OFFICE OF
CHIEF COUNSEL

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

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Reference: Arm=s Length Interest Rates on Inter-Company Lending

Dear :

You have asked for information regarding the determination of an arm=s length interest rate for inter-company lending by a U.S. corporation to foreign subsidiaries when the laws of the country of the foreign subsidiary set a maximum rate of interest that is lower than the U.S. applicable federal rate (AFR).

Generally, if a corporation makes a loan to a controlled subsidiary and charges no interest or interest at a rate that is not equal to an arm=s length rate with respect to such loan, the Internal Revenue Service may make an appropriate section 482 allocation to reflect an arm=s length rate of interest for such loan. The regulations addressing section 482 interest adjustments are contained in section 1.482-2(a) of our regulations. The arm=s length rate is generally determined by looking to the rate of interest that would be charged between unrelated parties under similar circumstances. The regulations provide that for certain categories of loans where the interest rate charged falls within a safe haven range between 100% and 130% of the AFR, it will be treated as an arm=s length rate. The safe haven interest range is not available for lenders in the business of making loans to unrelated parties or in the case of foreign currency loans.

Coordination provisions under the section 482 regulations provide that if certain other Internal Revenue Code sections apply such as section 7872, dealing with certain below-market loans, the provisions of that other code section will apply first and then section 482 will also be applied if necessary. Whether or not those other Internal Revenue Code sections apply, if the interest rate on the loan (after any application of such other Code sections) is different than the arm's length rate (or safe haven interest rate, where applicable), a section 482 adjustment may be made to reflect an arm=s length rate of interest.

The regulations under section 1.482-1(h) take into account certain foreign legal restrictions, provided (i) the restriction is generally applicable (to both controlled and uncontrolled entities), (ii) the taxpayer has exhausted all remedies for obtaining a waiver of such restrictions, (iii) the restrictions expressly prevent the payment or receipt of all or part of the section 482 arm=s length amount and (iv) the taxpayer has not engaged in arrangements to circumvent the restrictions. A qualified foreign legal restriction will be taken into account only to the extent the restriction affects an uncontrolled taxpayer under comparable circumstances for a comparable period of time. If this comparable effect is established so that the arm=s length price is the foreign legal restriction amount, the maximum rate set by the foreign government would generally be accepted.

Absent evidence showing the comparable effect on an uncontrolled taxpayer, the restriction may still be taken into account if the taxpayer makes a deferred-income election pursuant to section 1.482-1(h)(2) of our regulations. Under the election, taxpayer must treat the portion of the arm=s length amount, the payment or receipt of which is prevented because of applicable foreign legal restrictions, as deferrable income until payment or receipt of the relevant item ceases to be prevented by the foreign legal restriction. This election may generally be made on a written statement attached to a timely-filed U.S. income tax return (or an amended return) identifying the affected transactions, the parties to the transactions, and the applicable foreign legal restrictions. Therefore, once these conditions are met, though the maximum rate set by the foreign government would not constitute an arm=s length rate, the difference between the arm=s length (or safe haven rate, where applicable) and such maximum rate would generally be treated as deferred income, recognized only if the rate restriction is eased or lifted.

In addition, you have specifically asked by what processes the taxpayer may illustrate to the Internal Revenue Service that it is relying on the foreign legal restrictions provisions under our regulations in taking the position that the rate on the inter-company loan is in compliance with the arm=s length principles of section 482.

Other than the deferred income election mentioned above, there are no further reporting requirements under section 482 if the taxpayer takes a reporting position that the foreign legal restriction in question is a valid restriction under the regulations. The taxpayer may present the reasoning for its position if the issue comes up on audit. In this regard, a taxpayer may find it useful to file a disclosure statement, such as a Form 8275 ADisclosure Statement,@ with its timely-filed or amended income tax return. Taxpayer may also consider developing and maintaining other transfer pricing analysis and documentation reflecting the reasoning and support for its position that the maximum rate set by the foreign government should be treated as an arm=s length rate.

For your convenience, we have attached copies of the code sections and regulations cited above. We hope this information is helpful to you. If you have any questions, please feel free to call me .

Sincerely,

Chief, Branch 6
Office of Associate Chief Counsel (International)

Encl: Treas. Reg. ' ' 1.482-1(h) and 1.482-2(a)
Form 8275 Disclosure Statement