

§ 1.6038A-2T

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under paragraphs (b) (3) through (5) of this section. Such a foreign reporting corporation nonetheless is subject to the record maintenance requirements of § 1.6038A-3 and the requirements of §§ 1.6038A-5 and 1.6038A-6. The name, address, and taxpayer identification number of each domestic reporting corporation that provided such information must be indicated on Form 5472 in the space provided for the information under paragraphs (b) (1) and (2) of this section.

(3) *Transactions with a corporation subject to reporting under section 6038.* A reporting corporation is not required to make a return of information on Form 5472 with respect to a related foreign corporation for a taxable year for which a U.S. person that controls the foreign related corporation makes a return of information on Form 5471 that is required under section 6038 and this section, if that return contains information required under § 1.6038-2(f)(11) with respect to the reportable transactions between the reporting corporation and the related corporation for that taxable year. Such a reporting corporation also is not subject to §§ 1.6038A-3 and 1.6038A-5. It remains subject to the general record maintenance requirements of section 6001.

(4) *Transactions with a foreign sales corporation.* A reporting corporation is not required to make a return of information on Form 5472 with respect to a related corporation that qualifies as a foreign sales corporation for a taxable year for which the foreign sales corporation files Form 1120-FSC.

(g) *Filing Form 5472 when transactions with related parties engaged in by a partnership are attributed to a reporting corporation.* If transactions engaged in by a partnership are attributed under § 1.6038A-1(e)(2) to a reporting corporation, the reporting corporation need report on Form 5472 only the percentage of the value of the transaction or transactions equal to the percentage of its partnership interest. Thus, for example, if a partnership buys \$1000 of widgets from the foreign parent of a reporting corporation whose partnership interest in the partnership equals 50 percent of the partnership interests (and the remaining 50 percent is held by unrelated parties), the reporting

corporation must report \$500 of purchases from a foreign related party on Form 5472.

(h) *Effective dates for certain reporting corporations.* For effective dates for this section, see § 1.6038A-1(n).

[T.D. 8353, 56 FR 28063, June 19, 1991, as amended by T.D. 9113, 69 FR 5932, Feb. 9, 2004]

§ 1.6038A-2T Requirement of return (temporary).

(a) through (c) [Reserved]. For further guidance, see § 1.6038A-2(a) through (c).

(d) *Time and place for filing returns.* A Form 5472 required under this section shall be filed with the reporting corporation's income tax return for the taxable year by the due date (including extensions) of that return. A duplicate Form 5472 (including any attachments and schedules) shall be filed at the same time with the Internal Revenue Service Center, Philadelphia, PA 19255. A Form 5472 that is timely filed electronically satisfies the duplicate filing requirement.

(e) Through (g) [Reserved]. For further guidance, see § 1.6038A-2(e) through (g).

(h) *Effective date.* (1) This section applies for taxable years ending on or after January 1, 2003. For taxable years ending prior to January 1, 2003, see § 1.6038A-2(d) in effect prior to January 1, 2003 (see 26 CFR part 1 revised as of April 1, 2002).

(2) The applicability of this section expires on or before February 6, 2007.

[T.D. 9113, 69 FR 5932, Feb. 9, 2004]

§ 1.6038A-3 Record maintenance.

(a) *General maintenance requirements—*

(1) Section 6001 and section 6038A. A reporting corporation must keep the permanent books of account or records as required by section 6001 that are sufficient to establish the correctness of the federal income tax return of the corporation, including information, documents, or records ("records") to the extent they may be relevant to determine the correct U.S. tax treatment of transactions with related parties. Under section 6001, the District Director may require any person to make such returns, render such statements,

or keep such specific records as will enable the District Director to determine whether or not that person is liable for any of the taxes to which the regulations under part I have application. See section 6001 and the regulations thereunder. Such records must be permanent, accurate, and complete, and must clearly establish income, deductions, and credits. Additionally, in appropriate cases, such records include sufficient relevant cost data from which a profit and loss statement may be prepared for products or services transferred between a reporting corporation and its foreign related parties. This requirement includes records of the reporting corporation itself, as well as to records of any foreign related party that may be relevant to determine the correct U.S. tax treatment of transactions between the reporting corporation and foreign related parties. The relevance of such records with respect to related party transactions shall be determined upon the basis of all the facts and circumstances. Section 6038A and this section provide detailed guidance regarding the required maintenance of records with respect to such transactions and specify penalties for noncompliance. Banks and other financial institutions shall follow the specific record maintenance rules described in paragraph (h) of this section.

(2) *Safe harbor.* A safe harbor for record maintenance is provided under paragraph (c) of this section, which sets forth detailed guidance concerning the types of records to be maintained with respect to related party transactions. The safe harbor consists of an all-inclusive list of record types that could be relevant to different taxpayers under a variety of facts and circumstances. It does not constitute a checklist of records that every reporting corporation must maintain or that generally should be requested by the Service. A specific reporting corporation is required to maintain, and the Service will request, only those records enumerated in the safe harbor (including material profit and loss statements) that may be relevant to its business or industry and to the correct U.S. tax treatment of its transactions with its foreign related parties. Accordingly, not every item listed in the

safe harbor must be maintained by every reporting corporation. A corporation that maintains or causes another person to maintain the records listed in paragraph (c)(2) of this section that may be relevant to its foreign related party transactions and to its business or industry will be deemed to have met the record maintenance requirements of section 6038A.

(3) *Examples.* The following examples illustrate the rules of this paragraph.

Example 1. RC, a U.S. reporting corporation, is owned by two shareholders, F and P. F is a foreign corporation that owns 30 percent of the stock of RC. P is a domestic corporation that owns the remaining 70 percent. RC purchases tangible property from F; however, the only potential audit issue with respect to these transactions is their treatment under section 482. It is determined that F does not in fact control RC and the two corporations do not constitute a group of "controlled taxpayers" for purposes of section 482 and the regulations thereunder. There are no other reportable transactions between RC and F. Under §1.6038A-1(g), F is a foreign related party with respect to RC. Accordingly, RC is required to report its purchases of property from F under the reporting requirements of §1.6038A-2. Nevertheless, because section 482 is not applicable to the transactions between RC and F, the records created by F with respect to its sales to RC are not relevant for purposes of determining the correct tax treatment of these transactions. RC is required to maintain its own records of these transactions under the requirements of section 6001, but the transactions are not subject to the record maintenance requirements of this section. If, however, on audit it is determined that F does control RC, all records relevant to determining the arm's length consideration for the tangible property under section 482 will be subject to these requirements.

Example 2. FP, a foreign person, owns 30 percent of the stock of RC, a reporting corporation. The remaining 70 percent of RC stock is held by persons that are not 25-percent foreign shareholders. It is determined that FP is related to RC within the meaning of section 482 and the regulations thereunder. The only transactions between FP and RC are FP's capital contributions, dividends paid from RC to FP, and loans from FP to RC. Under section 6001, RC is required to maintain all documentation necessary to establish the U.S. tax treatment of the capital contributions, dividends, and loans. RC is not required to maintain records in other categories listed in paragraph (c)(3) of this section because they are not relevant to the transactions between FP and RC. Records of FP not related to these transactions are not

subject to the record maintenance requirements under section 6038A(a) and this section.

Example 3. G, a foreign multinational group, creates Sub, a wholly-owned U.S. subsidiary, in order to purchase tangible property from unrelated parties in the United States and resell such property to G. The property purchased by Sub is either used in G's business or resold to other unrelated parties by G. Sub's sole function is to act as a buyer for G and these purchases are the only transactions that G has with any U.S. affiliates. Under all the facts and circumstances of this case, it is determined that an analysis of the group's worldwide profit attributable to the property it purchases from Sub is not relevant for purposes of determining the tax treatment of the sales from Sub to G. Therefore, the records with respect to the profitability of G are not subject to the record maintenance requirements of this section. However, all records related to the appropriate method under section 482 for determining an arm's-length consideration for the property sold by Sub to G are subject to the record maintenance requirements of this section.

Example 4. S, a U.S. reporting corporation, is the purchasing agent for its multinational parent group. It arranges for the purchase and export of miscellaneous tangible property to X, Y, and Z, each of which is a foreign related party. The miscellaneous tangible property is purchased from unrelated third parties for resale to X, Y, and Z. These resales of miscellaneous tangible property constitute the sole transactions between S and X, Y, and Z. The purchasing agent activity of S is not an integral part of the business activity of S or of any beneficiary of the purchasing agent services provided by S as defined in § 1.482-2(b)(7). Under § 1.482-2(b)(7), the arm's-length charge is deemed to be equal to the costs or deductions incurred with respect to the provision of the purchasing agent services. S is required to maintain records to permit verification upon audit of such costs or deductions. The records of X, Y, and Z are not relevant to the costs or deductions incurred by S with respect to its purchasing agent activities. Therefore, under section 6038A and this section, only the records maintained by S that permit verification of the costs and deductions of the purchasing agent services are relevant. Accordingly, solely with respect to these transactions, records of X, Y, and Z need not be maintained under section 6038A or this section. If, however, upon audit, it is determined that S is not merely engaging in services not integral to its business as defined in § 1.482-2(b)(7), the record maintenance requirements under section 6038A(a) and this section will be applicable to the records of S, X, Y and Z to the extent that such records are relevant for determining

the correct tax treatment of transactions engaged in by X, Y, or Z with S. If S has other transactions with X, S must maintain or cause to be maintained records that may be relevant with respect to those transactions.

(b) *Other maintenance requirements—*
(1) *Indirectly related records.* This section applies to records that are directly or indirectly related to transactions between the reporting corporation and any foreign related parties. An example of records that are indirectly related to such transactions is records possessed by a foreign subsidiary of a foreign related party that document the raw material or component costs of a product that is manufactured or assembled by the subsidiary and sold as a finished product by the foreign related party to the reporting corporation.

(2) *Foreign related party or third-party maintenance.* If records that are required to be maintained under this section are in the control of a foreign related party, the records may be obtained or compiled (if not already in the possession of the foreign related party or already compiled) under the direction of the reporting corporation and then maintained by the reporting corporation, the foreign related party, or a third party. Thus, for example, a foreign related party may either itself maintain such records outside the United States or permit a third party to maintain such records outside the United States, provided that the conditions described in paragraph (f) of this section are met. Upon a request for such records by the Service, a foreign related party or third party may make arrangements with the District Director to furnish the records directly, rather than through the reporting corporation.

(3) *Translation of records.* When records are provided to the Service under a request for production, any portion of such records must be translated into the English language within 30 days of a request for translation of that portion by the District Director. To the extent that any requested documents are identical to documents that have already been translated, an explanation of how such documents are identical instead may be provided. An extension of this time period may be requested under paragraph (f)(4) of this

section. Appropriate extensions will be liberally granted for translation requests where circumstances warrant. If a good faith effort is made to translate accurately the requested documents within the specified time period, the reporting corporation will not be subject to the penalties in §§ 1.6038A-4 and 1.6038A-7.

(4) *Exception for foreign governments.* A foreign government is not subject to the obligation to maintain records under this section.

(5) *Records relating to conduit financing arrangements.* See § 1.881-4 relating to conduit financing arrangements.

(c) *Specific records to be maintained for safe harbor—(1) In general.* A reporting corporation that maintains or causes another person to maintain the records specified in this paragraph (c) that are relevant to its business or industry and to the correct U.S. tax treatment of its transactions with its foreign related parties will be deemed to have met the record maintenance requirements of this section. This paragraph provides general descriptions of the categories of records to be maintained; the particular title or label applied by a reporting corporation or related party does not control. Functional equivalents of the specified documents are acceptable. Record maintenance in accordance with this safe harbor, however, requires only the maintenance of types of documents described in paragraph (c)(2) of this section that are directly or indirectly related to transactions between the reporting corporation and any foreign related party. Additionally, to the extent the reporting corporation establishes that records in a particular category are not applicable to the industry or business of the reporting corporation and any foreign related party, maintenance of such records is not required under this paragraph. Record maintenance in accordance with this paragraph (c) generally does not require the original creation of records that are ordinarily not created by the reporting corporation or its related parties. (If, however, a document that is actually created is described in this paragraph (c), it is to be maintained even if the document is not of the type ordinarily created by the reporting corporation or its related

parties.) There are two exceptions to the rule. First, basic accounting records that are sufficient to document the U.S. tax effects of transactions between related parties must be created and retained, if they do not otherwise exist. Second, records sufficient to produce material profit and loss statements as described in paragraphs (c)(2)(ii) and (3) of this section that are relevant for determining the U.S. tax treatment of transactions between the reporting corporation and foreign related parties must be created if such records are not ordinarily maintained. All internal records storage and retrieval systems used for each taxable year must be retained.

(2) *Descriptions of categories of documents to be maintained.* The following records must be maintained in order to satisfy this paragraph (c) to the extent they may be relevant to determine the correct U.S. tax treatment of transactions between the reporting corporation and any foreign related party.

(i) *Original entry books and transaction records.* This category includes books and records of original entry or their functional equivalents, however designated or labelled, that are relevant to transactions between any foreign related party and the reporting corporation. Examples include, but are not limited to, general ledgers, sales journals, purchase order books, cash receipts books, cash disbursement books, canceled checks and bank statements, workpapers, sales contracts, and purchase invoices. Descriptive material to explicate entries in the foregoing types of records, such as a chart of accounts or an accounting policy manual, is included in this category.

(ii) *Profit and loss statements.* This category includes records from which the reporting corporation can compile and supply, within a reasonable time, material profit and loss statements of the reporting corporation and all related parties as defined in § 1.6038A-1(d) (the "related party group") that reflect profit or loss of the related party group attributable to U.S.-connected products or services as defined in paragraph (c)(7)(i) of this section. The determination of whether a profit and loss statement is material is made under the rules provided in paragraph

(c)(3) of this section. The material profit and loss statements described in this paragraph (c)(2)(ii) must reflect the consolidated revenue and expenses of all members of the related party group. Thus, records in this category include the documentation of the cost of raw materials used by a related party to manufacture finished goods that are then sold by another related party to the reporting corporation. The records should be kept under U.S. generally accepted accounting principles if they are ordinarily maintained in such manner; if not, an explanation of the material differences between the accounting principles used and U.S. generally accepted accounting principles must be made available. The statements need not reflect tracing of the actual costs borne by the group with respect to its U.S.-connected products or services; rather, any reasonable method may be used to allocate the group's worldwide costs to the revenues generated by the sales of those products or services. An explanation of the methods used to allocate specific items to a particular profit and loss statement must be made available. The explanation of material differences between accounting principles and the explanation of allocation methods must be sufficient to permit a comparison of the profitability of the group to that of the reporting corporation attributable to the provision of U.S.-connected products or services.

(iii) *Pricing documents.* This category includes all documents relevant to establishing the appropriate price or rate for transactions between the reporting corporation and any foreign related party. Examples include, but are not limited to, documents related to transactions involving the same or similar products or services entered into by the reporting corporation or a foreign related party with related and unrelated parties; shipping and export documents; commission agreements; documents relating to production or assembly facilities; third-party and intercompany purchase invoices; manuals, specifications, and similar documents relating to or describing the performance of functions conducted at particular locations; intercompany correspondence discussing any instructions or assistance relating to such

transactions provided to the reporting corporations by the related foreign person (or vice versa); intercompany and intracompany correspondence concerning the price or the negotiation of the price used in such transactions; documents related to the value and ownership of intangibles used or developed by the reporting corporation or the foreign related party; documents related to cost of goods sold and other expenses; and documents related to direct and indirect selling, and general and administrative expenses (for example, relating to advertising, sales promotions, or warranties).

(iv) *Foreign country and third party filings.* This category includes financial and other documents relevant to transactions between a reporting corporation and any foreign related party filed with or prepared for any foreign government entity, any independent commission, or any financial institution.

(v) *Ownership and capital structure records.* This category includes records or charts showing the relationship between the reporting corporation and the foreign related party; the location, ownership, and status (for example, joint venture, partnership, branch, or division) of all entities and offices directly or indirectly involved in the transactions between the reporting corporation and any foreign related party; a worldwide organization chart; records showing the management structure of all foreign affiliates; and loan documents, agreements, and other documents relating to any transfer of the stock of the reporting corporation that results in the change of the status of a foreign person as a foreign related party.

(vi) *Records of loans, services, and other non-sales transactions.* This category includes relevant documents relating to loans (including all deposits by one foreign related party or reporting corporation with an unrelated party and a subsequent loan by that unrelated party to a foreign related party or reporting corporation that is in substance a direct loan between a reporting corporation and a foreign related party); guarantees of a foreign related party of debts of the reporting corporation, and vice versa; hedging arrangements or other risk shifting or

currency risk shifting arrangements involving the reporting corporation and any foreign related party; security agreements between the reporting corporation and any foreign related party; research and development expense allocations between any foreign related party and the reporting corporation; service transactions between any foreign related party and the reporting corporation, including, for example, a description of the allocation of charges for management services, time or travel records, or allocation studies; import and export transactions between a reporting corporation and any foreign related party; the registration of patents and copyrights with respect to transactions between the reporting corporation and any foreign related party; and documents regarding lawsuits in foreign countries that relate to such transactions between a reporting corporation and any foreign related party (for example, product liability suits for U.S. products).

(vii) *Records relating to conduit financing arrangements.* See §1.881-4 relating to conduit financing arrangements.

(3) *Material profit and loss statements.* For purposes of paragraph (c)(2)(ii) of this section, the determination of whether a profit and loss statement is material will be made according to the following rules. An agreement between the reporting corporation and the District Director as described in paragraph (e) of this section may identify material profit and loss statements of the related party group and describe the items to be included in any profit and loss statements for which records are to be maintained to satisfy the requirements of paragraph (c)(2)(ii) of this section. In the absence of such an agreement, a profit and loss statement will be material if it meets any of the following tests: the existing records test described in paragraph (c)(4) of this section, the significant industry segment test described in paragraph (c)(5) of this section, or the high profit test described in paragraph (c)(6) of this section.

(4) *Existing records test.* A profit and loss statement is material under the existing records test described in this paragraph (c)(4) if any member of the related party group creates or compiles

such statement in the course of its business operations and the statement reflects the profit or loss of the related party group attributable to the provision of U.S.-connected products or services (regardless of whether the profit and loss attributable to U.S.-connected products or services is shown separately or included within the calculation of aggregate figures on the statement). For example, a profit and loss statement is described in this paragraph if it was produced for internal accounting or management purposes, or for disclosure to shareholders, financial institutions, government agencies, or any other persons. Such existing statements and the records from which they were compiled (to the extent such records relate to profit and loss attributable to U.S.-connected products or services) are subject to the record maintenance requirements described in paragraph (c)(2)(ii) of this section.

(5) *Significant industry segment test—*
(i) *In general.* A profit and loss statement is material under the significant industry segment test described in this paragraph (c)(5) if—

(A) The statement reflects the profit or loss of the related party group attributable to the group's provision of U.S.-connected products or services within a single industry segment (as defined in paragraph (c)(7)(ii) of this section);

(B) The worldwide gross revenue attributable to such industry segment is 10 percent or more of the worldwide gross revenue attributable to the group's combined industry segments; and

(C) The amount of gross revenue earned by the group from the provision of U.S.-connected products or services within such industry segment is \$25 million or more in the taxable year.

(ii) *Form of the statements.* Profit and loss statements compiled for the group's provision of U.S.-connected products or services in each significant industry segment must reflect revenues and expenses attributable to the operations in such segment by all members of the related party group. Statements may show each related party's revenues and expenses separately, or may be prepared in a consolidated

format. Any reasonable method may be used to allocate the group's worldwide costs within the industry segment to the U.S.-connected products or services within that segment. An explanation of the methods used to prepare consolidated statements and to allocate specific items to a particular profit and loss statement must be made available, and the records from which the consolidations and allocations were prepared must be maintained.

(iii) *Special rule for component sales.* Where the U.S.-connected products or services consist of components that are incorporated into other products or services before sale to customers, the portion of the total gross revenue derived from sales of the finished products or services attributable to the components may be determined on the basis of relative costs of production. Thus, where relevant for determining whether the \$25 million threshold in paragraph (c)(5)(i)(C) of this section has been met, the amount of gross revenue derived by the related party group from the provision of the finished products or services may be reduced by multiplying it by a fraction, the numerator of which is the costs of production of the related party group attributable to the component products or services that constitute U.S.-connected products or services and the denominator of which is the costs of production of the related party group attributable to the finished products in which such components are incorporated.

(iv) *Level of specificity required.* In applying the significant industry segment test of this paragraph (c)(5), groups of related products and services must be chosen to provide a reasonable level of specificity that results in the greatest number of separate significant industry segments in comparison to other possible classifications. This determination must be made on the basis of the particular facts presented by the operations of the related party group. The following rules, however, provide general guidelines for making such classifications. First, the related party group's operations that involve the provision of U.S.-connected products should be grouped into product lines. The rules of this paragraph (c)(5)

should then be applied to determine if any such product line would, standing alone, constitute a significant industry segment when compared to the related party group's operations as a whole. Any significant industry segments determined at the level of product lines should be further segregated, and tested for significant industry segments, at the level of separate products. Finally, any significant industry segments determined at the level of separate products should be segregated, and tested for significant industry segments, at the level of separate models. Similar principles should be applied in classifying and testing types of services. A profit and loss statement reflecting the related party group's provision of any product or service (or group of products or services as classified under these rules) that constitutes a significant industry segment will be considered material for purposes of this paragraph (c)(5). For definitions of the terms "product", "related products or services", "model", and "product line", see paragraph (c)(7) of this section.

(v) *Examples.* The rules for determining reasonable levels of specificity for significant industry segments may be illustrated by the following examples.

Example 1. A related party group is engaged in the manufacture and worldwide sales of automobiles and aftermarket parts. The group's operations within the categories of "automobiles" and "aftermarket parts" are each sufficient to constitute significant industry segments for the group under the rules of this paragraph (c)(5). No narrower classification of aftermarket parts results in any significant industry segments. Automobiles produced by the group are generally classified for marketing purposes by trade names; aggregating groups of automobiles by these trade names results in three significant industry segments, those for trade names A, B, and C. Finally, two car models sold under the trade name A ("A1" and "A2") and one car model sold under the trade name B ("B3"), produce sufficient revenue to constitute significant industry segments. Such classifications into trade names and car models are generally used in the related party group's industry; moreover, different types of classifications would produce fewer significant industry segments. Accordingly, a reasonable level of specificity for this related party group's industry segments would be eight categories of products consisting of

“automobiles”, “aftermarket parts”, “A”, “B”, “C”, “A1”, “A2”, and “B3”.

Example 2. A related party group is engaged in manufacturing electronic goods that are distributed at retail in the United States by the reporting corporation. The group sells three types of products in the United States: televisions, radios, and video cassette recorders (VCRs). Each of these three broad product areas constitutes a significant industry segment for the group as a whole. VCRs can be further segregated by price into high-end and low-end models, and the provision of each constitutes a significant industry segment for the group. Revenues from only one VCR model, model number VCRX-10, are sufficiently large to make the provision of that model a significant industry segment. With respect to televisions, the group normally accounts for these products by size. Using this classification, portable televisions, medium-sized televisions, and consoles each constitute significant industry segments. Narrower classifications by television model numbers result in no additional significant industry segments. Finally, a single radio product line, those sold under the trade name R, produces sufficient revenue to constitute a significant industry segment, but no other radio models or product groups are large enough to constitute a significant industry segment. In each case, these classifications conform to normal business practices in the industry and result in the greatest possible number of significant industry segments for this related party group. Accordingly, a reasonable level of specificity for this related party group’s industry segments would include the ten categories consisting of “VCRs”, “high-end VCRs”, “low-end VCRs”, “model number VCRX-10”, “televisions”, “portable televisions”, “medium-sized televisions”, “console televisions”, “radios”, and “radio trade name R”.

(6) *High profit test*—(i) *In general.* A profit and loss statement is material under the high profit test described in this paragraph (c)(6) if—

(A) The statement reflects the profit or loss of the related party group attributable to the group’s provision of U.S.-connected products or services within a single industry segment (as defined in paragraph (c)(7)(ii) of this section);

(B) The amount of gross revenue earned by the group from the provision of U.S.-connected products or services within such industry segment is \$100 million or more in the taxable year; and

(C) The return on assets test described in paragraph (c)(6)(ii) of this

section is satisfied with respect to the products and services attributable to such segment.

Accordingly, a significant industry segment (as determined under paragraph (c)(5) of this section) must be divided into any narrower industry segments that meet the high profit test of this paragraph (c)(6), even if such narrower segments would not, standing alone, meet the significant industry segment test of paragraph (c)(5) of this section.

(ii) *Return on assets test.* An industry segment meets the return on assets test if the rate of return on assets earned by the related party group on its worldwide operations within this industry segment exceeds 15 percent, and is at least 200 percent of the return on assets earned by the group in all industry segments combined. For purposes of this paragraph, the rate of return on assets earned by an industry segment is determined by dividing that segment’s operating profit (as defined in paragraph (c)(7)(v) of this section) by its identifiable assets (as defined in paragraph (c)(7)(iv) of this section).

(iii) *Additional rules.* The rules in paragraphs (c)(5)(ii) through (iv) of this section describing the application of the significant industry segment test shall apply in a similar manner for purposes of the high profit test.

(7) *Definitions.* The following definitions apply for purposes of paragraphs (c)(2)(ii), (c)(5), and (c)(6) of this section.

(i) *U.S.-connected products or services.* The term *U.S.-connected products or services* means products or services that are imported to or exported from the United States by transfers between the reporting corporation and any of its foreign related parties.

(ii) *Industry segment.* An industry segment is a segment of the related party group’s combined operations that is engaged in providing a product or service or a group of related products or services (as defined in paragraph (c)(7)(vii) of this section) primarily to customers that are not members of the related party group.

(iii) *Gross revenue of an industry segment.* Gross revenue of an industry segment includes receipts (prior to reduction for cost of goods sold) both from

sales to customers outside of the related party group and from sales or transfers to other industry segments within the related party group (but does not include sales or transfers between members of the related party group within the same industry segment). Interest from sources outside the related party group and interest earned on trade receivables between industry segments is included in gross revenue if the asset on which the interest is earned is included among the industry segment's identifiable assets, but interest earned on advances or loans to other industry segments is not included.

(iv) *Identifiable assets of an industry segment.* The identifiable assets of an industry segment are those tangible and intangible assets of the related party group that are used by the industry segment, including assets that are used exclusively by that industry segment and an allocated portion of assets used jointly by two or more industry segments. The value of an identifiable asset may be determined using any reasonable method (such as book value or fair market value) applied consistently. Any allocation of assets among industry segments must be made on a reasonable basis, and a description of such basis must be provided. Assets of an industry segment that transfers products or services to another industry segment shall not be allocated to the receiving segment. Assets that represent part of the related party group's investment in an industry segment, such as goodwill, shall be included in the industry segment's identifiable assets. Assets maintained for general corporate purposes (that is, those not used in the operations of any industry segment) shall not be allocated to industry segments.

(v) *Operating profit of an industry segment.* The operating profit of an industry segment is its gross revenue (as defined in paragraph (c)(7)(iii) of this section) minus all operating expenses. None of the following shall be added or deducted in computing the operating profit of an industry segment: revenue earned at the corporate level and not derived from the operations of any industry segment; general corporate expenses; interest expense; domestic and

foreign income taxes; and other extraordinary items not reflecting the ongoing business operations of the industry segment.

(vi) *Product.* The term *product* means an item of property (or combination of component parts) that is the result of a production process, is primarily sold to unrelated parties (or incorporated by the related party group into other products sold to unrelated parties), and performs a specific function.

(vii) *Related products or services.* The term *related products or services* means groupings of products and types of services that reflect reasonable accounting, marketing, or other business practices within the industries in which the related party group operates.

(viii) *Model.* The term *model* means a classification of products that incorporate particular components, options, styles, and any other unique features resulting in product differentiation. Examples of models are electronic products that are sold or accounted for under a single model number and automobiles sold under a single model name.

(ix) *Product line.* The term *product line* means a group of products that are aggregated into a single classification for accounting, marketing, or other business purposes. Examples of product lines are groups of products that perform similar functions; products that are marketed under the same trade names, brand names, or trademarks; and products that are related economically (that is, having similar rates of profitability, similar degrees of risk, and similar opportunities for growth).

(8) *Example.* The application of the rules for determining material profit and loss statements under paragraphs (c)(4) through (7) of this section is illustrated by the following example.

Example. (i) *Facts.* A multinational enterprise manufactures 50 different agricultural and chemical products that are sold through Subl, its wholly owned U.S. subsidiary, and other subsidiaries located in foreign countries. The parent company of the enterprise, P, is a foreign corporation. The corporations participating in the enterprise form a related party group, and Subl is a reporting corporation for purposes of section 6038A. Under the facts and circumstances of this case, an analysis of the group's worldwide profit attributable to its products sold in the

U.S. is relevant for determining an arm's length consideration under section 482 for the transfers of goods between Subl and its foreign affiliates.

(ii) *Existing records test.* For management purposes, the group prepares profit and loss statements that are segmented by sales in different geographic markets. One of these statements shows the combined worldwide profitability of the group. Another statement shows the profitability of the group attributable to its North American sales. Both of these profit and loss statements reflect aggregate figures that include sales to unrelated parties of products that have been transferred from P and other group members to Subl (that is, the group's "U.S.-connected products"). The two statements meet the existing records test described in paragraph (c)(4) of this section.

(iii) *Significant industry segments.* The group's worldwide gross revenue in all industry segments is \$2 billion. An analysis of the group's 50 products demonstrates that they are reasonably grouped into eight industry segments (each of which earns roughly \$250 million in worldwide gross revenue). Segments 1 through 6 relate to agricultural products and Segments 7 and 8 relate to other chemical products. More specific categories would result in groupings that generate less than 10 percent of the group's worldwide gross revenue (that is, less than \$200 million each); these narrower categories would thus fail the gross revenue percentage test of paragraph (c)(5)(i)(B) of this section. The gross revenue in each of the eight segments from the sale to unrelated parties of U.S.-connected products is as follows: \$180 million for Segment 1; \$30 million for Segment 2; and less than \$25 million for each of Segments 3 through 8. Under the \$25 million threshold test of paragraph (c)(5)(i)(C) of this section, the group's significant industry segments are thus limited to Segments 1 and 2. In addition, the combined operations of the group related to agricultural products (encompassing Segments 1 through 6 on an aggregated basis), constitute a single significant industry segment.

(iv) *High profit test.* One highly profitable product line within Segment 1, HPPL, accounts for \$120 million gross revenue from Subl's domestic sales of U.S.-connected products (and thus exceeds the \$100 million gross revenue threshold in paragraph (c)(6)(i)(B) of this section). The return on the identifiable assets attributable to the HPPL product line is 85 percent, which is more than 15 percent and more than twice the return on assets earned by the group from its worldwide operations in its combined industry segments. The group's industry segment for HPPL thus meets the high profit test described in paragraph (c)(6) of this section.

(v) *Material Profit and Loss Statements.* The group's material profit and loss statements

consist of statements for combined worldwide sales and North American sales (under the existing records test); Segment 1, Segment 2, and aggregated Segments 1-6 (under the significant industry segment test); and HPPL (under the high profit test). Under paragraph (c) of this section, Subl is required to retain the combined worldwide sales and North American sales profit and loss statements and to maintain sufficient records so that it can compile and supply upon request statements of the group's profitability from sales of its U.S.-connected products within Segment 1, Segment 2, aggregated Segments 1-6, and HPPL. These records need not be in the possession of Subl and may be kept under the control of and produced by P or any third party. The statements for Segment 1, Segment 2, aggregated Segments 1-6, and HPPL do not require tracing of actual costs to the U.S.-connected products; rather, these statements may be prepared by using any reasonable method to allocate a portion of the industry segment's overall operating costs to the sales of U.S.-connected products within that segment.

(d) *Liability for certain partnership record maintenance.* A reporting corporation to which transactions engaged in by a partnership are attributed under § 1.6038A-1 (e)(2) is subject to the record maintenance requirements of this section to the extent of the transactions so attributed.

(e) *Agreements with the District Director—(1) In general.* The District Director who has audit jurisdiction over the reporting corporation may negotiate and enter into an agreement with a reporting corporation that establishes the records the reporting corporation must maintain or cause another to maintain, how the records must be maintained, the period of retention for the records, and by whom the records must be maintained in order to satisfy the reporting corporation's obligations under this section.

(2) *Content of agreement—(i) In general.* The agreement may include provisions relating to the authorization of agent requirement, the record maintenance requirement, and the production and translation time periods that vary the rules contained in these regulations under section 6038A. The District Director will generally require a reporting corporation to maintain only those records specified under the safe harbor provisions of paragraph (c) of this section that permit an adequate audit of the income tax return of the

reporting corporation and to provide such authorizations of agent that permit adequate access to such records. In most instances, required record maintenance for a particular reporting corporation under a negotiated agreement will be less than the broad range of records described under the safe harbor provisions. Additionally, a provision specifying the effective date and the expiration date of the agreement that may vary the effective date of the regulations may be included.

(ii) *Significant industry segment test.* A District Director may determine which industry segment profit and loss statements are material for purposes of requiring the maintenance of records (under either paragraph (a)(1) of this section or the safe harbor described in paragraph (a)(2) of this section). The industry segments that the District Director determines are material need not be the industry segments that meet the significant industry segment test under paragraph (c)(5) of this section or the high profit test under paragraph (c)(6) of this section. For this purpose, a reporting corporation will be required to maintain only those records from which profit and loss statements for the related party group may be constructed with respect to industry segments identified by the District Director. To the extent that existing profit and loss statements are similar in scope and level of detail to statements for industry segments that would otherwise be described under the tests of paragraphs (c)(5) and (6) of this section, the District Director shall accept the existing statements instead of the statements that would otherwise be required under paragraphs (c)(5) and (6) of this section.

(iii) *Example.* The following example illustrates the rules of paragraph (e)(2)(ii) of this section.

Example. The District Director determines that RC, a reporting corporation that is a manufacturer of related chemical products, has two industry segments, Segment 1 and Segment 2. While both industry segments meet the significant industry segment test of paragraph (c)(5) of this section, Segment 1 has a relatively low volume of sales to foreign related parties. Additionally, Segment 1 consists of products that produce only a small profit margin because the product is generic and other companies also sell the

product. The District Director enters into an agreement with RC that requires only records from which a profit and loss statement for the related party group can be constructed for Segment 2. Therefore, RC is not required to maintain records for Segment 1 from which a profit and loss statement for the related party group can be constructed. The other record maintenance requirements under this section apply, however.

(3) *Circumstances of agreement.* The District Director generally will enter into an agreement under this paragraph (e) upon request by the reporting corporation when the District Director believes that the District has or can obtain sufficient knowledge of the business or industry of the reporting corporation to limit the record maintenance requirement to particular documents.

(4) *Agreement as part of APA process.* An agreement with a reporting corporation under this paragraph (e) may be entered into as a part of the Advance Pricing Agreement (APA) process at any time during the APA process, insofar as the agreement relates to the subject matter of the APA.

(f) *U.S. maintenance—(1) General rule.* Records that must be maintained under this section must be maintained within the United States, unless the conditions described in paragraph (f)(2) of this section are met.

(2) *Non-U.S. maintenance requirements.* A reporting corporation may maintain outside the United States records not ordinarily maintained in the United States but required to be maintained in the United States under this section. However, the reporting corporation must either:

(i) Deliver to the Service the original documents (or duplicates) requested within 60 days of the request by the Service for such records and provide translations of such documents within 30 days of a request for translations of specific documents; or

(ii) Move the original documents (or duplicates) requested to the United States within 60 days of the request of the Service for such records; provide the Service with an index to the requested records, the name and address of a custodian located within the United States having control over the records, and the address where the records are located within 60 days of

the Service's request for the records; and continue to maintain the records within the United States throughout the period of retention described in paragraph (g) of this section. For summons procedures with respect to records that have been moved to the United States, see sections 6038A(e), 7602, 7603, and 7604.

With respect to any material profit and loss statements required to be created (either under paragraph (c) of this section or under an agreement with the District Director), unless otherwise specified, "120 days" shall be substituted for "60 days" in this paragraph (f)(2), and labels and text with respect to such statements must be in the English language.

(3) *Prior taxable years.* The non-U.S. maintenance requirements described in paragraph (f)(2) of this section apply to records located outside the United States that were in existence on or after March 20, 1990, without regard to the taxable year to which such records relate.

(4) *Scheduled production for high volume or other reasons.* Upon a written request, for good cause shown, the District Director may grant an extension of the time for the production or translation of the requested documents. Such requests should be made within 30 days of the request for records by the Service. If an extension is needed because of the volume of records requested or the amount of translation requested, the District Director may allow production or translation to be scheduled over a period of time so that not all records need be produced or translated at the same time.

(5) *Required U.S. maintenance.* The District Director (with the concurrence of the Assistant Commissioner (International)), may require, for cause, the maintenance within the United States of any records specified in paragraph (f)(1) of this section. Such a requirement will be imposed only if there exists a clear pattern of failure to maintain or timely produce the required records. The assessment of a monetary penalty under section 6038A(d) and § 1.6038A-4 for failure to maintain records is not necessarily sufficient to require the maintenance of records within the United States.

(g) *Period of retention.* Records required to be maintained by section 6038A(a) and this section shall be kept as long as they may be relevant or material to determining the correct tax treatment of any transaction between the reporting corporation and a related party, but in no case less than the applicable statute of limitations on assessment and collection with respect to the taxable year in which the transaction or item to which the records relate affects the U.S. tax liability of the reporting corporation. See section 6001 and the regulations thereunder.

(h) *Application of record maintenance rules to banks and other financial institutions.* [Reserved]

(i) *Effective dates.* For effective dates for this section, see § 1.6038A-1(n).

[T.D. 8353, 56 FR 28065, June 19, 1991; T.D. 8353, 56 FR 41792, Aug. 23, 1991, as amended by T.D. 8611, 60 FR 41015, Aug. 11, 1995]

§ 1.6038A-4 Monetary penalty.

(a) *Imposition of monetary penalty—(1) In general.* If a reporting corporation fails to furnish the information described in § 1.6038A-2 within the time and manner prescribed in § 1.6038A-2 (d) and (e), fails to maintain or cause another to maintain records as required by § 1.6038A-3, or (in the case of records maintained outside the United States) fails to meet the non-U.S. record maintenance requirements within the applicable time prescribed in § 1.6038A-3(f), a penalty of \$10,000 shall be assessed for each taxable year with respect to which such failure occurs. Such a penalty may be imposed by the District Director or the Director of the Internal Revenue Service Center where the Form 5472 is filed. The filing of a substantially incomplete Form 5472 constitutes a failure to file Form 5472. Where, however, the information described in § 1.6038A-2 (b)(3) through (5) is not required to be reported, a Form 5472 filed without such information is not a substantially incomplete Form 5472.

(2) *Liability for certain partnership transactions.* A reporting corporation to which transactions engaged in by a partnership are attributed under § 1.6038A-1(e)(2) is subject to the rules of this section to the extent failures