§ 1.482–4T Methods to determine tax-

(i) Based on this information, the present
discounted value of the projected
whopperchopper sales is approximately $10
million, yielding an equivalent royalty rate
of approximately 5%. Thus, the equivalent
royalty amounts for each year are as follows:

<table>
<thead>
<tr>
<th>Year</th>
<th>Projected sales</th>
<th>Equivalent royalty amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$2,500,000</td>
<td>$125,000</td>
</tr>
<tr>
<td>2</td>
<td>2,600,000</td>
<td>130,000</td>
</tr>
<tr>
<td>3</td>
<td>2,700,000</td>
<td>135,000</td>
</tr>
<tr>
<td>4</td>
<td>2,700,000</td>
<td>135,000</td>
</tr>
<tr>
<td>5</td>
<td>2,750,000</td>
<td>137,500</td>
</tr>
</tbody>
</table>

(iv) If in any of the five taxable years the
equivalent royalty amount is determined not
to be an arm’s length amount, a periodic ad-
justment may be made pursuant to §1.482-
4(f)(2)(i). The adjustment in such case would
be equal to the difference between the equiv-
elent royalty amount and the arm’s length
royalty in that taxable year.

(7) [Reserved]. For further guidance, see §1.482–4T(f)(7).

g) [Reserved] For further guidance, see §1.482–4T(g).

(h) Effective/applicability date—(1) In
general. The provisions of paragraphs
(f)(3)(i)(A), (f)(3)(ii), and (f)(4) of this
section are generally applicable for
taxable years beginning after July 31,
2009.

(2) Election to apply regulation to ear-
lier taxable years. A person may elect to
apply the provisions of paragraphs
(f)(3)(i)(A), (f)(3)(ii), and (f)(4) of this
section to earlier taxable years in ac-
cordance with the rules set forth in
§1.482–9(n)(2).

[T.D. 8552, 59 FR 35016, July 8, 1994; T.D. 9278,
71 FR 44484, Aug. 4, 2006; T.D. 9456, 74 FR
38843, Aug. 4, 2009]

§ 1.482–4T Methods to determine tax-
able income in connection with a
transfer of intangible property
(temporary).

(a) through (f)(3)(i)(A) [Reserved] For
further guidance, see §1.482–4(a)

(B) Cost sharing arrangements. The
rules in this paragraph (f)(3) regarding
ownership with respect to cost shared
intangibles and cost sharing arrange-
ments will apply only as provided in
§1.482–7T.

(f)(3)(ii) through (f)(6) [Reserved] For
further guidance, see §1.482–4(f)(3)(ii)
through (f)(6).

(g) Coordination with rules governing
cost sharing arrangements. Section 1.482–
7T provides the specific methods to be
used to determine arm’s length results
of controlled transactions in connec-
tion with a cost sharing arrangement.

This section provides the specific
methods to be used to determine arm’s
length results of a transfer of intan-
gible property, including in an arrange-
ment for sharing the costs and risks of
developing intangibles other than a
cost sharing arrangement covered by
§1.482–7T. In the case of such an ar-
rangement, consideration of the prin-
ciples, methods, comparability, and re-
liability considerations set forth in
§1.482–7T is relevant in determining the
best method, including an unspecified
method, under this section, as appro-
priately adjusted in light of the dif-
fences in the facts and circumstances
between such arrangement and a cost
sharing arrangement.

(h) Effective/applicability date. The
provisions of paragraphs (f)(3)(i)(B) and
(g) of this section are generally appli-
cable on January 5, 2009.

(i) Expiration date. The applicabil-
ity of this section expires on or before De-
cember 30, 2011.

[T.D. 9278, 71 FR 44484, Aug. 4, 2006, as amend-
ed by T.D. 9441, 74 FR 351, Jan. 5, 2009; T.D.
9456, 74 FR 38843, Aug. 4, 2009]

§ 1.482–5 Comparable profits method.

(a) In general. The comparable profits
method evaluates whether the amount
charged in a controlled transaction is
arm’s length based on objective mea-
ures of profitability (profit level indi-
cators) derived from uncontrolled tax-
payers that engage in similar business
activities under similar circumstances.

(b) Determination of arm’s length re-
result—(1) In general. Under the com-
parable profits method, the determina-
 tion of an arm’s length result is based
on the amount of operating profit that
the tested party would have earned on
related party transactions if its profit
level indicator were equal to that of an
uncontrolled comparable (comparable
operating profit). Comparable oper-
ating profit is calculated by deter-
mining a profit level indicator for an
uncontrolled comparable, and applying
the profit level indicator to the finan-
cial data related to the tested party’s
most narrowly identifiable business ac-
tivity for which data incorporating the
controlled transaction is available (relevant business activity). To the extent possible, profit level indicators should be applied solely to the tested party's financial data that is related to controlled transactions. The tested party's reported operating profit is compared to the comparable operating profits derived from the profit level indicators of uncontrolled comparables to determine whether the reported operating profit represents an arm's length result.

(2) Tested party—(i) In general. For purposes of this section, the tested party will be the participant in the controlled transaction whose operating profit attributable to the controlled transactions can be verified using the most reliable data and requiring the fewest and most reliable adjustments, and for which reliable data regarding uncontrolled comparables can be located. Consequently, in most cases the tested party will be the least complex of the controlled taxpayers and will not own valuable intangible property or unique assets that distinguish it from potential uncontrolled comparables.

(ii) Adjustments for tested party. The tested party's operating profit must first be adjusted to reflect all other allocations under section 482, other than adjustments pursuant to this section.

(3) Arm's length range. See §1.482-1(e)(2) for the determination of the arm's length range. For purposes of the comparable profits method, the arm's length range will be established using comparable operating profits derived from a single profit level indicator.

(4) Profit level indicators. Profit level indicators are ratios that measure relationships between profits and costs incurred or resources employed. A variety of profit level indicators can be calculated in any given case. Whether use of a particular profit level indicator is appropriate depends upon a number of factors, including the nature of the activities of the tested party, the reliability of the available data with respect to uncontrolled comparables, and the extent to which the profit level indicator is likely to produce a reliable measure of the income that the tested party would have earned had it dealt with controlled taxpayers at arm's length, taking into account all of the facts and circumstances. The profit level indicators should be derived from a sufficient number of years of data to reasonably measure returns that accrue to uncontrolled comparables. Generally, such a period should encompass at least the taxable year under review and the preceding two taxable years. This analysis must be applied in accordance with §1.482-1(f)(2)(iii)(D).

Profit level indicators that may provide a reliable basis for comparing operating profits of the tested party and uncontrolled comparables include the following—

(i) Rate of return on capital employed. The rate of return on capital employed is the ratio of operating profit to operating assets. The reliability of this profit level indicator increases as operating assets play a greater role in generating operating profits for both the tested party and the uncontrolled comparable. In addition, reliability under this profit level indicator depends on the extent to which the composition of the tested party's assets is similar to that of the uncontrolled comparable. Finally, difficulties in properly valuing operating assets will diminish the reliability of this profit level indicator.

(ii) Financial ratios. Financial ratios measure relationships between profit and costs or sales revenue. Since functional differences generally have a greater effect on the relationship between profit and costs or sales revenue than the relationship between profit and operating assets, financial ratios are more sensitive to functional differences than the rate of return on capital employed. Therefore, closer functional comparability normally is required under a financial ratio than under the rate of return on capital employed to achieve a similarly reliable measure of an arm's length result. Financial ratios that may be appropriate include the following—

(A) Ratio of operating profit to sales; and

(B) Ratio of gross profit to operating expenses. Reliability under this profit level indicator also depends on the extent to which the composition of the tested party's operating expenses is similar to that of the uncontrolled comparables.
(iii) Other profit level indicators. Other profit level indicators not described in this paragraph (b)(4) may be used if they provide reliable measures of the income that the tested party would have earned had it dealt with controlled taxpayers at arm’s length. However, profit level indicators based solely on internal data may not be used under this paragraph (b)(4) because they are not objective measures of profitability derived from operations of uncontrolled taxpayers engaged in similar business activities under similar circumstances.

(c) Comparability and reliability considerations—(1) In general. Whether results derived from application of this method are the most reliable measure of the arm’s length result must be determined using the factors described under the best method rule in §1.482–1(c).

(2) Comparability—(i) In general. The degree of comparability between an uncontrolled taxpayer and the tested party is determined by applying the provisions of §1.482–1(d)(2). The comparable profits method compares the profitability of the tested party, measured by a profit level indicator (generally based on operating profit), to the profitability of uncontrolled taxpayers in similar circumstances. As with all methods that rely on external market benchmarks, the greater the degree of comparability between the tested party and the uncontrolled taxpayer, the more reliable will be the results derived from the application of this method. The determination of the degree of comparability between the tested party and the uncontrolled taxpayer depends upon all the relevant facts and circumstances, including the relevant lines of business, the products or services involved, the asset composition employed (including the nature and quantity of tangible and intangible assets and working capital), the size and scope of operations, and the stage in a business or product cycle.

(ii) Functional, risk and resource comparability. An operating profit represents a return for the investment of resources and assumption of risks. Therefore, although all of the factors described in §1.482–1(d)(3) must be considered, comparability under this method is particularly dependent on resources employed and risks assumed. Moreover, because resources and risks usually are directly related to functions performed, it is also important to consider functions performed in determining the degree of comparability between the tested party and an uncontrolled taxpayer. The degree of functional comparability required to obtain a reliable result under the comparable profits method, however, is generally less than that required under the resale price or cost plus methods. For example, because differences in functions performed often are reflected in operating expenses, taxpayers performing different functions may have very different gross profit margins but earn similar levels of operating profit.

(iii) Other comparability factors. Other factors listed in §1.482–1(d)(3) also may be particularly relevant under the comparable profits method. Because operating profit usually is less sensitive than gross profit to differences in business experience (such as whether the business is in a start-up phase or is mature), or differences in management efficiency (as indicated, for example, by objective evidence such as expanding or contracting sales or executive compensation over time). Accordingly, if material differences in these factors are identified based on objective evidence, the reliability of the analysis may be affected.

(iv) Adjustments for the differences between the tested party and the uncontrolled taxpayers. If there are differences between the tested party and an uncontrolled comparable that would materially affect the profits determined under the relevant profit level indicator, adjustments should be made.
Internal Revenue Service, Treasury

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Internal Revenue Service, Treasury § 1.482–5

according to the comparability provisions of § 1.482–1(d)(2). In some cases, the assets of an uncontrolled comparable may need to be adjusted to achieve greater comparability between the tested party and the uncontrolled comparable. In such cases, the uncontrolled comparable’s operating income attributable to those assets must also be adjusted before computing a profit level indicator in order to reflect the income and expense attributable to the adjusted assets. In certain cases it may also be appropriate to adjust the operating profit of the tested party and comparable parties. For example, where there are material differences in accounts payable among the comparable parties and the tested party, it will generally be appropriate to adjust the operating profit of each party by increasing it to reflect an imputed interest charge on each party’s accounts payable. As another example, it may be appropriate to adjust the operating profit of a party to account for material differences in the utilization of or accounting for stock-based compensation (as defined by §1.482–7T(d)(3)(i)) among the tested party and comparable parties.

(3) Data and assumptions—(i) In general. The reliability of the results derived from the comparable profits method is affected by the quality of the data and assumptions used to apply this method.

(ii) Consistency in accounting. The degree of consistency in accounting practices between the controlled transaction and the uncontrolled comparables that materially affect operating profit affects the reliability of the result. Thus, for example, if differences in inventory and other cost accounting practices would materially affect operating profit, the ability to make reliable adjustments for such differences would affect the reliability of the results.

(iii) Allocations between the relevant business activity and other activities. The reliability of the allocation of costs, income, and assets between the relevant business activity and other activities of the tested party or an uncontrolled comparable will affect the reliability of the determination of operating profit and profit level indicators. If it is not possible to allocate costs, income, and assets directly based on factual relationships, a reasonable allocation formula may be used. To the extent direct allocations are not made, the reliability of the results derived from the application of this method is reduced relative to the results of a method that requires fewer allocations of costs, income, and assets. Similarly, the reliability of the results derived from the application of this method is affected by the extent to which it is possible to apply the profit level indicator to the tested party’s financial data that is related solely to the controlled transactions. For example, if the relevant business activity is the assembly of components purchased from both controlled and uncontrolled suppliers, it may not be possible to apply the profit level indicator solely to financial data related to the controlled transactions. In such a case, the reliability of the results derived from the application of this method will be reduced.

(d) Definitions. The definitions set forth in paragraphs (d)(1) through (6) of this section apply for purposes of this section.

(1) Sales revenue means the amount of the total receipts from sale of goods and provision of services, less returns and allowances. Accounting principles and conventions that are generally accepted in the trade or industry of the controlled taxpayer under review must be used.

(2) Gross profit means sales revenue less cost of goods sold.

(3) Operating expenses includes all expenses not included in cost of goods sold except for interest expense, foreign income taxes (as defined in §1.901–2(a)), domestic income taxes, and any other expenses not related to the operation of the relevant business activity. Operating expenses ordinarily include expenses associated with advertising, promotion, sales, marketing, warehousing and distribution, administration, and a reasonable allowance for depreciation and amortization.

(4) Operating profit means gross profit less operating expenses. Operating profit includes all income derived from the business activity being evaluated by the comparable profits method, but
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does not include interest and dividends, income derived from activities not being tested by this method, or extraordinary gains and losses that do not relate to the continuing operations of the tested party.

(5) **Reported operating profit** means the operating profit of the tested party reflected on a timely filed U.S. income tax return. If the tested party files a U.S. income tax return, its operating profit is considered reflected on a U.S. income tax return if the calculation of taxable income on its return for the taxable year takes into account the income attributable to the controlled transaction under review. If the tested party does not file a U.S. income tax return, its operating profit is considered reflected on a U.S. income tax return in any taxable year for which income attributable to the controlled transaction under review affects the calculation of the U.S. taxable income of any other member of the same controlled group. If the comparable operating profit of the tested party is derived from financial statements or other accounting records and reports of comparable parties, adjustments may be made to the reported operating profit of the tested party in order to account for material differences between the tested party’s operating profit reported for U.S. income tax purposes and the tested party’s operating profit for financial statement purposes. In addition, in accordance with §1.482–1(f)(2)(ii)(D), adjustments under section 482 that are finally determined may be taken into account in determining reported operating profit.

(6) **Operating assets.** The term operating assets means the value of all assets used in the relevant business activity of the tested party, including fixed assets and current assets (such as cash, cash equivalents, accounts receivable, and inventories).

The term does not include investments in subsidiaries, excess cash, and portfolio investments. Operating assets may be measured by their net book value or by their fair market value, provided that the same method is consistently applied to the tested party and the comparable parties, and consistently applied from year to year. In addition, it may be necessary to take into account recent acquisitions, leased assets, intangibles, currency fluctuations, and other items that may not be explicitly recorded in the financial statements of the tested party or uncontrolled comparable. Finally, operating assets must be measured by the average of the values for the beginning of the year and the end of the year, unless substantial fluctuations in the value of operating assets during the year make this an inaccurate measure of the average value over the year. In such a case, a more accurate measure of the average value of operating assets must be applied.

(e) **Examples.** The following examples illustrate the application of this section.

Example 1. Transfer of tangible property resulting in no adjustment. (i) FP is a publicly traded foreign corporation with a U.S. subsidiary, USSub, that is under audit for its 1996 taxable year. FP manufactures a consumer product for worldwide distribution. USSub imports the assembled product and distributes it within the United States at the wholesale level under the FP name.

(ii) FP does not allow uncontrolled taxpayers to distribute the product. Similar products are produced by other companies but none of them is sold to uncontrolled taxpayers or to uncontrolled distributors.

(iii) Based on all the facts and circumstances, the district director determines that the comparable profits method will provide the most reliable measure of an arm’s length result. USSub is selected as the tested party because it engages in activities that are less complex than those undertaken by FP.

There is data from a number of independent operators of wholesale distribution businesses. These potential comparables are further narrowed to select companies in the same industry segment that perform similar functions and bear similar risks to USSub. An analysis of the information available on these taxpayers shows that the ratio of operating profit to sales is the most appropriate profit level indicator, and this ratio is relatively stable where at least three years are included in the average. For the taxable years 1994 through 1996, USSub shows the following results:

<table>
<thead>
<tr>
<th>Year</th>
<th>Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>1994</td>
<td>$500,000</td>
</tr>
<tr>
<td>1995</td>
<td>$560,000</td>
</tr>
<tr>
<td>1996</td>
<td>$500,000</td>
</tr>
<tr>
<td>Average</td>
<td>$560,000</td>
</tr>
</tbody>
</table>

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(iv) After adjustments have been made to account for identified material differences between USSub and the uncontrolled distributors, the average ratio of operating profit to sales is calculated for each of the uncontrolled distributors. Applying each ratio to USSub would lead to the following comparable operating profit (COP) for USSub:

- **Example 1:**
  - USSub reported the following income and expenses:
    - Sales: $500,000
    - Cost of Goods Sold: $370,000
    - Operating Profit: $20,000
  - The interquartile range of comparable operating profits for 1996 falls outside this range. Although USSub’s average reported operating profit for 1996 ($20,000) is within this range.
  - Therefore, the district director concludes that it is likely that all material differences between USSub and the uncontrolled distributors have been identified.
  - The data is not sufficiently complete to conclude that it is likely that all material differences between USSub and the uncontrolled distributors have been identified.
  - Therefore, an arm’s length range can be established only pursuant to §1.482-1(e)(2)(iii)(B). The district director measures the arm’s length range by the interquartile range of results, which consists of the results ranging from $19,760 to $34,840. Although USSub’s operating income for 1996 shows a loss of $4,600, the district director determines that no allocation should be made, because USSub’s average reported operating profit of $20,000 is within this range.

- **Example 2:** Transfer of tangible property resulting in adjustment.
  - The facts are the same as in Example 1 except that USSub reported the following income and expenses:
    - Sales: $500,000
    - Cost of Goods Sold: $370,000
    - Operating Profit: $20,000
  - The district director measures the arm’s length range by the interquartile range of results, which consists of the results ranging from $19,760 to $34,840. Although USSub’s average reported operating profit for 1996 is $20,000, the district director determines that no allocation should be made, because USSub’s average reported operating profit of $20,000 is within this range.

(ii) The interquartile range of comparable operating profits remains the same as derived in Example 1: $19,790 to $34,840. USSub’s average operating profit for the years 1994 through 1996 ($0) falls outside this range. Therefore, the district director determines that an allocation may be appropriate.

(iii) To determine the amount, if any, of the allocation, the district director compares USSub’s reported operating profit for 1996 to comparable operating profits derived from the uncontrolled comparables and applied to USSub’s 1996 sales to derive the following results:

<table>
<thead>
<tr>
<th>Uncontrolled distributor</th>
<th>OP/S (per cent)</th>
<th>USSub COP</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>1.7</td>
<td>$8,840</td>
</tr>
<tr>
<td>B</td>
<td>3.1</td>
<td>16,120</td>
</tr>
<tr>
<td>C</td>
<td>3.8</td>
<td>19,760</td>
</tr>
<tr>
<td>D</td>
<td>4.5</td>
<td>23,400</td>
</tr>
<tr>
<td>E</td>
<td>4.7</td>
<td>24,440</td>
</tr>
<tr>
<td>F</td>
<td>4.8</td>
<td>24,960</td>
</tr>
<tr>
<td>G</td>
<td>4.9</td>
<td>25,440</td>
</tr>
<tr>
<td>H</td>
<td>6.7</td>
<td>34,840</td>
</tr>
<tr>
<td>I</td>
<td>9.9</td>
<td>51,480</td>
</tr>
<tr>
<td>J</td>
<td>10.5</td>
<td>54,600</td>
</tr>
</tbody>
</table>

(v) Based on these results, the median of the comparable operating profits for 1996 is $14,250. Therefore, USSub’s income for 1996 is increased by $21,250, the difference between USSub’s reported operating profit for 1996 and the median of the comparable operating profits for 1996.

- **Example 3:** Multiple year analysis.
  - The facts are the same as in Example 2 except that USSub reported the following income and expenses:
    - Sales: $500,000
    - Cost of Goods Sold: $370,000
    - Operating Profit: $20,000
  - The district director examines the taxpayer’s results for the 1997 taxable year. As in Example 2, the district director increases USSub’s income for the 1996 taxable year by $21,250. The results for the 1997 taxable year, together with the 1995 and 1996 taxable years, are as follows:

<table>
<thead>
<tr>
<th>Uncontrolled distributor</th>
<th>OP/S (per cent)</th>
<th>USSub COP</th>
</tr>
</thead>
<tbody>
<tr>
<td>B</td>
<td>2.9</td>
<td>14,500</td>
</tr>
<tr>
<td>I</td>
<td>3.0</td>
<td>15,000</td>
</tr>
<tr>
<td>J</td>
<td>4.4</td>
<td>22,000</td>
</tr>
<tr>
<td>G</td>
<td>7.4</td>
<td>37,000</td>
</tr>
</tbody>
</table>
through 1996 taxable years derived from a manufacturing a new "high tech widget" (htw) that is manufactured by its foreign subsidiary located in country M and N to ManuCo's average sales for the years 1995 through 1997, ranges from $15,500 to $30,000. In determining whether an allocation for the 1997 taxable year may be made, the district director compares USSub's average reported operating profit for the years 1995 through 1997 to the interquartile range of average comparable operating profits over this period. USSub's average reported operating profit is determined without regard to the adjustment made with respect to the 1996 taxable year. See §1.482-1(f)(2)(iii)(D). Therefore, USSub's average reported operating profit for the years 1995 through 1997 is ($10,000). Because this amount of income falls outside the interquartile range, the district director determines that an allocation may be appropriate.

(ii) To determine the amount, if any, of the allocation for the 1997 taxable year, the district director compares USSub's reported operating profits derived from the uncontrolled distributors' results for 1997. The median of the comparable operating profits over this period is $12,000. Based on this comparison, the district director increases USSub's 1997 taxable income by $2,000, the difference between the median of the comparable operating profits for the 1997 taxable year and USSub's reported operating profit of ($10,000) for the 1997 taxable year.

Example 4. Transfer of intangible to offshore manufacturer. (i) DevCo is a U.S. developer, producer and marketer of widgets. DevCo develops a new “high tech widget” (htw) that is manufactured by its foreign subsidiary located in Country H. ManuCo sells the htw to MarkCo (a U.S. subsidiary of DevCo) for distribution and marketing in the United States. The taxable year 1996 is under audit, and the district director examines whether the royalty rate of 5 percent paid by ManuCo to DevCo is an arm’s length consideration for the htw technology.

(ii) Based on all the facts and circumstances, the district director determines that the comparable profits method will provide the most reliable measure of an arm’s length result. ManuCo is selected as the tested party because it engages in relatively routine manufacturing activities, while DevCo engages in a variety of complex activities using unique and valuable intangibles. Finally, because ManuCo engages in manufacturing activities, it is determined that the ratio of operating profit to operating assets is an appropriate profit level indicator.

(iii) Uncontrolled taxpayers performing similar functions cannot be found in country H. It is determined that data available in countries M and N provides the best match of companies in a similar market performing similar functions and bearing similar risks. Such data is sufficiently complete to identify many of the material differences between ManuCo and the uncontrolled comparables, and to make adjustments to account for such differences. However, data is not sufficiently complete so that it is likely that no material differences remain. In particular, the differences in geographic markets might have materially affected the results of the various companies.

(iv) In a separate analysis, it is determined that the price that ManuCo charged to MarkCo for the htw’s is an arm’s length price under §1.482-3(b). Therefore, ManuCo’s financial data derived from its sales to MarkCo are reliable. ManuCo’s financial data from 1994–1996 is as follows:

<table>
<thead>
<tr>
<th></th>
<th>1994</th>
<th>1995</th>
<th>1996</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$24,000</td>
<td>$25,000</td>
<td>$26,000</td>
<td>$25,000</td>
</tr>
<tr>
<td>Sales to MarkCo</td>
<td>25,000</td>
<td>30,000</td>
<td>35,000</td>
<td>30,000</td>
</tr>
<tr>
<td>Cost of Goods Sold</td>
<td>6,250</td>
<td>7,500</td>
<td>8,750</td>
<td>7,500</td>
</tr>
<tr>
<td>Royalty to DevCo (5%)</td>
<td>1,250</td>
<td>1,500</td>
<td>1,750</td>
<td>1,500</td>
</tr>
<tr>
<td>Other</td>
<td>5,000</td>
<td>6,000</td>
<td>7,000</td>
<td>6,000</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
<td>1,000</td>
</tr>
<tr>
<td>Operating Profit</td>
<td>17,750</td>
<td>21,500</td>
<td>25,250</td>
<td>21,250</td>
</tr>
</tbody>
</table>

(vi) Applying the ratios of average operating profit to operating assets for the 1994 through 1996 taxable years derived from a group of similar uncontrolled comparables located in country M and N to ManuCo’s average operating assets for the same period

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<table>
<thead>
<tr>
<th></th>
<th>1995</th>
<th>1996</th>
<th>1997</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$560,000</td>
<td>$500,000</td>
<td>$530,000</td>
<td>$530,000</td>
</tr>
<tr>
<td>Cost of Good Sold</td>
<td>460,000</td>
<td>400,000</td>
<td>430,000</td>
<td>430,000</td>
</tr>
<tr>
<td>Operating Expenses</td>
<td>110,000</td>
<td>110,000</td>
<td>110,000</td>
<td>110,000</td>
</tr>
<tr>
<td>Operating Profit</td>
<td>(10,000)</td>
<td>(10,000)</td>
<td>(10,000)</td>
<td>(10,000)</td>
</tr>
</tbody>
</table>

\[
\text{Operating Profit} \times \frac{\text{Operating Assets}}{\text{Sales}}
\]
§ 1.482–6 Profit split method.  

(a) In general. The profit split method evaluates whether the allocation of the combined operating profit or loss attributable to one or more controlled transactions is arm’s length by reference to the relative value of each controlled taxpayer’s contribution to that combined operating profit or loss. The combined operating profit or loss must be derived from the most narrowly identifiable business activity of the controlled taxpayers for which data is available that includes the controlled transactions (relevant business activity).

(b) Appropriate share of profits and losses. The relative value of each controlled taxpayer’s contribution to the success of the relevant business activity must be determined in a manner that reflects the functions performed, risks assumed, and resources employed by each participant in the relevant business activity, consistent with the comparability provisions of §1.482–1(d)(3). Such an allocation is intended to correspond to the division of profit or loss that would result from an arrangement between uncontrolled taxpayers, each performing functions similar to those of the various controlled taxpayers engaged in the relevant business activity. The profit allocated to any particular member of a controlled group is not necessarily limited to the total operating profit of the group from the relevant business activity. For example, in a given year, one member of the group may earn a profit while another member incurs a loss. In addition, it may not be assumed that the combined operating profit or loss from the relevant business activity should be shared equally, or in any other arbitrary proportion. The specific method of allocation must be determined under paragraph (c) of this section.

(c) Application—(1) In general. The allocation of profit or loss under the