No specific provisions apply to intercompany service charges, but Argentine tax authorities have the authority to make adjustments. Intercompany service charges may be reviewed when a tax return is audited. However, our Argentina office is not aware of any case in which adjustments have been made.

To support intercompany service charges, it is advisable to have detailed vouchers, contracts, and the like available for the tax authorities. In some cases, a report from a C.P.A. firm has been sufficient.

PRICING

Generally, intercompany pricing is not reviewed when a tax return is audited. The tax authorities do, however, have the power to adjust intercompany prices in import and export transactions. Our office is not aware of any case in which the tax authorities have adjusted intercompany prices.

AUSTRALIA

SECTION 482 ALLOCATIONS BY IRS

The Australian tax laws have no provision for an adjustment to a prior year's tax return as a result of a Section 482 adjustment. They do, however, have a disallowance provision which has no time limitation, but it does not give their tax authorities the power to substitute prices different from those actually paid. If the Australian subsidiary pays the U.S. parent an amount equal to the IRS adjustment, it is very doubtful whether the payment will be allowed as a deduction on the subsidiary's current year's tax return.

The tax treaty between the U.S. and Australia provides that the tax authorities of both countries are to resolve questions of the allocation of profits between related entities. Our Australian office has indicated that they have had experience with this provision in connection with the allocation of general and administrative expenses. The expenses were allocated proportionately on the basis of gross sales.

ALLOCATIONS UNDER TAX LAWS OF AUSTRALIA

Australia does not have a provision like Section 482. However, as mentioned above, the treaty provision for the allocation of profits has been used in the same manner.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalty, rent, etc. charges require exchange control approval, but no approval is necessary for tax purposes. As long as these agreements provide for an arm's length charge, the approval will be granted. These charges are as a general rule deductible for purposes of Australian income tax. If these charges are excessive, the question of whether they will be adjusted or disallowed entirely is currently being litigated. If an adjustment or disallowance is made there will be no penalties as long as a full and true disclosure of all the facts was made.

SERVICE CHARGES

In the past, intercompany service charges have not been reviewed by the Australian tax authorities, however, our office in Australia has indicated that these charges are now being scrutinized and the case of first impression is under litigation.

PRICING

Our office has indicated that the Australian tax authorities have the power to adjust intercompany prices, but have yet to utilize this power.

BELGIUM

SECTION 482 ALLOCATIONS BY IRS

The Belgian tax laws make no provision for adjusting a prior year's tax return in cases where the IRS has made adjustments between a U.S. company and its Belgian subsidiary. Furthermore, if the Belgian subsidiary makes a payment in the current year, it will not be allowed as a deduction for Belgian income tax purposes.

The tax treaty between Belgium and the U.S. provides that the tax authorities of both countries are to resolve questions of the allocation of profits between related entities. However, it appears that this provision will not eliminate double taxation, since the Belgian tax authorities do not allow retroactive adjustments. The only relief accorded will be in the form of a larger foreign tax credit available to the U.S. parent.

ALLOCATIONS UNDER TAX LAWS OF BELGIUM

Belgium has a provision in their Income Tax Code similar to Section 482 which gives the Belgian tax authorities the power to make adjustments where there have been "abnormal advantages" derived either directly or indirectly due to "ties of interdependence". The determinations of "abnormal advantages" and "ties of interdependence" are questions of fact. No detailed regulations exist which spell out their application.

If a U.S. company has a branch in Belgium which constitutes a permanent establishment under the treaty, any adjustments would be made in accordance with the terms of the treaty rather than under the Belgian Income Tax Code. The treaty provides that a permanent establishment shall have attributed to it "the net industrial and commercial profit which it might be expected to derive if it were an independent enterprise engaged in the same or similar activities under the same or similar conditions". In effect, this treaty provision gives the Belgian tax authorities power to adjust intercompany charges where an arm's length charge has not been made.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, rentals, royalties, etc. do not have to be approved by the Belgian tax and/or other authorities. Although

these agreements can be made and amended without the approval of any authority, the amounts may be reviewed to determine if they are equivalent to an arm's length charge. Just as in determining an arm's length charge under Section 482, the Belgian tax authorities will take into consideration all of the surrounding facts and circumstances of the transaction. Our office in Belgium states that it is advisable to fix the charge in a written contract, although this will not absolutely preclude a review and adjustment. Such charges are deductible in Belgium, but any amount in excess of an arm's length charge may be disallowed. No penalties are imposed as a result of the disallowance of excessive intercompany charges.

SERVICE CHARGES

Intercompany service charges may be reviewed by the Belgian tax authorities, even though there are no specific provisions dealing with such charges. The power of review stems from the general provision which allows adjustment of profits where there is "abnormal advantage" resulting from "ties of interdependence."

PRICING

Intercompany pricing is reviewed by the Belgian tax authorities. There are no specific provisions which deal with intercompany pricing, but as a matter of practice, the arm's length test will be applied.

BRAZIL

SECTION 482 ALLOCATIONS BY IRS

The Brazilian tax authorities will not allow a controlled subsidiary of a U.S. corporation to adjust its prior years' tax returns as a result of Section 482 adjustments. Furthermore, a present payment equal to the adjustments for prior years will not be allowed as a deduction on the current year's tax return.

The U.S. senate approved a tax treaty with Brazil on June 6, 1968, but it will not come into effect until the instruments of ratification are exchanged. The new treaty has a provision for the elimination of double taxation due to the allocation of profits between related entities.

ALLOCATIONS UNDER TAX LAWS OF BRAZIL

The Brazilian tax law does not contain a provision similar to Section 482. However, intercompany transactions are so strictly regulated that such a provision is not necessary.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest must be approved and registered at the Central Bank of Brazil. Otherwise, the payments cannot be remitted and the interest would not be allowed as a deductible expense. In addition, the percentage of interest paid may not exceed the interest usually charged in the country in which the credit originated.

If 50% or more of the capital stock of a Brazilian company is owned directly or indirectly by foreign stockholders, the Brazilian company is prohibited from paying royalties for patents or trademarks. If there is less than 50% ownership, payments of royalties can be remitted and are deductible for tax purposes only if they are covered by an agreement which has been approved and registered at the Central Bank of Brazil. Payments must be within limits set by law depending upon the degree of necessity for the product.

Intercompany charges for technical, scientific, administrative, and similar assistance can as a general rule only be paid during the first five years of operations – extendable for another five years in certain cases. If these charges are to be remitted and deducted they must be made pursuant to an agreement which has been approved and registered at the Central Bank of Brazil. They are also limited in the same manner as are royalties.

The rule applicable to royalties also applies to rentals with the addition of the legal requirement that the rentals may not exceed the amounts usually paid for rental of similar property.

A penalty tax of more than 50% is imposed on any payments which are not made pursuant to an approved agreement.

SERVICE CHARGES

Intercompany service charges of all types are subject to the limitations described under the preceding heading.

PRICING

Brazil has an excise tax which is imposed at rates of 3 to 20% on the sale of manufactured products. Therefore, intercompany pricing is strictly regulated and reviewed by excise tax agents as opposed to income tax agents. The intercompany price can never be less than 80% of the normal selling price.

CANADA

SECTION 482 ALLOCATIONS BY IRS

The Canadian tax authorities will generally allow a controlled subsidiary of a U.S. corporation to adjust its prior years' tax returns for Section 482 adjustment. There is a four year statute of limitations on such adjustments. Adjustments will not be allowed, however, for interest where no legal obligation to pay such interest existed. As a general rule, a present payment equal to the adjustments for prior years would not be allowed as a deduction on the current year's tax return.

The tax treaty between Canada and the U.S. provides that both countries are to cooperate in resolving questions of allocation of profits between related entities. In practice, this treaty provision has not been applied in connection with Section 482 adjustments. The Canadian Department of National Revenue has taken the position that there is no double taxation since two separate taxpayers are involved. Our Canadian office feels that there is little hope that this tax treaty provision will assist in eliminating cases of double taxation resulting from a Section 482 adjustment.

ALLOCATIONS UNDER TAX LAWS OF CANADA

The Canadian tax law contains two sections which are very similar to Section 482. There are, however, no detailed regulations to be followed in applying these provisions. Most of Canada's tax treaties with other countries contain provisions to eliminate double taxation due to the allocation of profits between related entities. In practice these provisions have not been used.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalties, rentals, etc. are subject to approval by the Canadian tax authorities. While such approval need not be obtained in advance prior approval may be sought if a taxpayer so desires. Such payments are deductible for tax purposes but they may be adjusted if considered excessive. Generally, only the amount that is considered in excess of what is reasonable will be disallowed. Where interest, however, is paid on money borrowed and reloaned at a lower interest rate, the Canadian tax authorities are likely to disallow the full amount of the interest paid. Penalties are not imposed when adjustments to intercompany charges are made unless fraud or gross negligence is proven.

SERVICE CHARGES

Intercompany service charges are generally reviewed in great detail when a tax return is audited. Canada's income tax law has a specific provision which deals with such charges and the Canadian tax authorities are not hesitant to apply it. Our Canadian office is aware of several cases in which intercompany service charges have been adjusted. Intercompany service charges must be supported by detailed schedules showing the specific items involved, costs, and methods of allocation.

PRICING

Intercompany pricing is generally reviewed when a tax return is audited. Two sections of the income tax act specifically deal with intercompany pricing. If intercompany prices are not at arm's length, they will be adjusted. Our Canadian office has dealt with many cases in which intercompany prices were adjusted by the Canadian tax authorities.

CHILE

SECTION 482 ALLOCATIONS BY IRS

Under the Chilean tax law, a taxpayer is allowed to adjust only his preceding year's tax return. This provision is of virtually no value in connection with a Section 482 adjustment since a U.S. corporation's tax return

is seldom, if ever, audited during the year after it is filed. If a Chilean subsidiary makes a current payment to its U.S. parent for allocations relating to prior years, it may be possible to deduct the payment on its current year's tax return provided sufficient documentary evidence is exhibited and the transaction is exceptional and non-recurring. The deduction would not be allowed with respect to intercompany pricing of imported goods.

ALLOCATIONS UNDER TAX LAWS OF CHILE

The Chilean tax law contains no provision similar to Section 482. However, loans or advances by a Chilean taxpayer to another party, whether related or not, are presumed to bear interest at the rate of 10 percent per annum. This presumption can be rebutted by submitting documentary evidence that the loan or advance was agreed to be on a non-interest-bearing basis. A contract signed before a notary public is sufficient evidence.

INTEREST, ROYALTY, AND RENTAL CHARGES

Any agreement or amendment thereto between a Chilean resident and a nonresident which will involve a payment to the nonresident must be approved by the Chilean Central Bank. The Central Bank's Executive Committee examines each agreement for its reasonableness before they will approve it. To determine reasonableness the Committee will look at such factors as the relationship of payments to the local enterprise's volume of sales, profits before and after taxes, capital investment, and proportions of foreign and local raw materials to be used. Our office indicated that a royalty in excess of 12 percent of gross sales, a rental or service charge of over 20% of net taxable income, or an interest rate higher than the rate prevalent in the lender's country will be considered unreasonable.

Generally speaking, interest, royalty and rental payments are deductible for tax purposes if they are made pursuant to an agreement approved by the Central Bank. However, notwithstanding such approval, the Chilean Internal Revenue Service may consider a payment excessive and adjust it accordingly. If an adjustment is made which results in a tax deficiency, interest at the rate of 39.6 percent per annum is charged on the deficiency. There are no penalties, as such, imposed on adjustments of intercompany charges.

SERVICE CHARGES

No specific provisions in the Chilean Income Tax Law deal with intercompany service charges. However, as a general rule, they are deductible if supported by documentary evidence and if related to income-producing activities. An invoice attested to by the Chilean Consul in the country of origin is considered sufficient documentary evidence.

All intercompany transactions are reviewed by the Chilean Internal Revenue Service when a tax return is audited. Our office informs us that they are aware of several instances where intercompany service charges have been adjusted. In one case, charges for international promotion and brand name advertising were disallowed completely.

PRICING

The Chilean Central Bank must authorize the import and export of all goods of any nature, as well as approve the agreement of sale. Before approval is granted, the Central Bank will make sure that established quotas are not being exceeded and that the prices charged are in line with international quotations for goods of identical or similar nature, quality, etc. The Chilean Internal Revenue Service's review of intercompany prices is limited to determining that they were approved by the Central Bank.

COLOMBIA

SECTION 482 ALLOCATIONS BY IRS

The Colombian tax authorities will not allow a local company to adjust its prior years' tax returns where there has been a Section 482 adjustment to the related U.S. company. However, a payment by the Colombian subsidiary to its U.S. parent for the allocations relating to prior years will be deductible in the year of payment.

ALLOCATIONS UNDER TAX LAWS OF COLOMBIA

The Colombian tax law does not contain a provision similar to Section 482.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements, and amendments thereto, for the payment of interest, royalties, rentals, etc. are subject to approval in Colombia. Once the agreement is approved, all payments thereunder are deductible for tax purposes. The Colombian tax authorities do not review intercompany charges except to see if they have been approved. The deduction of an unapproved payment will be disallowed. There are no penalties as a result of such a disallowance.

SERVICE CHARGES

Intercompany service charges are not an allowable deduction unless they are paid pursuant to an agreement that has been approved by the Colombian government.

PRICING

Intercompany pricing is not reviewed by the Colombian tax authorities, inasmuch as all imports and exports are subject to prior exchange control approval.

COSTA RICA

SECTION 482 ALLOCATIONS BY IRS

The Costa Rican tax authorities will not allow a local company to adjust its prior years' tax returns as a result of a Section 482 adjustment to its U.S. parent.

ALLOCATIONS UNDER TAX LAWS OF COSTA RICA

The Costa Rican tax law does not contain a provision similar to Section 482.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalties, rentals, etc. do not have to be approved by the Costa Rican government. In general, such payments are deductible for tax purposes. However, they may be adjusted or

disallowed entirely depending upon the surrounding circumstances if they are considered excessive. No penalties are imposed as a result of an adjustment or disallowance except where bad faith exists.

SERVICE CHARGES

Intercompany service charges are reviewed during tax return audits. Although there are no specific provisions in the Costa Rican tax laws regarding intercompany service charges, they may be adjusted if they are not reasonable and adequately documented by invoices and accounting records.

PRICING

Intercompany pricing is reviewed when a tax return is audited in Costa Rica. Although there are no specific provisions dealing with intercompany pricing, the Costa Rican tax authorities have the power to make adjustments.

DENMARK

SECTION 482 ALLOCATIONS BY IRS

It is very doubtful whether the Danish tax authorities will allow an adjustment to a subsidiary's prior years' tax returns resulting from a Section 482 adjustment. If such an adjustment were allowed, it would have to be made within five years. If an adjustment to a prior year's tax return is not allowed, as a general rule a payment equal to the Section 482 allocation by the Danish corporation to its U.S. parent will be deductible in the current year. Although Denmark and the U.S. have a tax treaty which provides that the tax authorities of the two countries are to resolve questions of the allocation of profits between related entities our office is not aware of any case in which this provision has been utilized.

ALLOCATIONS UNDER TAX LAWS OF DENMARK

The Danish tax law contains a provision very similar to Section 482. However, detailed regulations do not exist regarding its application. Our office advises that this provision is seldom, if ever, enforced. In addition to this provision, Denmark has several tax treaties with other countries which

contain provisions with respect to the allocation of profits between related entities, but they too are seldom, if ever, used.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalties, rentals, etc. do not have to be approved by the Danish government. Such payments are deductible for tax purposes in Denmark, but they will be adjusted to reflect an arm's length charge if considered excessive. An adjustment will not be subject to a penalty unless bad faith is present.

SERVICE CHARGES

Unless intercompany service charges seem way-out-of-line, they will not be reviewed when a tax return is audited. While no specific provisions concerning the adjustment of intercompany service charges exist, the Danish tax authorities have the power to make adjustments under their "Section 482 rule." Our office is aware of several cases in which intercompany service charges have been adjusted.

PRICING

As a general rule intercompany pricing is not reviewed when a tax return is audited. The Danish tax authorities have the power to adjust intercompany prices under their "Section 482 rule" but rarely do so.

FRANCE

SECTION 482 ALLOCATIONS BY IRS

The French tax authorities will not allow a controlled subsidiary of a U.S. corporation to adjust its prior years' tax returns as a result of a Section 482 adjustment. Furthermore, present payments equal to the 482 adjustment will not be allowed as a deduction on the current year's tax return.

The tax treaty between France and the U.S. provides that the tax authorities of both countries are to cooperate in resolving questions of the allocation of profits between related entities. This provision has been used in

France to disallow expenses of a French company which are deemed to be essentially for the benefit of a U.S. parent company. Ideally this provision should be applied so that the tax authorities of both countries cooperate and agree on any allocations; thereby preventing double taxation. However, as a practical matter, neither country seems willing to allow an encroachment on their sovereignty with respect to determining the profits of a company organized under their respective laws. Our French office believes that it will be some time before the tax authorities of the two countries will cooperate to the extent necessary to prevent double taxation in cases of allocation.

ALLOCATIONS UNDER TAX LAWS OF FRANCE

Article 57 of the French Income Tax Code is very similar to Section 482. It, however, is written in more general terms, with no detailed regulations as to its application, thus giving the French tax authorities somewhat more power than Section 482 gives to the IRS. When a French company's tax return is audited, the tax authorities do not hesitate to apply Article 57.

France has several tax treaties with other countries which contain a provision to prevent double taxation in cases of allocation, but as a practical matter they are seldom applied.

INTEREST, ROYALTY, AND RENTAL CHARGES

In France, loans from abroad, whether or not from a related party, may be considered direct investments. Loans which are direct investments, must be registered with the Ministry of Finance and Economics. Any modification to the loan agreement must also be registered.

Agreements for the payment of royalties for patents, trademarks, etc. must be registered by the French company with the French Ministry of Industry and Trade at least two months before the agreement goes into effect. Within forty days after the agreement is registered, the Ministry must give its "opinion" on the definitive terms of the agreement. It is not in the form of an approval or disapproval; however if an adverse opinion is given, it would not be advisable to carry out the agreement. The opinion is required so that the French contracting party may be apprised of, and hopefully make use of any existing French technology in the field covered by the agreement. An amendment to an existing agreement must undergo the same

process. A statement of the revenues and expenses derived from carrying out the agreement must be filed with the Ministry each year.

Rental agreements are not required to be registered or approved. As a general rule, payments of interest, royalties and rentals are deductible for French income tax purposes. Interest payments to shareholders, however, are not deductible in two cases. First, where a particular shareholder loans an amount in excess of his equity contribution and charges a rate higher than that charged by the Banque de France (at present, approximately 9%) less two percentage points. Second, where shareholders that have "de jure" or "de facto" control over the company's affairs make loans exceeding the amount of the company's capital.

In addition to these specific provisions, Article 57 gives the French tax authorities the power to disallow any payments of interest, royalties, rentals, etc. which are considered excessive under the circumstances. A caveat is warranted here in connection with royalty agreements, because even though the French Ministry of Trade and Industry cannot disapprove a royalty agreement, if the payments are for know-how, technical assistance, etc., which is within the realm of French technology, they may communicate this to the tax authorities who in turn may disallow all or a portion of these payments as being unnecessary or excessive.

SERVICE CHARGES

Intercompany service charges are reviewed when a tax return is audited, and this review is generally more extensive where a foreign parent company is concerned. There are no specific provisions that deal with intercompany charges, but Article 57 gives the French tax authorities the power to adjust or disallow these charges. Our French office is aware of several cases in which adjustments were made.

PRICING

Intercompany pricing may be reviewed when a tax return is audited, but the review is not as great as in other areas of intercompany transactions. There are no specific provisions concerning intercompany prices; the power to review and adjust again stems from the general rule of Article 57. Up until now, this type of adjustment has been infrequent, occurring only where a gross misstatement of profits is disclosed.

GERMANY

SECTION 482 ALLOCATIONS BY IRS

In theory a controlled subsidiary is allowed to adjust its prior years' tax returns as a result of a Section 482 adjustment. However, such adjustments are looked upon with suspicion by the German tax authorities; the burden of proving that the original charges were unreasonable is difficult. As a practical matter, the statute of limitations is immaterial since the adjustment should be made in the current year's tax return.

The tax treaty between Germany and the U.S. provides that the tax authorities of both countries will cooperate to resolve questions of the allocation of profits between related entities. The German tax authorities are willing to apply this provision in cases where true double taxation is present. In some cases the tax authorities may first demand that the German judicial channels be exhausted. This could mean three to four years of litigation. This is, however, not a condition in every case.

ALLOCATIONS UNDER TAX LAWS OF GERMANY

The German tax law does not contain a provision similar to Section 482. They do, however, have various provisions which yield the same results. One section of the law dealing with the capital transfer tax provides that if a subsidiary makes an insufficient payment to its parent for services, the parent is deemed to have made a concealed contribution to capital which is subject to a 2.5% transfer tax.

Germany has tax treaties with several countries. All of the more recent treaties conform to the OECD model and contain provisions to eliminate cases of double taxation due to the allocation of profits between related entities. Although most of the German tax treaties contain this provision, the treaty with the U.S. is the only one which expressly sets out a settlement procedure. During the negotiations which preceded the drafting of the OECD model treaty, Germany was the only country which wanted to confirm the right of related companies to demand an identical adjustment. Thus, there is little hope that correlative adjustments through a settlement procedure can be made when dealing with countries other than the U.S.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalties, rentals, etc. need not be approved in Germany.

As a general rule such payments are fully deductible for tax purposes. Different rules, however, are applied to a German branch even though it may be taxable as a permanent establishment. Since a German branch is not considered a separate legal entity, contracts between a U.S. corporation and its German branch are not recognized. Interest paid by a branch to its home office normally is not deductible. However, a recent judicial decision in Germany allowed a branch to deduct interest paid to its home office where that office had taken out a loan solely for the purpose of obtaining assets for the branch. This same principal might be applied to other charges incurred by the home office for the benefit of the branch.

Interest, royalty, rental, etc. payments which are considered excessive will be adjusted by the German tax authority. Such adjustments are not subject to penalties unless fraud is present. Excessive payments may be found to be hidden distributions which will result in significantly greater taxes.

SERVICE CHARGES

Intercompany service charges may be reviewed when a tax return is audited. Audits usually occur every four to five years. The German tax authorities may require extensive documentation as well as sworn affidavits from key personnel to support an intercompany service charge. Generally a statement by a U.S. CPA firm as to reasonableness will be sufficient for this purpose.

The German tax authorities are authorized to use an arm's length charge in determining the amount of an adjustment. Our office informs us that the auditors working for the tax authorities in Germany are becoming more sophisticated with respect to intercompany allocations and all intercompany charges are expected to be subject to closer scrutiny in the future.

PRICING

Intercompany pricing is reviewed when a tax return is audited. Arm's length prices are used as a guide to determine if an adjustment is necessary. As a general rule, arm's length prices are easily ascertainable, therefore, adjustments are much more frequent in the intercompany pricing area than in other areas.

INDIA

SECTION 482 ALLOCATIONS BY IRS

The Indian tax authorities will not allow a controlled subsidiary of a U.S. corporation to adjust its prior years' tax returns for Section 482 adjustments. Furthermore, it is doubtful whether a present payment equal to the adjustments for prior years would be allowed as a deduction on the current year's tax return. If a contract specifically provided for the contingency of a Section 482 adjustment, the payment might be allowed as a deduction.

ALLOCATIONS UNDER TAX LAWS OF INDIA

The Indian tax law does not contain a provision similar to Section 482. They do, however, have various provisions which are aimed at accomplishing the same results, but in practice they are seldom applied.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements, and amendments thereto, for the payment of interest, royalties, rentals, etc. must be approved if they exceed 5% of profits. Such payments are deductible for tax purposes, but they may be adjusted if they are considered excessive. Penalties are not generally imposed when adjustments to intercompany charges are made but interest will be due if there is an additional tax assessment.

SERVICE CHARGES

Intercompany service charges are reviewed when a tax return is audited in India. Although there are no specific provisions concerning intercompany service charges, the Indian tax authorities do have the power to make adjustments to these charges. Our office in India is aware of several cases where such adjustments were made. Adequate support for intercompany service charges may consist of certificates from practicing CPA's or chartered accountants.

PRICING

Intercompany pricing is reviewed when a tax return is audited in India. The Indian tax authorities have the power to make adjustments to intercompany prices and sometimes do.

ITALY

SECTION 482 ALLOCATIONS BY IRS

The Italian tax authorities will not allow a controlled subsidiary of a U.S. corporation to adjust its prior years' tax returns as a result of a Section 482 adjustment. If a controlled subsidiary makes a present payment it may be deductible on the current year's tax return if that payment merely reflects what an arm's length charge should have been. Italy and the U.S. have a tax treaty which provides that the tax authorities of both countries are to resolve questions of allocation of profits between related entities. Our office in Italy is unaware of any cases in which this treaty provision has been applied.

ALLOCATIONS UNDER TAX LAWS OF ITALY

Italy has several provisions in its tax law which provide for adjustments similar to those under Section 482. There are no regulations under these sections and only a limited amount of case law.

All of the existing tax treaties between Italy and other countries contain a provision to eliminate cases of double taxation due to the allocation of profits between related entities.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalties, rentals, etc. are not subject to prior approval by the tax authorities in Italy. They must, however, be filed with the Italian Exchange Office for authorization of the transfer of currency.

Payments of royalties, rentals, etc. are deductible for tax purposes in Italy. Interest payments to a nonresident are subject to a 30% withholding tax. The gross amount of the interest is deductible if this tax is paid. If, on the other hand, this tax is not withheld, only 70% of the gross amount paid is deductible.

If the payment of interest, royalties, rentals, etc. is considered excessive it may be adjusted. There are no penalties for such adjustments.

SERVICE CHARGES

When a tax return is audited in Italy, intercompany service charges are reviewed. While these charges are, as a general rule, deductible, any excessive portion may be disallowed. In support of intercompany service charges, the tax authorities may request details of the expenses borne by the parent company as well as any written contracts related to the charges.

PRICING

Intercompany pricing is reviewed when a tax return is audited in Italy. Our office is aware of several cases where the Italian tax authorities have adjusted intercompany prices.

JAMAICA

SECTION 482 ALLOCATIONS BY IRS

The Jamaican tax authorities will allow a controlled subsidiary of a U.S. corporation to adjust its prior years' tax returns for Section 482 adjustments if they are satisfied as to the reasonableness of the adjustments. The statute of limitations for such adjustments is six years.

ALLOCATIONS UNDER TAX LAWS OF JAMAICA

The tax treaty between the U.S. and the U.K. currently applies to Jamaica. The Jamaican tax law does not contain a provision for allocations similar to Section 482. It contains a provision for eliminating cases of double taxation due to the allocation of profits between related entities. A tax treaty between the U.S. and Jamaica is presently being negotiated and it, too, in all likelihood will contain such a provision.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements, and amendments thereto, for the payment of interest, royalties, rentals, etc. must be approved by the Bank of Jamaica pursuant to the exchange control law. Such payments are deductible for tax purposes, but may be adjusted if considered excessive. Penalties will not be imposed as a result of such adjustments in the absence of fraud.

SERVICE CHARGES

Intercompany service charges are reviewed when a tax return is audited. Although there are no specific provisions concerning intercompany service charges, the Jamaican tax authorities do have the power to make adjustments to these charges. However, our office in Jamaica is unaware of any case where adjustments have been made.

PRICING

Intercompany pricing is reviewed when a tax return is audited in Jamaica. Here again, the Jamaican tax authorities have the power to make adjustments, although there are no specific provisions which deal with intercompany pricing.

JAPAN

SECTION 482 ALLOCATIONS BY IRS

When a U.S. company is subjected to Section 482 adjustment with respect to intercompany transactions with its controlled subsidiary in Japan, it is very doubtful whether the Japanese tax authorities will allow the subsidiary to adjust a prior year's tax return. If the allocation will result in an increase in the profits of the subsidiary for a prior year, there is a possibility that the adjustment will be allowed. On the other hand, an allocation which results in a reduction in profits would probably never be allowed.

If a controlled subsidiary makes a present payment to its parent for allocations relating to prior years, it may deduct such payment on its current year's tax return. A reasonable explanation for the deduction must accompany the tax return.

The tax treaty between Japan and the U.S. provides that both countries are to cooperate in resolving questions of allocation of profits between related entities. In practice, this treaty provision has not been applied. Our office in Japan has not had a case where the U.S. tax authorities have been contacted to prevent double taxation. On the other hand, the Japanese tax authorities have allowed adjustments where it has been proved that there was a true case of double taxation.

ALLOCATIONS UNDER TAX LAWS OF JAPAN

The Japanese tax law does not contain a provision similar to Section 482. However, the Japanese tax authorities do insist upon a fair allocation of profits between related entities. Japan's tax treaty with the U.S. is the only one that has a provision which will assist in eliminating cases of double taxation due to the allocation of profits between related entities.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalties, rentals, etc. must be approved under the Foreign Exchange Regulations Act and the Foreign Investment laws. Any modifications or amendments of approved agreements are also subject to approval. Approval for such agreements is a lengthy process and may take several months.

Payments of interest, royalties, rentals, etc. are deductible for tax purposes in Japan. Such payments may be adjusted to an amount which is considered "fair and reasonable". Adjustments will not result in a penalty unless there is evidence of intent to evade taxes. If, however, adjustments are large and appear to form a consistent pattern there is the danger that the taxpayer may have his "Blue Form" cancelled. The main advantage lost by cancellation of a taxpayer's "Blue Form" is the right to carry forward losses.

SERVICE CHARGES

When a tax return is audited in Japan intercompany service charges are carefully reviewed. Although there are no provisions in the Japanese tax laws concerning intercompany service charges, they may be adjusted. If these charges are supported by adequate documentation, no adjustments will be made. Adequate documentation may consist of resolutions of the Board of Directors, bylaws of the company providing for such charges, or written approval of the President and Managing Directors. If the subsidiary has agreed to such charges, the tax authorities will then consider that they have been made in good faith and at arm's length.

PRICING

Intercompany pricing is carefully reviewed when a tax return is audited in Japan, but adjustments seldom, if ever, occur. This stems from the Japanese tax authorities' attitude that if a subsidiary has agreed to a price, it must be at arm's length.

MAURITIUS

SECTION 482 ALLOCATIONS BY IRS

Although there are no specific provisions in the Mauritius Income Tax Code which would allow a controlled subsidiary of a U.S. corporation to adjust its prior years' tax returns as a result of a Section 482 adjustment, our office believes that the income tax authorities would allow such adjustments if U.S. tax returns were submitted. There is a four year statute of limitations on adjustments. If a controlled subsidiary makes a present payment of the allocated charge, our office believes that it would be allowed as a deduction on the current year's tax return. No tax treaty presently exists between the U.S. and Mauritius.

ALLOCATIONS UNDER TAX LAWS OF MAURITIUS

Mauritius has a provision in its tax law which is somewhat similar to Section 482. It gives the Commissioner the power to make any adjustments necessary to prevent the evasion of tax.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalties, rentals, etc. do not have to be approved in Mauritius. Such payments are deductible; however, any payments in excess of what is considered fair and reasonable will be disallowed. No penalties are imposed as a result of the disallowance of intercompany charges.

SERVICE CHARGES

Intercompany service charges are reviewed when a tax return is audited in Mauritius. No specific provisions deal with intercompany service charges, but as a general rule they must be fair and reasonable. The amount over that which is considered fair and reasonable will be disallowed. The basis on which the charges are computed and the manner in which they are reflected in the related company's account may have to be shown in support of the deduction.

PRICING

Intercompany pricing is seldom reviewed when a tax return is audited in Mauritius. The tax authorities do, however, have the authority to adjust intercompany prices where necessary to prevent the evasion of a tax.

MEXICO

SECTION 482 ALLOCATIONS BY IRS

The Mexican tax authorities will not allow a controlled subsidiary of a U.S. corporation to adjust its prior years' tax returns for Section 482 adjustments. Furthermore, it is very doubtful whether a present payment equal to the adjustments for prior years would be allowed as a deduction on the current year's tax return. No tax treaty presently exists between Mexico and the U.S.

ALLOCATIONS UNDER TAX LAWS OF MEXICO

The Mexican tax law neither contains a provision similar to Section 482 nor does Mexico have any tax treaties which provide for resolving questions of the allocation of profits between related entities.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalties, rentals, etc. need not be approved by the Mexican government. Such payments are deductible for tax purposes and since there is a withholding tax imposed on such payments, adjustments are seldom made. In the rare case when an adjustment is made, no penalties are imposed but interest at the rate of 2% per month is imposed upon the amount of the tax deficiency.

SERVICE CHARGES

Intercompany service charges are reviewed when a tax return is audited in Mexico. Although there are no specific provisions concerning intercompany service charges, the Mexican tax authorities do have the power to make adjustments to these charges. However, our office in Mexico is unaware of

any case in which such adjustments have been made. Detailed vouchers, contracts, etc. should be available to support such charges.

PRICING

Intercompany pricing is reviewed when a tax return is audited. Specific provisions in the Mexican law provide that the cost of imported merchandise must correspond to actual market price. To determine actual market price, the Mexican tax authorities may look to either domestic prices or foreign prices. Our office in Mexico is aware of several cases where adjustments have been made to intercompany pricing.

NETHERLANDS

SECTION 482 ALLOCATIONS BY IRS

The Dutch tax authorities will allow as a matter of practice (not of right), a controlled subsidiary of a U.S. company to adjust its prior years' tax returns as a result of a Section 482 adjustment. As a general rule the statute of limitations for such adjustments is five years but in exceptional cases a longer period might be allowed. A present payment might be deductible on the current year's tax return, but since no specific provision allowing this exists, it depends largely upon the approval of the local tax inspector.

The tax treaty between the Netherlands and the U.S. provides that the two countries are to cooperate in resolving questions of the allocation of profits between related entities in order to avoid double taxation. Our office in the Netherlands has been assured by the Dutch Ministry of Finance that it is more than willing to cooperate in cases of double taxation.

ALLOCATIONS UNDER TAX LAWS OF NETHERLANDS

There are no specific provisions in the Dutch tax law which correspond to Section 482. However, judicial decisions have interpreted general provisions to the extent that the principles of Section 482 are applied in practice.

Most of the tax treaties in force in the Netherlands contain a provision dealing with the elimination of cases of double taxation due to allocation of profits between related entities.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalties, rentals, etc. must be approved for foreign exchange purposes, but not for tax purposes.

Payments of interest, royalties, rentals, etc. are deductible for tax purposes in the Netherlands. However, these payments will be adjusted if considered excessive. No penalties are imposed as a result of such adjustments.

SERVICE CHARGES

Intercompany service charges are reviewed when a tax return is audited in the Netherlands. While no specific provisions exist concerning intercompany service charges, the tax authorities do have the power to adjust such charges if considered excessive. In general, intercompany charges are compared with arm's length charges between unrelated companies to determine if a particular charge is excessive. Such comparisons are very difficult with respect to intercompany management charges. This places an onerous burden on the tax inspector, he must prove that the charges are in excess of an arm's length amount.

PRICING

Intercompany pricing is always reviewed when a tax return is audited in the Netherlands. Our office in the Netherlands states that the Dutch tax authorities are "very much awake on the point of shifting profit in this manner".

PANAMA

SECTION 482 ALLOCATIONS BY IRS

The Panamanian tax authorities will neither allow a controlled subsidiary of a U.S. corporation to adjust its prior years' tax returns as a result of a Section 482 adjustment nor will they allow a present payment to be deducted on the current year's tax return. No tax treaty presently exists between the U.S. and Panama.

ALLOCATIONS UNDER TAX LAWS OF PANAMA

The Panamanian tax law does not contain a provision similar to Section 482. As a practical matter, however, the Panamanian tax authorities may adjust an intercompany charge.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalties, rentals, etc. do not have to be approved in Panama. Such payments are deductible for income tax purposes and as a general rule are not adjusted. Our office advises that the tax authorities will frequently question lump sum payments where such adjustments are made. No penalties are imposed.

SERVICE CHARGES

Intercompany service charges are reviewed when a tax return is audited in Panama. While no specific provisions exist in Panama's tax law dealing with intercompany service charges, such charges may be adjusted under various general provisions. To support intercompany service charges it is preferable to have a written contract; a debit voucher with detailed explanations may be enough, however.

PRICING

Intercompany pricing is not reviewed when a tax return is audited in Panama. There are no specific provisions in the Panamanian tax laws which concern intercompany pricing. Our office is unaware of any case where the Panamanian tax authorities have adjusted intercompany prices.

PHILIPPINES

SECTION 482 ALLOCATIONS BY IRS

The Philippine tax authorities will allow a controlled subsidiary of a U.S. corporation to adjust its prior years' tax returns as a result of a Section 482 adjustment. Additional deductions taken on a prior years' tax return, say for interest, will result in additional income to the U.S. corporation–subject to a

withholding tax of 35%. Statutory interest and penalties may be assessed on the tax deficiency in addition to the withholding tax. There is a two year statute of limitations on amending a prior year's tax return where the amendment would result in a refund of tax paid. If, however, the amendment results in a tax deficiency, the amendment will be allowed at any time. A present payment by a controlled subsidiary to its U.S. parent will be allowed as a deduction on the current year's tax return only if the subsidiary is on a cash basis.

A tax treaty between the U.S. and the Philippines, approved by the U.S. Senate on June 6, 1968, will come into effect as soon as the instruments of ratification are exchanged. It contains a provision to assist in eliminating cases of double taxation due to the allocation of profits between related entities.

ALLOCATIONS UNDER TAX LAWS OF THE PHILIPPINES

Section 44 of the Philippine tax code is identical to Section 482. In addition, Section 179 of the Philippine Income Tax Regulations corresponds to T.D. 6595 issued under Section 482 in 1962. The Philippine tax authorities have applied Section 44 in several cases, but it hasn't been enforced as extensively as is Section 482 in the U.S.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalties, rental, etc. are not subject to approval in the Philippines. Such payments are deductible in the Philippines if they are ordinary and necessary business expenses paid or incurred during the taxable year. If these payments are based on an arm's length charge they may be adjusted. Interest at the rate of 6% per annum is imposed on the additional assessment resulting from such adjustments. If fraud is present the deficiency is subject to a 50% surcharge.

SERVICE CHARGES

Intercompany service charges are reviewed when a tax return is audited in the Philippines. No specific provisions in the Philippine tax laws deal with intercompany service charges, but the tax authorities are given the power to review and adjust such charges under Section 44. To support the deducti-

bility of such charges, it would be advisable to have a resolution of the Board of Directors or a contract which specifies the nature and the amount of the charges.

PRICING

The tax authorities have the power to adjust intercompany pricing under Section 44. While the tax authorities always review intercompany pricing when they audit a tax return, adjustments are rarely made.

RHODESIA

SECTION 482 ALLOCATIONS BY IRS

The Rhodesian tax authorities may allow a subsidiary to adjust its prior years' tax returns as a result of a Section 482 adjustment. There is a six year statute of limitations. No tax treaty presently exists between Rhodesia and the U.S.

ALLOCATIONS UNDER TAX LAWS OF RHODESIA

There is no specific provision in the Rhodesian tax law which corresponds to Section 482. All intercompany transactions are reviewed, however.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalties, rentals, etc. are not subject to prior approval in Rhodesia. Such payments are deductible to the extent that they are incurred for the purposes of a trade or business or in the production of income. Any portion of a charge which is considered excessive may be adjusted. No penalties will be imposed as a result of an adjustment unless an attempt to evade tax is evidenced.

SERVICE CHARGES

Intercompany service charges are reviewed when a tax return is audited in Rhodesia. While no specific provisions exist which deal with intercompany service charges, the Rhodesian tax authorities have the power to adjust such

charges to reflect what they consider a reasonable amount. When an intercompany service charge is contested, the charge should be supported by documentation which shows the basis of its calculation or determination.

PRICING

When a tax return is audited in Rhodesia, the tax authorities will review intercompany pricing. The Commissioner is given the power to adjust intercompany prices to what he considers to be fair market value.

SOUTH AFRICA

SECTION 482 ALLOCATIONS BY IRS

The South African tax authorities will not allow the controlled subsidiary of a U.S. corporation to adjust its prior years' tax returns for Section 482 adjustments. The only case where a company can adjust its prior years' tax returns is where there is a legal liability to pay in those years. In addition, a current payment by a South African subsidiary to its U.S. parent for allocations relating to prior years will not be allowed as a deduction on the current year's tax return.

The tax treaty between South Africa and the U.S. provides that the tax authorities of both countries are to cooperate in resolving questions of the allocation of profits between related entities. Our office is unaware of any case where this provision has been applied. They have discussed its application with the local tax authorities, who have indicated that they would not apply it where there has been an adjustment under Section 482.

ALLOCATIONS UNDER TAX LAWS OF SOUTH AFRICA

Section 103 of the South African Income Tax Act is a general provision which gives the tax authorities the power to set aside a transaction if they are of the opinion that the transaction was entered into for the purpose of postponing, avoiding, or reducing any tax. It does not, however, grant the power to create income as does Section 482. For example, under Section 482 the IRS can impute income for interest, royalties, rentals, etc. There are no detailed regulations under Section 103, but there are a number of judicial

decisions which have been used as precedents in the enforcement of this section. There are tax treaties between South Africa and a number of other countries which contain a provision to assist in eliminating cases of double taxation due to the allocation of profits between related entities. It is unlikely, however, that any of these treaties will assist in eliminating double taxation if the allocations relate to prior years.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalties, rentals, etc. need not be approved in South Africa. Such payments are deductible for tax purposes, but any portion which is considered excessive will be disallowed. As a general rule, no penalties are imposed as a result of the disallowance of an intercompany charge.

SERVICE CHARGES

Intercompany service charges are reviewed each year when the tax authorities make their assessment for tax. There are no specific provisions in the South African Tax Act which concern intercompany service charges, but they may be subject to adjustment on the basis of Section 103. All intercompany service charges should be supported by a formal agreement between the related parties.

PRICING

When the South African Tax authorities make their yearly assessment for tax, they may review intercompany pricing. There are no specific provisions in the South African Tax Act which deal with intercompany pricing, but again Section 103 may be used as a basis for adjustment. Such adjustments have been very infrequent in the past.

SWEDEN

SECTION 482 ALLOCATIONS BY IRS

The Swedish tax authorities will allow the controlled subsidiary of a U.S. corporation to adjust its prior years' tax returns as a result of a Section 482

adjustment where they believe that such adjustments are fair and reasonable. As a general rule, a tax return can be adjusted only until the due date of the tax return for the following year. Thus, it is advisable to make adjustments for prior years on the current year's tax return. Adjustments, if booked immediately upon discovery, may be allowed as a deduction in the current year.

The tax treaty between Sweden and the U.S. provides that the tax authorities of both countries are to cooperate in resolving questions of the allocation of profits between related entities. To the knowledge of our office in Sweden this provision has only been applied once. The case arose several years ago and is as yet unsettled. It is doubtful whether this provision will assist in eliminating cases of double taxation.

ALLOCATIONS UNDER TAX LAWS OF SWEDEN

Section 483 of the Swedish tax code is very similar to Section 482. There are no detailed regulations delineating the applicability of this section, but the tax authorities do have the power to adjust any intercompany charge.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalties, rentals, etc. do not have to be approved in Sweden. It is possible, however, to have an agreement approved or disapproved by an advance ruling of the National Swedish Tax Board. Payments of interest, royalties, rentals, etc. are as a general rule deductible for tax purposes. These payments will be adjusted, however, if considered excessive. Penalties are imposed only when bad faith is present.

SERVICE CHARGES

Intercompany service charges are reviewed when the Swedish tax authorities perform an audit. There are no specific provisions in the Swedish tax law which deal with intercompany service charges, but the Swedish tax authorities have the power to adjust such charges under Section 483. Thorough documentation including details of calculations should be available to support such charges.

PRICING

Intercompany pricing may be reviewed when a tax return is audited in Sweden. There are no specific provisions in the Swedish tax law concerning intercompany pricing, but as a general rule the arm's length standard is applied. In the past, there have been very few cases of adjustment of intercompany prices.

SWITZERLAND

SECTION 482 ALLOCATIONS BY IRS

A controlled Swiss subsidiary of a U.S. corporation may not adjust its prior years' tax returns as a result of a Section 482 adjustment. In Switzerland, all accounts must be presented to a shareholders' meeting no later than six months after the closing date of a fiscal year. Once these accounts are approved at the shareholders' meeting they cannot be adjusted. In addition, a present payment would not be deductible in the current year's tax return.

The tax treaty between Switzerland and the U.S. provides that the tax authorities of both countries are to cooperate in resolving questions of the allocation of profits between related entities. This provision has not been applied in practice. The Swiss tax authorities' concept of double taxation is that it is limited to the case where there is double taxation of the same person or corporation. Double taxation, therefore, cannot result from Section 482 adjustments between a U.S. corporation and its Swiss subsidiary. On the other hand, a Section 482 adjustment with respect to a Swiss branch could result in double taxation.

ALLOCATIONS UNDER TAX LAWS OF SWITZERLAND

There are various provisions in the Swiss tax law, both Federal and Cantonal which accomplish the same results as Section 482. There are no detailed regulations under these provisions, but there are a large number of court decisions and published administrative positions.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalties, rentals, etc. are not

subject to prior approval in Switzerland. Such agreements may, however, be submitted to the tax authorities for approval. This practice may be advisable in cases where it is thought later adjustments are possible.

Payments of interest, royalties, rentals, etc. are deductible for tax purposes. Such payments must be equivalent to an arm's length charge. Any portion that is considered in excess of an arm's length charge will be disallowed. As a general rule no penalties will be imposed where a charge is disallowed. A penalty is possible, however, when the excessive charge was solely for the purpose of tax avoidance.

SERVICE CHARGES

Intercompany service charges will be reviewed by the Swiss tax authorities when they audit a tax return. There are no specific provisions in the Swiss tax law which deal with intercompany service charges. General provisions have been interpreted by court and administrative decisions to require that all charges be at an arm's length rate. Intercompany service charges are frequently adjusted in Switzerland. To support intercompany service charges, one may be required to submit contracts, correspondence, and detailed invoices.

PRICING

Since Switzerland is a popular country for base companies, intercompany prices are likely to be reviewed when the Swiss tax authorities audit a tax return. No specific provisions in the Swiss tax law concern intercompany pricing but the arm's length rule is generally applied.

UNITED KINGDOM

SECTION 482 ALLOCATIONS BY IRS

The U.K. tax authorities may allow a controlled subsidiary of a U.S. corporation to adjust its prior years' tax returns as a result of a Section 482 adjustment. The statute of limitations is six years. Although prior years' tax returns can be amended, our U.K. office states that it is likely that the U.K. tax authorities would make the adjustment in the current year's tax return.

The tax treaty between the U.S. and U.K. provides that the tax authorities of both countries are to cooperate in resolving questions of allocation of profits between related entities. Our U.K. office is unaware of any cases in which this provision has been applied.

ALLOCATIONS UNDER TAX LAWS OF UNITED KINGDOM

Section 469 of the 1952 Income Tax Act is very similar to Section 482. There are no detailed regulations delineating the applicability of this section, but as a general rule it is applied to the same sort of situations as is Section 482. The extent to which this section is enforced depends largely on the local inspector of taxes.

Most of the tax treaties between the U.K. and other countries contain a provision which may assist in eliminating cases of double taxation due to the allocation of profits between related entities. These provisions, however, have seldom been applied.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalties, rentals etc. must be approved by the exchange control office of the Bank of England. Unless the Bank of England has reason to suppose that the agreement represents a subterfuge, it will not challenge or limit the size of any royalties or fee. While approval of an initial agreement may take several weeks, approval of subsequent amendments usually takes only a few days. Payments made under approved agreements are deductible for tax purposes. If, however, the U.K. tax authorities consider the payments excessive they may be adjusted. Penalties are not imposed as a result of such adjustments except in the case of fraud or willful misrepresentation.

SERVICE CHARGES

Intercompany service charges are reviewed annually when a tax return is submitted to the U.K. tax authorities. A tax return is not audited in the strict sense of the word except in cases where it is thought that fraud may be present. To support intercompany service charges, the U.K. tax authorities may require a statement of the services rendered together with all supporting documents.

PRICING

Section 469 of the 1952 Income Tax Act provides that intercompany prices must be at arm's length. Intercompany prices may be reviewed by the U.K. tax authorities. While our member firm has not been involved in any cases where the U.K. tax authorities have adjusted intercompany prices, they have advised clients to adjust intercompany prices before the tax return was prepared.

VENEZUELA

SECTION 482 ALLOCATIONS BY IRS

The Venezuelan tax authorities may allow a controlled subsidiary of a U.S. corporation to adjust its prior years' tax returns as a result of a Section 482 adjustment. However, expenses must be incurred in Venezuela to be deductible for Venezuelan tax purposes. The deductability of expenses does not depend on the place of payment, but rather upon where the economic transaction takes place or where the services are performed. Such adjustments are subject to a five year statute of limitations. The tax authorities will not allow a present payment equal to the adjustments for prior years as a deduction on the current year's tax return.

ALLOCATIONS UNDER TAX LAWS OF VENEZUELA

The Venezuelan tax law does not contain a provision similar to Section 482. Thus, there will be no allocations as such, but it should be noted that improper expenses (those incurred outside of Venezuela) will be disallowed.

INTEREST, ROYALTY, AND RENTAL CHARGES

Agreements for the payment of interest, royalties, rentals, etc. need not be approved by the government of Venezuela. Payments for interest and royalties will be deductible only if the withholding tax on such payments has been withheld and paid over to the tax authorities. Rental expenses will be deductible only if the asset is located in Venezuela. Rental income

is not subject to the withholding tax. In cases where intercompany charges are considered excessive they will be adjusted. Such adjustments may be subject to substantial penalty - ranging from 10% to 200% of the amount of the tax deficiency.

SERVICE CHARGES

Intercompany service charges are reviewed when a tax return is audited. Payments for intercompany service charges are deductible only if they are for the performance of services in Venezuela. Since a company which renders services to a related company in Venezuela is subject to the Venezuelan income tax, adjustments are not made. Our office in Venezuela is unaware of any case where an adjustment has been made.

PRICING

Intercompany pricing is reviewed when a tax return is audited. If intercompany prices are greater than normal market prices, adjustments will be made. Our office is aware of several cases in which intercompany prices have been adjusted.

ZAMBIA

SECTION 482 ALLOCATIONS BY IRS

The Zambian tax authorities may allow a controlled subsidiary of a U.S. corporation to adjust its prior years' tax returns as a result of a Section 482 adjustment. There is a six year statute of limitations. No tax treaty presently exists between Zambia and the U.S.

ALLOCATIONS UNDER TAX LAWS OF ZAMBIA

Zambian tax law does not contain a provision similar to Section 482.

INTEREST, ROYALTY, AND RENTAL CHARGES

Payments of interest, royalties, rentals, etc. are deductible for tax purposes in Zambia if for business purposes or for the production of

income. If the Zambian tax authorities consider a payment excessive, they may make adjustments. No penalties will be imposed as a result of such adjustments unless an attempt to evade tax is evidenced.

SERVICE CHARGES

Intercompany service charges are reviewed when a tax return is audited in Zambia. No specific provisions deal with intercompany service charges, and adjustments are rarely made.

PRICING

Intercompany pricing is reviewed when a tax return is audited in Zambia. There are no specific provisions in the tax law which concern intercompany pricing and again, adjustments rarely occur.

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