

**DEPARTMENT OF THE TREASURY****Internal Revenue Service****26 CFR Parts 1 and 31, and 602**

[TD 9456]

RIN 1545-B178, 1545-B179, 1545-B180

**Treatment of Services Under Section 482; Allocation of Income and Deductions From Intangible Property; Stewardship Expense****AGENCY:** Internal Revenue Service (IRS), Treasury.**ACTION:** Final regulations and removal of temporary regulations.

**SUMMARY:** This document contains final regulations that provide guidance regarding the treatment of controlled services transactions under section 482 and the allocation of income from intangible property, in particular with respect to contributions by a controlled party to the value of intangible property owned by another controlled party. This document also contains final regulations that modify the regulations under section 861 concerning stewardship expenses to be consistent with the changes made to the regulations under section 482. These final regulations potentially affect controlled taxpayers within the meaning of section 482. They provide updated guidance necessary to reflect economic and legal developments since the issuance of the current guidance.

**DATES: Effective Date:** These regulations are effective on July 31, 2009.**Applicability Dates:** These regulations apply to taxable years beginning after July 31, 2009.**FOR FURTHER INFORMATION CONTACT:**

Carol B. Tan or Gregory A. Spring, (202) 435-5265 for matters relating to section 482, or Richard L. Chewning (202) 622-3850 for matters relating to stewardship expenses (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:****Paperwork Reduction Act**

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-2149. The collection of information in these final regulations is in § 1.482-9. This information is required to enable the IRS to verify that a taxpayer is reporting the correct amount of taxable income. An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information

unless it displays a valid control number.

Books and records relating to a collection of information must be retained as long as their contents might become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

**Background**

Section 482 of the Internal Revenue Code generally provides that the Secretary may allocate gross income, deductions, and credits between or among two or more organizations, trades or businesses owned or controlled by the same interests in order to prevent evasion of taxes or clearly to reflect income of a controlled taxpayer.

Regulations under section 482 published in the **Federal Register** (33 FR 5849) on April 16, 1968, provided guidance with respect to a wide range of controlled transactions, including transfers of tangible and intangible property and the provision of services. Revised and updated transfer pricing regulations were published in the **Federal Register** (59 FR 34971, 60 FR 65553, 61 FR 21955, and 68 FR 51171) on July 8, 1994, December 20, 1995, May 13, 1996, and August 26, 2003. While comprehensive in other respects, these regulations did not modify substantively the rules dealing with controlled services transactions. On September 10, 2003, proposed regulations relating to the treatment of controlled services transactions and the allocation of income from intangible property, in particular with respect to contributions by a controlled party to the value of intangible property owned by another controlled party (the 2003 proposed regulations), were published in the **Federal Register** (68 FR 53448, REG-146893-02 and REG-115037-00).

On August 4, 2006, temporary regulations relating to the treatment of controlled services transactions, the allocation of income from intangible property, and stewardship expenses (the 2006 temporary regulations) were published in the **Federal Register** (71 FR 44466, TD 9278, REG-146893-02, REG-115037-00, and REG-138603-03). A notice of proposed rulemaking cross-referencing the temporary regulations was published in the **Federal Register** on the same day (71 FR 44247, REG-146893-02, REG-115037-00, and REG-138603-03). Written comments responding to the notice of proposed rulemaking were received, and a public hearing was held on October 27, 2006.

The 2006 temporary regulations are generally effective with respect to

taxable years beginning after December 31, 2006, and Notice 2007-5, 2007-1 C.B. 269, published on January 16, 2007, partially modified the effective date of the 2006 temporary regulations as it pertained to the identification of controlled services transactions eligible to be priced at cost. Accordingly, the 2006 temporary regulations related to the new services cost method in § 1.482-9T(b) (described in Section A.1 in this preamble) apply to taxable years after December 31, 2007, with the exception of the business judgment rule described in § 1.482-9T(b)(2), which had the same effective date (taxable years after December 31, 2006) as the other provisions of the temporary regulations.

By issuing the 2006 temporary regulations in temporary and proposed form, the Treasury Department and the IRS provided taxpayers an opportunity to submit additional comments prior to the time these regulations became effective. See § 601.601(d)(2)(ii)(b). After consideration of all the comments, the proposed regulations under section 482 are adopted as revised by this Treasury decision, and the corresponding temporary regulations are removed.

**Explanation of Revisions and Summary of Comments***Introduction*

The Treasury Department and the IRS received a number of comments on the 2006 temporary regulations from taxpayers, their representatives, as well as industry and professional groups. Commentators generally approved of the 2006 temporary regulations and found the changes from the 2003 proposed regulations to be useful. Specifically, commentators approved of the replacement of the simplified cost-based method with the services cost method (SCM) and the inclusion of the shared services arrangement provision in the SCM rules. Commentators also generally approved of changes made to the profit split method. However, commentators did express concerns with some aspects of the 2006 temporary regulations.

While these final regulations reflect some modifications in response to comments received on the 2006 temporary regulations, both the format and the substance of the final regulations are generally consistent with the 2006 temporary regulations. The changes adopted are intended to make certain clarifications and improvements without fundamentally altering the policies reflected in the 2006 temporary regulations.

## Explanation of Provisions

### A. Controlled Services

#### 1. Services Cost Method—Treas. Reg. § 1.482–9(b)

##### a. Applicability of the Services Cost Method

Most comments focused on the SCM. Several commentators requested confirmation that application of the SCM is a matter within the control of the taxpayer, provided that the underlying services otherwise qualify for the SCM. Some commentators stated that the 2006 temporary regulations could be interpreted as requiring a taxpayer to apply the SCM if all the conditions for that method were satisfied.

Notice 2007–5 confirmed that taxpayers control whether the SCM applies. The final regulations make this clear. Section 1.482–9(b)(1) provides that, if a taxpayer applies the SCM in accordance with the rules of § 1.482–9(b), which requires that a statement evidencing the taxpayer's intent to apply the SCM be contained in the taxpayer's books and records, then the SCM will be considered the best method for purposes of § 1.482–1(c).

##### b. Specified Covered Services

Several commentators contended that the proposed list of specified covered services in Announcement 2006–50, 2006–2 C.B. 321, is too narrow. One commentator listed tax planning and public relations activities as examples of activities not on the list that illustrated the narrowness of the list. Some commentators suggested that the list should refer to departments, cost centers, or accounting classifications, rather than to specific activities or groups of activities. One commentator suggested that all activities in particular departments should be identified as eligible for the SCM. Commentators also stated that a comprehensive analysis would be required and that it would be too burdensome to track employee time for activities that are specified covered services vs. non-specified covered services. See § 601.601(d)(2)(ii)(b). The Treasury Department and the IRS also received suggestions to broaden the general administrative provision and add additional specific activities to the list of specified covered services, including warehousing and distribution, quality control and quality assurance relating to manufacturing and construction, and environmental remediation.

The SCM is intended to provide a practical and administrable means of identifying low-margin services that

may be evaluated by reference to total services cost without a markup. The list of services eligible to be priced at cost in the specified covered services portion of the SCM was added specifically in response to requests from commentators that the former simplified cost-based method be eliminated and replaced with just such a list of eligible services. In response to public comments, the Treasury Department and the IRS published Rev. Proc. 2007–13, 2007–1 C.B. 295, which added several categories as well as activities within existing categories. In particular, public relations and tax planning services were added to the list, and the individual categories of specified covered services were expanded to include “other similar activities.”

After careful consideration, the Treasury Department and the IRS believe that Rev. Proc. 2007–13 strikes the appropriate balance between broadening the list to include services similar to the specific services described and expanding the categories of services. The Treasury Department and the IRS do not believe that other additional services suggested by commentators were appropriate, but will continue to consider other recommendations for additional services to be added to the list in the future.

One commentator expressed concern that a review of services to determine if they qualify as specified covered services may require a more extensive analysis than under previous regulations, including interviews of individual employees or of small groups of employees. Although the covered services list is not applied on a departmental basis, a reasonable aggregation of similar services may be appropriate for performing the specified covered services analysis in some cases. To determine if the services cost method should apply to a particular service (or group of services) performed by a group of employees, the aggregation principle of Treas. Reg. § 1.482–1(f)(2)(i)(A) should be followed as appropriate. In certain cases, aggregation may assure a more accurate result, especially if it recognizes synergies that an individual employee analysis might ignore. An aggregation of employee services may, thus, efficiently evaluate the work of employees engaged in a common function, as well as recognize the added value that their collaborative effort might produce. Conversely, analysis on an aggregate basis does not permit characterization of an individual service as a specified covered service if it, in fact, is not a specified covered service.

### c. Low Margin Covered Services

Commentators provided comments on low margin covered services described in § 1.482–9T(b)(4)(ii) of the 2006 temporary regulations. One commentator believed that the 7 percent limit is too high for the SCM. In the commentator's view, the limit should be lower because the 7 percent figure will cover activities that are risky. Most of the commentators, however, believed that the 7 percent limit is an appropriate measure. The Treasury Department and the IRS continue to believe that the 7 percent limit is appropriate in light of its purpose. That is, it minimizes the compliance burden on taxpayers and the IRS for relatively low-margin services.

Several commentators requested more guidance on low margin covered services. One commentator suggested that the Treasury Department and the IRS develop an analysis to determine if certain services have a markup of 7 percent or less and publish the results. For example, the IRS could develop a set of comparables for various groups of low margin services, such as human resources, accounting and finance, information services, and training. Some commentators requested guidance on when and how often a transfer pricing study is needed to support a determination that services are low margin covered services. In this regard, some commentators requested that the regulations specify a period of years (such as three years) for which a transfer pricing study may be valid for purposes of determining if a service is a low margin covered service. In support of this request, one commentator stated that the regulations could provide, for example, that the reliance period could apply to taxpayers whose facts and circumstances have not changed materially from the time the service was most recently established as a covered service.

The Treasury Department and IRS did not adopt this proposal. Because there may be significant differences among services across different businesses, a standardized, IRS-developed comparables set would not be feasible and would conflict with the fact intensive nature of an appropriately robust transfer pricing analysis. For similar reasons, the Treasury Department and the IRS did not adopt the proposal to specify the frequency or timing of transfer pricing analyses to support taxpayer positions. To do so would be inconsistent with a proper comparability analysis, including consideration of the time at which

transactions were undertaken, as well as other relevant economic circumstances.

One other commentator requested that the midpoint should be used in measuring a comparable markup on total services costs for purposes of low margin covered services. While it may be true that, in some cases, the midpoint could be used depending on the statistical method used, the interquartile range ordinarily provides an acceptable measure of an arm's length range. See § 1.482-1(e)(2)(iii)(B). Therefore, the Treasury Department and the IRS believe that the interquartile range of the comparable median markup is an appropriate measure.

#### d. Excluded Activities

One commentator requested that engineering be removed from the list of services that are ineligible for the SCM in § 1.482-9T(b)(3) of the 2006 temporary regulations. This comment was not adopted, since, in the view of the Treasury Department and the IRS, intragroup engineering services generally should be subject to a robust transfer pricing analysis.

#### e. Business Judgment Rule

Several commentators expressed concern over how the business judgment rule would be administered. Some commentators requested that statements in the preamble about the business judgment rule in the 2006 temporary regulations be incorporated in final regulations. Other commentators suggested that the business judgment rule should be applied by reference to one or more trades or business of the controlled group rather than of the renderer, recipient, or both. These commentators claimed that the business judgment rule may yield incorrect results in some cases, for example, where a headquarters services company or other legal entity is established solely to provide centralized support services. The activities performed by such an entity would potentially be ineligible for the SCM under the business judgment rule because they would constitute the entity's core capability.

The Treasury Department and the IRS agree that the business judgment rule should be determined on a controlled group basis and expressed this view in Notice 2007-5. The final regulations clarify that the business judgment rule is determined by reference to a trade or business of the controlled group.

Section 3.04 of Notice 2007-5 clarified that the business judgment rule "is satisfied by a reasonable exercise of the taxpayer's business judgment, not a reasonable exercise of the IRS's judgment in examining the taxpayer."

The Treasury Department and the IRS reiterate that the final regulations incorporate a high threshold for application of the business judgment rule to exclude services otherwise eligible for the SCM. Section 1.482-9(b)(5) provides that the rule is based on a taxpayer's reasonable conclusion in its business judgment that the rule is satisfied. It has come to the attention of the Treasury Department and the IRS that the clarification in the notice of the business judgment rule has been misconstrued as creating a non-rebuttable presumption that a taxpayer's determination under the business judgment rule is always correct. This construction of the clarification was not intended and is not supported by the plain language of the business judgment rule. The business judgment rule requires a reasonable conclusion by the taxpayer. Thus, the taxpayer's business judgment is only the starting point of the analysis, and the taxpayer must make a reasonable conclusion in that regard. Whether the taxpayer's conclusion is reasonable may be subject to examination by the IRS in the course of an audit.

One commentator suggested that the regulations adopt a "principal activity" test similar to the test described in the *Organisation for Economic Cooperation and Development Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines)* in place of the business judgment rule. The Treasury Department and the IRS decline to adopt this suggestion. Another commentator pointed out that the examples illustrating the business judgment rule more accurately describe a high value service or intangible property, rather than a covered service. The Treasury Department and the IRS agree that some of the examples in the temporary regulations could be read as describing transfers of intangible property rather than provisions of services involving the intangible property. Some examples have been edited to improve clarity, including to ensure that they cannot be read as describing transfers of intangible property.

Commentators also raised questions concerning how to evidence the necessary business judgment; for example, whether an executive's representation must be preferred to the tax director's. The business judgment rule is applied on a case-by-case basis and takes into account the taxpayer's facts and circumstances.

One other commentator requested that the business judgment rule take into account whether a particular activity,

such as that of a corporate tax department, contributes to the operating profit (as defined in § 1.482-5(d)(3)) of one or more controlled parties. Notice 2007-5 provided several clarifications to the business judgment rule, including a clarification that the business judgment rule should take into account whether a particular activity contributes to the operating profit of one or more controlled parties. After further consideration, the Treasury Department and the IRS decided not to add an operating profit consideration to the business judgment rule because the operating profit concept is broader than the intended rule and because it would implicitly require taxpayers to do the type of economic analysis (and create the attendant administrative burden for taxpayers) that the business judgment rule is intended to eliminate.

The Treasury Department and the IRS continue to believe, however, that the conclusion in Notice 2007-5 is correct—that activities such as back office tax services should not fail the business judgment rule because they may affect net income by reducing domestic or foreign income taxes. Depending on the facts and circumstances, tax services may or may not satisfy the business judgment rule.

#### f. Reorganization of the SCM

Section 1.482-9T(b) of the 2006 temporary regulations contains several requirements, all of which have to be satisfied in order for the SCM to be applicable. In other words, the requirements under § 1.482-9T(b) are conjunctive; failure to satisfy one of the requirements renders a service ineligible for SCM treatment regardless of whether any of the other requirements is satisfied. The Treasury Department and the IRS are aware that the rules under § 1.482-9T(b) have been misinterpreted as disjunctive such that satisfaction of only one of the requirements renders a service eligible for the SCM. This view is unsupported by the plain language of § 1.482-9T(b). To improve clarity, the requirements for the SCM are reorganized in the final regulations. Section § 1.482-9(b)(2) lists the conditions necessary for a service to be eligible for the SCM and provides a cross-reference to the paragraph in § 1.482-9(b) that corresponds to each condition. In summary, to be eligible for the SCM, a service must be a covered service, the service cannot be an excluded activity, the service cannot be precluded from constituting a covered service by reason of the business judgment rule, and adequate books and records must be maintained with respect to the service. The

reorganization does not substantively change the SCM rules.

Modifications have also been made to the list of excluded activities to harmonize it with Rev. Proc. 2007-13. In particular, instead of referring to "excluded transactions," the regulations now refer to "excluded activities."

#### g. Shared Services Arrangements

In general, commentators supported the shared services arrangement (SSA) provision in the 2006 temporary regulations as a useful mechanism for allocation of costs from shared or centralized services. Commentators called into question, however, the restriction of SSAs to covered services priced under the SCM. In response, Notice 2007-5 provided that a SSA may be used for controlled services transactions outside of the SCM context. Specifically, Notice 2007-5 states: "This Notice confirms that taxpayers may also make allocations of arm's length charges for services ineligible for the SCM that yield a benefit to multiple members of a controlled group. In such a case, however, the flexible rules under the SCM for establishing the joint benefits and selecting the allocation key are inapplicable. Instead, the more robust analysis under the general transfer pricing rules applies for purposes of determining the appropriate arm's length charges, benefits, allocation keys, *etc.*" The Treasury Department and the IRS considered providing additional SSA rules to services priced under methods other than the SCM, but concluded that such rules would be unnecessary. In any event, as stated in Notice 2007-5, the flexible SSA rules for establishing the joint benefits and selecting the allocation key are inapplicable in the non-SCM context.

Other commentators requested that a SSA should be respected even if a party that reasonably anticipates a benefit makes a payment equivalent to its share under an SSA to the service provider pursuant to a different arrangement. For example, assume that a controlled service provider performs services to ten taxpayers that are members of its controlled group. Assume further that nine of the service recipients agree in a single written contract to allocate the arm's length charge based on a reasonable allocation basis, but the tenth service recipient pays for its share of the services pursuant to a separate agreement. These comments were not adopted because whether an agreement constitutes a SSA requires a case-by-case determination based on the facts and circumstances.

Some commentators observed that the SSA rules require the allocation of costs

on the basis that "most reliably reflects" the participants' respective shares of reasonably anticipated benefits, but some of the examples use the phrase "precisely known." This led the commentators to question whether the SSA rules create an unattainable standard or, at least, a higher standard than the reasonable standard for allocation of costs described in Treas. Reg. § 1.482-9T(k) and to suggest a change to the examples. The examples do not create a standard based on precisely known shares of reasonably anticipated benefits. Rather, the examples use hypothetical, precisely known reasonably anticipated benefits as a measuring stick to provide an easily understood comparative analysis of potential allocation keys for illustrative purposes. The suggested changes are not adopted.

#### 2. Comparable Uncontrolled Services Price Method—Treas. Reg. § 1.482-9(c)

The comparable uncontrolled services price (CUSP) method evaluates whether the consideration in a controlled services transaction is arm's length by comparison to the price charged in a comparable uncontrolled services transaction. This method is closely analogous to the comparable uncontrolled price (CUP) method in § 1.482-3(b).

One commentator objected to the statement in the second sentence of § 1.482-9T(c)(1) of the 2006 temporary regulations that, to be evaluated under the CUSP method, a controlled service ordinarily must be "identical to or have a high degree of similarity" to the uncontrolled comparable transactions. The commentator claimed that such language creates a higher standard for determining the best method than in the rest of the section 482 regulations. For example, both § 1.482-1(c)(1) and § 1.482-9T(c)(2)(i) refer to the "most reliable measure of an arm's length result" standard. The sentence in question was intended merely as a guide to when the CUSP method is applicable. It was not intended to change the standard under the best method rule. To avoid further confusion, the sentence is removed, but without effecting a substantive change.

The CUSP method in these final regulations is substantially similar to the corresponding method in the 2006 temporary regulations.

#### 3. Cost of Services Plus Method—Treas. Reg. § 1.482-9(e)

The cost of services plus method is generally analogous to the cost plus method for transfers of tangible property in existing § 1.482-3(d). The cost of

services plus method evaluates whether the amount charged in a controlled services transaction is arm's length by reference to the gross services profit markup realized in comparable uncontrolled transactions. Section 1.482-9T(e)(3)(ii)(A) provides that, if the appropriate gross services profit markup is derived from comparable uncontrolled services transactions of other service providers, then, in evaluating comparability, the controlled taxpayer must consider the results under this method expressed as a markup on total services costs of the controlled taxpayer because functional differences may be reflected in differences in service costs other than those included in comparable transactional costs.

One commentator objected to the required consideration of the results of the cost of services plus method expressed as a markup on total services costs of the controlled taxpayer when external comparables are utilized. In the commentator's view, this rule requires a confirming analysis under a comparable profits method (CPM) and, therefore, places an undue burden on the taxpayer. The same commentator also expressed the concern that the rule would create an even greater burden by requiring two sets of external comparables for application of the two methods.

These comments are not adopted for several reasons. First, the restatement of the price does not require researching two sets of external comparables under two different methods. The sole purpose of the calculation is to determine whether it is necessary to perform additional evaluation of functional comparability under the cost of services plus method. That is, if the price indicates a markup on the renderer's total services cost that is either low or negative when restated, this may indicate differences in functions that have not been accounted for under the traditional comparability factors under the cost of services plus method. Thus, a low or negative markup merely suggests the need for additional inquiry, which may lead to a determination that the cost of services plus method is not the most reliable measure of an arm's length result under the best method rule.

The cost of services plus method is adopted in the final regulations without change.

#### 4. Profit Split Method—Treas. Reg. §§ 1.482-9(g) and 1.482-6(c)(3)(i)(B)

The final regulations provide additional guidance concerning application of the comparable profit

split and the residual profit split methods to controlled services transactions in § 1.482-9(g) and § 1.482-6(c)(3)(i)(B). Generally, the comparable profit split and the residual profit split methods evaluate 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 contributions to the combined operating profit or loss.

The Treasury Department and the IRS received several comments on the profit split method. One commentator requested that § 1.482-8T(b), *Example 12* of the 2006 temporary regulations explain why the profit split method is preferable to using the financial results of a set of publicly-traded companies engaged in selling merchandise and related promotion and marketing activities. *Example 12* is revised in the final regulations to address this comment.

Another commentator argued that the profit split method should not apply to a party that does not own valuable intangible property or does not use any such property in the related party transaction being evaluated. The commentator noted that other parts of the regulations, such as the CPM, CUSP method, and costs of services plus method reference valuable intangible property in the examples. The same commentator asserted that the profit split method should be limited to parties that bear substantial risk in their intercompany transactions. The Treasury Department and the IRS believe that limiting application of the profit split method to contributions of valuable intangible property or the bearing of risks would be inappropriate. The changes in the 2006 temporary regulations to routine and non-routine contributions is an appropriate standard and conformed to the changes to § 1.482-6T(c)(3)(i)(B)(1), which defines a nonroutine contribution as "a contribution that is not accounted for as a routine contribution." In other words, a nonroutine contribution is one for which the return cannot be determined by reference to market benchmarks.

The 2006 temporary regulations provide that the residual profit split method ordinarily is used where multiple controlled taxpayers make significant nonroutine contributions. A commentator requested that this provision be removed because it suggests that the method always applies where there are no market benchmarks. The provision regarding the residual profit split method that the commentator requested be removed has been changed to conform to language in

the cost sharing regulations. Accordingly, § 1.482-9(g)(1) provides that the residual profit split method may not be used where only one controlled taxpayer makes significant nonroutine contributions. The commentator also claimed that the residual profit split method contains an inconsistency because, although the method applies when there are no market benchmarks, the method includes a market benchmark analysis for comparability purposes. Compare §§ 1.482-9(g)(1) and 1.482-6(c)(3)(i)(B)(2). The Treasury Department and the IRS do not consider that there is an inconsistency. The method contemplates the use of market benchmarks, if available, to determine the profit split that will be applied to the return to nonroutine contributions already determined under the method. The same commentator requested that the sentence in § 1.482-6T(c)(2)(ii)(B) of the 2006 temporary regulations relating to the comparable profit split method that states that "the comparable profit split method may not be used if the combined operating profit (as a percentage of the combined assets) of the uncontrolled comparables varies significantly from that earned by the controlled taxpayers" should be deleted. These comments are not adopted, since the stated condition is fundamental to comparability under the method.

#### 5. Contingent Payments—Treas. Reg. § 1.482-9(i)

The 2006 temporary regulations provide detailed guidance concerning contingent-payment contractual terms. The rules built on the principle that, in structuring controlled transactions, taxpayers are free to choose from among a wide range of risk allocations. The provision acknowledged that contingent-payment terms—terms requiring compensation to be paid only if specified results are obtained—may be particularly relevant in the context of controlled services transactions.

Commentators raised several concerns about the substance and scope of this provision. One commentator said that the regulations do not address whether a taxpayer may, in the absence of a written agreement, present facts to demonstrate that a contingent payment arrangement best reflects the economic substance of the underlying transactions. The Treasury Department and the IRS do not agree that an arrangement may be treated as a contingent payment arrangement under § 1.482-9(i)(2) if the arrangement does not satisfy the requirements of the contingent payment arrangement provision, including the written contract requirement. However, where

the Commissioner exercises its authority pursuant to § 1.482-1(d)(3)(ii)(B) to impute contractual terms, the taxpayer may present additional facts to indicate if an alternative agreement best reflects the economic substance of the underlying transaction, consistent with the parties' course of conduct in a particular case. See § 1.482-1(d)(3)(ii)(C), *Examples 4 and 6*.

The same commentator also pointed out that the requirement to evaluate whether a specified contingency bears a direct relationship to the controlled services transaction based on all of the facts and circumstances should be combined with the specified contingency requirement. The Treasury Department and the IRS agree that the language in § 1.482-9(i)(2) should be clarified. Accordingly, the regulations remove the last sentence in § 1.482-9T(i)(2)(i)(C) of the 2006 temporary regulations relating to a specified contingency and combine it with the requirement under § 1.482-9T(i)(2)(i)(B). Thus, § 1.482-9(i)(2)(i)(B) now requires that the contract state that payment for a controlled services transaction is contingent (in whole or in part) upon the happening of a future benefit (within the meaning of § 1.482-9(l)(3)) for the recipient directly related to the activity or group of activities. For this purpose, whether the future benefit is directly related to the activity or group of activities is evaluated based on all the facts and circumstances.

#### 6. Total Services Costs—Treas. Reg. § 1.482-9(j)

In the 2006 temporary regulations, total services costs include all costs directly identified with provision of the controlled services, as well as all other costs reasonably allocable to such services under § 1.482-9(k). "Costs" must reflect all resources expended, used, or made available to render the service. Generally accepted accounting principles (GAAP) or Federal income tax accounting rules may provide an appropriate starting point, but neither would necessarily be conclusive in evaluating whether an item must be included in total services costs.

Another commentator requested that value added costs (that is, labor costs and depreciation) should be distinguished from total services costs. The commentator stated that a markup on value added costs may be more reliable than a markup on total costs in certain instances and that this could be a useful measure for any of the transfer pricing methods, including the cost of services plus method. The regulations already provide flexibility in the context of the cost of services plus method,

which is determined by reference to comparable transactional costs, the comparable profits method, and unspecified methods. Consequently, the comment is not adopted. The definition of total services costs in these regulations is, thus, similar to the provisions in the 2006 temporary regulations.

Section 1.482-9T(j) of the 2006 temporary regulations explicitly states that total services costs include stock-based compensation, and *Examples 3 through 6* of § 1.482-9T(f)(3) illustrate when stock-based compensation constitutes a material difference requiring adjustments for comparability and reliability purposes. Commentators requested further guidance regarding the valuation, comparability, and reliability considerations for stock-based compensation. Other commentators objected to the explicit statement that stock-based compensation can be a total services cost. These final regulations do not provide further guidance regarding stock-based compensation. The Treasury Department and the IRS continue to consider technical issues involving stock-based compensation in the services and other contexts and intend to address those issues in a subsequent guidance project.

#### 7. Controlled Services Transactions and Shareholder Activities—Treas. Reg. § 1.482-9(l)

Section 1.482-9(l) sets forth a threshold test for determining whether an activity constitutes a controlled services transaction subject to the general framework of § 1.482-9. Section 1.482-9(l)(3) provides rules for determining whether an activity provides a benefit. Paragraphs (l)(3)(ii) through (v) provide guidelines that indicate the presence or absence of a benefit. Section 1.482-9T(l)(3)(iv) of the 2006 temporary regulations provides that an activity is a shareholder activity if the sole effect of that activity is either to protect the renderer's capital investment in the recipient or in other members of the controlled group, or to facilitate compliance by the renderer with reporting, legal, or regulatory requirements applicable specifically to the renderer, or both.

The Treasury Department and the IRS received comments on shareholder activities. Some commentators asserted that the "sole effect" language is too restrictive and that the language should be replaced by a "primary effect" standard. Other commentators argued that the language appropriately encompasses shareholder activities. Another commentator requested a change to the regulations such that a

shareholder activity should be considered to have a sole effect only if the benefits provided to the other controlled group members are either (i) indirect or remote or (ii) duplicative.

The Treasury Department and the IRS believe that the "sole effect" language is appropriate. The "primary effect" language in the 2003 proposed regulations could inappropriately include activities that are not true shareholder activities and may even consist of substantial activities that are non-shareholder activities. An activity that is described in § 1.482-9(l)(3)(ii) through (iv) does not produce a benefit, but the mere fact that an activity is not described in § 1.482-9(l)(3)(ii) through (iv) does not mean that the activity necessarily provides a benefit. An activity not described in § 1.482-9(l)(3)(ii) through (iv) provides a benefit only if it satisfies the incremental value standard of § 1.482-9(l)(3)(i). Furthermore, for that purpose, it may be more reliable, depending on the facts and circumstances, to measure incremental value on a functional aggregate activity, rather than a component activity-by-activity basis.

#### 8. Third Party Costs—Treas. Reg. § 1.482-9(l)(4)

Under § 1.482-9T(l)(4) of the 2006 temporary regulations, a controlled services transaction may be analyzed as a single transaction or as two separate transactions depending on which approach provides the most reliable measure of the arm's length result under the best method rule in existing § 1.482-1(c). Two examples are provided illustrating different alternatives when a controlled services transaction included expenses related to a third-party contract (third party costs) with a controlled taxpayer. In both examples, third party costs that could be reliably disaggregated could be charged at cost. Commentators requested that all third party costs be treated as "pass through" items that are not subject to a markup applicable to costs incurred by the renderer in its capacity as service provider.

The Treasury Department and the IRS continue to maintain the view that whether to consider "pass through" items as disaggregated from, or aggregated with, other functions and costs, depends on which analysis most reliably reflects an arm's length result. Therefore, the rules of § 1.482-9(l)(4) are adopted without change.

#### 9. Coordination With Other Transfer Pricing Rules—Treas. Reg. § 1.482-9(m) and Guarantees

Section 1.482-9(m) provides coordination rules applicable to a controlled services transaction that is combined with, or includes elements of, a non-services transaction. These coordination rules rely on the best method rule in existing § 1.482-1(c)(1) to determine which method or methods would provide the most reliable measure of an arm's length result for a particular controlled transaction.

##### a. Services Subject to a Qualified Cost Sharing Arrangement—Treas. Reg. § 1.482-9(m)(3)

Section 1.482-9T(m)(3) of the 2006 temporary regulations states that services provided by a controlled participant under a qualified cost sharing arrangement are subject to existing § 1.482-7. As part of the temporary cost sharing regulations (TD 9441, 2009-7 I.R.B. 460, 74 FR 340) published on January 5, 2009, the Treasury Department and the IRS replaced the coordination rules with new § 1.482-9T(m)(3). Section 1.482-9(m)(3) is reserved pending finalization of the cost sharing regulations.

##### b. Global Dealing Operations

The Treasury Department and the IRS are working on new global dealing regulations. The intent of the Treasury Department and the IRS is that, when final global dealing regulations are issued, those regulations will govern the evaluation of the activities performed by a global dealing operation. Pending the issuance of new global dealing regulations, taxpayers may rely on the proposed global dealing regulations to govern financial transactions entered into in connection with a global dealing operation as defined in proposed § 1.482-8. Thus, the cross-reference under proposed § 1.482-9(m)(6) (71 FR 44247), which provides that a controlled services transaction does not include a financial transaction entered into in connection with a global dealing operation as defined in proposed § 1.482-8, remains in proposed form. Section 1.482-9(m)(6) in these final regulations is reserved pending issuance of global dealing regulations.

##### c. Guarantees, Including Financial Guarantees

Financial transactions, including guarantees, are explicitly excluded from eligibility for the SCM by § 1.482-9(b)(4)(viii). However, no inference is intended that financial transactions (including guarantees) would otherwise be considered the provision of services

for transfer pricing purposes. The Treasury Department and the IRS intend to issue future guidance regarding financial guarantees.

*B. Income Attributable to Intangible Property—Treas. Reg. § 1.482-4(f)(3) and (4)*

Paragraphs (3) and (4) of § 1.482-4(f) provide rules for determining the owner of intangible property for purposes of section 482 and also provide rules for determining the arm's length compensation in situations where a controlled party other than the owner makes contributions to the value of intangible property. Section 1.482-4(f)(3)(i)(A) provides that the legal owner of intangible property pursuant to the intellectual property law of the relevant jurisdiction, or the holder of rights constituting intangible property pursuant to contractual terms (such as the terms of a license) or other legal provision, will be considered the sole owner of intangible property for purposes of this section unless such ownership is inconsistent with the economic substance of the underlying transactions. Some commentators believe that the rules should specify that a holder of bare legal title to intangible property should not be presumed to be the owner when other parties have all of the other benefits and burdens of ownership. After considering the public comments, the Treasury Department and the IRS continue to believe that the legal ownership standard as set forth in § 1.482-4(f)(3)(i)(A) is the appropriate framework for determining ownership of intangible property under section 482.

The provisions of § 1.482-4(f)(3) and (4) are adopted without change.

*C. Economic Substance*

A number of commentators expressed similar and sometimes interrelated concerns regarding economic substance considerations, imputation of contractual terms, the realistic alternatives principle, and the rules for income attributable to intangible property. The common thread running through these comments is a concern that the IRS will inappropriately treat taxpayers as having engaged in transactions different from those in which they actually engaged.

Section 1.482-4(f)(3)(i)(A) provides that, if no owner of intangible property is identified under the intellectual property law of the relevant jurisdiction, or pursuant to contractual terms (including terms imputed pursuant to § 1.482-1(d)(3)(ii)(B)) or other legal provision, then the controlled taxpayer that has control of intangible property,

based on all the facts and circumstances, will be considered the sole owner of intangible property for purposes of this section. One commentator believes that the control rule for determining ownership of non-legally protected intangibles allows the IRS to attribute ownership of intangible property in a manner that is inconsistent with economic substance. Accordingly, the comment suggests that such control determinations must be consistent with economic substance in all cases. In the context of the control rule in § 1.482-4(f)(3)(i)(A), this is already reflected in the language "including terms imputed pursuant to § 1.482-1(d)(3)(ii)(B)."

Section 1.482-9T(h) of the 2006 temporary regulations provides that, consistent with the specified methods, an unspecified method should take into account the general principle that uncontrolled taxpayers compare the terms of a particular transaction to the realistic alternatives to that transaction, including economically similar transactions structured as other than services transactions, and only enter into a transaction if none of the alternatives is preferable to it. The realistic alternatives concept was imported from § 1.482-1(f)(2)(ii) to be consistent with the general aim to coordinate the analyses under the various sections of the regulations under section 482. This provision allows flexibility to consider non-services alternatives to a services transaction, for example, a transfer or license of intangible property, if such an approach provides the most reliable measure of an arm's length result.

Commentators suggested that the realistic alternative principle be clarified so that only transactions actually engaged in by the controlled taxpayer can constitute realistic alternatives or that the principle be removed altogether on the grounds that it inappropriately treats taxpayers as engaging in transactions other than those they chose. The Treasury Department and the IRS do not agree with the assertion that consideration of realistic alternatives improperly disregards a taxpayer's chosen arrangement and that the realistic alternative principle is limited to internal comparables. It is a longstanding principle under § 1.482-1(f)(2)(ii)(A) and in the valuation field, generally, that, although the Commissioner will evaluate the results of a transaction as actually structured by the taxpayer unless it lacks economic substance, the Commissioner may consider alternatives available in determining the arm's length valuation

of the controlled transaction. The realistic alternatives principle does not recast the transaction. Rather, it assumes that taxpayers are rational and will not choose to price an arrangement in a manner that makes them worse off economically than another available alternative. Thus, if the price associated with a realistic alternative appears preferable in comparison with the price associated with the chosen arrangement, the logical implication is that the actual arrangement has been priced incorrectly through a flawed application of the best method rule. This is further reflected in the example in § 1.482-9T(h), which illustrates when realistic alternatives may be considered to evaluate the arm's length consideration, and explicitly states that the best method rule of § 1.482-1(c) governs the analysis.

The unspecified method provisions in these final regulations are adopted without change.

Section 1.482-9(i)(3) provides that, consistent with the authority in § 1.482-1(d)(3)(ii)(B), the Commissioner may impute contingent-payment contractual terms in a controlled services transaction if the economic substance of the transaction is consistent with the existence of such terms. When the 2003 proposed regulations were issued, commentators expressed concerns with the rule for imputing contingent payment terms to the extent that it permits the IRS to recast arrangements if there is a disagreement about the pricing of a service. The temporary regulations responded to this concern by providing a new *Example 5* in § 1.482-1T(d)(3)(ii)(C) to illustrate that if a taxpayer's pricing is outside of the arm's length range, that fact alone would not support imputation of additional contractual terms based on economic substance grounds. Commentators responded, however, that the last sentence of *Example 5* perpetuated the same problem of allowing the IRS to recast arrangements if there were pricing disputes between a taxpayer and the IRS.

The Treasury Department and the IRS agree that the last sentence of *Example 5* in § 1.482-1T(d)(3)(ii)(C) did not clearly convey its intended meaning, which is that a transfer pricing method and the price derived from the application of that method do not inform the terms of the transaction or the risks borne by the entities. Rather, the selection and application of a transfer pricing method should be based on a comparability analysis of the transaction, which must consider the risks borne by each entity in the transaction. Thus, the last sentence in § 1.482-1T(d)(3)(ii)(C) *Example 5*,

paragraph (iv), was intended to explain that the IRS is not required to accept the transfer pricing method and form of payment terms of a transaction as represented by a taxpayer if they are inconsistent with the conduct of the entities and the economic substance of the transaction. Because this sentence caused confusion, it has been removed. However, the Treasury Department and the IRS affirm that the IRS may impute contingent-payment terms where the economic substance of the transaction is consistent with the existence of such terms.

#### D. Stewardship Expenses—§ 1.861-8

The regulations under § 1.861-8(e)(4) conform to, and are consistent with, the language relating to controlled services transactions as set forth in § 1.482-9(l). The regulations under § 1.861-8(e)(4) are applicable for taxable years beginning after December 31, 2006.

#### E. Effective/Applicability Date—§ 1.482-9(n)

These regulations are applicable for taxable years beginning after July 31, 2009. Controlled taxpayers may elect to apply retroactively all of the provisions of these regulations to any taxable year beginning after September 10, 2003. Such election will be effective for the year of the election and all subsequent taxable years.

#### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation. It is hereby certified that the collections of information in this regulation will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the collections of information are related to elective provisions for determining taxable income that simplify and reduce compliance burdens in connection with controlled services transactions. When collection of information is required, it is expected to take taxpayers approximately 2 hours to comply, and the administrative and economic costs will be nominal in comparison with the resulting simplification and reduction of compliance burdens. Thus, the economic impact of the collections of information will not be significant. Similarly, while some small entities may be subject to the collections of

information if they elect one of the provisions, the collections of information are not expected to affect a substantial number of small entities. Accordingly, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

#### Drafting Information

The principal authors of these regulations are Carol B. Tan and Gregory A. Spring, Office of Associate Chief Counsel (International) for matters relating to section 482, and Richard L. Chewing, Office of Associate Chief Counsel (International) for matters relating to stewardship expenses.

#### List of Subjects

##### 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

##### 26 CFR Part 31

Employment taxes, Income taxes, Penalties, Pensions, Railroad retirement, Reporting and recordkeeping requirements, Social Security and Unemployment compensation.

##### 26 CFR Part 602

Reporting and recordkeeping requirements.

#### Adoption of Amendments to the Regulations

■ Accordingly, 26 CFR parts 1, 31, and 602 are amended as follows:

#### PART 1—INCOME TAXES

■ **Paragraph 1.** The authority citation for part 1 is amended by adding an entry in numerical order to read in part as follows:

**Authority:** 26 U.S.C. 7805 \* \* \*.

Section 1.482-9 also issued under 26 U.S.C. 482. \* \* \*

■ **Par. 2.** Section 1.482-0 is amended as follows:

■ 1. The introductory text is revised.

■ 2. The entries for § 1.482-1(a)(1), (d)(3)(ii)(C), (d)(3)(v), (f)(2)(ii)(A), (f)(2)(iii)(B), (g)(4)(iii), (i) and (j) are revised.

■ 3. The entries for § 1.482-2(b), (e) and (f) are revised.

■ 4. The entries for § 1.482-4(f)(3), (f)(4), (g), and (h) are revised.

■ 5. The entry for § 1.482-4(f)(7) is removed.

■ 6. The entries for § 1.482-6(c)(2)(ii)(B)(1), (c)(2)(ii)(D), (c)(3)(i)(A),

(c)(3)(i)(B), (c)(3)(ii)(D), and (d) are revised

■ 7. The entry for § 1.482-8(c) is added.

■ 8. The entries for § 1.482-9 are revised.

The addition and revisions read as follows:

#### § 1.482-0 Outline of regulations under section 482.

This section contains major captions for §§ 1.482-1 through 1.482-9.

#### § 1.482-1 Allocation of income and deductions among taxpayers.

- (a) \* \* \*
- (1) Purpose and scope.  
\* \* \* \* \*
- (d) \* \* \*
- (3) \* \* \*
- (ii) \* \* \*
- (C) Examples.  
\* \* \* \* \*
- (v) Property or services.  
\* \* \* \* \*
- (f) \* \* \*
- (2) \* \* \*
- (ii) \* \* \*
- (A) In general.  
\* \* \* \* \*
- (iii) \* \* \*
- (A) \* \* \*
- (B) Circumstances warranting consideration of multiple year data.  
\* \* \* \* \*
- (g) \* \* \*
- (4) \* \* \*
- (iii) Examples.  
\* \* \* \* \*
- (i) Definitions.
- (j) Effective/applicability date.

#### § 1.482-2 Determination of taxable income in specific situations.

- \* \* \* \* \*
- (b) Rendering of services.  
\* \* \* \* \*
- (e) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-2T(e).
- (f) Effective/applicability date.  
\* \* \* \* \*

#### § 1.482-4 Methods to determine taxable income in connection with a transfer of intangible property.

- \* \* \* \* \*
- (f) \* \* \*
- (3) Ownership of intangible property.
- (i) Identification of owner.
- (A) In general.
- (B) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-4T(f)(3)(i)(B).
- (ii) Examples.
- (4) Contribution to the value of intangible property owned by another.
- (i) In general.

(ii) Examples.

\* \* \* \* \*

(g) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-4T(g).

(h) Effective/applicability date.

\* \* \* \* \*

**§ 1.482-6 Profit split method.**

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(ii) \* \* \*

(B) \* \* \*

(1) In general.

\* \* \* \* \*

(D) Other factors affecting reliability.

\* \* \* \* \*

(3) \* \* \*

(i) \* \* \*

(A) Allocate income to routine contributions.

(B) Allocate residual profit.

(1) Nonroutine contributions generally.

(2) Nonroutine contributions of intangible property.

(ii) \* \* \*

(D) Other factors affecting reliability.

\* \* \* \* \*

(d) Effective/applicability date.

**§ 1.482-8 Examples of the best method rule.**

\* \* \* \* \*

(c) Effective/applicability date.

**§ 1.482-9 Methods to determine taxable income in connection with a controlled services transaction.**

(a) In general.

(b) Services cost method.

(1) In general.

(2) Eligibility for the services cost method.

(3) Covered services.

(i) Specified covered services.

(ii) Low margin covered services.

(4) Excluded activities.

(5) Not services that contribute significantly to fundamental risks of business success or failure.

(6) Adequate books and records.

(7) Shared services arrangement.

(i) In general.

(ii) Requirements for shared services arrangement.

(A) Eligibility.

(B) Allocation.

(C) Documentation.

(iii) Definitions and special rules.

(A) Participant.

(B) Aggregation.

(C) Coordination with cost sharing arrangements.

(8) Examples.

(c) Comparable uncontrolled services price method.

(1) In general.

(2) Comparability and reliability considerations.

(i) In general.

(ii) Comparability.

(A) In general.

(B) Adjustments for differences between controlled and uncontrolled transactions.

(iii) Data and assumptions.

(3) Arm's length range.

(4) Examples.

(5) Indirect evidence of the price of a comparable uncontrolled services transaction.

(i) In general.

(ii) Example.

(d) Gross services margin method.

(1) In general.

(2) Determination of arm's length price.

(i) In general.

(ii) Relevant uncontrolled transaction.

(iii) Applicable uncontrolled price.

(iv) Appropriate gross services profit.

(v) Arm's length range.

(3) Comparability and reliability considerations.

(i) In general.

(ii) Comparability.

(A) Functional comparability.

(B) Other comparability factors.

(C) Adjustments for differences between controlled and uncontrolled transactions.

(D) Buy-sell distributor.

(iii) Data and assumptions.

(A) In general.

(B) Consistency in accounting.

(4) Examples.

(e) Cost of services plus method.

(1) In general.

(2) Determination of arm's length price.

(i) In general.

(ii) Appropriate gross services profit.

(iii) Comparable transactional costs.

(iv) Arm's length range.

(3) Comparability and reliability considerations.

(i) In general.

(ii) Comparability.

(A) Functional comparability.

(B) Other comparability factors.

(C) Adjustments for differences between the controlled and uncontrolled transactions.

(iii) Data and assumptions.

(A) In general.

(B) Consistency in accounting.

(4) Examples.

(f) Comparable profits method.

(1) In general.

(2) Determination of arm's length result.

(i) Tested party.

(ii) Profit level indicators.

(iii) Comparability and reliability considerations—Data and assumptions—Consistency

in accounting.

(3) Examples.

(g) Profit split method.

(1) In general.

(2) Examples.

(h) Unspecified methods.

(i) Contingent-payment contractual terms for services.

(1) Contingent-payment contractual terms recognized in general.

(2) Contingent-payment arrangement.

(i) General requirements.

(A) Written contract.

(B) Specified contingency.

(C) Basis for payment.

(ii) Economic substance and conduct.

(3) Commissioner's authority to

impute contingent-payment terms.

(4) Evaluation of arm's length charge.

(5) Examples.

(j) Total services costs.

(k) Allocation of costs.

(1) In general.

(2) Appropriate method of allocation and apportionment.

(i) Reasonable method standard.

(ii) Use of general practices.

(3) Examples.

(l) Controlled services transaction.

(1) In general.

(2) Activity.

(3) Benefit.

(i) In general.

(ii) Indirect or remote benefit.

(iii) Duplicative activities.

(iv) Shareholder activities.

(v) Passive association.

(4) Disaggregation of transactions.

(5) Examples.

(m) Coordination with transfer pricing rules for other transactions.

(1) Services transactions that include other types of transactions.

(2) Services transactions that effect a transfer of intangible property.

(3) [Reserved]. For further guidance, see § 1.482-0T, the entry for § 1.482-9T(m)(3).

(4) Other types of transactions that include controlled services transactions.

(5) Examples.

(n) Effective/applicability date.

(1) In general.

(2) Election to apply regulations to earlier taxable years.

■ **Par. 3.** Section 1.482-0T is amended as follows:

■ 1. Revise the section heading and introductory text.

■ 2. Revise the section headings for §§ 1.482-1T, 1.482-4T and 1.482.9T and the entries for §§ 1.482-1T, 1.482-2T, 1.482-4T and 1.482.9T.

■ 3. Remove the entries for § 1.482-6T. The revisions read as follows:

**§ 1.482-0T Outline of regulations under section 482 (temporary).**

This section contains major captions for §§ 1.482-1T, 1.482-2T, 1.482-4T, 1.482-7T, 1.482-8T, and 1.482-9T.

**§ 1.482-1T Allocation of income and deductions among taxpayers (temporary).**

(a) through (b)(2) [Reserved]. For further guidance, see § 1.482-0, the entries for § 1.482-1(a) through (b)(2).

(i) Methods.

(ii) [Reserved]. For further guidance, see § 1.482-0, the entry for § 1.482-1(b)(2)(ii).

(iii) Coordination of methods applicable to certain intangible development arrangements.

(c) through (i) [Reserved]. For further guidance, see § 1.482-0, the entries for § 1.482-1(c) through (i).

(j) Effective/applicability date.

(k) Expiration date.

**§ 1.482-2T Determination of taxable income in specific situations (temporary).**

(a) through (d) [Reserved]. For further guidance, see § 1.482-0, the entries for § 1.482-2(a) through (d).

(e) Cost sharing arrangement.

(f) Effective/applicability date.

(1) In general.

(2) Election to apply regulation to earlier taxable years.

(3) Expiration date.

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

(a) through (f)(3)(i)(A) [Reserved]. For further guidance, see § 1.482-0, the entries for § 1.482-4(a) through (f)(3)(i)(A).

(B) Cost sharing arrangements.

(f)(3)(ii) through (f)(6) [Reserved]. For further guidance, see § 1.482-0, the entries for § 1.482-4(f)(3)(ii) through (f)(6).

(g) Coordination with rules governing cost sharing arrangements.

(h) Effective/applicability date.

(i) Expiration date.

\* \* \* \* \*

**§ 1.482-9T Methods to determine taxable income in connection with a controlled services transaction (temporary).**

(a) through (m)(2) [Reserved]. For further guidance, see § 1.482-0, the entries for § 1.482-9(a) through (m)(2).

(3) Coordination with rules governing cost sharing arrangements.

(n) Effective/applicability dates.

(o) Expiration date.

■ **Par. 4.** Section 1.482-1 is amended by revising paragraphs (a)(1), (d)(3)(ii)(C) *Examples 3, 4, 5, and 6*, (d)(3)(v), (f)(2)(ii)(A), (f)(2)(iii)(B), (g)(4)(i), (g)(4)(iii) *Example 1*, (i), and (j)(6) to read as follows:

**§ 1.482-1 Allocation of income and deductions among taxpayers.**

(a) *In general*—(1) *Purpose and scope.* The purpose of section 482 is to ensure that taxpayers clearly reflect income

attributable to controlled transactions and to prevent the avoidance of taxes with respect to such transactions. Section 482 places a controlled taxpayer on a tax parity with an uncontrolled taxpayer by determining the true taxable income of the controlled taxpayer. This section sets forth general principles and guidelines to be followed under section 482. Section 1.482-2 provides rules for the determination of the true taxable income of controlled taxpayers in specific situations, including controlled transactions involving loans or advances or the use of tangible property. Sections 1.482-3 through 1.482-6 provide rules for the determination of the true taxable income of controlled taxpayers in cases involving the transfer of property. Section 1.482-7T sets forth the cost sharing provisions applicable to taxable years beginning on or after January 5, 2009. Section 1.482-8 provides examples illustrating the application of the best method rule. Finally, § 1.482-9 provides rules for the determination of the true taxable income of controlled taxpayers in cases involving the performance of services.

\* \* \* \* \*

(d) \* \* \*

(3) \* \* \*

(ii) \* \* \*

(C) \* \* \*

*Example 3. Contractual terms imputed from economic substance.* (i) FP, a foreign producer of wristwatches, is the registered holder of the YY trademark in the United States and in other countries worldwide. In year 1, FP enters the United States market by selling YY wristwatches to its newly organized United States subsidiary, USSub, for distribution in the United States market. USSub pays FP a fixed price per wristwatch. USSub and FP undertake, without separate compensation, marketing activities to establish the YY trademark in the United States market. Unrelated foreign producers of trademarked wristwatches and their authorized United States distributors respectively undertake similar marketing activities in independent arrangements involving distribution of trademarked wristwatches in the United States market. In years 1 through 6, USSub markets and sells YY wristwatches in the United States. Further, in years 1 through 6, USSub undertakes incremental marketing activities in addition to the activities similar to those observed in the independent distribution transactions in the United States market. FP does not directly or indirectly compensate USSub for performing these incremental activities during years 1 through 6. Assume that, aside from these incremental activities, and after any adjustments are made to improve the reliability of the comparison, the price paid per wristwatch by the independent, authorized distributors of wristwatches would provide the most reliable measure of the arm's length price paid per YY wristwatch by USSub.

(ii) By year 7, the wristwatches with the YY trademark generate a premium return in the United States market, as compared to wristwatches marketed by the independent distributors. In year 7, substantially all the premium return from the YY trademark in the United States market is attributed to FP, for example through an increase in the price paid per watch by USSub, or by some other means.

(iii) In determining whether an allocation of income is appropriate in year 7, the Commissioner may consider the economic substance of the arrangements between USSub and FP, and the parties' course of conduct throughout their relationship. Based on this analysis, the Commissioner determines that it is unlikely that, *ex ante*, an uncontrolled taxpayer operating at arm's length would engage in the incremental marketing activities to develop or enhance intangible property owned by another party unless it received contemporaneous compensation or otherwise had a reasonable anticipation of receiving a future benefit from those activities. In this case, USSub's undertaking the incremental marketing activities in years 1 through 6 is a course of conduct that is inconsistent with the parties' attribution to FP in year 7 of substantially all the premium return from the enhanced YY trademark in the United States market. Therefore, the Commissioner may impute one or more agreements between USSub and FP, consistent with the economic substance of their course of conduct, which would afford USSub an appropriate portion of the premium return from the YY trademark wristwatches. For example, the Commissioner may impute a separate services agreement that affords USSub contingent-payment compensation for its incremental marketing activities in years 1 through 6, which benefited FP by contributing to the value of the trademark owned by FP. In the alternative, the Commissioner may impute a long-term, exclusive agreement to exploit the YY trademark in the United States that allows USSub to benefit from the incremental marketing activities it performed. As another alternative, the Commissioner may require FP to compensate USSub for terminating USSub's imputed long-term, exclusive agreement to exploit the YY trademark in the United States, an agreement that USSub made more valuable at its own expense and risk. The taxpayer may present additional facts that could indicate which of these or other alternative agreements best reflects the economic substance of the underlying transactions, consistent with the parties' course of conduct in the particular case.

*Example 4. Contractual terms imputed from economic substance.* (i) FP, a foreign producer of athletic gear, is the registered holder of the AA trademark in the United States and in other countries worldwide. In year 1, FP enters into a licensing agreement that affords its newly organized United States subsidiary, USSub, exclusive rights to certain manufacturing and marketing intangible property (including the AA trademark) for purposes of manufacturing and marketing athletic gear in the United States under the AA trademark. The contractual terms of this

agreement obligate USSub to pay FP a royalty based on sales, and also obligate both FP and USSub to undertake without separate compensation specified types and levels of marketing activities. Unrelated foreign businesses license independent United States businesses to manufacture and market athletic gear in the United States, using trademarks owned by the unrelated foreign businesses. The contractual terms of these uncontrolled transactions require the licensees to pay royalties based on sales of the merchandise, and obligate the licensors and licensees to undertake without separate compensation specified types and levels of marketing activities. In years 1 through 6, USSub manufactures and sells athletic gear under the AA trademark in the United States. Assume that, after adjustments are made to improve the reliability of the comparison for any material differences relating to marketing activities, manufacturing or marketing intangible property, and other comparability factors, the royalties paid by independent licensees would provide the most reliable measure of the arm's length royalty owed by USSub to FP, apart from the additional facts in paragraph (ii) of this *Example 4*.

(i) In years 1 through 6, USSub performs incremental marketing activities with respect to the AA trademark athletic gear, in addition to the activities required under the terms of the license agreement with FP, that are also incremental as compared to those observed in the comparables. FP does not directly or indirectly compensate USSub for performing these incremental activities during years 1 through 6. By year 7, AA trademark athletic gear generates a premium return in the United States, as compared to similar athletic gear marketed by independent licensees. In year 7, USSub and FP enter into a separate services agreement under which FP agrees to compensate USSub on a cost basis for the incremental marketing activities that USSub performed during years 1 through 6, and to compensate USSub on a cost basis for any incremental marketing activities it may perform in year 7 and subsequent years. In addition, the parties revise the license agreement executed in year 1, and increase the royalty to a level that attributes to FP substantially all the premium return from sales of the AA trademark athletic gear in the United States.

(iii) In determining whether an allocation of income is appropriate in year 7, the Commissioner may consider the economic substance of the arrangements between USSub and FP and the parties' course of conduct throughout their relationship. Based on this analysis, the Commissioner determines that it is unlikely that, ex ante, an uncontrolled taxpayer operating at arm's length would engage in the incremental marketing activities to develop or enhance intangible property owned by another party unless it received contemporaneous compensation or otherwise had a reasonable anticipation of a future benefit. In this case, USSub's undertaking the incremental marketing activities in years 1 through 6 is a course of conduct that is inconsistent with the parties' adoption in year 7 of contractual terms by which FP compensates USSub on a cost basis for the incremental marketing

activities that it performed. Therefore, the Commissioner may impute one or more agreements between USSub and FP, consistent with the economic substance of their course of conduct, which would afford USSub an appropriate portion of the premium return from the AA trademark athletic gear. For example, the Commissioner may impute a separate services agreement that affords USSub contingent-payment compensation for the incremental activities it performed during years 1 through 6, which benefited FP by contributing to the value of the trademark owned by FP. In the alternative, the Commissioner may impute a long-term, exclusive United States license agreement that allows USSub to benefit from the incremental activities. As another alternative, the Commissioner may require FP to compensate USSub for terminating USSub's imputed long-term United States license agreement, a license that USSub made more valuable at its own expense and risk. The taxpayer may present additional facts that could indicate which of these or other alternative agreements best reflects the economic substance of the underlying transactions, consistent with the parties' course of conduct in this particular case.

*Example 5. Non-arm's length compensation.* (i) The facts are the same as in paragraph (i) of *Example 4*. As in *Example 4*, assume that, after adjustments are made to improve the reliability of the comparison for any material differences relating to marketing activities, manufacturing or marketing intangible property, and other comparability factors, the royalties paid by independent licensees would provide the most reliable measure of the arm's length royalty owed by USSub to FP, apart from the additional facts described in paragraph (ii) of this *Example 5*.

(ii) In years 1 through 4, USSub performs certain incremental marketing activities with respect to the AA trademark athletic gear, in addition to the activities required under the terms of the basic license agreement, that are also incremental as compared with those activities observed in the comparables. At the start of year 1, FP enters into a separate services agreement with USSub, which states that FP will compensate USSub quarterly, in an amount equal to specified costs plus X%, for these incremental marketing functions. Further, these written agreements reflect the intent of the parties that USSub receive such compensation from FP throughout the term of the agreement, without regard to the success or failure of the promotional activities. During years 1 through 4, USSub performs marketing activities pursuant to the separate services agreement and in each year USSub receives the specified compensation from FP on a cost of services plus basis.

(iii) In evaluating year 4, the Commissioner performs an analysis of independent parties that perform promotional activities comparable to those performed by USSub and that receive separately-stated compensation on a current basis without contingency. The Commissioner determines that the magnitude of the specified cost plus X% is outside the arm's length range in each of years 1 through 4. Based on an evaluation of all the facts and circumstances, the Commissioner makes an allocation to require

payment of compensation to USSub for the promotional activities performed in year 4, based on the median of the interquartile range of the arm's length markups charged by the uncontrolled comparables described in paragraph (e)(3) of this section.

(iv) Given that based on facts and circumstances, the terms agreed by the controlled parties were that FP would bear all risks associated with the promotional activities performed by USSub to promote the AA trademark product in the United States market, and given that the parties' conduct during the years examined was consistent with this allocation of risk, the fact that the cost of services plus markup on USSub's services was outside the arm's length range does not, without more, support imputation of additional contractual terms based on alternative views of the economic substance of the transaction, such as terms indicating that USSub, rather than FP, bore the risk associated with these activities.

*Example 6. Contractual terms imputed from economic substance.* (i) Company X is a member of a controlled group that has been in operation in the pharmaceutical sector for many years. In years 1 through 4, Company X undertakes research and development activities. As a result of those activities, Company X developed a compound that may be more effective than existing medications in the treatment of certain conditions.

(ii) Company Y is acquired in year 4 by the controlled group that includes Company X. Once Company Y is acquired, Company X makes available to Company Y a large amount of technical data concerning the new compound, which Company Y uses to register patent rights with respect to the compound in several jurisdictions, making Company Y the legal owner of such patents. Company Y then enters into licensing agreements with group members that afford Company Y 100% of the premium return attributable to use of the intangible property by its subsidiaries.

(iii) In determining whether an allocation is appropriate in year 4, the Commissioner may consider the economic substance of the arrangements between Company X and Company Y, and the parties' course of conduct throughout their relationship. Based on this analysis, the Commissioner determines that it is unlikely that an uncontrolled taxpayer operating at arm's length would make available the results of its research and development or perform services that resulted in transfer of valuable know-how to another party unless it received contemporaneous compensation or otherwise had a reasonable anticipation of receiving a future benefit from those activities. In this case, Company X's undertaking the research and development activities and then providing technical data and know-how to Company Y in year 4 is inconsistent with the registration and subsequent exploitation of the patent by Company Y. Therefore, the Commissioner may impute one or more agreements between Company X and Company Y consistent with the economic substance of their course of conduct, which would afford Company X an appropriate portion of the premium return from the patent rights. For example, the Commissioner

may impute a separate services agreement that affords Company X contingent-payment compensation for its services in year 4 for the benefit of Company Y, consisting of making available to Company Y technical data, know-how, and other fruits of research and development conducted in previous years. These services benefited Company Y by giving rise to and contributing to the value of the patent rights that were ultimately registered by Company Y. In the alternative, the Commissioner may impute a transfer of patentable intangible property rights from Company X to Company Y immediately preceding the registration of patent rights by Company Y. The taxpayer may present additional facts that could indicate which of these or other alternative agreements best reflects the economic substance of the underlying transactions, consistent with the parties' course of conduct in the particular case.

\* \* \* \* \*

(v) *Property or services.* Evaluating the degree of comparability between controlled and uncontrolled transactions requires a comparison of the property or services transferred in the transactions. This comparison may include any intangible property that is embedded in tangible property or services being transferred (embedded intangibles). The comparability of the embedded intangibles will be analyzed using the factors listed in § 1.482-4(c)(2)(iii)(B)(1) (comparable intangible property). The relevance of product comparability in evaluating the relative reliability of the results will depend on the method applied. For guidance concerning the specific comparability considerations applicable to transfers of tangible and intangible property and performance of services, see §§ 1.482-3 through 1.482-6 and § 1.482-9; see also §§ 1.482-3(f), 1.482-4(f)(4), and 1.482-9(m), dealing with the coordination of the intangible and tangible property and performance of services rules.

\* \* \* \* \*

(f) \* \* \*

(2) \* \* \*

(ii) *Allocation based on taxpayer's actual transactions—(A) In general.* The Commissioner will evaluate the results of a transaction as actually structured by the taxpayer unless its structure lacks economic substance. However, the Commissioner may consider the alternatives available to the taxpayer in determining whether the terms of the controlled transaction would be acceptable to an uncontrolled taxpayer faced with the same alternatives and operating under comparable circumstances. In such cases the Commissioner may adjust the consideration charged in the controlled transaction based on the cost or profit of an alternative as adjusted to account for

material differences between the alternative and the controlled transaction, but will not restructure the transaction as if the alternative had been adopted by the taxpayer. See paragraph (d)(3) of this section (factors for determining comparability; contractual terms and risk); §§ 1.482-3(e), 1.482-4(d), and 1.482-9(h) (unspecified methods).

\* \* \* \* \*

(iii) \* \* \*

(B) *Circumstances warranting consideration of multiple year data.* The extent to which it is appropriate to consider multiple year data depends on the method being applied and the issue being addressed. Circumstances that may warrant consideration of data from multiple years include the extent to which complete and accurate data are available for the taxable year under review, the effect of business cycles in the controlled taxpayer's industry, or the effects of life cycles of the product or intangible property being examined. Data from one or more years before or after the taxable year under review must ordinarily be considered for purposes of applying the provisions of paragraph (d)(3)(iii) of this section (risk), paragraph (d)(4)(i) of this section (market share strategy), § 1.482-4(f)(2) (periodic adjustments), § 1.482-5 (comparable profits method), § 1.482-9(f) (comparable profits method for services), and § 1.482-9(i) (contingent-payment contractual terms for services). On the other hand, multiple year data ordinarily will not be considered for purposes of applying the comparable uncontrolled price method of § 1.482-3(b) or the comparable uncontrolled services price method of § 1.482-9(c) (except to the extent that risk or market share strategy issues are present).

\* \* \* \* \*

(g) \* \* \*

(4) *Setoffs—(i) In general.* If an allocation is made under section 482 with respect to a transaction between controlled taxpayers, the Commissioner will take into account the effect of any other non-arm's length transaction between the same controlled taxpayers in the same taxable year which will result in a setoff against the original section 482 allocation. Such setoff, however, will be taken into account only if the requirements of paragraph (g)(4)(ii) of this section are satisfied. If the effect of the setoff is to change the characterization or source of the income or deductions, or otherwise distort taxable income, in such a manner as to affect the U.S. tax liability of any member, adjustments will be made to reflect the correct amount of each

category of income or deductions. For purposes of this setoff provision, the term arm's length refers to the amount defined in paragraph (b) of this section (arm's length standard), without regard to the rules in § 1.482-2(a) that treat certain interest rates as arm's length rates of interest.

\* \* \* \* \*

(iii) \* \* \*

*Example 1.* P, a U.S. corporation, renders construction services to S, its foreign subsidiary in Country Y, in connection with the construction of S's factory. An arm's length charge for such services determined under § 1.482-9 would be \$100,000. During the same taxable year P makes available to S the use of a machine to be used in the construction of the factory, and the arm's length rental value of the machine is \$25,000. P bills S \$125,000 for the services, but does not charge S for the use of the machine. No allocation will be made with respect to the undercharge for the machine if P notifies the district director of the basis of the claimed setoff within 30 days after the date of the letter from the district director transmitting the examination report notifying P of the proposed adjustment, establishes that the excess amount charged for services was equal to an arm's length charge for the use of the machine and that the taxable income and income tax liabilities of P are not distorted, and documents the correlative allocations resulting from the proposed setoff.

\* \* \* \* \*

(i) *Definitions.* The definitions set forth in paragraphs (i)(1) through (i)(10) of this section apply to this section and §§ 1.482-2 through 1.482-9.

\* \* \* \* \*

(j) \* \* \*

(6)(i) The provisions of paragraphs (a)(1), (d)(3)(ii)(C) *Example 3*, *Example 4*, *Example 5*, and *Example 6*, (d)(3)(v), (f)(2)(ii)(A), (f)(2)(iii)(B), (g)(4)(i), (g)(4)(iii), and (i) of this section are generally applicable for taxable years beginning after July 31, 2009.

(ii) A person may elect to apply the provisions of paragraphs (a)(1), (b)(2)(i), (d)(3)(ii)(C) *Example 3*, *Example 4*, *Example 5*, and *Example 6*, (d)(3)(v), (f)(2)(ii)(A), (f)(2)(iii)(B), (g)(4)(i), (g)(4)(iii), and (i) of this section to earlier taxable years in accordance with the rules set forth in § 1.482-9(n)(2).

■ **Par. 5.** Section 1.482-1T is amended by revising paragraphs (a), (b)(1), the first sentence in paragraph (b)(2)(i), (b)(2)(ii), the second sentence in paragraph (b)(2)(iii), (c), (d), (e), (f), (g), (h), (i), and (j) to read as follows:

**§ 1.482-1T Allocation of income and deductions among taxpayers (temporary).**

(a) through (b)(1) [Reserved]. For further guidance, see § 1.482-1(a) through (b)(1).

(b)(2) \* \* \* (i) \* \* \* Sections 1.482-2 through 1.482-6, 1.482-7T and 1.482-

9 provide specific methods to be used to evaluate whether transactions between or among members of the controlled group satisfy the arm's length standard, and if they do not, to determine the arm's length result. \* \* \*

(ii) [Reserved]. For further guidance, see § 1.482-1(b)(2)(ii).

(iii) \* \* \* Sections 1.482-4 and 1.482-9, as appropriate, provide the specific methods to be used to determine arm's length results of arrangements, including partnerships, for sharing the costs and risks of developing intangible property, other than a cost sharing arrangement covered by § 1.482-7T. \* \* \*

(c) through (j)(5) [Reserved]. For further guidance, see § 1.482-1(c) through (j)(5).

(j)(6)(i) The provisions of paragraphs (b)(2)(i) and (b)(2)(iii) of this section are generally applicable on January 5, 2009.

(ii) [Reserved]. For further guidance, see § 1.482-1(j)(6)(ii).

(iii) The applicability of paragraphs (b)(2)(i) and (b)(2)(iii) of this section expires on or before December 30, 2011.

■ Par. 6. Section 1.482-2 is amended by revising paragraph (b), (e), and adding paragraph (f) to read as follows:

§ 1.482-2 Determination of taxable income in specific situations.

\* \* \* \* \*

(b) *Rendering of services.* For rules governing allocations under section 482 to reflect an arm's length charge for controlled transactions involving the rendering of services, see § 1.482-9.

\* \* \* \* \*

(e) [Reserved]. For further guidance, see § 1.482-2T(e).

(f) *Effective/applicability date*—(1) *In general.* The provision of paragraph (b) of this section is generally applicable for taxable years beginning after July 31, 2009.

(2) *Election to apply regulation to earlier taxable years.* A person may elect to apply the provisions of paragraph (b) of this section to earlier taxable years in accordance with the rules set forth in § 1.482-9(n)(2).

■ Par. 7. Section 1.482-2T is amended as follows:

■ 1. Revise paragraphs (a), (b), (c), (d), and (f)(2).

■ 2. Remove the first sentence in both paragraphs (f)(1) and (f)(3).

The revisions read as follows:

§ 1.482-2T Determination of taxable income in specific situations (temporary).

(a) through (d) [Reserved]. For further guidance, see § 1.482-2(a) through (d).

\* \* \* \* \*

(f) \* \* \*

(2) [Reserved]. For further guidance, see § 1.482-2(f)(2).

\* \* \* \* \*

■ Par. 8. Section 1.482-4 is amended as follows:

■ 1. Revise paragraphs (f)(3) and (f)(4).

■ 2. Add paragraphs (g) and (h).

The revisions and addition read as follows:

§ 1.482-4 Methods to determine taxable income in connection with a transfer of intangible property.

\* \* \* \* \*

(f) \* \* \*

(3) *Ownership of intangible property*—(i) *Identification of owner*—(A) *In general.* The legal owner of intangible property pursuant to the intellectual property law of the relevant jurisdiction, or the holder of rights constituting an intangible property pursuant to contractual terms (such as the terms of a license) or other legal provision, will be considered the sole owner of the respective intangible property for purposes of this section unless such ownership is inconsistent with the economic substance of the underlying transactions. See § 1.482-1(d)(3)(ii)(B) (identifying contractual terms). If no owner of the respective intangible property is identified under the intellectual property law of the relevant jurisdiction, or pursuant to contractual terms (including terms imputed pursuant to § 1.482-1(d)(3)(ii)(B)) or other legal provision, then the controlled taxpayer who has control of the intangible property, based on all the facts and circumstances, will be considered the sole owner of the intangible property for purposes of this section.

(B) [Reserved]. For further guidance, see § 1.482-4T(f)(3)(i)(B).

(ii) *Examples.* The principles of this paragraph (f)(3) are illustrated by the following examples:

*Example 1.* FP, a foreign corporation, is the registered holder of the AA trademark in the United States. FP licenses to its U.S. subsidiary, USSub, the exclusive rights to manufacture and market products in the United States under the AA trademark. FP is the owner of the trademark pursuant to intellectual property law. USSub is the owner of the license pursuant to the terms of the license, but is not the owner of the trademark. See paragraphs (b)(3) and (4) of this section (defining an intangible as, among other things, a trademark or a license).

*Example 2.* The facts are the same as in *Example 1.* As a result of its sales and marketing activities, USSub develops a list of several hundred creditworthy customers that regularly purchase AA trademarked products. Neither the terms of the contract between FP and USSub nor the relevant intellectual property law specify which party

owns the customer list. Because USSub has knowledge of the contents of the list, and has practical control over its use and dissemination, USSub is considered the sole owner of the customer list for purposes of this paragraph (f)(3).

(4) *Contribution to the value of intangible property owned by another*—

(i) *In general.* The arm's length consideration for a contribution by one controlled taxpayer that develops or enhances the value, or may be reasonably anticipated to develop or enhance the value, of intangible property owned by another controlled taxpayer will be determined in accordance with the applicable rules under section 482. If the consideration for such a contribution is embedded within the contractual terms for a controlled transaction that involves such intangible property, then ordinarily no separate allocation will be made with respect to such contribution. In such cases, pursuant to § 1.482-1(d)(3), the contribution must be accounted for in evaluating the comparability of the controlled transaction to uncontrolled comparables, and accordingly in determining the arm's length consideration in the controlled transaction.

(ii) *Examples.* The principles of this paragraph (f)(4) are illustrated by the following examples:

*Example 1.* A, a member of a controlled group, allows B, another member of the controlled group, to use tangible property, such as laboratory equipment, in connection with B's development of an intangible that B owns. By furnishing tangible property, A makes a contribution to the development of intangible property owned by another controlled taxpayer, B. Pursuant to paragraph (f)(4)(i) of this section, the arm's length charge for A's furnishing of tangible property will be determined under the rules for use of tangible property in § 1.482-2(c).

*Example 2.* (i) *Facts.* FP, a foreign producer of wristwatches, is the registered holder of the YY trademark in the United States and in other countries worldwide. FP enters into an exclusive, five-year, renewable agreement with its newly organized U.S. subsidiary, USSub. The contractual terms of the agreement grant USSub the exclusive right to re-sell YY trademark wristwatches in the United States, obligate USSub to pay a fixed price per wristwatch throughout the entire term of the contract, and obligate both FP and USSub to undertake without separate compensation specified types and levels of marketing activities.

(ii) The consideration for FP's and USSub's marketing activities, as well as the consideration for the exclusive right to re-sell YY trademarked merchandise in the United States, are embedded in the transfer price paid for the wristwatches. Accordingly, pursuant to paragraph (f)(4)(i) of this section, ordinarily no separate allocation would be

appropriate with respect to these embedded contributions.

(iii) Whether an allocation is warranted with respect to the transfer price for the wristwatches is determined under §§ 1.482-1, 1.482-3, and this section through § 1.482-6. The comparability analysis would include consideration of all relevant factors, including the nature of the intangible property embedded in the wristwatches and the nature of the marketing activities required under the agreement. This analysis would also take into account that the compensation for the activities performed by USSub and FP, as well as the consideration for USSub's use of the YY trademark, is embedded in the transfer price for the wristwatches, rather than provided for in separate agreements. See §§ 1.482-3(f) and 1.482-9(m)(4).

*Example 3.* (i) *Facts.* FP, a foreign producer of athletic gear, is the registered holder of the AA trademark in the United States and in other countries. In year 1, FP licenses to a newly organized U.S. subsidiary, USSub, the exclusive rights to use certain manufacturing and marketing intangible property to manufacture and market athletic gear in the United States under the AA trademark. The license agreement obligates USSub to pay a royalty based on sales of trademarked merchandise. The license agreement also obligates FP and USSub to perform without separate compensation specified types and levels of marketing activities. In year 1, USSub manufactures and sells athletic gear under the AA trademark in the United States.

(ii) The consideration for FP's and USSub's respective marketing activities is embedded in the contractual terms of the license for the AA trademark. Accordingly, pursuant to paragraph (f)(4)(i) of this section, ordinarily no separate allocation would be appropriate with respect to the embedded contributions in year 1. See § 1.482-9(m)(4).

(iii) Whether an allocation is warranted with respect to the royalty under the license agreement would be analyzed under § 1.482-1, and this section through § 1.482-6. The comparability analysis would include consideration of all relevant factors, such as the term and geographical exclusivity of the license, the nature of the intangible property subject to the license, and the nature of the marketing activities required to be undertaken pursuant to the license. Pursuant to paragraph (f)(4)(i) of this section, the analysis would also take into account the fact that the compensation for the marketing services is embedded in the royalty paid for use of the AA trademark, rather than provided for in a separate services agreement. For illustrations of application of the best method rule, see § 1.482-8 *Examples 10, 11, and 12.*

*Example 4.* (i) *Facts.* The year 1 facts are the same as in *Example 3*, with the following exceptions. In year 2, USSub undertakes certain incremental marketing activities in addition to those required by the contractual terms of the license for the AA trademark executed in year 1. The parties do not execute a separate agreement with respect to these incremental marketing activities performed by USSub. The license agreement executed in year 1 is of sufficient duration

that it is reasonable to anticipate that USSub will obtain the benefit of its incremental activities, in the form of increased sales or revenues of trademarked products in the U.S. market.

(ii) To the extent that it was reasonable to anticipate that USSub's incremental marketing activities would increase the value only of USSub's intangible property (that is, USSub's license to use the AA trademark for a specified term), and not the value of the AA trademark owned by FP, USSub's incremental activities do not constitute a contribution for which an allocation is warranted under paragraph (f)(4)(i) of this section.

*Example 5.* (i) *Facts.* The year 1 facts are the same as in *Example 3*. In year 2, FP and USSub enter into a separate services agreement that obligates USSub to perform certain incremental marketing activities to promote AA trademark athletic gear in the United States, above and beyond the activities specified in the license agreement executed in year 1. In year 2, USSub begins to perform these incremental activities, pursuant to the separate services agreement with FP.

(ii) Whether an allocation is warranted with respect to USSub's incremental marketing activities covered by the separate services agreement would be evaluated under §§ 1.482-1 and 1.482-9, including a comparison of the compensation provided for the services with the results obtained under a method pursuant to § 1.482-9, selected and applied in accordance with the best method rule of § 1.482-1(c).

(iii) Whether an allocation is warranted with respect to the royalty under the license agreement is determined under § 1.482-1, and this section through § 1.482-6. The comparability analysis would include consideration of all relevant factors, such as the term and geographical exclusivity of the license, the nature of the intangible property subject to the license, and the nature of the marketing activities required to be undertaken pursuant to the license. The comparability analysis would take into account that the compensation for the incremental activities by USSub is provided for in the separate services agreement, rather than embedded in the royalty paid for use of the AA trademark. For illustrations of application of the best method rule, see § 1.482-8 *Examples 10, 11, and 12.*

*Example 6.* (i) *Facts.* The year 1 facts are the same as in *Example 3*. In year 2, FP and USSub enter into a separate services agreement that obligates FP to perform incremental marketing activities, not specified in the year 1 license, by advertising AA trademarked athletic gear in selected international sporting events, such as the Olympics and the soccer World Cup. FP's corporate advertising department develops and coordinates these special promotions. The separate services agreement obligates USSub to pay an amount to FP for the benefit to USSub that may reasonably be anticipated as the result of FP's incremental activities. The separate services agreement is not a qualified cost sharing arrangement under § 1.482-7T. FP begins to perform the incremental activities in year 2 pursuant to the separate services agreement.

(ii) Whether an allocation is warranted with respect to the incremental marketing activities performed by FP under the separate services agreement would be evaluated under § 1.482-9. Under the circumstances, it is reasonable to anticipate that FP's activities would increase the value of USSub's license as well as the value of FP's trademark. Accordingly, the incremental activities by FP may constitute in part a controlled services transaction for which USSub must compensate FP. The analysis of whether an allocation is warranted would include a comparison of the compensation provided for the services with the results obtained under a method pursuant to § 1.482-9, selected and applied in accordance with the best method rule of § 1.482-1(c).

(iii) Whether an allocation is appropriate with respect to the royalty under the license agreement would be evaluated under §§ 1.482-1 through 1.482-3, this section, and §§ 1.482-5 and 1.482-6. The comparability analysis would include consideration of all relevant factors, such as the term and geographical exclusivity of USSub's license, the nature of the intangible property subject to the license, and the marketing activities required to be undertaken by both FP and USSub pursuant to the license. This comparability analysis would take into account that the compensation for the incremental activities performed by FP was provided for in the separate services agreement, rather than embedded in the royalty paid for use of the AA trademark. For illustrations of application of the best method rule, see § 1.482-8, *Example 10, Example 11, and Example 12.*

\* \* \* \* \*

(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 earlier 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 accordance with the rules set forth in § 1.482-9(n)(2).

■ **Par. 9.** Section 1.482-4T is amended as follows:

■ 1. Revise paragraphs (a), (b), (c), (d), (e), (f)(1), (f)(2), (f)(3)(i)(A), (f)(3)(ii), (f)(4), (f)(5), (f)(6), and (h)(3).

■ 2. Redesignate paragraph (h)(1) as paragraph (h), revise the heading and remove the first sentence in newly-designated paragraph (h).

■ 3. Remove paragraph (h)(2).

■ 4. Redesignate paragraph (h)(3) as paragraph (i).

The revisions read as follows:

**§ 1.482-4T Methods to determine taxable 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) through (f)(3)(i)(A).

(B) \* \* \*

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

(g) \* \* \*

(h) *Effective/applicability date.* \* \* \*

■ **Par. 10.** Section 1.482-6 is amended by revising paragraphs (c)(2)(ii)(B)(1), (c)(2)(ii)(D), (c)(3)(i)(A), (c)(3)(i)(B), (c)(3)(ii)(D), and adding paragraph (d) to read as follows:

**§ 1.482-6 Profit split method.**

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(ii) \* \* \*

(B) *Comparability—(1) In general.* The degree of comparability between the controlled and uncontrolled taxpayers is determined by applying the comparability provisions of § 1.482-1(d). The comparable profit split compares the division of operating profits among the controlled taxpayers to the division of operating profits among uncontrolled taxpayers engaged in similar activities under similar circumstances. Although all of the factors described in § 1.482-1(d)(3) must be considered, comparability under this method is particularly dependent on the considerations described under the comparable profits method in § 1.482-5(c)(2) or § 1.482-9(f)(2)(iii) because this method is based on a comparison of the operating profit of the controlled and uncontrolled taxpayers. In addition, because the contractual terms of the relationship among the participants in the relevant business activity will be a principal determinant of the allocation of functions and risks among them, comparability under this method also depends particularly on the degree of similarity of the contractual terms of the controlled and uncontrolled taxpayers. Finally, the comparable profit split may not be used if the combined operating profit (as a percentage of the combined assets) of the uncontrolled comparables varies significantly from that earned by the controlled taxpayers.

\* \* \* \* \*

(D) *Other factors affecting reliability.* Like the methods described in §§ 1.482-3, 1.482-4, 1.482-5, and 1.482-9, the comparable profit split relies exclusively on external market benchmarks. As indicated in § 1.482-1(c)(2)(i), as the degree of comparability between the controlled and

uncontrolled transactions increases, the relative weight accorded the analysis under this method will increase. In addition, the reliability of the analysis under this method may be enhanced by the fact that all parties to the controlled transaction are evaluated under the comparable profit split. However, the reliability of the results of an analysis based on information from all parties to a transaction is affected by the reliability of the data and the assumptions pertaining to each party to the controlled transaction. Thus, if the data and assumptions are significantly more reliable with respect to one of the parties than with respect to the others, a different method, focusing solely on the results of that party, may yield more reliable results.

\* \* \* \* \*

(3) \* \* \*

(i) \* \* \*

(A) *Allocate income to routine contributions.* The first step allocates operating income to each party to the controlled transactions to provide a market return for its routine contributions to the relevant business activity. Routine contributions are contributions of the same or a similar kind to those made by uncontrolled taxpayers involved in similar business activities for which it is possible to identify market returns. Routine contributions ordinarily include contributions of tangible property, services and intangible property that are generally owned by uncontrolled taxpayers engaged in similar activities. A functional analysis is required to identify these contributions according to the functions performed, risks assumed, and resources employed by each of the controlled taxpayers. Market returns for the routine contributions should be determined by reference to the returns achieved by uncontrolled taxpayers engaged in similar activities, consistent with the methods described in §§ 1.482-3, 1.482-4, 1.482-5 and 1.482-9.

(B) *Allocate residual profit—(1) Nonroutine contributions generally.* The allocation of income to the controlled taxpayer's routine contributions will not reflect profits attributable to each controlled taxpayer's contributions to the relevant business activity that are not routine (nonroutine contributions). A nonroutine contribution is a contribution that is not accounted for as a routine contribution. Thus, in cases where such nonroutine contributions are present there normally will be an unallocated residual profit after the allocation of income described in paragraph (c)(3)(i)(A) of this section. Under this second step, the residual

profit generally should be divided among the controlled taxpayers based upon the relative value of their nonroutine contributions to the relevant business activity. The relative value of the nonroutine contributions of each taxpayer should be measured in a manner that most reliably reflects each nonroutine contribution made to the uncontrolled transaction and each controlled taxpayer's role in the nonroutine contributions. If the nonroutine contribution by one of the controlled taxpayers is also used in other business activities (such as transactions with other controlled taxpayers), an appropriate allocation of the value of the nonroutine contribution must be made among all the business activities in which it is used.

(2) *Nonroutine contributions of intangible property.* In many cases, nonroutine contributions of a taxpayer to the relevant business activity may be contributions of intangible property. For purposes of paragraph (c)(3)(i)(B)(1) of this section, the relative value of nonroutine intangible property contributed by taxpayers may be measured by external market benchmarks that reflect the fair market value of such intangible property. Alternatively, the relative value of nonroutine intangible property contributions may be estimated by the capitalized cost of developing the intangible property and all related improvements and updates, less an appropriate amount of amortization based on the useful life of each intangible property. Finally, if the intangible property development expenditures of the parties are relatively constant over time and the useful life of the intangible property contributed by all parties is approximately the same, the amount of actual expenditures in recent years may be used to estimate the relative value of nonroutine intangible property contributions.

\* \* \* \* \*

(ii) \* \* \*

(D) *Other factors affecting reliability.* Like the methods described in §§ 1.482-3, 1.482-4, 1.482-5, and 1.482-9, the first step of the residual profit split relies exclusively on external market benchmarks. As indicated in § 1.482-1(c)(2)(i), as the degree of comparability between the controlled and uncontrolled transactions increases, the relative weight accorded the analysis under this method will increase. In addition, to the extent the allocation of profits in the second step is not based on external market benchmarks, the reliability of the analysis will be decreased in relation to an analysis

under a method that relies on market benchmarks. Finally, the reliability of the analysis under this method may be enhanced by the fact that all parties to the controlled transaction are evaluated under the residual profit split. However, the reliability of the results of an analysis based on information from all parties to a transaction is affected by the reliability of the data and the assumptions pertaining to each party to the controlled transaction. Thus, if the data and assumptions are significantly more reliable with respect to one of the parties than with respect to the others, a different method, focusing solely on the results of that party, may yield more reliable results.

\* \* \* \* \*

(d) *Effective/applicability date*—(1) *In general.* The provisions of paragraphs (c)(2)(ii)(B)(1) and (D), (c)(3)(i)(A) and (B), and (c)(3)(ii)(D) of this section are generally applicable for taxable years beginning after July 31, 2009.

(2) *Election to apply regulation to earlier taxable years.* A person may elect to apply the provisions of paragraphs (c)(2)(ii)(B)(1) and (D), (c)(3)(i)(A) and (B), and (c)(3)(ii)(D) of this section to earlier taxable years in accordance with the rules set forth in § 1.482–9(n)(2).

#### § 1.482–6T [Removed]

■ **Par. 11.** Section 1.482–6T is removed.

■ **Par. 12.** Section 1.482–8 is amended by revising paragraph (b) *Examples 10, 11, 12, 13, 14, 15, 16, 17 and 18*, and adding paragraph (c) to read as follows:

#### § 1.482–8 Examples of the best method rule.

\* \* \* \* \*

(b) \* \* \*

*Example 10. Cost of services plus method preferred to other methods.* (i) FP designs and manufactures consumer electronic devices that incorporate advanced technology. In year 1, FP introduces Product X, an entertainment device targeted primarily at the youth market. FP's wholly-owned, exclusive U.S. distributor, USSub, sells Product X in the U.S. market. USSub hires an independent marketing firm, Agency A, to promote Product X in the U.S. market. Agency A has successfully promoted other electronic products on behalf of other uncontrolled parties. USSub executes a one-year, renewable contract with Agency A that requires it to develop the market for Product X, within an annual budget set by USSub. In years 1 through 3, Agency A develops advertising, buys media, and sponsors events featuring Product X. Agency A receives a markup of 25% on all expenses of promoting Product X, with the exception of media buys, which are reimbursed at cost. During year 3, sales of Product X decrease sharply, as Product X is displaced by competitors' products. At the end of year 3, sales of Product X are discontinued.

(ii) Prior to the start of year 4, FP develops a new entertainment device, Product Y. Like Product X, Product Y is intended for sale to the youth market, but it is marketed under a new trademark distinct from that used for Product X. USSub decides to perform all U.S. market promotion for Product Y. USSub hires key Agency A staff members who handled the successful Product X campaign. To promote Product Y, USSub intends to use methods similar to those used successfully by Agency A to promote Product X (print advertising, media, event sponsorship, etc.). FP and USSub enter into a one-year, renewable agreement concerning promotion of Product Y in the U.S. market. Under the agreement, FP compensates USSub for promoting Product Y, based on a cost of services plus markup of A%. Third-party media buys by USSub in connection with Product Y are reimbursed at cost.

(iii) Assume that under the contractual arrangements between FP and USSub, the arm's length consideration for Product Y and the trademark or other intangible property may be determined reliably under one or more transfer pricing methods. At issue in this example is the separate evaluation of the arm's length compensation for the year 4 promotional activities performed by USSub pursuant to its contract with FP.

(iv) USSub's accounting records contain reliable data that separately state the costs incurred to promote Product Y. A functional analysis indicates that USSub's activities to promote Product Y in year 4 are similar to activities performed by Agency A during years 1 through 3 under the contract with FP. In other respects, no material differences exist in the market conditions or the promotional activities performed in year 4, as compared to those in years 1 through 3.

(v) It is possible to identify uncontrolled distributors or licensees of electronic products that perform, as one component of their business activities, promotional activities similar to those performed by USSub. However, it is unlikely that publicly available accounting data from these companies would allow computation of the comparable transactional costs or total services costs associated with the marketing or promotional activities that these entities perform, as one component of business activities. If that were possible, the comparable profits method for services might provide a reliable measure of an arm's length result. The functional analysis of the marketing activities performed by USSub in year 4 indicates that they are similar to the activities performed by Agency A in years 1 through 3 for Product X. Because reliable information is available concerning the markup on costs charged in a comparable uncontrolled transaction, the most reliable measure of an arm's length price is the cost of services plus method in § 1.482–9(e).

*Example 11. CPM for services preferred to other methods.* (i) FP manufactures furniture and accessories for residential use. FP sells its products to retailers in Europe under the trademark, "Moda." FP holds all worldwide rights to the trademark, including in the United States. USSub is FP's wholly-owned subsidiary in the U.S. market and the exclusive U.S. distributor of FP's

merchandise. Historically, USSub dealt only with specialized designers in the U.S. market and advertised in trade publications targeted to this market. Although items sold in the U.S. and Europe are physically identical, USSub's U.S. customers generally resell the merchandise as non-branded merchandise.

(ii) FP retains an independent firm to evaluate the feasibility of selling FP's trademarked merchandise in the general wholesale and retail market in the United States. The study concludes that this segment of the U.S. market, which is not exploited by USSub, may generate substantial profits. Based on this study, FP enters into a separate agreement with USSub, which provides that USSub will develop this market in the United States for the benefit of FP. USSub separately accounts for personnel expenses, overhead, and out-of-pocket costs attributable to the initial stage of the marketing campaign (Phase I). USSub receives as compensation its costs, plus a markup of X%, for activities in Phase I. At the end of Phase I, FP will evaluate the program. If success appears likely, USSub will begin full-scale distribution of trademarked merchandise in the new market segment, pursuant to agreements negotiated with FP at that time.

(iii) Assume that under the contractual arrangements in effect between FP and USSub, the arm's length consideration for the merchandise and the trademark or other intangible property may be determined reliably under one or more transfer pricing methods. At issue in this example is the separate evaluation of the arm's length compensation for the marketing activities conducted by USSub in years 1 and following.

(iv) A functional analysis reveals that USSub's activities consist primarily of modifying the promotional materials created by FP, negotiating media buys, and arranging promotional events. FP separately compensates USSub for all Phase I activities, and detailed accounting information is available regarding the costs of these activities. The Phase I activities of USSub are similar to those of uncontrolled companies that perform, as their primary business activity, a range of advertising and media relations activities on a contract basis for uncontrolled parties.

(v) No information is available concerning the comparable uncontrolled prices for services in transactions similar to those engaged in by FP and USSub. Nor is any information available concerning uncontrolled transactions that would allow application of the cost of services plus method. It is possible to identify uncontrolled distributors or licensees of home furnishings that perform, as one component of their business activities, promotional activities similar to those performed by USSub. However, it is unlikely that publicly available accounting data from these companies would allow computation of the comparable transactional costs or total services costs associated with the marketing or promotional activities that these entities perform, as one component of their business activities. On the other hand, it is possible to identify uncontrolled advertising and media relations companies, the principal

business activities of which are similar to the Phase I activities of USSub. Under these circumstances, the most reliable measure of an arm's length price is the comparable profits method of § 1.482-9(f). The uncontrolled advertising comparables' treatment of material items, such as classification of items as cost of goods sold or selling, general, and administrative expenses, may differ from that of USSub. Such inconsistencies in accounting treatment between the uncontrolled comparables and the tested party, or among the comparables, are less important when using the ratio of operating profit to total services costs under the comparable profits method for services in § 1.482-9(f). Under this method, the operating profit of USSub from the Phase I activities is compared to the operating profit of uncontrolled parties that perform general advertising and media relations as their primary business activity.

*Example 12. Residual profit split preferred to other methods.* (i) USP is a manufacturer of athletic apparel sold under the AA trademark, to which FP owns the worldwide rights. USP sells AA trademark apparel in countries throughout the world, but prior to year 1, USP did not sell its merchandise in Country X. In year 1, USP acquires an uncontrolled Country X company which becomes its wholly-owned subsidiary, XSub. USP enters into an exclusive distribution arrangement with XSub in Country X. Before being acquired by USP in year 1, XSub distributed athletic apparel purchased from uncontrolled suppliers and resold that merchandise to retailers. After being acquired by USP in year 1, XSub continues to distribute merchandise from uncontrolled suppliers and also begins to distribute AA trademark apparel. Under a separate agreement with USP, XSub uses its best efforts to promote the AA trademark in Country X, with the goal of maximizing sales volume and revenues from AA merchandise.

(ii) Prior to year 1, USP executed long-term endorsement contracts with several prominent professional athletes. These contracts give USP the right to use the names and likenesses of the athletes in any country in which AA merchandise is sold during the term of the contract. These contracts remain in effect for five years, starting in year 1. Before being acquired by USP, XSub renewed a long-term agreement with SportMart, an uncontrolled company that owns a nationwide chain of sporting goods retailers in Country X. XSub has been SportMart's primary supplier from the time that SportMart began operations. Under the agreement, SportMart will provide AA merchandise preferred shelf-space and will feature AA merchandise at no charge in its print ads and seasonal promotions. In consideration for these commitments, USP and XSub grant SportMart advance access to new products and the right to use the professional athletes under contract with USP in SportMart advertisements featuring AA merchandise (subject to approval of content by USP).

(iii) Assume that it is possible to segregate all transactions by XSub that involve distribution of merchandise acquired from uncontrolled distributors (non-controlled

transactions). In addition, assume that, apart from the activities undertaken by USP and XSub to promote AA apparel in Country X, the arm's length compensation for other functions performed by USP and XSub in the Country X market in years 1 and following can be reliably determined. At issue in this *Example 12* is the application of the residual profit split analysis to determine the appropriate division between USP and XSub of the balance of the operating profits from the Country X market, that is the portion attributable to nonroutine contributions to the marketing and promotional activities.

(iv) A functional analysis of the marketing and promotional activities conducted in the Country X market, as described in this example, indicates that both USP and XSub made nonroutine contributions to the business activity. USP contributed the long-term endorsement contracts with professional athletes. XSub contributed its long-term contractual rights with SportMart, which were made more valuable by its successful, long-term relationship with SportMart.

(v) Based on the facts and circumstances, including the fact that both USP and XSub made valuable nonroutine contributions to the marketing and promotional activities and an analysis of the availability (or lack thereof) of comparable and reliable market benchmarks, the Commissioner determines that the most reliable measure of an arm's length result is the residual profit split method in § 1.482-9(g). The residual profit split analysis would take into account both routine and nonroutine contributions by USP and XSub, in order to determine an appropriate allocation of the combined operating profits in the Country X market from the sale of AA merchandise and from related promotional and marketing activities.

*Examples 13 through 18.* [Reserved]. For further guidance, see § 1.482-8T(b) *Examples 13 through 18.*

(c) *Effective/applicability date*—(1) *In general.* The provisions of paragraph (b) *Examples 10, 11, and 12* of this section are generally applicable for taxable years beginning after July 31, 2009.

(2) *Election to apply regulation to earlier taxable years.* A person may elect to apply the provisions of paragraph (b) *Examples 10, 11, and 12* of this section to earlier taxable years in accordance with the rules set forth in § 1.482-9(n)(2).

■ **Par. 13.** Section 1.482-8T is amended as follows:

■ 1. Revise paragraph (b) *Examples 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11* and *12.*

■ 2. Redesignate paragraph (c)(1) as paragraph (c), revise the heading and remove the first sentence in newly-designated paragraph (c).

■ 3. Remove paragraph (c)(2).

■ 4. Redesignate paragraph (c)(3) as paragraph (d) and remove the first sentence.

The revisions read as follows:

**§ 1.482-8T Examples of the best method rule (temporary).**

\* \* \* \* \*

(b) *Examples 1 through 12.* [Reserved]. For further guidance, see § 1.482-8(b) *Examples 1 through 12.*

\* \* \* \* \*

(c) *Effective/applicability date.* \* \* \*

\* \* \* \* \*

■ **Par. 14.** Section 1.482-9 is added to read as follows:

**§ 1.482-9 Methods to determine taxable income in connection with a controlled services transaction.**

(a) *In general.* The arm's length amount charged in a controlled services transaction must be determined under one of the methods provided for in this section. Each method must be applied in accordance with the provisions of § 1.482-1, including the best method rule of § 1.482-1(c), the comparability analysis of § 1.482-1(d), and the arm's length range of § 1.482-1(e), except as those provisions are modified in this section. The methods are—

(1) The services cost method, described in paragraph (b) of this section;

(2) The comparable uncontrolled services price method, described in paragraph (c) of this section;

(3) The gross services margin method, described in paragraph (d) of this section;

(4) The cost of services plus method, described in paragraph (e) of this section;

(5) The comparable profits method, described in § 1.482-5 and in paragraph (f) of this section;

(6) The profit split method, described in § 1.482-6 and in paragraph (g) of this section; and

(7) Unspecified methods, described in paragraph (h) of this section.

(b) *Services cost method*—(1) *In general.* The services cost method evaluates whether the amount charged for certain services is arm's length by reference to the total services costs (as defined in paragraph (j) of this section) with no markup. If a taxpayer applies the services cost method in accordance with the rules of this paragraph (b), then it will be considered the best method for purposes of § 1.482-1(c), and the Commissioner's allocations will be limited to adjusting the amount charged for such services to the properly determined amount of such total services costs.

(2) *Eligibility for the services cost method.* To apply the services cost method to a service in accordance with the rules of this paragraph (b), all of the following requirements must be satisfied with respect to the service—

(j) The service is a covered service as defined in paragraph (b)(3) of this section;

(ii) The service is not an excluded activity as defined in paragraph (b)(4) of this section;

(iii) The service is not precluded from constituting a covered service by the business judgment rule described in paragraph (b)(5) of this section; and

(iv) Adequate books and records are maintained as described in paragraph (b)(6) of this section.

(3) *Covered services.* For purposes of this paragraph (b), covered services consist of a controlled service transaction or a group of controlled service transactions (see § 1.482-1(f)(2)(i) (aggregation of transactions)) that meet the definition of specified covered services or low margin covered services.

(i) *Specified covered services.* Specified covered services are controlled services transactions that the Commissioner specifies by revenue procedure. Services will be included in such revenue procedure based upon the Commissioner's determination that the specified covered services are support services common among taxpayers across industry sectors and generally do not involve a significant median comparable markup on total services costs. For the definition of the median comparable markup on total services costs, see paragraph (b)(3)(ii) of this section. The Commissioner may add to, subtract from, or otherwise revise the specified covered services described in the revenue procedure by subsequent revenue procedure, which amendments will ordinarily be prospective only in effect.

(ii) *Low margin covered services.* Low margin covered services are controlled services transactions for which the median comparable markup on total services costs is less than or equal to seven percent. For purposes of this paragraph (b), the median comparable markup on total services costs means the excess of the arm's length price of the controlled services transaction determined under the general section 482 regulations without regard to this paragraph (b), using the interquartile range described in § 1.482-1(e)(2)(iii)(C) and as necessary adjusting to the median of such interquartile range, over total services costs, expressed as a percentage of total services costs.

(4) *Excluded activity.* The following types of activities are excluded activities:

(i) Manufacturing.

(ii) Production.

(iii) Extraction, exploration, or processing of natural resources.

(iv) Construction.

(v) Reselling, distribution, acting as a sales or purchasing agent, or acting under a commission or other similar arrangement.

(vi) Research, development, or experimentation.

(vii) Engineering or scientific.

(viii) Financial transactions, including guarantees.

(ix) Insurance or reinsurance.

(5) *Not services that contribute significantly to fundamental risks of business success or failure.* A service cannot constitute a covered service unless the taxpayer reasonably concludes in its business judgment that the service does not contribute significantly to key competitive advantages, core capabilities, or fundamental risks of success or failure in one or more trades or businesses of the controlled group, as defined in § 1.482-1(i)(6). In evaluating the reasonableness of the conclusion required by this paragraph (b)(5), consideration will be given to all the facts and circumstances.

(6) *Adequate books and records.* Permanent books of account and records are maintained for as long as the costs with respect to the covered services are incurred by the renderer. Such books and records must include a statement evidencing the taxpayer's intention to apply the services cost method to evaluate the arm's length charge for such services. Such books and records must be adequate to permit verification by the Commissioner of the total services costs incurred by the renderer, including a description of the services in question, identification of the renderer and the recipient of such services, and sufficient documentation to allow verification of the methods used to allocate and apportion such costs to the services in question in accordance with paragraph (k) of this section.

(7) *Shared services arrangement—(i) In general.* If the services cost method is used to evaluate the amount charged for covered services, and such services are the subject of a shared services arrangement, then the arm's length charge to each participant for such services will be the portion of the total costs of the services otherwise determined under the services cost method of this paragraph (b) that is properly allocated to such participant pursuant to the arrangement.

(ii) *Requirements for shared services arrangement.* A shared services arrangement must meet the requirements described in this paragraph (b)(7).

(A) *Eligibility.* To be eligible for treatment under this paragraph (b)(7), a shared services arrangement must—

(1) Include two or more participants;

(2) Include as participants all controlled taxpayers that reasonably anticipate a benefit (as defined under paragraph (l)(3)(i) of this section) from one or more covered services specified in the shared services arrangement; and

(3) Be structured such that each covered service (or each reasonable aggregation of services within the meaning of paragraph (b)(7)(iii)(B) of this section) confers a benefit on at least one participant in the shared services arrangement.

(B) *Allocation.* The costs for covered services must be allocated among the participants based on their respective shares of the reasonably anticipated benefits from those services, without regard to whether the anticipated benefits are in fact realized. Reasonably anticipated benefits are benefits as defined in paragraph (l)(3)(i) of this section. The allocation of costs must provide the most reliable measure of the participants' respective shares of the reasonably anticipated benefits under the principles of the best method rule. See § 1.482-1(c). The allocation must be applied on a consistent basis for all participants and services. The allocation to each participant in each taxable year must reasonably reflect that participant's respective share of reasonably anticipated benefits for such taxable year. If the taxpayer reasonably concluded that the shared services arrangement (including any aggregation pursuant to paragraph (b)(7)(iii)(B) of this section) allocated costs for covered services on a basis that most reliably reflects the participants' respective shares of the reasonably anticipated benefits attributable to such services, as provided for in this paragraph (b)(7), then the Commissioner may not adjust such allocation basis.

(C) *Documentation.* The taxpayer must maintain sufficient documentation to establish that the requirements of this paragraph (b)(7) are satisfied, and include—

(1) A statement evidencing the taxpayer's intention to apply the services cost method to evaluate the arm's length charge for covered services pursuant to a shared services arrangement;

(2) A list of the participants and the renderer or renderers of covered services under the shared services arrangement;

(3) A description of the basis of allocation to all participants, consistent with the participants' respective shares of reasonably anticipated benefits; and

(4) A description of any aggregation of covered services for purposes of the shared services arrangement, and an indication whether this aggregation (if any) differs from the aggregation used to evaluate the median comparable markup for any low margin covered services described in paragraph (b)(3)(ii) of this section.

(iii) *Definitions and special rules*—(A) *Participant*. A participant is a controlled taxpayer that reasonably anticipates benefits from covered services subject to a shared services arrangement that substantially complies with the requirements described in this paragraph (b)(7).

(B) *Aggregation*. Two or more covered services may be aggregated in a reasonable manner taking into account all the facts and circumstances, including whether the relative magnitude of reasonably anticipated benefits of the participants sharing the costs of such aggregated services may be reasonably reflected by the allocation basis employed pursuant to paragraph (b)(7)(ii)(B) of this section. The aggregation of services under a shared services arrangement may differ from the aggregation used to evaluate the median comparable markup for any low margin covered services described in paragraph (b)(3)(ii) of this section, provided that such alternative aggregation can be implemented on a reasonable basis, including appropriately identifying and isolating relevant costs, as necessary.

(C) *Coordination with cost sharing arrangements*. To the extent that an allocation is made to a participant in a shared services arrangement that is also a participant in a cost sharing arrangement subject to § 1.482-7T, such amount with respect to covered services is first allocated pursuant to the shared services arrangement under this paragraph (b)(7). Costs allocated pursuant to a shared services arrangement may (if applicable) be further allocated between the intangible property development activity under § 1.482-7T and other activities of the participant.

(8) *Examples*. The application of this section is illustrated by the following examples. No inference is intended whether the presence or absence of one or more facts is determinative of the conclusion in any example. For purposes of *Examples 1 through 14*, assume that Company P and its subsidiaries, Company Q and Company R, are corporations and members of the same group of controlled entities (PQR Controlled Group). For purposes of *Example 15*, assume that Company P and its subsidiary, Company S, are

corporations and members of the same group of controlled entities (PS Controlled Group). For purposes of *Examples 16 through 24*, assume that Company P and its subsidiaries, Company X, Company Y, and Company Z, are corporations and members of the same group of controlled entities (PXYZ Group) and that Company P and its subsidiaries satisfy all of the requirements for a shared services arrangement specified in paragraphs (b)(7)(ii) and (iii) of this section.

*Example 1. Data entry services.* (i) Company P, Company Q, and Company R own and operate hospitals. Each owns an electronic database of medical information gathered by doctors and nurses during interviews and treatment of its patients. All three databases are maintained and updated by Company P's administrative support employees who perform data entry activities by entering medical information from the paper records of Company P, Company Q, and Company R into their respective databases.

(ii) Assume that these services relating to data entry are specified covered services within the meaning of paragraph (b)(3)(i) of this section. Under the facts and circumstances of the business of the PQR Controlled Group, the taxpayer could reasonably conclude that these services do not contribute significantly to the controlled group's key competitive advantages, core capabilities, or fundamental risks of success or failure in the group's business. If these services meet the other requirements of this paragraph (b), Company P will be eligible to charge these services to Company Q and Company R in accordance with the services cost method.

*Example 2. Data entry services.* (i) Company P, Company Q, and Company R specialize in data entry, data processing, and data conversion. Company Q and Company R's data entry activities involve converting medical information data contained in paper records to a digital format. Company P specializes in data entry activities. This specialization reflects, in part, proprietary quality control systems and specially trained data entry experts used to ensure the highest degree of accuracy of data entry services. Company P is engaged by Company Q and Company R to perform these data entry activities for them. Company Q and Company R then charge their customers for the data entry activities performed by Company P.

(ii) Assume that these services performed by Company P relating to data entry are specified covered services within the meaning of paragraph (b)(3)(i) of this section. Under the facts and circumstances, the taxpayer is unable to reasonably conclude that these services do not contribute significantly to the controlled group's key competitive advantages, core capabilities, or fundamental risks of success or failure in the group's business. Company P is not eligible to charge these services to Company Q and Company R in accordance with the services cost method.

*Example 3. Recruiting services.* (i) Company P, Company Q, and Company R are

manufacturing companies that sell their products to unrelated retail establishments. Company P's human resources department recruits mid-level managers and engineers for itself as well as for Company Q and Company R by attending job fairs and other recruitment events. For recruiting higher-level managers and engineers, each of these companies uses recruiters from unrelated executive search firms.

(ii) Assume that these services relating to recruiting are specified covered services within the meaning of paragraph (b)(3)(i) of this section. Under the facts and circumstances of the business of the PQR Controlled Group, the taxpayer could reasonably conclude that these services do not contribute significantly to the controlled group's key competitive advantages, core capabilities, or fundamental risks of success or failure in the group's business. If these services meet the other requirements of this paragraph (b), Company P will be eligible to charge these services to Company Q and Company R in accordance with the services cost method.

*Example 4. Recruiting services.* (i) Company Q and Company R are executive recruiting service companies that are hired by other companies to recruit professionals. Company P is a recruiting agency that is engaged by Company Q and Company R to perform recruiting activities on their behalf in certain geographic areas.

(ii) Assume that the services performed by Company P are specified covered services within the meaning of paragraph (b)(3)(i) of this section. Under the facts and circumstances, the taxpayer is unable to reasonably conclude that these services do not contribute significantly to the controlled group's key competitive advantages, core capabilities, or fundamental risks of success or failure in the group's business. Company P is not eligible to charge these services to Company Q and Company R in accordance with the services cost method.

*Example 5. Credit analysis services.* (i) Company P is a manufacturer and distributor of clothing for retail stores. Company Q and Company R are distributors of clothing for retail stores. As part of its operations, personnel in Company P perform credit analysis on its customers. Most of the customers have a history of purchases from Company P, and the credit analysis involves a review of the recent payment history of the customer's account. For new customers, the personnel in Company P perform a basic credit check of the customer using reports from a credit reporting agency. On behalf of Company Q and Company R, Company P performs credit analysis on customers who order clothing from Company Q and Company R using the same method as Company P uses for itself.

(ii) Assume that these services relating to credit analysis are specified covered services within the meaning of paragraph (b)(3)(i) of this section. Under the facts and circumstances of the business of the PQR Controlled Group, the taxpayer could reasonably conclude that these services do not contribute significantly to the controlled group's key competitive advantages, core capabilities, or fundamental risks of success

or failure in the group's business. If these services meet the other requirements of this paragraph (b), Company P will be eligible to charge these services to Company Q and Company R in accordance with the services cost method.

*Example 6. Credit analysis services.* (i) Company P, Company Q, and Company R lease furniture to retail customers who present a significant credit risk and are generally unable to lease furniture from other providers. As part of its leasing operations, personnel in Company P perform credit analysis on each of the potential lessees. The personnel have developed special expertise in determining whether a particular customer who presents a significant credit risk (as indicated by credit reporting agencies) will be likely to make the requisite lease payments on a timely basis. Also, as part of its operations, Company P performs similar credit analysis services for Company Q and Company R, which charge correspondingly high monthly lease payments.

(ii) Assume that these services relating to credit analysis are specified covered services within the meaning of paragraph (b)(3)(i) of this section. Under the facts and circumstances, the taxpayer is unable to reasonably conclude that these services do not contribute significantly to the controlled group's key competitive advantages, core capabilities, or fundamental risks of success or failure in the group's business. Company P is not eligible to charge these services to Company Q and Company R in accordance with the services cost method.

*Example 7. Credit analysis services.* (i) Company P is a large full-service bank, which provides products and services to corporate and consumer markets, including unsecured loans, secured loans, lines of credit, letters of credit, conversion of foreign currency, consumer loans, trust services, and sales of certificates of deposit. Company Q makes routine consumer loans to individuals, such as auto loans and home equity loans. Company R makes only business loans to small businesses.

(ii) Company P performs credit analysis and prepares credit reports for itself, as well as for Company Q and Company R. Company P, Company Q and Company R regularly employ these credit reports in the ordinary course of business in making decisions regarding extensions of credit to potential customers (including whether to lend, rate of interest, and loan terms).

(iii) Assume that these services relating to credit analysis are specified covered services within the meaning of paragraph (b)(3)(i) of this section. Under the facts and circumstances, the credit analysis services constitute part of a "financial transaction" described in paragraph (b)(4)(viii) of this section. Company P is not eligible to charge these services to Company Q and Company R in accordance with the services cost method.

*Example 8. Data verification services.* (i) Company P, Company Q and Company R are manufacturers of industrial supplies. Company P's accounting department performs periodic reviews of the accounts payable information of Company P, Company Q and Company R, and identifies any

inaccuracies in the records, such as double-payments and double-charges.

(ii) Assume that these services relating to verification of data are specified covered services within the meaning of paragraph (b)(3)(i) of this section. Under the facts and circumstances of the business of the PQR Controlled Group, the taxpayer could reasonably conclude that these services do not contribute significantly to the controlled group's key competitive advantages, core capabilities, or fundamental risks of success or failure in the group's business. If these services meet the other requirements of this paragraph (b), Company P will be eligible to charge these services to Company Q and Company R in accordance with the services cost method.

*Example 9. Data verification services.* (i) Company P gathers and inputs information regarding accounts payable and accounts receivable from unrelated parties and utilizes its own computer system to analyze that information for purposes of identifying errors in payment and receipts (data mining). Company P is compensated for these services based on a fee that reflects a percentage of amounts collected by customers as a result of the data mining services. These activities constitute a significant portion of Company P's business. Company P performs similar activities for Company Q and Company R by analyzing their accounts payable and accounts receivable records.

(ii) Assume that these services relating to data mining are specified covered services within the meaning of paragraph (b)(3)(i) of this section. Under the facts and circumstances, the taxpayer is unable to reasonably conclude that these services do not contribute significantly to the controlled group's key competitive advantages, core capabilities, or fundamental risks of success or failure in the group's business. Company P is not eligible to charge these services to Company Q and Company R in accordance with the services cost method.

*Example 10. Legal services.* (i) Company P is a domestic corporation with two wholly-owned foreign subsidiaries, Company Q and Company R. Company P and its subsidiaries manufacture and distribute equipment used by industrial customers. Company P maintains an in-house legal department consisting of attorneys experienced in a wide range of business and commercial matters. Company Q and Company R maintain small legal departments, consisting of attorneys experienced in matters that most frequently arise in the normal course of business of Company Q and Company R in their respective jurisdictions.

(ii) Company P seeks to maintain in-house legal staff with the ability to address the majority of legal matters that arise in the United States with respect to the operations of Company P, as well as any U.S. reporting or compliance obligations of Company Q or Company R. These include the preparation and review of corporate contracts relating to, for example, product sales, equipment purchases and leases, business liability insurance, real estate, employee salaries and benefits. Company P relies on outside attorneys for major business transactions and highly technical matters such as patent

licenses. The in-house legal staffs of Company Q and Company R are much more limited. It is necessary for Company P to retain several local law firms to handle litigation and business disputes arising from the activities of Company Q and Company R. Although Company Q and Company R pay the fees of these law firms, the hiring authority and general oversight of the firms' representation is in the legal department of Company P.

(iii) In determining what portion of the legal expenses of Company P may be allocated to Company Q and Company R, Company P first excludes any expenses relating to legal services that constitute shareholder activities and other items that are not properly analyzed as controlled services. Assume that the remaining services relating to general legal functions performed by in-house legal counsel are specified covered services within the meaning of paragraph (b)(3)(i) of this section. Under the facts and circumstances of the business of the PQR Controlled Group, the taxpayer could reasonably conclude that these latter services do not contribute significantly to the controlled group's key competitive advantages, core capabilities, or fundamental risks of success or failure in the group's business. If these services meet the other requirements of this paragraph (b), Company P will be eligible to charge these services to Company Q and Company R in accordance with the services cost method.

*Example 11. Legal services.* (i) Company P is a domestic holding company whose operating companies, Company Q and Company R, generate electric power for consumers by operating nuclear plants. Assume that, although Company P owns 100% of the stock of Companies Q and R, the companies do not elect to file a consolidated Federal income tax return with Company P.

(ii) Company P maintains an in-house legal department that includes attorneys who are experts in the areas of Federal utilities regulation, Federal labor and environmental law, and securities law. Companies Q and R maintain their own, smaller in-house legal staffs comprising experienced attorneys in the areas of state and local utilities regulation, state labor and employment law, and general commercial law. The legal department of Company P performs general oversight of the legal affairs of the company and determines whether a particular matter would be more efficiently handled by the Company P legal department, by the legal staffs in the operating companies, or in rare cases, by retained outside counsel. In general, Company P has succeeded in minimizing duplication and overlap of functions between the legal staffs of the various companies or by retained outside counsel.

(iii) The domestic nuclear power plant operations of Companies Q and R are subject to extensive regulation by the U.S. Nuclear Regulatory Commission (NRC). Operators are required to obtain pre-construction approval, operating licenses, and, at the end of the operational life of the nuclear reactor, nuclear decommissioning certificates. Company P files consolidated financial statements on behalf of itself, as well as Companies Q and R, with the United States

Securities and Exchange Commission (SEC). In these SEC filings, Company P discloses that failure to obtain any of these licenses (and the related periodic renewals) or agreeing to licenses on terms less favorable than those granted to competitors would have a material adverse impact on the operations of Company Q or Company R. Company Q and Company R do not have in-house legal staff with experience in the NRC area. Company P maintains a group of in-house attorneys with specialized expertise in the NRC area that exclusively represents Company Q and Company R before the NRC. Although Company P occasionally hires an outside law firm or industry expert to assist on particular NRC matters, the majority of the work is performed by the specialized legal staff of Company P.

(iv) Certain of the legal services performed by Company P constitute duplicative or shareholder activities that do not confer a benefit on the other companies and therefore do not need to be allocated to the other companies, while certain other legal services are eligible to be charged to Company Q and Company R in accordance with the services cost method.

(v) Assume that the specialized legal services relating to nuclear licenses performed by in-house legal counsel of Company P are specified covered services within the meaning of paragraph (b)(3)(i) of this section. Under the facts and circumstances, the taxpayer is unable to reasonably conclude that these services do not contribute significantly to the controlled group's key competitive advantages, core capabilities, or fundamental risks of success or failure in the group's business. Company P is not eligible to charge these services to Company Q and Company R in accordance with the services cost method.

*Example 12. Group of services.* (i) Company P, Company Q, and Company R are manufacturing companies that sell their products to unrelated retail establishments. Company P has an enterprise resource planning (ERP) system that maintains data relating to accounts payable and accounts receivable information for all three companies. Company P's personnel perform the daily operations on this ERP system such as inputting data relating to accounts payable and accounts receivable into the system and extracting data relating to accounts receivable and accounts payable in the form of reports or electronic media and providing those data to all three companies. Periodically, Company P's computer specialists also modify the ERP system to adapt to changing business functions in all three companies. Company P's computer specialists make these changes by either modifying the underlying software program or by purchasing additional software or hardware from unrelated third party vendors.

(ii) Assume that the services relating to accounts payable and accounts receivable are specified covered services within the meaning of paragraph (b)(3)(i) of this section. Under the facts and circumstances of the business of the PQR Controlled Group, the taxpayer could reasonably conclude that these services do not contribute significantly to the controlled group's key competitive

advantages, core capabilities, or fundamental risks of success or failure in the group's business. If these services meet the other requirements of this paragraph (b), Company P will be eligible to charge these services to Company Q and Company R in accordance with the services cost method.

(iii) Assume that the services performed by Company P's computer specialists that relate to modifying the ERP system are specifically excluded from the services described in a revenue procedure referenced in paragraph (b)(3) of this section as developing hardware or software solutions (such as systems integration, Web site design, writing computer programs, modifying general applications software, or recommending the purchase of commercially available hardware or software). If these services do not constitute low margin covered services within the meaning of paragraph (b)(3)(ii) of this section, then Company P is not eligible to charge these services to Company Q and Company R in accordance with the services cost method.

*Example 13. Group of services.* (i) Company P manufactures and sells widgets under an exclusive contract to Customer 1. Company Q and Company R sell widgets under exclusive contracts to Customer 2 and Customer 3, respectively. At least one year in advance, each of these customers can accurately forecast its need for widgets. Using these forecasts, each customer over the course of the year places orders for widgets with the appropriate company, Company P, Company Q, or Company R. A customer's actual need for widgets seldom deviates from that customer's forecasted need.

(ii) It is most efficient for the PQR Controlled Group companies to manufacture and store an inventory of widgets in advance of delivery. Although all three companies sell widgets, only Company P maintains a centralized warehouse for widgets. Pursuant to a contract, Company P provides storage of these widgets to Company Q and Company R at an arm's length price.

(iii) Company P's personnel also obtain orders from all three companies' customers to draw up purchase orders for widgets as well as make payment to suppliers for widget replacement parts. In addition, Company P's personnel use data entry to input information regarding orders and sales of widgets and replacement parts for all three companies into a centralized computer system. Company P's personnel also maintain the centralized computer system and extract data for all three companies when necessary.

(iv) Assume that these services relating to tracking purchases and sales of inventory are specified covered services within the meaning of paragraph (b)(3)(i) of this section. Under the facts and circumstances of the business of the PQR Controlled Group, the taxpayer could reasonably conclude that these services do not contribute significantly to the controlled group's key competitive advantages, core capabilities, or fundamental risks of success or failure in the group's business. If these services meet the other requirements of this paragraph (b), Company P will be eligible to charge these services to Company Q and Company R in accordance with the services cost method.

*Example 14. Group of services.* (i) Company P, Company Q, and Company R assemble and sell gadgets to unrelated customers. Each of these companies purchases the components necessary for assembly of the gadgets from unrelated suppliers. As a service to its subsidiaries, Company P's personnel obtain orders for components from all three companies, prepare purchase orders, and make payment to unrelated suppliers for the components. In addition, Company P's personnel use data entry to input information regarding orders and sales of gadgets for all three companies into a centralized computer. Company P's personnel also maintain the centralized computer system and extract data for all three companies on an as-needed basis. The services provided by Company P personnel, in conjunction with the centralized computer system, constitute a state-of-the-art inventory management system that allows Company P to order components necessary for assembly of the gadgets on a "just-in-time" basis.

(ii) Unrelated suppliers deliver the components directly to Company P, Company Q and Company R. Each company stores the components in its own facilities for use in filling specific customer orders. The companies do not maintain any inventory that is not identified in specific customer orders. Because of the efficiencies associated with services provided by personnel of Company P, all three companies are able to significantly reduce their inventory-related costs. Company P's Chief Executive Officer makes a statement in one of its press conferences with industry analysts that its inventory management system is critical to the company's success.

(iii) Assume that these services relating to tracking purchases and sales of inventory are specified covered services within the meaning of paragraph (b)(3)(i) of this section. Under the facts and circumstances, the taxpayer is unable to reasonably conclude that these services do not contribute significantly to the controlled group's key competitive advantages, core capabilities, or fundamental risks of success or failure in the group's business. Company P is not eligible to charge these services to Company Q and Company R in accordance with the services cost method.

*Example 15. Low margin covered services.* Company P renders certain accounting services to Company S. Company P uses the services cost method for the accounting services, and determines the amount charged as its total cost of rendering the services, with no markup. Based on an application of the section 482 regulations without regard to this paragraph (b), the interquartile range of arm's length markups on total services costs for these accounting services is between 3% and 9%, and the median is 6%. Because the median comparable markup on total services costs is 6%, which is less than 7%, the accounting services constitute low margin covered services within the meaning of paragraph (b)(3)(ii) of this section.

*Example 16. Shared services arrangement and reliable measure of reasonably anticipated benefit (allocation key).* (i) Company P operates a centralized data processing facility that performs automated

invoice processing and order generation for all of its subsidiaries, Companies X, Y, Z, pursuant to a shared services arrangement.

(ii) In evaluating the shares of reasonably anticipated benefits from the centralized data processing services, the total value of the merchandise on the invoices and orders may not provide the most reliable measure of reasonably anticipated benefits shares, because value of merchandise sold does not bear a relationship to the anticipated benefits from the underlying covered services.

(iii) The total volume of orders and invoices processed may provide a more reliable basis for evaluating the shares of reasonably anticipated benefits from the data processing services. Alternatively, depending on the facts and circumstances, total central processing unit time attributable to the transactions of each subsidiary may provide a more reliable basis on which to evaluate the shares of reasonably anticipated benefits.

*Example 17. Shared services arrangement and reliable measure of reasonably anticipated benefit (allocation key).* (i)

Company P operates a centralized center that performs human resources functions, such as administration of pension, retirement, and health insurance plans that are made available to employees of its subsidiaries, Companies X, Y, Z, pursuant to a shared services arrangement.

(ii) In evaluating the shares of reasonably anticipated benefits from these centralized services, the total revenues of each subsidiary may not provide the most reliable measure of reasonably anticipated benefit shares, because total revenues do not bear a relationship to the shares of reasonably anticipated benefits from the underlying services.

(iii) Employee headcount or total compensation paid to employees may provide a more reliable basis for evaluating the shares of reasonably anticipated benefits from the covered services.

*Example 18. Shared services arrangement and reliable measure of reasonably anticipated benefit (allocation key).* (i)

Company P performs human resource services (service A) on behalf of the PXYZ Group that qualify for the services cost method. Under that method, Company P determines the amount charged for these services pursuant to a shared services arrangement based on an application of paragraph (b)(7) of this section. Service A constitutes a specified covered service described in a revenue procedure pursuant to paragraph (b)(3)(i) of this section. The total services costs for service A otherwise determined under the services cost method is 300.

(ii) Companies X, Y and Z reasonably anticipate benefits from service A. Company P does not reasonably anticipate benefits from service A. Assume that if relative reasonably anticipated benefits were precisely known, the appropriate allocation of charges pursuant to paragraph (k) of this section to Company X, Y and Z for service A is as follows:

**SERVICE A**  
[Total cost 300]

Company	
X .....	150
Y .....	75
Z .....	75

(iii) The total number of employees (employee headcount) in each company is as follows:

- Company X—600 employees.
- Company Y—250 employees.
- Company Z—250 employees.

(iv) Company P allocates the 300 total services costs of service A based on employee headcount as follows:

**SERVICE A**  
[Total cost 300]

Allocation key	Company	
	Headcount	Amount
X .....	600	164
Y .....	250	68
Z .....	250	68

(v) Based on these facts, Company P may reasonably conclude that the employee headcount allocation basis most reliably reflects the participants' respective shares of the reasonably anticipated benefits attributable to service A.

*Example 19. Shared services arrangement and reliable measure of reasonably anticipated benefit (allocation key).* (i) Company P performs accounts payable services (service B) on behalf of the PXYZ Group and determines the amount charged for the services under such method pursuant to a shared services arrangement based on an application of paragraph (b)(7) of this section. Service B is a specified covered service described in a revenue procedure pursuant to paragraph (b)(3)(i) of this section. The total services costs for service B otherwise determined under the services cost method is 500.

(ii) Companies X, Y and Z reasonably anticipate benefits from service B. Company P does not reasonably anticipate benefits from service B. Assume that if relative reasonably anticipated benefits were precisely known, the appropriate allocation of charges pursuant to paragraph (k) of this section to Companies X, Y and Z for service B is as follows:

**SERVICE B**  
[Total cost 500]

Company	
X .....	125
Y .....	205
Z .....	170

(iii) The total number of employees (employee headcount) in each company is as follows:

- Company X—600.
- Company Y—200.
- Company Z—200.

(iv) The total number of transactions (transaction volume) with uncontrolled customers by each company is as follows:

- Company X—2,000.
- Company Y—4,000.
- Company Z—3,500.

(v) If Company P allocated the 500 total services costs of service B based on employee headcount, the resulting allocation would be as follows:

**SERVICE B**  
[Total cost 500]

Allocation key	Company	
	Headcount	Amount
X .....	600	300
Y .....	200	100
Z .....	200	100

(vi) In contrast, if Company P used volume of transactions with uncontrolled customers as the allocation basis under the shared services arrangement, the allocation would be as follows:

**SERVICE B**  
[Total cost 500]

Allocation key	Company	
	Transaction Volume	Amount
X .....	2,000	105
Y .....	4,000	211
Z .....	3,500	184

(vii) Based on these facts, Company P may reasonably conclude that the transaction volume, but not the employee headcount, allocation basis most reliably reflects the participants' respective shares of the reasonably anticipated benefits attributable to service B.

*Example 20. Shared services arrangement and aggregation.* (i) Company P performs human resource services (service A) and accounts payable services (service B) on behalf of the PXYZ Group that qualify for the services cost method. Company P determines the amount charged for these services under such method pursuant to a shared services arrangement based on an application of paragraph (b)(7) of this section. Service A and service B are specified covered services described in a revenue procedure pursuant to paragraph (b)(3)(i) of this section. The total services costs otherwise determined under the services cost method for service A is 300 and for service B is 500; total services costs

for services A and B are 800. Company P determines that aggregation of services A and B for purposes of the arrangement is appropriate.

(ii) Companies X, Y and Z reasonably anticipate benefits from services A and B. Company P does not reasonably anticipate benefits from services A and B. Assume that if relative reasonably anticipated benefits were precisely known, the appropriate allocation of total charges pursuant to paragraph (k) of this section to Companies X, Y and Z for services A and B is as follows:

SERVICES A AND B [Total cost 800]	
Company	
X .....	350
Y .....	100
Z .....	350

(iii) The total volume of transactions with uncontrolled customers in each company is as follows:  
 Company X—2,000.  
 Company Y—4,000.

Company Z—4,000.  
 (iv) The total number of employees in each company is as follows:  
 Company X—600.  
 Company Y—200.  
 Company Z—200.

(v) If Company P allocated the 800 total services costs of services A and B based on transaction volume or employee headcount, the resulting allocation would be as follows:

**AGGREGATED SERVICES AB**  
 [Total cost 800]

Company	Allocation key		Allocation key	
	Transaction volume	Amount	Headcount	Amount
X .....	2,000	160	600	480
Y .....	4,000	320	200	160
Z .....	4,000	320	200	160

(vi) In contrast, if aggregated services AB were allocated by reference to the total U.S. dollar value of sales to uncontrolled parties (trade sales) by each company, the following results would obtain:

**AGGREGATED SERVICES AB**  
 [Total costs 800]

Company	Allocation key	
	Trade sales (millions)	Amount
X .....	\$400	314
Y .....	120	94
Z .....	500	392

(vii) Based on these facts, Company P may reasonably conclude that the trade sales, but not the transaction volume or the employee headcount, allocation basis most reliably reflects the participants' respective shares of the reasonably anticipated benefits attributable to services AB.

*Example 21. Shared services arrangement and aggregation.* (i) Company P performs services A through P on behalf of the PXYZ Group that qualify for the services cost method. Company P determines the amount charged for these services under such method pursuant to a shared services arrangement based on an application of paragraph (b)(7) of this section. All of these services A through P constitute either specified covered services or low margin covered services described in paragraph (b)(3) of this section.

The total services costs for services A through P otherwise determined under the services cost method is 500. Company P determines that aggregation of services A through P for purposes of the arrangement is appropriate.

(ii) Companies X and Y reasonably anticipate benefits from services A through P and Company Z reasonably anticipates benefits from services A through M but not from services N through P (Company Z performs services similar to services N through P on its own behalf). Company P does not reasonably anticipate benefits from services A through P. Assume that if relative reasonably anticipated benefits were precisely known, the appropriate allocation of total charges pursuant to paragraph (k) of this section to Company X, Y, and Z for services A through P is as follows:

Company	Services A–M (cost 490)	Services N–P (cost 10)	Services A–P (total cost 500)
X .....	90	5	95
Y .....	240	5	245
Z .....	160	.....	160

(iii) The total volume of transactions with uncontrolled customers in each company is as follows:

Company X—2,000.  
 Company Y—4,500.  
 Company Z—3,500.

(iv) Company P allocates the 500 total services costs of services A through P based on transaction volume as follows:

**AGGREGATED SERVICES A–Z**  
 [Total costs 500]

Company	Allocation key	
	Transaction volume	Amount
X .....	2,000	100
Y .....	4,500	225
Z .....	3,500	175

(v) Based on these facts, Company P may reasonably conclude that the transaction volume allocation basis most reliably reflects

the participants' respective shares of the reasonably anticipated benefits attributable to services A through P.

*Example 22. Renderer reasonably anticipates benefits.* (i) Company P renders services on behalf of the PXYZ Group that qualify for the services cost method. Company P determines the amount charged for these services under such method. Company P's share of reasonably anticipated benefits from services A, B, C, and D is 20% of the total reasonably anticipated benefits of all participants. Company P's total services cost for services A, B, C, and D charged within the Group is 100.

(ii) Based on an application of paragraph (b)(7) of this section, Company P charges 80 which is allocated among Companies X, Y, and Z. No charge is made to Company P under the shared services arrangement for activities that it performs on its own behalf.

*Example 23. Coordination with cost sharing arrangement.* (i) Company P performs human resource services (service A) on behalf of the PXYZ Group that qualify for the services cost method. Company P determines the amount charged for these services under such method pursuant to a shared services arrangement based on an application of paragraph (b)(7) of this section. Service A constitutes a specified covered service described in a revenue procedure pursuant to paragraph (b)(3)(i) of this section. The total services costs for service A otherwise determined under the services cost method is 300.

(ii) Company X, Y, Z, and P reasonably anticipate benefits from service A. Using a basis of allocation that is consistent with the controlled participants' respective shares of the reasonably anticipated benefits from the shared services, the total charge of 300 is allocated as follows:

X—100.  
Y—50.  
Z—25.  
P—125.

(iii) In addition to performing services, P undertakes 500 of R&D and incurs manufacturing and other costs of 1,000.

(iv) Companies P and X enter into a cost sharing arrangement in accordance with § 1.482-7T. Under the arrangement, Company P will undertake all intangible property development activities. All of Company P's research and development (R&D) activity is devoted to the intangible property development activity under the cost sharing arrangement. Company P will manufacture, market, and otherwise exploit the product in its defined territory. Companies P and X will share intangible property development costs in accordance with their reasonably anticipated benefits from the intangible property, and Company X will make payments to Company P as required under § 1.482-7T. Company X will manufacture, market, and otherwise exploit the product in the rest of the world.

(v) A portion of the charge under the shared services arrangement is in turn allocable to the intangible property development activity undertaken by Company P. The most reliable estimate of the proportion allocable to the intangible property development activity is determined to be 500 (Company P's R&D expenses) divided by 1,500 (Company P's total non-covered services costs), or one-third. Accordingly, one-third of Company P's charge of 125, or 42, is allocated to the intangible property development activity. Companies P and X must share the intangible property development costs of the cost shared intangible property (including the charge of 42 that is allocated under the shared services arrangement) in proportion to their respective shares of reasonably anticipated benefits under the cost sharing arrangement. That is, the reasonably anticipated benefit shares under the cost

sharing arrangement are determined separately from reasonably anticipated benefit shares under the shared services arrangement.

*Example 24. Coordination with cost sharing arrangement.* (i) The facts and analysis are the same as in *Example 25*, except that Company X also performs intangible property development activities related to the cost sharing arrangement. Using a basis of allocation that is consistent with the controlled participants' respective shares of the reasonably anticipated benefits from the shared services, the 300 of service costs is allocated as follows:

X—100.  
Y—50.  
Z—25.  
P—125.

(ii) In addition to performing services, Company P undertakes 500 of R&D and incurs manufacturing and other costs of 1,000. Company X undertakes 400 of R&D and incurs manufacturing and other costs of 600.

(iii) Companies P and X enter into a cost sharing arrangement in accordance with § 1.482-7T. Under the arrangement, both Companies P and X will undertake intangible property development activities. All of the research and development activity conducted by Companies P and X is devoted to the intangible property development activity under the cost sharing arrangement. Both Companies P and X will manufacture, market, and otherwise exploit the product in their respective territories and will share intangible property development costs in accordance with their reasonably anticipated benefits from the intangible property, and both will make payments as required under § 1.482-7T.

(iv) A portion of the charge under the shared services arrangement is in turn allocable to the intangible property development activities undertaken by Companies P and X. The most reliable estimate of the portion allocable to Company P's intangible property development activity is determined to be 500 (Company P's R&D expenses) divided by 1,500 (P's total non-covered services costs), or one-third. Accordingly, one-third of Company P's allocated services cost method charge of 125, or 42, is allocated to its intangible property development activity.

(v) In addition, it is necessary to determine the portion of the charge under the shared services arrangement to Company X that should be further allocated to Company X's intangible property development activities under the cost sharing arrangement. The most reliable estimate of the portion allocable to Company X's intangible property development activity is 400 (Company X's R&D expenses) divided by 1,000 (Company X's costs), or 40%. Accordingly, 40% of the 100 that was allocated to Company X, or 40, is allocated in turn to Company X's intangible property development activities. Company X makes a payment to Company P of 100 under the shared services arrangement and includes 40 of services cost method charges in the pool of intangible property development costs.

(vi) The parties' respective contributions to intangible property development costs under the cost sharing arrangement are as follows:

P:  $500 + (0.333 * 125) = 542$   
X:  $400 + (0.40 * 100) = 440$

(c) *Comparable uncontrolled services price method—(1) In general.* The comparable uncontrolled services price method evaluates whether the amount charged in a controlled services transaction is arm's length by reference to the amount charged in a comparable uncontrolled services transaction.

(2) *Comparability and reliability considerations—(i) 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). The application of these factors under the comparable uncontrolled services price method is discussed in paragraphs (c)(2)(ii) and (iii) of this section.

(ii) *Comparability—(A) In general.* The degree of comparability between controlled and uncontrolled transactions is determined by applying the provisions of § 1.482-1(d). Although all of the factors described in § 1.482-1(d)(3) must be considered, similarity of the services rendered, and of the intangible property (if any) used in performing the services, generally will have the greatest effects on comparability under this method. In addition, because even minor differences in contractual terms or economic conditions could materially affect the amount charged in an uncontrolled transaction, comparability under this method depends on close similarity with respect to these factors, or adjustments to account for any differences. The results derived from applying the comparable uncontrolled services price method generally will be the most direct and reliable measure of an arm's length price for the controlled transaction if an uncontrolled transaction has no differences from the controlled transaction that would affect the price, or if there are only minor differences that have a definite and reasonably ascertainable effect on price and for which appropriate adjustments are made. If such adjustments cannot be made, or if there are more than minor differences between the controlled and uncontrolled transactions, the comparable uncontrolled services price method may be used, but the reliability of the results as a measure of the arm's length price will be reduced. Further, if there are material differences for which reliable adjustments cannot be made, this method ordinarily will not provide

a reliable measure of an arm's length result.

(B) *Adjustments for differences between controlled and uncontrolled transactions.* If there are differences between the controlled and uncontrolled transactions that would affect price, adjustments should be made to the price of the uncontrolled transaction according to the comparability provisions of § 1.482-1(d)(2). Specific examples of factors that may be particularly relevant to application of this method include—

- (1) Quality of the services rendered;
- (2) Contractual terms (for example, scope and terms of warranties or guarantees regarding the services, volume, credit and payment terms, allocation of risks, including any contingent-payment terms and whether costs were incurred without a provision for current reimbursement);
- (3) Intangible property (if any) used in rendering the services;
- (4) Geographic market in which the services are rendered or received;
- (5) Risks borne (for example, costs incurred to render the services, without provision for current reimbursement);
- (6) Duration or quantitative measure of services rendered;
- (7) Collateral transactions or ongoing business relationships between the renderer and the recipient, including arrangement for the provision of tangible property in connection with the services; and
- (8) Alternatives realistically available to the renderer and the recipient.

(iii) *Data and assumptions.* The reliability of the results derived from the comparable uncontrolled services price method is affected by the completeness and accuracy of the data used and the reliability of the assumptions made to apply the method. See § 1.482-1(c) (best method rule).

(3) *Arm's length range.* See § 1.482-1(e)(2) for the determination of an arm's length range.

(4) *Examples.* The principles of this paragraph (c) are illustrated by the following examples:

*Example 1. Internal comparable uncontrolled services price.* Company A, a United States corporation, performs shipping, stevedoring, and related services for controlled and uncontrolled parties on a short-term or as-needed basis. Company A charges uncontrolled parties in Country X a uniform fee of \$60 per container to place loaded cargo containers in Country X on oceangoing vessels for marine transportation. Company A also performs identical services in Country X for its wholly-owned subsidiary, Company B, and there are no substantial differences between the controlled and uncontrolled transactions. In evaluating the appropriate measure of the

arm's length price for the container-loading services performed for Company B, because Company A renders substantially identical services in Country X to both controlled and uncontrolled parties, it is determined that the comparable uncontrolled services price constitutes the best method for determining the arm's length price for the controlled services transaction. Based on the reliable data provided by Company A concerning the price charged for services in comparable uncontrolled transactions, a loading charge of \$60 per cargo container will be considered the most reliable measure of the arm's length price for the services rendered to Company B. See paragraph (c)(2)(ii)(A) of this section.

*Example 2. External comparable uncontrolled services price.* (i) The facts are the same as in *Example 1*, except that Company A performs services for Company B, but not for uncontrolled parties. Based on information obtained from unrelated parties (which is determined to be reliable under the comparability standards set forth in paragraph (c)(2) of this section), it is determined that uncontrolled parties in Country X perform services comparable to those rendered by Company A to Company B, and that such parties charge \$60 per cargo container.

(ii) In evaluating the appropriate measure of an arm's length price for the loading services that Company A renders to Company B, the \$60 per cargo container charge is considered evidence of a comparable uncontrolled services price. See paragraph (c)(2)(ii)(A) of this section.

*Example 3. External comparable uncontrolled services price.* The facts are the same as in *Example 2*, except that uncontrolled parties in Country X render similar loading and stevedoring services, but only under contracts that have a minimum term of one year. If the difference in the duration of the services has a material effect on prices, adjustments to account for these differences must be made to the results of the uncontrolled transactions according to the provisions of § 1.482-1(d)(2), and such adjusted results may be used as a measure of the arm's length result.

*Example 4. Use of valuable intangible property.* (i) Company A, a United States corporation in the biotechnology sector, renders research and development services exclusively to its affiliates. Company B is Company A's wholly-owned subsidiary in Country X. Company A renders research and development services to Company B.

(ii) In performing its research and development services function, Company A uses proprietary software that it developed internally. Company A uses the software to evaluate certain genetically engineered compounds developed by Company B. Company A owns the copyright on this software and does not license it to uncontrolled parties.

(iii) No uncontrolled parties can be identified that perform services identical or with a high degree of similarity to those performed by Company A. Because there are material differences for which reliable adjustments cannot be made, the comparable uncontrolled services price method is unlikely to provide a reliable measure of the

arm's length price. See paragraph (c)(2)(ii)(A) of this section.

*Example 5. Internal comparable.* (i) Company A, a United States corporation, and its subsidiaries render computer consulting services relating to systems integration and networking to business clients in various countries. Company A and its subsidiaries render only consulting services, and do not manufacture computer hardware or software nor distribute such products. The controlled group is organized according to industry specialization, with key industry specialists working for Company A. These personnel typically form the core consulting group that teams with consultants from the local-country subsidiaries to serve clients in the subsidiaries' respective countries.

(ii) Company A and its subsidiaries sometimes undertake engagements directly for clients, and sometimes work as subcontractors to unrelated parties on more extensive supply-chain consulting engagements for clients. In undertaking the latter engagements with third party consultants, Company A typically prices its services based on consulting hours worked multiplied by a rate determined for each category of employee. The company also charges, at no markup, for out-of-pocket expenses such as travel, lodging, and data acquisition charges. The Company has established the following schedule of hourly rates:

Category	Rate
Project managers .....	\$400 per hour.
Technical staff .....	\$300 per hour.

(iii) Thus, for example, a project involving 100 hours of the time of project managers and 400 hours of technical staff time would result in the following project fees (without regard to any out-of-pocket expenses): ((100 hrs. × \$400/hr.) + [400 hrs. × \$300/hr.]) = \$40,000 + \$120,000 = \$160,000.

(iv) Company B, a Country X subsidiary of Company A, contracts to perform consulting services for a Country X client in the banking industry. In undertaking this engagement, Company B uses its own consultants and also uses Company A project managers and technical staff that specialize in the banking industry for 75 hours and 380 hours, respectively. In determining an arm's length charge, the price that Company A charges for consulting services as a subcontractor in comparable uncontrolled transactions will be considered evidence of a comparable uncontrolled services price. Thus, in this case, a payment of \$144,000, (or [75 hrs. × \$400/hr.] + [380 hrs. × \$300/hr.] = \$30,000 + \$114,000) may be used as a measure of the arm's length price for the work performed by Company A project managers and technical staff. In addition, if the comparable uncontrolled services price method is used, then, consistent with the practices employed by the comparables with respect to similar types of expenses, Company B must reimburse Company A for appropriate out-of-pocket expenses. See paragraph (c)(2)(ii)(A) of this section.

*Example 6. Adjustments for differences.* (i) The facts are the same as in *Example 5*,

except that the engagement is undertaken with the client on a fixed fee basis. That is, prior to undertaking the engagement Company B and Company A estimate the resources required to undertake the engagement, and, based on hourly fee rates, charge the client a single fee for completion of the project. Company A's portion of the engagement results in fees of \$144,000.

(ii) The engagement, once undertaken, requires 20% more hours by each of Companies A and B than originally estimated. Nevertheless, the unrelated client pays the fixed fee that was agreed upon at the start of the engagement. Company B pays Company A \$144,000, in accordance with the fixed fee arrangement.

(iii) Company A often enters into similar fixed fee engagements with clients. In addition, Company A's records for similar engagements show that when it experiences cost overruns, it does not collect additional fees from the client for the difference between projected and actual hours. Accordingly, in evaluating whether the fees paid by Company B to Company A are arm's length, it is determined that no adjustments to the intercompany service charge are warranted. See § 1.482-1(d)(3)(ii) and paragraph (c)(2)(ii)(A) of this section.

(5) *Indirect evidence of the price of a comparable uncontrolled services transaction*—(i) *In general.* The price of a comparable uncontrolled services transaction may be derived based on indirect measures of the price charged in comparable uncontrolled services transactions, but only if—

(A) The data are widely and routinely used in the ordinary course of business in the particular industry or market segment for purposes of determining prices actually charged in comparable uncontrolled services transactions;

(B) The data are used to set prices in the controlled services transaction in the same way they are used to set prices in uncontrolled services transactions of the controlled taxpayer, or in the same way they are used by uncontrolled taxpayers to set prices in uncontrolled services transactions; and

(C) The amount charged in the controlled services transaction may be reliably adjusted to reflect differences in quality of the services, contractual terms, market conditions, risks borne (including contingent-payment terms), duration or quantitative measure of services rendered, and other factors that may affect the price to which uncontrolled taxpayers would agree.

(ii) *Example.* The following example illustrates this paragraph (c)(5):

*Example. Indirect evidence of comparable uncontrolled services price.*

(i) Company A is a United States insurance company. Company A's wholly-owned Country X subsidiary, Company B, performs specialized risk analysis for Company A as well as for uncontrolled parties. In determining the price actually charged to

uncontrolled entities for performing such risk analysis, Company B uses a proprietary, multi-factor computer program, which relies on the gross value of the policies in the customer's portfolio, the relative composition of those policies, their location, and the estimated number of personnel hours necessary to complete the project. Uncontrolled companies that perform comparable risk analysis in the same industry or market-segment use similar proprietary computer programs to price transactions with uncontrolled customers (the competitors' programs may incorporate different inputs, or may assign different weights or values to individual inputs, in arriving at the price).

(ii) During the taxable year subject to audit, Company B performed risk analysis for uncontrolled parties as well as for Company A. Because prices charged to uncontrolled customers reflected the composition of each customer's portfolio together with other factors, the prices charged in Company B's uncontrolled transactions do not provide a reliable basis for determining the comparable uncontrolled services price for the similar services rendered to Company A. However, in evaluating an arm's length price for the studies performed by Company B for Company A, Company B's proprietary computer program may be considered as indirect evidence of the comparable uncontrolled services price that would be charged to perform the services for Company A. The reliability of the results obtained by application of this internal computer program as a measure of an arm's length price for the services will be increased to the extent that Company A used the internal computer program to generate actual transaction prices for risk-analysis studies performed for uncontrolled parties during the same taxable year under audit; Company A used data that are widely and routinely used in the ordinary course of business in the insurance industry to determine the price charged; and Company A reliably adjusted the price charged in the controlled services transaction to reflect differences that may affect the price to which uncontrolled taxpayers would agree.

(d) *Gross services margin method*—(1) *In general.* The gross services margin method evaluates whether the amount charged in a controlled services transaction is arm's length by reference to the gross profit margin realized in comparable uncontrolled transactions. This method ordinarily is used in cases where a controlled taxpayer performs services or functions in connection with an uncontrolled transaction between a member of the controlled group and an uncontrolled taxpayer. This method may be used where a controlled taxpayer renders services (agent services) to another member of the controlled group in connection with a transaction between that other member and an uncontrolled taxpayer. This method also may be used in cases where a controlled taxpayer contracts to

provide services to an uncontrolled taxpayer (intermediary function) and another member of the controlled group actually performs a portion of the services provided.

(2) *Determination of arm's length price*—(i) *In general.* The gross services margin method evaluates whether the price charged or amount retained by a controlled taxpayer in the controlled services transaction in connection with the relevant uncontrolled transaction is arm's length by determining the appropriate gross profit of the controlled taxpayer.

(ii) *Relevant uncontrolled transaction.* The relevant uncontrolled transaction is a transaction between a member of the controlled group and an uncontrolled taxpayer as to which the controlled taxpayer performs agent services or an intermediary function.

(iii) *Applicable uncontrolled price.* The applicable uncontrolled price is the price paid or received by the uncontrolled taxpayer in the relevant uncontrolled transaction.

(iv) *Appropriate gross services profit.* The appropriate gross services profit is computed by multiplying the applicable uncontrolled price by the gross services profit margin in comparable uncontrolled transactions. The determination of the appropriate gross services profit will take into account any functions performed by other members of the controlled group, as well as any other relevant factors described in § 1.482-1(d)(3). The comparable gross services profit margin may be determined by reference to the commission in an uncontrolled transaction, where that commission is stated as a percentage of the price charged in the uncontrolled transaction.

(v) *Arm's length range.* See § 1.482-1(e)(2) for determination of the arm's length range.

(3) *Comparability and reliability considerations*—(i) *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). The application of these factors under the gross services margin method is discussed in paragraphs (d)(3)(ii) and (iii) of this section.

(ii) *Comparability*—(A) *Functional comparability.* The degree of comparability between an uncontrolled transaction and a controlled transaction is determined by applying the comparability provisions of § 1.482-1(d). A gross services profit provides compensation for services or functions that bear a relationship to the relevant uncontrolled transaction, including an

operating profit in return for the investment of capital and the assumption of risks by the controlled taxpayer performing the services or functions under review. Therefore, although all of the factors described in § 1.482-1(d)(3) must be considered, comparability under this method is particularly dependent on similarity of services or functions performed, risks borne, intangible property (if any) used in providing the services or functions, and contractual terms, or adjustments to account for the effects of any such differences. If possible, the appropriate gross services profit margin should be derived from comparable uncontrolled transactions by the controlled taxpayer under review, because similar characteristics are more likely found among different transactions by the same controlled taxpayer than among transactions by other parties. In the absence of comparable uncontrolled transactions involving the same controlled taxpayer, an appropriate gross services profit margin may be derived from transactions of uncontrolled taxpayers involving comparable services or functions with respect to similarly related transactions.

(B) *Other comparability factors.* Comparability under this method is not dependent on close similarity of the relevant uncontrolled transaction to the related transactions involved in the uncontrolled comparables. However, substantial differences in the nature of the relevant uncontrolled transaction and the relevant transactions involved in the uncontrolled comparables, such as differences in the type of property transferred or service provided in the relevant uncontrolled transaction, may indicate significant differences in the services or functions performed by the controlled and uncontrolled taxpayers with respect to their respective relevant transactions. Thus, it ordinarily would be expected that the services or functions performed in the controlled and uncontrolled transactions would be with respect to relevant transactions involving the transfer of property within the same product categories or the provision of services of the same general type (for example, information-technology systems design). Furthermore, significant differences in the intangible property (if any) used by the controlled taxpayer in the controlled services transaction as distinct from the uncontrolled comparables may also affect the reliability of the comparison. Finally, the reliability of profit measures based on gross services profit may be adversely affected by factors that have less effect on prices. For example, gross

services profit may be affected by a variety of other factors, including cost structures or efficiency (for example, differences in the level of experience of the employees performing the service in the controlled and uncontrolled transactions). Accordingly, if material differences in these factors are identified based on objective evidence, the reliability of the analysis may be affected.

(C) *Adjustments for differences between controlled and uncontrolled transactions.* If there are material differences between the controlled and uncontrolled transactions that would affect the gross services profit margin, adjustments should be made to the gross services profit margin, according to the comparability provisions of § 1.482-1(d)(2). For this purpose, consideration of the total services costs associated with functions performed and risks assumed may be necessary because differences in functions performed are often reflected in these costs. If there are differences in functions performed, however, the effect on gross services profit of such differences is not necessarily equal to the differences in the amount of related costs. Specific examples of factors that may be particularly relevant to this method include—

(1) Contractual terms (for example, scope and terms of warranties or guarantees regarding the services or function, volume, credit and payment terms, and allocation of risks, including any contingent-payment terms);

(2) Intangible property (if any) used in performing the services or function;

(3) Geographic market in which the services or function are performed or in which the relevant uncontrolled transaction takes place; and

(4) Risks borne, including, if applicable, inventory-type risk.

(D) *Buy-sell distributor.* If a controlled taxpayer that performs an agent service or intermediary function is comparable to a distributor that takes title to goods and resells them, the gross profit margin earned by such distributor on uncontrolled sales, stated as a percentage of the price for the goods, may be used as the comparable gross services profit margin.

(iii) *Data and assumptions—(A) In general.* The reliability of the results derived from the gross services margin method is affected by the completeness and accuracy of the data used and the reliability of the assumptions made to apply this method. See § 1.482-1(c) (best method rule).

(B) *Consistency in accounting.* The degree of consistency in accounting practices between the controlled

transaction and the uncontrolled comparables that materially affect the gross services profit margin affects the reliability of the results under this method.

(4) *Examples.* The principles of this paragraph (d) are illustrated by the following examples:

*Example 1. Agent services.* Company A and Company B are members of a controlled group. Company A is a foreign manufacturer of industrial equipment. Company B is a U.S. company that acts as a commission agent for Company A by arranging for Company A to make direct sales of the equipment it manufactures to unrelated purchasers in the U.S. market. Company B does not take title to the equipment but instead receives from Company A commissions that are determined as a specified percentage of the sales price for the equipment that is charged by Company A to the unrelated purchaser. Company B also arranges for direct sales of similar equipment by unrelated foreign manufacturers to unrelated purchasers in the U.S. market. Company B charges these unrelated foreign manufacturers a commission fee of 5% of the sales price charged by the unrelated foreign manufacturers to the unrelated U.S. purchasers for the equipment. Information regarding the comparable agent services provided by Company B to unrelated foreign manufacturers is sufficiently complete to conclude that it is likely that all material differences between the controlled and uncontrolled transactions have been identified and adjustments for such differences have been made. If the comparable gross services profit margin is 5% of the price charged in the relevant transactions involved in the uncontrolled comparables, then the appropriate gross services profit that Company B may earn and the arm's length price that it may charge Company A for its agent services is equal to 5% of the applicable uncontrolled price charged by Company A in sales of equipment in the relevant uncontrolled transactions.

*Example 2. Agent services.* The facts are the same as in *Example 1*, except that Company B does not act as a commission agent for unrelated parties and it is not possible to obtain reliable information concerning commission rates charged by uncontrolled commission agents that engage in comparable transactions with respect to relevant sales of property. It is possible, however, to obtain reliable information regarding the gross profit margins earned by unrelated parties that briefly take title to and then resell similar property in uncontrolled transactions, in which they purchase the property from foreign manufacturers and resell the property to purchasers in the U.S. market. Analysis of the facts and circumstances indicates that, aside from certain minor differences for which adjustments can be made, the uncontrolled parties that resell property perform similar functions and assume similar risks as Company B performs and assumes when it acts as a commission agent for Company A's sales of property. Under these circumstances, the gross profit margin earned by the

unrelated distributors on the purchase and resale of property may be used, subject to any adjustments for any material differences between the controlled and uncontrolled transactions, as a comparable gross services profit margin. The appropriate gross services profit that Company B may earn and the arm's length price that it may charge Company A for its agent services is therefore equal to this comparable gross services margin, multiplied by the applicable uncontrolled price charged by Company A in its sales of equipment in the relevant uncontrolled transactions.

*Example 3. Agent services.* (i) Company A and Company B are members of a controlled group. Company A is a U.S. corporation that renders computer consulting services, including systems integration and networking, to business clients.

(ii) In undertaking engagements with clients, Company A in some cases pays a commission of 3% of its total fees to unrelated parties that assist Company A in obtaining consulting engagements. Typically, such fees are paid to non-computer consulting firms that provide strategic management services for their clients. When Company A obtains a consulting engagement with a client of a non-computer consulting firm, Company A does not subcontract with the other consulting firm, nor does the other consulting firm play any role in Company A's consulting engagement.

(iii) Company B, a Country X subsidiary of Company A, assists Company A in obtaining an engagement to perform computer consulting services for a Company B banking industry client in Country X. Although Company B has an established relationship with its Country X client and was instrumental in arranging for Company A's engagement with the client, Company A's particular expertise was the primary consideration in motivating the client to engage Company A. Based on the relative contributions of Companies A and B in obtaining and undertaking the engagement, Company B's role was primarily to facilitate the consulting engagement between Company A and the Country X client. Information regarding the commissions paid by Company A to unrelated parties for providing similar services to facilitate Company A's consulting engagements is sufficiently complete to conclude that it is likely that all material differences between these uncontrolled transactions and the controlled transaction between Company B and Company A have been identified and that appropriate adjustments have been made for any such differences. If the comparable gross services margin earned by unrelated parties in providing such agent services is 3% of total fees charged in the relevant transactions involved in the uncontrolled comparables, then the appropriate gross services profit that Company B may earn and the arm's length price that it may charge Company A for its agent services is equal to this comparable gross services margin (3%), multiplied by the applicable uncontrolled price charged by Company A in its relevant uncontrolled consulting engagement with Company B's client.

*Example 4. Intermediary function.* (i) The facts are the same as in *Example 3*, except

that Company B contracts directly with its Country X client to provide computer consulting services and Company A performs the consulting services on behalf of Company B. Company A does not enter into a consulting engagement with Company B's Country X client. Instead, Company B charges its Country X client an uncontrolled price for the consulting services, and Company B pays a portion of the uncontrolled price to Company A for performing the consulting services on behalf of Company B.

(ii) Analysis of the relative contributions of Companies A and B in obtaining and undertaking the consulting contract indicates that Company B functioned primarily as an intermediary contracting party, and the gross services margin method is the most reliable method for determining the amount that Company B may retain as compensation for its intermediary function with respect to Company A's consulting services. In this case, therefore, because Company B entered into the relevant uncontrolled transaction to provide services, Company B receives the applicable uncontrolled price that is paid by the Country X client for the consulting services. Company A technically performs services for Company B when it performs, on behalf of Company B, the consulting services Company B contracted to provide to the Country X client. The arm's length amount that Company A may charge Company B for performing the consulting services on Company B's behalf is equal to the applicable uncontrolled price received by Company B in the relevant uncontrolled transaction, less Company B's appropriate gross services profit, which is the amount that Company B may retain as compensation for performing the intermediary function.

(iii) Reliable data concerning the commissions that Company A paid to uncontrolled parties for assisting it in obtaining engagements to provide consulting services similar to those it has provided on behalf of Company B provide useful information in applying the gross services margin method. However, consideration should be given to whether the third party commission data may need to be adjusted to account for any additional risk that Company B may have assumed as a result of its function as an intermediary contracting party, compared with the risk it would have assumed if it had provided agent services to assist Company A in entering into an engagement to provide its consulting service directly. In this case, the information regarding the commissions paid by Company A to unrelated parties for providing agent services to facilitate its performance of consulting services for unrelated parties is sufficiently complete to conclude that all material differences between these uncontrolled transactions and the controlled performance of an intermediary function, including possible differences in the amount of risk assumed in connection with performing that function, have been identified and that appropriate adjustments have been made. If the comparable gross services margin earned by unrelated parties in providing such agent services is 3% of total fees charged in Company B's relevant

uncontrolled transactions, then the appropriate gross services profit that Company B may retain as compensation for performing an intermediary function (and the amount, therefore, that is deducted from the applicable uncontrolled price to arrive at the arm's length price that Company A may charge Company B for performing consulting services on Company B's behalf) is equal to this comparable gross services margin (3%), multiplied by the applicable uncontrolled price charged by Company B in its contract to provide services to the uncontrolled party.

*Example 5. External comparable.* (i) The facts are the same as in *Example 4*, except that neither Company A nor Company B engages in transactions with third parties that facilitate similar consulting engagements.

(ii) Analysis of the relative contributions of Companies A and B in obtaining and undertaking the contract indicates that Company B's role was primarily to facilitate the consulting arrangement between Company A and the Country X client. Although no reliable internal data are available regarding comparable transactions with uncontrolled entities, reliable data exist regarding commission rates for similar facilitating services between uncontrolled parties. These data indicate that a 3% commission (3% of total engagement fee) is charged in such transactions. Information regarding the uncontrolled comparables is sufficiently complete to conclude that it is likely that all material differences between the controlled and uncontrolled transactions have been identified and adjusted for. If the appropriate gross services profit margin is 3% of total fees, then an arm's length result of the controlled services transaction is for Company B to retain an amount equal to 3% of total fees paid to it.

(e) *Cost of services plus method*—(1) *In general.* The cost of services plus method evaluates whether the amount charged in a controlled services transaction is arm's length by reference to the gross services profit markup realized in comparable uncontrolled transactions. The cost of services plus method is ordinarily used in cases where the controlled service renderer provides the same or similar services to both controlled and uncontrolled parties. This method is ordinarily not used in cases where the controlled services transaction involves a contingent-payment arrangement, as described in paragraph (i)(2) of this section.

(2) *Determination of arm's length price*—(i) *In general.* The cost of services plus method measures an arm's length price by adding the appropriate gross services profit to the controlled taxpayer's comparable transactional costs.

(ii) *Appropriate gross services profit.* The appropriate gross services profit is computed by multiplying the controlled taxpayer's comparable transactional costs by the gross services profit

markup, expressed as a percentage of the comparable transactional costs earned in comparable uncontrolled transactions.

(iii) *Comparable transactional costs.* Comparable transactional costs consist of the costs of providing the services under review that are taken into account as the basis for determining the gross services profit markup in comparable uncontrolled transactions. Depending on the facts and circumstances, such costs typically include all compensation attributable to employees directly involved in the performance of such services, materials and supplies consumed or made available in rendering such services, and may include as well other costs of rendering the services. Comparable transactional costs must be determined on a basis that will facilitate comparison with the comparable uncontrolled transactions. For that reason, comparable transactional costs may not necessarily equal total services costs, as defined in paragraph (j) of this section, and in appropriate cases may be a subset of total services costs. Generally accepted accounting principles or Federal income tax accounting rules (where Federal income tax data for comparable transactions or business activities are available) may provide useful guidance but will not conclusively establish the appropriate comparable transactional costs for purposes of this method.

(iv) *Arm's length range.* See § 1.482-1(e)(2) for determination of an arm's length range.

(3) *Comparability and reliability considerations*—(i) *In general.* Whether results derived from the 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).

(ii) *Comparability*—(A) *Functional comparability.* The degree of comparability between controlled and uncontrolled transactions is determined by applying the comparability provisions of § 1.482-1(d). A service renderer's gross services profit provides compensation for performing services related to the controlled services transaction under review, including an operating profit for the service renderer's investment of capital and assumptions 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 similarity of services or functions performed, risks borne, intangible property (if any) used in providing the services or functions, and contractual terms, or adjustments to

account for the effects of any such differences. If possible, the appropriate gross services profit markup should be derived from comparable uncontrolled transactions of the same taxpayer participating in the controlled services transaction because similar characteristics are more likely to be found among services provided by the same service provider than among services provided by other service providers. In the absence of such services transactions, an appropriate gross services profit markup may be derived from comparable uncontrolled services transactions of other service providers. If the appropriate gross services profit markup is derived from comparable uncontrolled services transactions of other service providers, in evaluating comparability the controlled taxpayer must consider the results under this method expressed as a markup on total services costs of the controlled taxpayer, because differences in functions performed may be reflected in differences in service costs other than those included in comparable transactional costs.

(B) *Other comparability factors.* Comparability under this method is less dependent on close similarity between the services provided than under the comparable uncontrolled services price method. Substantial differences in the services may, however, indicate significant functional differences between the controlled and uncontrolled taxpayers. Thus, it ordinarily would be expected that the controlled and uncontrolled transactions would involve services of the same general type (for example, information-technology systems design). Furthermore, if a significant amount of the controlled taxpayer's comparable transactional costs consists of service costs incurred in a tax accounting period other than the tax accounting period under review, the reliability of the analysis would be reduced. In addition, significant differences in the value of the services rendered, due for example to the use of valuable intangible property, may also affect the reliability of the comparison. Finally, the reliability of profit measures based on gross services profit may be adversely affected by factors that have less effect on prices. For example, gross services profit may be affected by a variety of other factors, including cost structures or efficiency-related factors (for example, differences in the level of experience of the employees performing the service in the controlled and uncontrolled transactions). Accordingly, if material differences in these factors

are identified based on objective evidence, the reliability of the analysis may be affected.

(C) *Adjustments for differences between the controlled and uncontrolled transactions.* If there are material differences between the controlled and uncontrolled transactions that would affect the gross services profit markup, adjustments should be made to the gross services profit markup earned in the comparable uncontrolled transaction according to the provisions of § 1.482-1(d)(2). For this purpose, consideration of the comparable transactional costs associated with the functions performed and risks assumed may be necessary, because differences in the functions performed are often reflected in these costs. If there are differences in functions performed, however, the effect on gross services profit of such differences is not necessarily equal to the differences in the amount of related comparable transactional costs. Specific examples of the factors that may be particularly relevant to this method include—

- (1) The complexity of the services;
- (2) The duration or quantitative measure of services;
- (3) Contractual terms (for example, scope and terms of warranties or guarantees provided, volume, credit and payment terms, allocation of risks, including any contingent-payment terms);
- (4) Economic circumstances; and
- (5) Risks borne.

(iii) *Data and assumptions*—(A) *In general.* The reliability of the results derived from the cost of services plus method is affected by the completeness and accuracy of the data used and the reliability of the assumptions made to apply this method. See § 1.482-1(c) (Best method rule).

(B) *Consistency in accounting.* The degree of consistency in accounting practices between the controlled transaction and the uncontrolled comparables that materially affect the gross services profit markup affects the reliability of the results under this method. Thus, for example, if differences in cost accounting practices would materially affect the gross services profit markup, the ability to make reliable adjustments for such differences would affect the reliability of the results obtained under this method. Further, reliability under this method depends on the extent to which the controlled and uncontrolled transactions reflect consistent reporting of comparable transactional costs. For purposes of this paragraph (e)(3)(iii)(B), the term *comparable transactional costs* includes the cost of acquiring tangible

property that is transferred (or used) with the services, to the extent that the arm's length price of the tangible property is not separately evaluated as a controlled transaction under another provision.

(4) *Examples.* The principles of this paragraph (e) are illustrated by the following examples:

*Example 1. Internal comparable.* (i) Company A designs and assembles information-technology networks and systems. When Company A renders services for uncontrolled parties, it receives compensation based on time and materials as well as certain other related costs necessary to complete the project. This fee includes the cost of hardware and software purchased from uncontrolled vendors and incorporated in the final network or system, plus a reasonable allocation of certain specified overhead costs incurred by Company A in providing these services. Reliable accounting records maintained by Company A indicate that Company A earned a gross services profit markup of 10% on its time, materials and specified overhead in providing design services during the year under examination on information technology projects for uncontrolled entities.

(ii) Company A designed an information-technology network for its Country X subsidiary, Company B. The services rendered to Company B are similar in scope and complexity to services that Company A rendered to uncontrolled parties during the year under examination. Using Company A's accounting records (which are determined to be reliable under paragraph (e)(3) of this section), it is possible to identify the comparable transactional costs involved in the controlled services transaction with reference to the costs incurred by Company A in rendering similar design services to uncontrolled parties. Company A's records indicate that it does not incur any additional types of costs in rendering similar services to uncontrolled customers. The data available are sufficiently complete to conclude that it is likely that all material differences between the controlled and uncontrolled transactions have been identified and adjusted for. Based on the gross services profit markup data derived from Company A's uncontrolled transactions involving similar design services, an arm's length result for the controlled services transaction is equal to the price that will allow Company A to earn a 10% gross services profit markup on its comparable transactional costs.

*Example 2. Inability to adjust for differences in comparable transactional costs.* The facts are the same as in *Example 1*, except that Company A's staff that rendered the services to Company B consisted primarily of engineers in training status or on temporary rotation from other Company A subsidiaries. In addition, the Company B network incorporated innovative features, including specially designed software suited to Company B's requirements. The use of less-experienced personnel and staff on temporary rotation, together with the special features of the Company B network, significantly increased

the time and costs associated with the project as compared to time and costs associated with similar projects completed for uncontrolled customers. These factors constitute material differences between the controlled and the uncontrolled transactions that affect the determination of Company A's comparable transactional costs associated with the controlled services transaction, as well as the gross services profit markup. Moreover, it is not possible to perform reliable adjustments for these differences on the basis of the available accounting data. Under these circumstances, the reliability of the cost of services plus method as a measure of an arm's length price is substantially reduced.

*Example 3. Operating loss by reference to total services costs.* The facts and analysis are the same as in *Example 1*, except that an unrelated Company C, instead of Company A, renders similar services to uncontrolled parties and publicly available information indicates that Company C earned a gross services profit markup of 10% on its time, materials and certain specified overhead in providing those services. As in *Example 1*, Company A still provides services for its Country X subsidiary, Company B. In accordance with the requirements in paragraph (e)(3)(ii) of this section, the taxpayer performs additional analysis and restates the results of Company A's controlled services transaction with its Country X subsidiary, Company B, in the form of a markup on Company A's total services costs. This analysis by reference to total services costs shows that Company A generated an operating loss on the controlled services transaction, which indicates that functional differences likely exist between the controlled services transaction performed by Company A and uncontrolled services transactions performed by Company C, and that these differences may not be reflected in the comparable transactional costs. Upon further scrutiny, the presence of such functional differences between the controlled and uncontrolled transactions may indicate that the cost of services plus method does not provide the most reliable measure of an arm's length result under the facts and circumstances.

*Example 4. Internal comparable.* (i) Company A, a U.S. corporation, and its subsidiaries perform computer consulting services relating to systems integration and networking for business clients in various countries. Company A and its subsidiaries render only consulting services and do not manufacture or distribute computer hardware or software to clients. The controlled group is organized according to industry specialization, with key industry specialists working for Company A. These personnel typically form the core consulting group that teams with consultants from the local-country subsidiaries to serve clients in the subsidiaries' respective countries.

(ii) On some occasions, Company A and its subsidiaries undertake engagements directly for clients. On other occasions, they work as subcontractors for uncontrolled parties on more extensive consulting engagements for clients. In undertaking the latter engagements with third-party consultants, Company A

typically prices its services at four times the compensation costs of its consultants, defined as the consultants' base salary plus estimated fringe benefits, as defined in this table:

Category	Rate
Project managers .....	\$100 per hour.
Technical staff .....	75 per hour.

(iii) In uncontrolled transactions, Company A also charges the customer, at no markup, for out-of-pocket expenses such as travel, lodging, and data acquisition charges. Thus, for example, a project involving 100 hours of time from project managers, and 400 hours of technical staff time would result in total compensation costs to Company A of  $(100 \text{ hrs.} \times \$100/\text{hr.}) + (400 \text{ hrs.} \times \$75/\text{hr.}) = \$10,000 + \$30,000 = \$40,000$ . Applying the markup of 300%, the total fee charged would thus be  $(4 \times \$40,000)$ , or \$160,000, plus out-of-pocket expenses.

(iv) Company B, a Country X subsidiary of Company A, contracts to render consulting services to a Country X client in the banking industry. In undertaking this engagement, Company B uses its own consultants and also uses the services of Company A project managers and technical staff that specialize in the banking industry for 75 hours and 380 hours, respectively. The data available are sufficiently complete to conclude that it is likely that all material differences between the controlled and uncontrolled transactions have been identified and adjusted for. Based on reliable data concerning the compensation costs to Company A, an arm's length result for the controlled services transaction is equal to \$144,000. This is calculated as follows:  $[4 \times (75 \text{ hrs.} \times \$100/\text{hr.})] + [4 \times (380 \text{ hrs.} \times \$75/\text{hr.})] = \$30,000 + \$114,000 = \$144,000$ , reflecting a 300% markup on the total compensation costs for Company A project managers and technical staff. In addition, consistent with Company A's pricing of uncontrolled transactions, Company B must reimburse Company A for appropriate out-of-pocket expenses incurred in performing the services.

(f) *Comparable profits method*—(1) *In general.* The comparable profits method evaluates whether the amount charged in a controlled transaction is arm's length, based on objective measures of profitability (profit level indicators) derived from uncontrolled taxpayers that engage in similar business activities under similar circumstances. The rules in § 1.482-5 relating to the comparable profits method apply to controlled services transactions, except as modified in this paragraph (f).

(2) *Determination of arm's length result*—(i) *Tested party.* This paragraph (f) applies where the relevant business activity of the tested party as determined under § 1.482-5(b)(2) is the rendering of services in a controlled services transaction. Where the tested party determined under § 1.482-5(b)(2) is instead the recipient of the controlled

services, the rules under this paragraph (f) are not applicable to determine the arm's length result.

(ii) *Profit level indicators.* In addition to the profit level indicators provided in § 1.482-5(b)(4), a profit level indicator that may provide a reliable basis for comparing operating profits of the tested party involved in a controlled services transaction and uncontrolled comparables is the ratio of operating profit to total services costs (as defined in paragraph (j) of this section).

(iii) *Comparability and reliability considerations—Data and assumptions—Consistency in accounting.* Consistency in accounting practices between the relevant business activity of the tested party and the uncontrolled service providers is particularly important in determining the reliability of the results under this method, but less than in applying the cost of services plus method.

Adjustments may be appropriate if materially different treatment is applied to particular cost items related to the relevant business activity of the tested party and the uncontrolled service providers. For example, adjustments may be appropriate where the tested party and the uncontrolled comparables use inconsistent approaches to classify similar expenses as “cost of goods sold” and “selling, general, and administrative expenses.” Although distinguishing between these two categories may be difficult, the distinction is less important to the extent that the ratio of operating profit to total services costs is used as the appropriate profit level indicator. Determining whether adjustments are necessary under these or similar circumstances requires thorough analysis of the functions performed and consideration of the cost accounting practices of the tested party and the uncontrolled comparables. Other adjustments as provided in § 1.482-

5(c)(2)(iv) may also be necessary to increase the reliability of the results under this method.

(3) *Examples.* The principles of this paragraph (f) are illustrated by the following examples:

*Example 1. Ratio of operating profit to total services costs as the appropriate profit level indicator.* (i) A Country T parent firm, Company A, and its Country Y subsidiary, Company B, both engage in manufacturing as their principal business activity. Company A also performs certain advertising services for itself and its affiliates. In year 1, Company A renders advertising services to Company B.

(ii) Based on the facts and circumstances, it is determined that the comparable profits method will provide the most reliable measure of an arm's length result. Company A is selected as the tested party. No data are available for comparable independent manufacturing firms that render advertising services to third parties. Financial data are available, however, for ten independent firms that render similar advertising services as their principal business activity in Country X. The ten firms are determined to be comparable under § 1.482-5(c). Neither Company A nor the comparable companies use valuable intangible property in rendering the services.

(iii) Based on the available financial data of the comparable companies, it cannot be determined whether these comparable companies report costs for financial accounting purposes in the same manner as the tested party. The publicly available financial data of the comparable companies segregate total services costs into cost of goods sold and sales, general and administrative costs, with no further segmentation of costs provided. Due to the limited information available regarding the cost accounting practices used by the comparable companies, the ratio of operating profits to total services costs is determined to be the most appropriate profit level indicator. This ratio includes total services costs to minimize the effect of any inconsistency in accounting practices between Company A and the comparable companies.

*Example 2. Application of the operating profit to total services costs profit level indicator.* (i) Company A is a foreign subsidiary of Company B, a U.S. corporation.

Company B is under examination for its year 1 taxable year. Company B renders management consulting services to Company A. Company B's consulting function includes analyzing Company A's operations, benchmarking Company A's financial performance against companies in the same industry, and to the extent necessary, developing a strategy to improve Company A's operational performance. The accounting records of Company B allow reliable identification of the total services costs of the consulting staff associated with the management consulting services rendered to Company A. Company A reimburses Company B for its costs associated with rendering the consulting services, with no markup.

(ii) Based on all the facts and circumstances, it is determined that the comparable profits method will provide the most reliable measure of an arm's length result. Company B is selected as the tested party, and its rendering of management consulting services is identified as the relevant business activity. Data are available from ten domestic companies that operate in the industry segment involving management consulting and that perform activities comparable to the relevant business activity of Company B. These comparables include entities that primarily perform management consulting services for uncontrolled parties. The comparables incur similar risks as Company B incurs in performing the consulting services and do not make use of valuable intangible property or special processes.

(iii) Based on the available financial data of the comparables, it cannot be determined whether the comparables report their costs for financial accounting purposes in the same manner as Company B reports its costs in the relevant business activity. The available financial data for the comparables report only an aggregate figure for costs of goods sold and operating expenses, and do not segment the underlying services costs. Due to this limitation, the ratio of operating profits to total services costs is determined to be the most appropriate profit level indicator.

(iv) For the taxable years 1 through 3, Company B shows the following results for the services performed for Company A:

	Year 1	Year 2	Year 3	Average
Revenues .....	1,200,000	1,100,000	1,300,000	1,200,000
Cost of Goods Sold .....	100,000	100,000	N/A	66,667
Operating Expenses .....	1,100,000	1,000,000	1,300,000	1,133,333
Operating Profit .....	0	0	0	0

(v) After adjustments have been made to account for identified material differences between the relevant business activity of Company B and the comparables, the average ratio for the taxable years 1 through 3 of operating profit to total services costs is calculated for each of the uncontrolled service providers. Applying each ratio to Company B's average total services costs from the relevant business activity for the taxable years 1 through 3 would lead to the

following comparable operating profit (COP) for the services rendered by Company B:

Uncontrolled service provider	OP/Total service costs (percent)	Company B COP
Company 1 ...	15.75	\$189,000
Company 2 ...	15.00	180,000
Company 3 ...	14.00	168,000
Company 4 ...	13.30	159,600

Uncontrolled service provider	OP/Total service costs (percent)	Company B COP
Company 5 ...	12.00	144,000
Company 6 ...	11.30	135,600
Company 7 ...	11.25	135,000
Company 8 ...	11.18	134,160
Company 9 ...	11.11	133,320
Company 10	10.75	129,000

(vi) The available data are not sufficiently complete to conclude that it is likely that all material differences between the relevant business activity of Company B and the comparables have been identified. Therefore, an arm's length range can be established only pursuant to § 1.482-1(e)(2)(iii)(B). The arm's length range is established by reference to the interquartile range of the results as calculated under § 1.482-1(e)(2)(iii)(C), which consists of the results ranging from \$168,000 to \$134,160. Company B's reported average operating profit of zero (\$0) falls outside this range. Therefore, an allocation may be appropriate.

(vii) Because Company B reported income of zero, to determine the amount, if any, of the allocation, Company B's reported operating profit for year 3 is compared to the comparable operating profits derived from the comparables' results for year 3. The ratio of operating profit to total services costs in year 3 is calculated for each of the comparables and applied to Company B's year 3 total services costs to derive the following results:

Uncontrolled service provider	OP/Total service costs (for year 3) (percent)	Company B COP
Company 1 ...	15.00	\$195,000
Company 2 ...	14.75	191,750
Company 3 ...	14.00	182,000
Company 4 ...	13.50	175,500
Company 5 ...	12.30	159,900
Company 6 ...	11.05	143,650
Company 7 ...	11.03	143,390

Uncontrolled service provider	OP/Total service costs (for year 3) (percent)	Company B COP
Company 8 ...	11.00	143,000
Company 9 ...	10.50	136,500
Company 10	10.25	133,250

(viii) Based on these results, the median of the comparable operating profits for year 3 is \$151,775. Therefore, Company B's income for year 3 is increased by \$151,775, the difference between Company B's reported operating profit for year 3 of zero and the median of the comparable operating profits for year 3.

*Example 3. Material difference in accounting for stock-based compensation.* (i) Taxpayer, a U.S. corporation the stock of which is publicly traded, performs controlled services for its wholly-owned subsidiaries. The arm's length price of these controlled services is evaluated under the comparable profits method for services in paragraph (f) of this section by reference to the net cost plus profit level indicator (PLI). Taxpayer is the tested party under paragraph (f)(2)(i) of this section. The Commissioner identifies the most narrowly identifiable business activity of the tested party for which data are available that incorporate the controlled transaction (the relevant business activity). The Commissioner also identifies four uncontrolled domestic service providers, Companies A, B, C, and D, each of which performs exclusively activities similar to the relevant business activity of Taxpayer that is

subject to analysis under paragraph (f) of this section. The stock of Companies A, B, C, and D is publicly traded on a U.S. stock exchange. Assume that Taxpayer makes an election to apply these regulations to earlier taxable years.

(ii) Stock options are granted to the employees of Taxpayer that engage in the relevant business activity. Assume that, as determined under a method in accordance with U.S. generally accepted accounting principles, the fair value of such stock options attributable to the employees' performance of the relevant business activity is 500 for the taxable year in question. In evaluating the controlled services, Taxpayer includes salaries, fringe benefits, and related compensation of these employees in "total services costs," as defined in paragraph (j) of this section. Taxpayer does not include any amount attributable to stock options in total services costs, nor does it deduct that amount in determining "reported operating profit" within the meaning of § 1.482-5(d)(5), for the year under examination.

(iii) Stock options are granted to the employees of Companies A, B, C, and D. Under a fair value method in accordance with U.S. generally accepted accounting principles, the comparables include in total compensation the value of the stock options attributable to the employees' performance of the relevant business activity for the annual financial reporting period, and treat this amount as an expense in determining operating profit for financial accounting purposes. The treatment of employee stock options is summarized in the following table:

	Salaries and other non-option compensation	Stock options fair value	Stock options expensed
Taxpayer .....	1,000	500	0
Company A .....	7,000	2,000	2,000
Company B .....	4,300	250	250
Company C .....	12,000	4,500	4,500
Company D .....	15,000	2,000	2,000

(iv) A material difference in accounting for stock-based compensation (within the meaning of § 1.482-7T(d)(3)(i)) exists. Analysis indicates that this difference would materially affect the measure of an arm's length result under this paragraph (f). In making an adjustment to improve comparability under §§ 1.482-1(d)(2) and 1.482-5(c)(2)(iv), the Commissioner includes in total services costs of the tested party the total compensation costs of 1,500 (including stock option fair value). In addition, the Commissioner calculates the net cost plus

PLI by reference to the financial-accounting data of Companies A, B, C, and D, which take into account compensatory stock options.

*Example 4. Material difference in utilization of stock-based compensation.*

(i) The facts are the same as in paragraph (i) of Example 3.

(ii) No stock options are granted to the employees of Taxpayer that engage in the relevant business activity. Thus, no deduction for stock options is made in determining "reported operating profit"

(within the meaning of § 1.482-5(d)(5)) for the taxable year under examination.

(iii) Stock options are granted to the employees of Companies A, B, C, and D, but none of these companies expense stock options for financial accounting purposes. Under a method in accordance with U.S. generally accepted accounting principles, however, Companies A, B, C, and D disclose the fair value of the stock options for financial accounting purposes. The utilization and treatment of employee stock options is summarized in the following table:

	Salaries and other non-option compensation	Stock options fair value	Stock options expensed
Taxpayer .....	1,000	0	N/A
Company A .....	7,000	2,000	0
Company B .....	4,300	250	0
Company C .....	12,000	4,500	0
Company D .....	15,000	2,000	0

(iv) A material difference in the utilization of stock-based compensation (within the meaning of § 1.482-7T(d)(3)(i)) exists. Analysis indicates that these differences would materially affect the measure of an arm's length result under this paragraph (f). In evaluating the comparable operating profits of the tested party, the Commissioner uses Taxpayer's total services costs, which include total compensation costs of 1,000. In considering whether an adjustment is

necessary to improve comparability under §§ 1.482-1(d)(2) and 1.482-5(c)(2)(iv), the Commissioner recognizes that the total compensation provided to employees of Taxpayer is comparable to the total compensation provided to employees of Companies A, B, C, and D. Because Companies A, B, C, and D do not expense stock-based compensation for financial accounting purposes, their reported operating profits must be adjusted in order to improve

comparability with the tested party. The Commissioner increases each comparable's total services costs, and also reduces its reported operating profit, by the fair value of the stock-based compensation incurred by the comparable company.

(v) The adjustments to the data of Companies A, B, C, and D described in paragraph (iv) of this Example 4 are summarized in the following table:

	Salaries and other non-option compensation	Stock options fair value	Total services costs (A)	Operating profit (B)	Net cost plus PLI (B/A) (Percent)
Per financial statements:					
Company A .....	7,000	2,000	25,000	6,000	24.00
Company B .....	4,300	250	12,500	2,500	20.00
Company C .....	12,000	4,500	36,000	11,000	30.56
Company D .....	15,000	2,000	27,000	7,000	25.93
As adjusted:					
Company A .....	7,000	2,000	27,000	4,000	14.81
Company B .....	4,300	250	12,750	2,250	17.65
Company C .....	12,000	4,500	40,500	6,500	16.05
Company D .....	15,000	2,000	29,000	5,000	17.24

*Example 5. Non-material difference in utilization of stock-based compensation.*

(i) The facts are the same as in paragraph (i) of Example 3.

(ii) Stock options are granted to the employees of Taxpayer that engage in the relevant business activity. Assume that, as determined under a method in accordance with U.S. generally accepted accounting principles, the fair value of such stock options attributable to the employees'

performance of the relevant business activity is 50 for the taxable year. Taxpayer includes salaries, fringe benefits, and all other compensation of these employees (including the stock option fair value) in "total services costs," as defined in paragraph (j) of this section, and deducts these amounts in determining "reported operating profit" within the meaning of § 1.482-5(d)(5), for the taxable year under examination.

(iii) Stock options are granted to the employees of Companies A, B, C, and D, but none of these companies expense stock options for financial accounting purposes. Under a method in accordance with U.S. generally accepted accounting principles, however, Companies A, B, C, and D disclose the fair value of the stock options for financial accounting purposes. The utilization and treatment of employee stock options is summarized in the following table:

	Salaries and other non-option compensation	Stock options fair value	Stock options expensed
Taxpayer .....	1,000	50	50
Company A .....	7,000	100	0
Company B .....	4,300	40	0
Company C .....	12,000	130	0
Company D .....	15,000	75	0

(iv) Analysis of the data reported by Companies A, B, C, and D indicates that an

adjustment for differences in utilization of stock-based compensation would not have a

material effect on the determination of an arm's length result.

	Salaries and other non-option compensation	Stock options fair value	Total services costs (A)	Operating profit (B)	Net cost plus PLI (B/A) (percent)
Per financial statements:					
Company A .....	7,000	100	25,000	6,000	24.00
Company B .....	4,300	40	12,500	2,500	20.00
Company C .....	12,000	130	36,000	11,000	30.56
Company D .....	15,000	75	27,000	7,000	25.93
As adjusted:					
Company A .....	7,000	100	25,100	5,900	23.51
Company B .....	4,300	40	12,540	2,460	19.62
Company C .....	12,000	130	36,130	10,870	30.09
Company D .....	15,000	75	27,075	6,925	25.58

(v) Under the circumstances, the difference in utilization of stock-based compensation

would not materially affect the determination of the arm's length result under this

paragraph (f). Accordingly, in calculating the net cost plus PLI, no comparability

adjustment is made to the data of Companies A, B, C, or D pursuant to §§ 1.482-1(d)(2) and 1.482-5(c)(2)(iv).

*Example 6. Material difference in comparables' accounting for stock-based compensation.* (i) The facts are the same as in paragraph (i) of *Example 3*.

(ii) Stock options are granted to the employees of Taxpayer that engage in the relevant business activity. Assume that, as determined under a method in accordance with U.S. generally accepted accounting principles, the fair value of such stock

options attributable to employees' performance of the relevant business activity is 500 for the taxable year. Taxpayer includes salaries, fringe benefits, and all other compensation of these employees (including the stock option fair value) in "total services costs," as defined in paragraph (j) of this section, and deducts these amounts in determining "reported operating profit" (within the meaning of § 1.482-5(d)(5)) for the taxable year under examination.

(iii) Stock options are granted to the employees of Companies A, B, C, and D.

Companies A and B expense the stock options for financial accounting purposes in accordance with U.S. generally accepted accounting principles. Companies C and D do not expense the stock options for financial accounting purposes. Under a method in accordance with U.S. generally accepted accounting principles, however, Companies C and D disclose the fair value of these options in their financial statements. The utilization and accounting treatment of options are depicted in the following table:

	Salary and other non-option compensation	Stock options fair value	Stock options expensed
Taxpayer .....	1,000	500	500
Company A .....	7,000	2,000	2,000
Company B .....	4,300	250	250
Company C .....	12,000	4,500	0
Company D .....	15,000	2,000	0

(iv) A material difference in accounting for stock-based compensation (within the meaning of § 1.482-7T(d)(3)(i)) exists. Analysis indicates that this difference would materially affect the measure of the arm's length result under paragraph (f) of this section. In evaluating the comparable operating profits of the tested party, the Commissioner includes in total services costs Taxpayer's total compensation costs of 1,500 (including stock option fair value of 500). In considering whether an adjustment is necessary to improve comparability under

§§ 1.482-1(d)(2) and 1.482-5(c)(2)(iv), the Commissioner recognizes that the total employee compensation (including stock options provided by Taxpayer and Companies A, B, C, and D) provides a reliable basis for comparison. Because Companies A and B expense stock-based compensation for financial accounting purposes, whereas Companies C and D do not, an adjustment to the comparables' operating profit is necessary. In computing the net cost plus PLI, the Commissioner uses the financial-accounting data of Companies A and B, as

reported. The Commissioner increases the total services costs of Companies C and D by amounts equal to the fair value of their respective stock options, and reduces the operating profits of Companies C and D accordingly.

(v) The adjustments described in paragraph (iv) of this *Example 6* are depicted in the following table. For purposes of illustration, the unadjusted data of Companies A and B are also included.

	Salaries and other non-option compensation	Stock options fair value	Total services costs (A)	Operating profit (B)	Net cost plus PLI (B/A) (percent)
Per financial statements:					
Company A .....	7,000	2,000	27,000	4,000	14.80
Company B .....	4,300	250	12,750	2,250	17.65
As adjusted:					
Company C .....	12,000	4,500	40,500	6,500	16.05
Company D .....	15,000	2,000	29,000	5,000	17.24

(g) *Profit split method*—(1) *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 relative value of each controlled taxpayer's contribution is determined in a manner that reflects the functions performed, risks assumed and resources employed by such controlled taxpayer in the relevant business activity. For application of the profit split method (both the comparable profit split and the residual profit split), see § 1.482-6. The residual profit split method may not be used where only one

controlled taxpayer makes significant nonroutine contributions.

(2) *Examples.* The principles of this paragraph (g) are illustrated by the following examples:

*Example 1. Residual profit split.* (i) Company A, a corporation resident in Country X, auctions spare parts by means of an interactive database. Company A maintains a database that lists all spare parts available for auction. Company A developed the software used to run the database. Company A's database is managed by Company A employees in a data center located in Country X, where storage and manipulation of data also take place. Company A has a wholly-owned subsidiary, Company B, located in Country Y. Company B performs marketing and advertising activities to promote Company A's interactive database. Company B solicits unrelated companies to auction spare parts

on Company A's database, and solicits customers interested in purchasing spare parts online. Company B owns and maintains a computer server in Country Y, where it receives information on spare parts available for auction. Company B has also designed a specialized communications network that connects its data center to Company A's data center in Country X. The communications network allows Company B to enter data from uncontrolled companies on Company A's database located in Country X. Company B's communications network also allows uncontrolled companies to access Company A's interactive database and purchase spare parts. Company B bore the risks and cost of developing this specialized communications network. Company B enters into contracts with uncontrolled companies and provides the companies access to Company A's database through the Company B network.

(ii) Analysis of the facts and circumstances indicates that both Company A and Company

B possess valuable intangible property that they use to conduct the spare parts auction business. Company A bore the economic risks of developing and maintaining software and the interactive database. Company B bore the economic risks of developing the necessary technology to transmit information from its server to Company A's data center, and to allow uncontrolled companies to access Company A's database. Company B helped to enhance the value of Company A's trademark and to establish a network of customers in Country Y. In addition, there are no market comparables for the transactions between Company A and Company B to reliably evaluate them separately. Given the facts and circumstances, the Commissioner determines that a residual profit split method will provide the most reliable measure of an arm's length result.

(iii) Under the residual profit split method, profits are first allocated based on the routine contributions of each taxpayer. Routine contributions include general sales, marketing or administrative functions performed by Company B for Company A for which it is possible to identify market returns. Any residual profits will be allocated based on the nonroutine contributions of each taxpayer. Since both Company A and Company B provided nonroutine contributions, the residual profits are allocated based on these contributions.

*Example 2. Residual profit split.* (i) Company A, a Country 1 corporation, provides specialized services pertaining to the processing and storage of Level 1 hazardous waste (for purposes of this example, the most dangerous type of waste). Under long-term contracts with private companies and governmental entities in Country 1, Company A performs multiple services, including transportation of Level 1 waste, development of handling and storage protocols, recordkeeping, and supervision of waste-storage facilities owned and maintained by the contracting parties. Company A's research and development unit has also developed new and unique processes for transport and storage of Level 1 waste that minimize environmental and occupational effects. In addition to this novel technology, Company A has substantial know-how and a long-term record of safe operations in Country 1.

(ii) Company A's subsidiary, Company B, has been in operation continuously for a number of years in Country 2. Company B has successfully completed several projects in Country 2 involving Level 2 and Level 3 waste, including projects with government-owned entities. Company B has a license in Country 2 to handle Level 2 waste (Level 3 does not require a license). Company B has established a reputation for completing these projects in a responsible manner. Company B has cultivated contacts with procurement officers, regulatory and licensing officials, and other government personnel in Country 2.

(iii) Country 2 government publishes invitations to bid on a project to handle the country's burgeoning volume of Level 1 waste, all of which is generated in government-owned facilities. Bidding is

limited to companies that are domiciled in Country 2 and that possess a license from the government to handle Level 1 or Level 2 waste. In an effort to submit a winning bid to secure the contract, Company B points to its Level 2 license and its record of successful completion of projects, and also demonstrates to these officials that it has access to substantial technical expertise pertaining to processing of Level 1 waste.

(iv) Company A enters into a long-term technical services agreement with Company B. Under this agreement, Company A agrees to supply to Company B project managers and other technical staff who have detailed knowledge of Company A's proprietary Level 1 remediation techniques. Company A commits to perform under any long-term contracts entered into by Company B. Company B agrees to compensate Company A based on a markup on Company A's marginal costs (pro rata compensation and current expenses of Company A personnel). In the bid on the Country 2 contract for Level 1 waste remediation, Company B proposes to use a multi-disciplinary team of specialists from Company A and Company B. Project managers from Company A will direct the team, which will also include employees of Company B and will make use of physical assets and facilities owned by Company B. Only Company A and Company B personnel will perform services under the contract. Country 2 grants Company B a license to handle Level 1 waste.

(v) Country 2 grants Company B a five-year, exclusive contract to provide processing services for all Level 1 hazardous waste generated in Country 2. Under the contract, Company B is to be paid a fixed price per ton of Level 1 waste that it processes each year. Company B undertakes that all services provided will meet international standards applicable to processing of Level 1 waste. Company B begins performance under the contract.

(vi) Analysis of the facts and circumstances indicates that both Company A and Company B make nonroutine contributions to the Level 1 waste processing activity in Country 2. In addition, it is determined that reliable comparables are not available for the services that Company A provides under the long-term contract, in part because those services incorporate specialized knowledge and process intangible property developed by Company A. It is also determined that reliable comparables are not available for the Level 2 license in Country 2, the successful track record, the government contacts with Country 2 officials, and other intangible property that Company B provided. In view of these facts, the Commissioner determines that the residual profit split method for services in paragraph (g) of this section provides the most reliable means of evaluating the arm's length results for the transaction. In evaluating the appropriate returns to Company A and Company B for their respective contributions, the Commissioner takes into account that the controlled parties incur different risks, because the contract between the controlled parties provides that Company A will be compensated on the basis of marginal costs incurred, plus a markup, whereas the

contract between Company B and the government of Country 2 provides that Company B will be compensated on a fixed-price basis per ton of Level 1 waste processed.

(vii) In the first stage of the residual profit split, an arm's length return is determined for routine activities performed by Company B in Country 2, such as transportation, recordkeeping, and administration. In addition, an arm's length return is determined for routine activities performed by Company A (administrative, human resources, etc.) in connection with providing personnel to Company B. After the arm's length return for these functions is determined, residual profits may be present. In the second stage of the residual profit split, any residual profit is allocated by reference to the relative value of the nonroutine contributions made by each taxpayer. Company A's nonroutine contributions include its commitment to perform under the contract and the specialized technical knowledge made available through the project managers under the services agreement with Company B. Company B's nonroutine contributions include its licenses to handle Level 1 and Level 2 waste in Country 2, its knowledge of and contacts with procurement, regulatory and licensing officials in the government of Country 2, and its record in Country 2 of successfully handling non-Level 1 waste.

(h) *Unspecified methods.* Methods not specified in paragraphs (b) through (g) of this section may be used to evaluate whether the amount charged in a controlled services transaction is arm's length. Any method used under this paragraph (h) must be applied in accordance with the provisions of § 1.482-1. Consistent with the specified methods, an unspecified method should take into account the general principle that uncontrolled taxpayers evaluate the terms of a transaction by considering the realistic alternatives to that transaction, including economically similar transactions structured as other than services transactions, and only enter into a particular transaction if none of the alternatives is preferable to it. For example, the comparable uncontrolled services price method compares a controlled services transaction to similar uncontrolled transactions to provide a direct estimate of the price to which the parties would have agreed had they resorted directly to a market alternative to the controlled services transaction. Therefore, in establishing whether a controlled services transaction achieved an arm's length result, an unspecified method should provide information on the prices or profits that the controlled taxpayer could have realized by choosing a realistic alternative to the controlled services transaction (for example, outsourcing a particular service function, rather than performing the

function itself). As with any method, an unspecified method will not be applied unless it provides the most reliable measure of an arm's length result under the principles of the best method rule. See § 1.482-1(c). Therefore, in accordance with § 1.482-1(d) (comparability), to the extent that an unspecified method relies on internal data rather than uncontrolled comparables, its reliability will be reduced. Similarly, the reliability of a method will be affected by the reliability of the data and assumptions used to apply the method, including any projections used.

*Example.* (i) Company T, a U.S. corporation, develops computer software programs including a real estate investment program that performs financial analysis of commercial real properties. Companies U, V, and W are owned by Company T. The primary business activity of Companies U, V, and W is commercial real estate development. For business reasons, Company T does not sell the computer program to its customers (on a compact disk or via download from Company T's server through the Internet). Instead, Company T maintains the software program on its own server and allows customers to access the program through the Internet by using a password. The transactions between Company T and Companies U, V, and W are structured as controlled services transactions whereby Companies U, V, and W obtain access via the Internet to Company T's software program for financial analysis. Each year, Company T provides a revised version of the computer program including the most recent data on the commercial real estate market, rendering the old version obsolete.

(ii) In evaluating whether the consideration paid by Companies U, V, and W to Company T was arm's length, the Commissioner may consider, subject to the best method rule of § 1.482-1(c), Company T's alternative of selling the computer program to Companies U, V, and W on a compact disk or via download through the Internet. The Commissioner determines that the controlled services transactions between Company T and Companies U, V, and W are comparable to the transfer of a similar software program on a compact disk or via download through the Internet between uncontrolled parties. Subject to adjustments being made for material differences between the controlled services transactions and the comparable uncontrolled transactions, the uncontrolled transfers of tangible property may be used to evaluate the arm's length results for the controlled services transactions between Company T and Companies U, V, and W.

(i) *Contingent-payment contractual terms for services—(1) Contingent-payment contractual terms recognized in general.* In the case of a contingent-payment arrangement, the arm's length result for the controlled services transaction generally would not require payment by the recipient to the renderer in the tax accounting period in which

the service is rendered if the specified contingency does not occur in that period. If the specified contingency occurs in a tax accounting period subsequent to the period in which the service is rendered, the arm's length result for the controlled services transaction generally would require payment by the recipient to the renderer on a basis that reflects the recipient's benefit from the services rendered and the risks borne by the renderer in performing the activities in the absence of a provision that unconditionally obligates the recipient to pay for the activities performed in the tax accounting period in which the service is rendered.

(2) *Contingent-payment arrangement.* For purposes of this paragraph (i), an arrangement will be treated as a contingent-payment arrangement if it meets all of the requirements in paragraph (i)(2)(i) of this section and is consistent with the economic substance and conduct requirement in paragraph (i)(2)(ii) of this section.

(i) *General requirements—(A) Written contract.* The arrangement is set forth in a written contract entered into prior to, or contemporaneous with, the start of the activity or group of activities constituting the controlled services transaction.

(B) *Specified contingency.* The contract states that payment for a controlled services transaction is contingent (in whole or in part) upon the happening of a future benefit (within the meaning of § 1.482-9(l)(3)) for the recipient directly related to the activity or group of activities. For purposes of the preceding sentence, whether the future benefit is directly related to the activity or group of activities is evaluated based on all the facts and circumstances.

(C) *Basis for payment.* The contract provides for payment on a basis that reflects the recipient's benefit from the services rendered and the risks borne by the renderer.

(ii) *Economic substance and conduct.* The arrangement, including the contingency and the basis for payment, is consistent with the economic substance of the controlled transaction and the conduct of the controlled parties. See § 1.482-1(d)(3)(ii)(B).

(3) *Commissioner's authority to impute contingent-payment terms.* Consistent with the authority in § 1.482-1(d)(3)(ii)(B), the Commissioner may impute contingent-payment contractual terms in a controlled services transaction if the economic substance of the transaction is consistent with the existence of such terms.

(4) *Evaluation of arm's length charge.* Whether the amount charged in a contingent-payment arrangement is arm's length will be evaluated in accordance with this section and other applicable regulations under section 482. In evaluating whether the amount charged in a contingent-payment arrangement for the manufacture, construction, or development of tangible or intangible property owned by the recipient is arm's length, the charge determined under the rules of §§ 1.482-3 and 1.482-4 for the transfer of similar property may be considered. See § 1.482-1(f)(2)(ii).

(5) *Examples.* The principles of this paragraph (i) are illustrated by the following examples:

*Example 1.* (i) Company X is a member of a controlled group that has operated in the pharmaceutical sector for many years. In year 1, Company X enters into a written services agreement with Company Y, another member of the controlled group, whereby Company X will perform certain research and development activities for Company Y. The parties enter into the agreement before Company X undertakes any of the research and development activities covered by the agreement. At the time the agreement is entered into, the possibility that any new products will be developed is highly uncertain and the possible market or markets for any products that may be developed are not known and cannot be estimated with any reliability. Under the agreement, Company Y will own any patent or other rights that result from the activities of Company X under the agreement and Company Y will make payments to Company X only if such activities result in commercial sales of one or more derivative products. In that event, Company Y will pay Company X, for a specified period, x% of Company Y's gross sales of each of such products. Payments are required with respect to each jurisdiction in which Company Y has sales of such a derivative product, beginning with the first year in which the sale of a product occurs in the jurisdiction and continuing for six additional years with respect to sales of that product in that jurisdiction.

(ii) As a result of research and development activities performed by Company X for Company Y in years 1 through 4, a compound is developed that may be more effective than existing medications in the treatment of certain conditions. Company Y registers the patent rights with respect to the compound in several jurisdictions in year 4. In year 6, Company Y begins commercial sales of the product in Jurisdiction A and, in that year, Company Y makes the payment to Company X that is required under the agreement. Sales of the product continue in Jurisdiction A in years 7 through 9 and Company Y makes the payments to Company X in years 7 through 9 that are required under the agreement.

(iii) The years under examination are years 6 through 9. In evaluating whether the contingent-payment terms will be recognized, the Commissioner considers

whether the conditions of paragraph (i)(2) of this section are met and whether the arrangement, including the specified contingency and basis of payment, is consistent with the economic substance of the controlled services transaction and with the conduct of the controlled parties. The Commissioner determines that the contingent-payment arrangement is reflected in the written agreement between Company X and Company Y; that commercial sales of products developed under the arrangement represent future benefits for Company Y directly related to the controlled services transaction; and that the basis for the payment provided for in the event such sales occur reflects the recipient's benefit and the renderer's risk. Consistent with § 1.482-1(d)(3)(ii)(B) and (iii)(B), the Commissioner determines that the parties' conduct over the term of the agreement has been consistent with their contractual allocation of risk; that Company X has the financial capacity to bear the risk that its research and development services may be unsuccessful and that it may not receive compensation for such services; and that Company X exercises managerial and operational control over the research and development, such that it is reasonable for Company X to assume the risk of those activities. Based on all these facts, the Commissioner determines that the contingent-payment arrangement is consistent with economic substance.

(iv) In determining whether the amount charged under the contingent-payment arrangement in each of years 6 through 9 is arm's length, the Commissioner evaluates under this section and other applicable rules under section 482 the compensation paid in each year for the research and development services. This analysis takes into account that under the contingent-payment terms Company X bears the risk that it might not receive payment for its services in the event that those services do not result in marketable products and the risk that the magnitude of its payment depends on the magnitude of product sales, if any. The Commissioner also considers the alternatives reasonably available to the parties in connection with the controlled services transaction. One such alternative, in view of Company X's willingness and ability to bear the risk and expenses of research and development activities, would be for Company X to undertake such activities on its own behalf and to license the rights to products successfully developed as a result of such activities. Accordingly, in evaluating whether the compensation of x% of gross sales that is paid to Company X during the first four years of commercial sales of derivative products is arm's length, the Commissioner may consider the royalties (or other consideration) charged for intangible property that are comparable to those incorporated in the derivative products and that resulted from Company X's research and development activities under the contingent-payment arrangement.

*Example 2.* (i) The facts are the same as in *Example 1*, except that no commercial sales ever materialize with regard to the patented compound so that, consistent with the agreement, Company Y makes no payments to Company X in years 6 through 9.

(ii) Based on all the facts and circumstances, the Commissioner determines that the contingent-payment arrangement is consistent with economic substance, and the result (no payments in years 6 through 9) is consistent with an arm's length result.

*Example 3.* (i) The facts are the same as in *Example 1*, except that, in the event that Company X's activities result in commercial sales of one or more derivative products by Company Y, Company Y will pay Company X a fee equal to the research and development costs borne by Company X plus an amount equal to x% of such costs, with the payment to be made in the first year in which any such sales occur. The x% markup on costs is within the range, ascertainable in year 1, of markups on costs of independent contract researchers that are compensated under terms that unconditionally obligate the recipient to pay for the activities performed in the tax accounting period in which the service is rendered. In year 6, Company Y makes the single payment to Company X that is required under the arrangement.

(ii) The years under examination are years 6 through 9. In evaluating whether the contingent-payment terms will be recognized, the Commissioner considers whether the requirements of paragraph (i)(2) of this section were met at the time the written agreement was entered into and whether the arrangement, including the specified contingency and basis for payment, is consistent with the economic substance of the controlled services transaction and with the conduct of the controlled parties. The Commissioner determines that the contingent-payment terms are reflected in the written agreement between Company X and Company Y and that commercial sales of products developed under the arrangement represent future benefits for Company Y directly related to the controlled services transaction. However, in this case, the Commissioner determines that the basis for payment provided for in the event such sales occur (costs of the services plus x%, representing the markup for contract research in the absence of any nonpayment risk) does not reflect the recipient's benefit and the renderer's risks in the controlled services transaction. Based on all the facts and circumstances, the Commissioner determines that the contingent-payment arrangement is not consistent with economic substance.

(iii) Accordingly, the Commissioner determines to exercise its authority to impute contingent-payment contractual terms that accord with economic substance, pursuant to paragraph (i)(3) of this section and § 1.482-1(d)(3)(ii)(B). In this regard, the Commissioner takes into account that at the time the arrangement was entered into, the possibility that any new products would be developed was highly uncertain and the possible market or markets for any products that may be developed were not known and could not be estimated with any reliability. In such circumstances, it is reasonable to conclude that one possible basis of payment, in order to reflect the recipient's benefit and the renderer's risks, would be a charge equal to a percentage of commercial sales of one or more derivative products that result from the research and development activities. The

Commissioner in this case may impute terms that require Company Y to pay Company X a percentage of sales of the products developed under the agreement in each of years 6 through 9.

(iv) In determining an appropriate arm's length charge under such imputed contractual terms, the Commissioner conducts an analysis under this section and other applicable rules under section 482, and considers the alternatives reasonably available to the parties in connection with the controlled services transaction. One such alternative, in view of Company X's willingness and ability to bear the risks and expenses of research and development activities, would be for Company X to undertake such activities on its own behalf and to license the rights to products successfully developed as a result of such activities. Accordingly, for purposes of its determination, the Commissioner may consider the royalties (or other consideration) charged for intangible property that are comparable to those incorporated in the derivative products that resulted from Company X's research and development activities under the contingent-payment arrangement.

(j) *Total services costs.* For purposes of this section, total services costs means all costs of rendering those services for which total services costs are being determined. Total services costs include all costs in cash or in kind (including stock-based compensation) that, based on analysis of the facts and circumstances, are directly identified with, or reasonably allocated in accordance with the principles of paragraph (k)(2) of this section to, the services. In general, costs for this purpose should comprise provision for all resources expended, used, or made available to achieve the specific objective for which the service is rendered. Reference to generally accepted accounting principles or Federal income tax accounting rules may provide a useful starting point but will not necessarily be conclusive regarding inclusion of costs in total services costs. Total services costs do not include interest expense, foreign income taxes (as defined in § 1.901-2(a)), or domestic income taxes.

(k) *Allocation of costs—(1) In general.* In any case where the renderer's activity that results in a benefit (within the meaning of paragraph (l)(3) of this section) for one recipient in a controlled services transaction also generates a benefit for one or more other members of a controlled group (including the benefit, if any, to the renderer), and the amount charged under this section in the controlled services transaction is determined under a method that makes reference to costs, costs must be allocated among the portions of the activity performed for the benefit of the

first mentioned recipient and such other members of the controlled group under this paragraph (k). The principles of this paragraph (k) must also be used whenever it is appropriate to allocate and apportion any class of costs (for example, overhead costs) in order to determine the total services costs of rendering the services. In no event will an allocation of costs based on a generalized or non-specific benefit be appropriate.

(2) *Appropriate method of allocation and apportionment*—(i) *Reasonable method standard.* Any reasonable method may be used to allocate and apportion costs under this section. In establishing the appropriate method of allocation and apportionment, consideration should be given to all bases and factors, including, for example, total services costs, total costs for a relevant activity, assets, sales, compensation, space utilized, and time spent. The costs incurred by supporting departments may be apportioned to other departments on the basis of reasonable overall estimates, or such costs may be reflected in the other departments' costs by applying reasonable departmental overhead rates. Allocations and apportionments of costs must be made on the basis of the full cost, as opposed to the incremental cost.

(ii) *Use of general practices.* The practices used by the taxpayer to apportion costs in connection with

preparation of statements and analyses for the use of management, creditors, minority shareholders, joint venturers, clients, customers, potential investors, or other parties or agencies in interest will be considered as potential indicators of reliable allocation methods, but need not be accorded conclusive weight by the Commissioner. In determining the extent to which allocations are to be made to or from foreign members of a controlled group, practices employed by the domestic members in apportioning costs among themselves will also be considered if the relationships with the foreign members are comparable to the relationships among the domestic members of the controlled group. For example, if for purposes of reporting to public stockholders or to a governmental agency, a corporation apportions the costs attributable to its executive officers among the domestic members of a controlled group on a reasonable and consistent basis, and such officers exercise comparable control over foreign members of the controlled group, such domestic apportionment practice will be considered in determining the allocations to be made to the foreign members.

(3) *Examples.* The principles of this paragraph (k) are illustrated by the following examples:

*Example 1.* Company A pays an annual license fee of 500x to an uncontrolled

taxpayer for unlimited use of a database within the corporate group. Under the terms of the license with the uncontrolled taxpayer, Company A is permitted to use the database for its own use and in rendering research services to its subsidiary, Company B. Company B obtains benefits from the database that are similar to those that it would obtain if it had independently licensed the database from the uncontrolled taxpayer. Evaluation of the arm's length charge (under a method in which costs are relevant) to Company B for the controlled services that incorporate use of the database must take into account the full amount of the license fee of 500x paid by Company A, as reasonably allocated and apportioned to the relevant benefits, although the incremental use of the database for the benefit of Company B did not result in an increase in the license fee paid by Company A.

*Example 2.* (i) Company A is a consumer products company located in the United States. Companies B and C are wholly-owned subsidiaries of Company A and are located in Countries B and C, respectively. Company A and its subsidiaries manufacture products for sale in their respective markets. Company A hires a consultant who has expertise regarding a manufacturing process used by Company A and its subsidiary, Company B. Company C, the Country C subsidiary, uses a different manufacturing process, and accordingly will not receive any benefit from the outside consultant hired by Company A. In allocating and apportioning the cost of hiring the outside consultant (100), Company A determines that sales constitute the most appropriate allocation key.

(ii) Company A and its subsidiaries have the following sales:

Company	A	B	C	Total
Sales .....	400	100	200	700

(iii) Because Company C does not obtain any benefit from the consultant, none of the costs are allocated to it. Rather, the costs of

100 are allocated and apportioned ratably to Company A and Company B as the entities that obtain a benefit from the campaign,

based on the total sales of those entities (500). An appropriate allocation of the costs of the consultant is as follows:

Company	A	B	Total
Allocation .....	400/500	100/500	100
Amount .....	80	20	

(1) *Controlled services transaction*—(1) *In general.* A controlled services transaction includes any activity (as defined in paragraph (1)(2) of this section) by one member of a group of controlled taxpayers (the renderer) that results in a benefit (as defined in paragraph (1)(3) of this section) to one or more other members of the controlled group (the recipient(s)).

(2) *Activity.* An activity includes the performance of functions, assumptions of risks, or use by a renderer of tangible or intangible property or other

resources, capabilities, or knowledge, such as knowledge of and ability to take advantage of particularly advantageous situations or circumstances. An activity also includes making available to the recipient any property or other resources of the renderer.

(3) *Benefit*—(i) *In general.* An activity is considered to provide a benefit to the recipient if the activity directly results in a reasonably identifiable increment of economic or commercial value that enhances the recipient's commercial position, or that may reasonably be

anticipated to do so. An activity is generally considered to confer a benefit if, taking into account the facts and circumstances, an uncontrolled taxpayer in circumstances comparable to those of the recipient would be willing to pay an uncontrolled party to perform the same or similar activity on either a fixed or contingent-payment basis, or if the recipient otherwise would have performed for itself the same activity or a similar activity. A benefit may result to the owner of intangible property if the renderer engages in an activity that

is reasonably anticipated to result in an increase in the value of that intangible property. Paragraphs (l)(3)(ii) through (v) of this section provide guidelines that indicate the presence or absence of a benefit for the activities in the controlled services transaction.

(ii) *Indirect or remote benefit.* An activity is not considered to provide a benefit to the recipient if, at the time the activity is performed, the present or reasonably anticipated benefit from that activity is so indirect or remote that the recipient would not be willing to pay, on either a fixed or contingent-payment basis, an uncontrolled party to perform a similar activity, and would not be willing to perform such activity for itself for this purpose. The determination whether the benefit from an activity is indirect or remote is based on the nature of the activity and the situation of the recipient, taking into consideration all facts and circumstances.

(iii) *Duplicative activities.* If an activity performed by a controlled taxpayer duplicates an activity that is performed, or that reasonably may be anticipated to be performed, by another controlled taxpayer on or for its own account, the activity is generally not considered to provide a benefit to the recipient, unless the duplicative activity itself provides an additional benefit to the recipient.

(iv) *Shareholder activities.* An activity is not considered to provide a benefit if the sole effect of that activity is either to protect the renderer's capital investment in the recipient or in other members of the controlled group, or to facilitate compliance by the renderer with reporting, legal, or regulatory requirements applicable specifically to the renderer, or both. Activities in the nature of day-to-day management generally do not relate to protection of the renderer's capital investment. Based on analysis of the facts and circumstances, activities in connection with a corporate reorganization may be considered to provide a benefit to one or more controlled taxpayers.

(v) *Passive association.* A controlled taxpayer generally will not be considered to obtain a benefit where that benefit results from the controlled taxpayer's status as a member of a controlled group. A controlled taxpayer's status as a member of a controlled group may, however, be taken into account for purposes of evaluating comparability between controlled and uncontrolled transactions.

(4) *Disaggregation of transactions.* A controlled services transaction may be analyzed as two separate transactions for purposes of determining the arm's

length consideration, if that analysis is the most reliable means of determining the arm's length consideration for the controlled services transaction. See the best method rule under § 1.482-1(c).

(5) *Examples.* The principles of this paragraph (l) are illustrated by the following examples. In each example, assume that Company X is a U.S. corporation and Company Y is a wholly-owned subsidiary of Company X in Country B.

*Example 1. In general.* In developing a worldwide advertising and promotional campaign for a consumer product, Company X pays for and obtains designation as an official sponsor of the Olympics. This designation allows Company X and all its subsidiaries, including Company Y, to identify themselves as sponsors and to use the Olympic logo in advertising and promotional campaigns. The Olympic sponsorship campaign generates benefits to Company X, Company Y, and other subsidiaries of Company X.

*Example 2. Indirect or remote benefit.* Based on recommendations contained in a study performed by its internal staff, Company X implements certain changes in its management structure and the compensation of managers of divisions located in the United States. No changes were recommended or considered for Company Y in Country B. The internal study and the resultant changes in its management may increase the competitiveness and overall efficiency of Company X. Any benefits to Company Y as a result of the study are, however, indirect or remote. Consequently, Company Y is not considered to obtain a benefit from the study.

*Example 3. Indirect or remote benefit.* Based on recommendations contained in a study performed by its internal staff, Company X decides to make changes to the management structure and management compensation of its subsidiaries, in order to increase their profitability. As a result of the recommendations in the study, Company X implements substantial changes in the management structure and management compensation scheme of Company Y. The study and the changes implemented as a result of the recommendations are anticipated to increase the profitability of Company X and its subsidiaries. The increased management efficiency of Company Y that results from these changes is considered to be a specific and identifiable benefit, rather than remote or speculative.

*Example 4. Duplicative activities.* At its corporate headquarters in the United States, Company X performs certain treasury functions for Company X and for its subsidiaries, including Company Y. These treasury functions include raising capital, arranging medium and long-term financing for general corporate needs, including cash management. Under these circumstances, the treasury functions performed by Company X do not duplicate the functions performed by Company Y's staff. Accordingly, Company Y is considered to obtain a benefit from the functions performed by Company X.

*Example 5. Duplicative activities.* The facts are the same as in *Example 4*, except that Company Y's functions include ensuring that the financing requirements of its own operations are met. Analysis of the facts and circumstances indicates that Company Y independently administers all financing and cash-management functions necessary to support its operations, and does not utilize financing obtained by Company X. Under the circumstances, the treasury functions performed by Company X are duplicative of similar functions performed by Company Y's staff, and the duplicative functions do not enhance Company Y's position. Accordingly, Company Y is not considered to obtain a benefit from the duplicative activities performed by Company X.

*Example 6. Duplicative activities.* Company X's in-house legal staff has specialized expertise in several areas, including intellectual property. The intellectual property legal staff specializes in technology licensing, patents, copyrights, and negotiating and drafting intellectual property agreements. Company Y is involved in negotiations with an unrelated party to enter into a complex joint venture that includes multiple licenses and cross-licenses of patents and copyrights. Company Y retains outside counsel that specializes in intellectual property law to review the transaction documents. Company Y does not have in-house counsel of its own to review intellectual property transaction documents. Outside counsel advises that the terms for the proposed transaction are advantageous to Company Y and that the contracts are valid and fully enforceable. Company X's intellectual property legal staff possess valuable knowledge of Company Y's patents and technological achievements. They are capable of identifying particular scientific attributes protected under patent that strengthen Company Y's negotiating position, and of discovering flaws in the patents offered by the unrelated party. To reduce risk associated with the transaction, Company X's intellectual property legal staff reviews the transaction documents before Company Y executes the contracts. Company X's intellectual property legal staff also separately evaluates the patents and copyrights with respect to the licensing arrangements and concurs in the opinion provided by outside counsel. The activities performed by Company X substantially duplicate the legal services obtained by Company Y, but they also reduce risk associated with the transaction in a way that confers an additional benefit on Company Y.

*Example 7. Shareholder activities.* Company X is a publicly held corporation. U.S. laws and regulations applicable to publicly held corporations such as Company X require the preparation and filing of periodic reports that show, among other things, profit and loss statements, balance sheets, and other material financial information concerning the company's operations. Company X, Company Y and each of the other subsidiaries maintain their own separate accounting departments that record individual transactions and prepare financial statements in accordance with their local accounting practices. Company Y, and

the other subsidiaries, forward the results of their financial performance to Company X, which analyzes and compiles these data into periodic reports in accordance with U.S. laws and regulations. Because Company X's preparation and filing of the reports relate solely to its role as an investor of capital or shareholder in Company Y or to its compliance with reporting, legal, or regulatory requirements, or both, these activities constitute shareholder activities and therefore Company Y is not considered to obtain a benefit from the preparation and filing of the reports.

**Example 8. Shareholder activities.** The facts are the same as in *Example 7*, except that Company Y's accounting department maintains a general ledger recording individual transactions, but does not prepare any financial statements (such as profit and loss statements and balance sheets). Instead, Company Y forwards the general ledger data to Company X, and Company X analyzes and compiles financial statements for Company Y, as well as for Company X's overall operations, for purposes of complying with U.S. reporting requirements. Company Y is subject to reporting requirements in Country B similar to those applicable to Company X in the United States. Much of the data that Company X analyzes and compiles regarding Company Y's operations for purposes of complying with the U.S. reporting requirements are made available to Company Y for its use in preparing reports that must be filed in Country B. Company Y incorporates these data, after minor adjustments for differences in local accounting practices, into the reports that it files in Country B. Under these circumstances, because Company X's analysis and compilation of Company Y's financial data does not relate solely to its role as an investor of capital or shareholder in Company Y, or to its compliance with reporting, legal, or regulatory requirements, or both, these activities do not constitute shareholder activities.

**Example 9. Shareholder activities.** Members of Company X's internal audit staff visit Company Y on a semiannual basis in order to review the subsidiary's adherence to internal operating procedures issued by Company X and its compliance with U.S. anti-bribery laws, which apply to Company Y on account of its ownership by a U.S. corporation. Because the sole effect of the reviews by Company X's audit staff is to protect Company X's investment in Company Y, or to facilitate Company X's compliance with U.S. anti-bribery laws, or both, the visits are shareholder activities and therefore Company Y is not considered to obtain a benefit from the visits.

**Example 10. Shareholder activities.** Country B recently enacted legislation that changed the foreign currency exchange controls applicable to foreign shareholders of Country B corporations. Company X concludes that it may benefit from changing the capital structure of Company Y, thus taking advantage of the new foreign currency exchange control laws in Country B. Company X engages an investment banking firm and a law firm to review the Country B legislation and to propose possible changes

to the capital structure of Company Y. Because Company X's retention of the firms facilitates Company Y's ability to pay dividends and other amounts and has the sole effect of protecting Company X's investment in Company Y, these activities constitute shareholder activities and Company Y is not considered to obtain a benefit from the activities.

**Example 11. Shareholder activities.** The facts are the same as in *Example 10*, except that Company Y bears the full cost of retaining the firms to evaluate the new foreign currency control laws in Country B and to make appropriate changes to its stock ownership by Company X. Company X is considered to obtain a benefit from the rendering by Company Y of these activities, which would be shareholder activities if conducted by Company X (see *Example 10*).

**Example 12. Shareholder activities.** The facts are the same as in *Example 10*, except that the new laws relate solely to corporate governance in Country B, and Company X retains the law firm and investment banking firm in order to evaluate whether restructuring would increase Company Y's profitability, reduce the number of legal entities in Country B, and increase Company Y's ability to introduce new products more quickly in Country B. Because Company X retained the law firm and the investment banking firm primarily to enhance Company Y's profitability and the efficiency of its operations, and not solely to protect Company X's investment in Company Y or to facilitate Company X's compliance with Country B's corporate laws, or to both, these activities do not constitute shareholder activities.

**Example 13. Shareholder activities.** Company X establishes detailed personnel policies for its subsidiaries, including Company Y. Company X also reviews and approves the performance appraisals of Company Y's executives, monitors levels of compensation paid to all Company Y personnel, and is involved in hiring and firing decisions regarding the senior executives of Company Y. Because this personnel-related activity by Company X involves day-to-day management of Company Y, this activity does not relate solely to Company X's role as an investor of capital or a shareholder of Company Y, and therefore does not constitute a shareholder activity.

**Example 14. Shareholder activities.** Each year, Company X conducts a two-day retreat for its senior executives. The purpose of the retreat is to refine the long-term business strategy of Company X and its subsidiaries, including Company Y, and to produce a confidential strategy statement. The strategy statement identifies several potential growth initiatives for Company X and its subsidiaries and lists general means of increasing the profitability of the company as a whole. The strategy statement is made available without charge to Company Y and the other subsidiaries of Company X. Company Y independently evaluates whether to implement some, all, or none of the initiatives contained in the strategy statement. Because the preparation of the strategy statement does not relate solely to Company X's role as an investor of capital or

a shareholder of Company Y, the expense of preparing the document is not a shareholder expense.

**Example 15. Passive association/benefit.** Company X is the parent corporation of a large controlled group that has been in operation in the information-technology sector for ten years. Company Y is a small corporation that was recently acquired by the Company X controlled group from local Country B owners. Several months after the acquisition of Company Y, Company Y obtained a contract to redesign and assemble the information-technology networks and systems of a large financial institution in Country B. The project was significantly larger and more complex than any other project undertaken to date by Company Y. Company Y did not use Company X's marketing intangible property to solicit the contract, and Company X had no involvement in the solicitation, negotiation, or anticipated execution of the contract. For purposes of this section, Company Y is not considered to obtain a benefit from Company X or any other member of the controlled group because the ability of Company Y to obtain the contract, or to obtain the contract on more favorable terms than would have been possible prior to its acquisition by the Company X controlled group, was due to Company Y's status as a member of the Company X controlled group and not to any specific activity by Company X or any other member of the controlled group.

**Example 16. Passive association/benefit.** The facts are the same as in *Example 15*, except that Company X executes a performance guarantee with respect to the contract, agreeing to assist in the project if Company Y fails to meet certain milestones. This performance guarantee allowed Company Y to obtain the contract on materially more favorable terms than otherwise would have been possible. Company Y is considered to obtain a benefit from Company X's execution of the performance guarantee.

**Example 17. Passive association/benefit.** The facts are the same as in *Example 15*, except that Company X began the process of negotiating the contract with the financial institution in Country B before acquiring Company Y. Once Company Y was acquired by Company X, the contract with the financial institution was entered into by Company Y. Company Y is considered to obtain a benefit from Company X's negotiation of the contract.

**Example 18. Passive association/benefit.** The facts are the same as in *Example 15*, except that Company X sent a letter to the financial institution in Country B, which represented that Company X had a certain percentage ownership in Company Y and that Company X would maintain that same percentage ownership interest in Company Y until the contract was completed. This letter allowed Company Y to obtain the contract on more favorable terms than otherwise would have been possible. Since this letter from Company X to the financial institution simply affirmed Company Y's status as a member of the controlled group and represented that this status would be maintained until the contract was completed,

Company Y is not considered to obtain a benefit from Company X's furnishing of the letter.

*Example 19. Passive association/benefit.* (i) S is a company that supplies plastic containers to companies in various industries. S establishes the prices for its containers through a price list that offers customers discounts based solely on the volume of containers purchased.

(ii) Company X is the parent corporation of a large controlled group in the information technology sector. Company Y is a wholly-owned subsidiary of Company X located in Country B. Company X and Company Y both purchase plastic containers from unrelated supplier S. In year 1, Company X purchases 1 million units and Company Y purchases 100,000 units. S, basing its prices on purchases by the entire group, completes the order for 1.1 million units at a price of \$0.95 per unit, and separately bills and ships the orders to each company. Companies X and Y undertake no bargaining with supplier S with respect to the price charged, and purchase no other products from supplier S.

(iii) R1 and its wholly-owned subsidiary R2 are a controlled group of taxpayers (unrelated to Company X or Company Y) each of which carries out functions comparable to those of Companies X and Y and undertakes purchases of plastic containers from supplier S, identical to those purchased from S by Company X and Company Y, respectively. S, basing its prices on purchases by the entire group, charges R1 and R2 \$0.95 per unit for the 1.1 million units ordered. R1 and R2 undertake no bargaining with supplier S with respect to the price charged, and purchase no other products from supplier S.

(iv) U is an uncontrolled taxpayer that carries out comparable functions and undertakes purchases of plastic containers from supplier S identical to Company Y. U is not a member of a controlled group, undertakes no bargaining with supplier S with respect to the price charged, and purchases no other products from supplier S. U purchases 100,000 plastic containers from S at the price of \$1.00 per unit.

(v) Company X charges Company Y a fee of \$5,000, or \$0.05 per unit of plastic containers purchased by Company Y, reflecting the fact that Company Y receives the volume discount from supplier S.

(vi) In evaluating the fee charged by Company X to Company Y, the Commissioner considers whether the transactions between R1, R2, and S or the transactions between U and S provide a more reliable measure of the transactions between Company X, Company Y and S. The Commissioner determines that Company Y's status as a member of a controlled group should be taken into account for purposes of evaluating comparability of the transactions, and concludes that the transactions between R1, R2, and S are more reliably comparable to the transactions between Company X, Company Y, and S. The comparable charge for the purchase was \$0.95 per unit. Therefore, obtaining the plastic containers at a favorable rate (and the resulting \$5,000 savings) is entirely due to Company Y's status as a member of the Company X

controlled group and not to any specific activity by Company X or any other member of the controlled group. Consequently, Company Y is not considered to obtain a benefit from Company X or any other member of the controlled group.

*Example 20. Disaggregation of transactions.* (i) X, a domestic corporation, is a pharmaceutical company that develops and manufactures ethical pharmaceutical products. Y, a Country B corporation, is a distribution and marketing company that also performs clinical trials for X in Country B. Because Y does not possess the capability to conduct the trials, it contracts with a third party to undertake the trials at a cost of \$100. Y also incurs \$25 in expenses related to the third-party contract (for example, in hiring and working with the third party).

(ii) Based on a detailed functional analysis, the Commissioner determines that Y performed functions beyond merely facilitating the clinical trials for X, such as audit controls of the third party performing those trials. In determining the arm's length price, the Commissioner may consider a number of alternatives. For example, for purposes of determining the arm's length price, the Commissioner may determine that the intercompany service is most reliably analyzed on a disaggregated basis as two separate transactions: in this case, the contract between Y and the third party could constitute an internal CUSP with a price of \$100. Y would be further entitled to an arm's length remuneration for its facilitating services. If the most reliable method is one that provides a markup on Y's costs, then "total services cost" in this context would be \$25. Alternatively, the Commissioner may determine that the intercompany service is most reliably analyzed as a single transaction, based on comparable uncontrolled transactions involving the facilitation of similar clinical trial services performed by third parties. If the most reliable method is one that provides a markup on all of Y's costs, and the base of the markup determined by the comparable companies includes the third-party clinical trial costs, then such a markup would be applied to Y's total services cost of \$125.

*Example 21. Disaggregation of transactions.* (i) X performs a number of administrative functions for its subsidiaries, including Y, a distributor of widgets in Country B. These services include those relating to working capital (inventory and accounts receivable/payable) management. To facilitate provision of these services, X purchases an ERP system specifically dedicated to optimizing working capital management. The system, which entails significant third-party costs and which includes substantial intellectual property relating to its software, costs \$1,000.

(ii) Based on a detailed functional analysis, the Commissioner determines that in providing administrative services for Y, X performed functions beyond merely operating the ERP system itself, since X was effectively using the ERP as an input to the administrative services it was providing to Y. In determining arm's length price for the services, the Commissioner may consider a number of alternatives. For example, if the

most reliable uncontrolled data is derived from companies that use similar ERP systems purchased from third parties to perform similar administrative functions for uncontrolled parties, the Commissioner may determine that a CPM is the best method for measuring the functions performed by X, and, in addition, that a markup on total services costs, based on the markup from the comparable companies, is the most reliable PLI. In this case, total services cost, and the basis for the markup, would include appropriate reflection of the ERP costs of \$1,000. Alternatively, X's functions may be most reliably measured based on comparable uncontrolled companies that perform similar administrative functions using their customers' own ERP systems. Under these circumstances, the total services cost would equal X's costs of providing the administrative services excluding the ERP cost of \$1,000.

(m) *Coordination with transfer pricing rules for other transactions—(1) Services transactions that include other types of transactions.* A transaction structured as a controlled services transaction may include other elements for which a separate category or categories of methods are provided, such as a loan or advance, a rental, or a transfer of tangible or intangible property. See §§ 1.482-1(b)(2) and 1.482-2(a), (c), and (d). Whether such an integrated transaction is evaluated as a controlled services transaction under this section or whether one or more elements should be evaluated separately under other sections of the section 482 regulations depends on which approach will provide the most reliable measure of an arm's length result. Ordinarily, an integrated transaction of this type may be evaluated under this section and its separate elements need not be evaluated separately, provided that each component of the transaction may be adequately accounted for in evaluating the comparability of the controlled transaction to the uncontrolled comparables and, accordingly, in determining the arm's length result in the controlled transaction. See § 1.482-1(d)(3).

(2) *Services transactions that effect a transfer of intangible property.* A transaction structured as a controlled services transaction may in certain cases include an element that constitutes the transfer of intangible property or may result in a transfer, in whole or in part, of intangible property. Notwithstanding paragraph (m)(1) of this section, if such element relating to intangible property is material to the evaluation, the arm's length result for the element of the transaction that involves intangible property must be corroborated or determined by an analysis under § 1.482-4.

(3) [Reserved]. For further guidance, see § 1.482-9T(m)(3).

(4) *Other types of transactions that include controlled services transactions.* A transaction structured other than as a controlled services transaction may include one or more elements for which separate pricing methods are provided in this section. Whether such an integrated transaction is evaluated under another section of the section 482 regulations or whether one or more elements should be evaluated separately under this section depends on which approach will provide the most reliable measure of an arm's length result. Ordinarily, a single method may be applied to such an integrated transaction, and the separate services component of the transaction need not be separately analyzed under this section, provided that the controlled services may be adequately accounted for in evaluating the comparability of the controlled transaction to the uncontrolled comparables and, accordingly, in determining the arm's length results in the controlled transaction. See § 1.482-1(d)(3).

(5) *Examples.* The principles of this paragraph (m) are illustrated by the following examples:

*Example 1.* (i) U.S. parent corporation Company X enters into an agreement to maintain equipment of Company Y, a foreign subsidiary. The maintenance of the equipment requires the use of spare parts. The cost of the spare parts necessary to maintain the equipment amounts to approximately 25 percent of the total costs of maintaining the equipment. Company Y pays a fee that includes a charge for labor and parts.

(ii) Whether this integrated transaction is evaluated as a controlled services transaction or is evaluated as a controlled services transaction and the transfer of tangible property depends on which approach will provide the most reliable measure of an arm's length result. If it is not possible to find comparable uncontrolled services transactions that involve similar services and tangible property transfers as the controlled transaction between Company X and Company Y, it will be necessary to determine the arm's length charge for the controlled services, and then to evaluate separately the arm's length charge for the tangible property transfers under § 1.482-1 and §§ 1.482-3 through 1.482-6. Alternatively, it may be possible to apply the comparable profits method of § 1.482-5 to evaluate the arm's length profit of Company X or Company Y from the integrated controlled transaction. The comparable profits method may provide the most reliable measure of an arm's length result if uncontrolled parties are identified that perform similar, combined functions of maintaining and providing spare parts for similar equipment.

*Example 2.* (i) U.S. parent corporation Company X sells industrial equipment to its

foreign subsidiary, Company Y. In connection with this sale, Company X renders to Company Y services that consist of demonstrating the use of the equipment and assisting in the effective start-up of the equipment. Company X structures the integrated transaction as a sale of tangible property and determines the transfer price under the comparable uncontrolled price method of § 1.482-3(b).

(ii) Whether this integrated transaction is evaluated as a transfer of tangible property or is evaluated as a controlled services transaction and a transfer of tangible property depends on which approach will provide the most reliable measure of an arm's length result. In this case, the controlled services may be similar to services rendered in the transactions used to determine the comparable uncontrolled price, or they may appropriately be considered a difference between the controlled transaction and comparable transactions with a definite and reasonably ascertainable effect on price for which appropriate adjustments can be made. See § 1.482-1(d)(3)(ii)(A)(6). In either case, application of the comparable uncontrolled price method to evaluate the integrated transaction may provide a reliable measure of an arm's length result, and application of a separate transfer pricing method for the controlled services element of the transaction is not necessary.

*Example 3.* (i) The facts are the same as in *Example 2* except that, after assisting Company Y in start-up, Company X also renders ongoing services, including instruction and supervision regarding Company Y's ongoing use of the equipment. Company X structures the entire transaction, including the incremental ongoing services, as a sale of tangible property, and determines the transfer price under the comparable uncontrolled price method of § 1.482-3(b).

(ii) Whether this integrated transaction is evaluated as a transfer of tangible property or is evaluated as a controlled services transaction and a transfer of tangible property depends on which approach will provide the most reliable measure of an arm's length result. It may not be possible to identify comparable uncontrolled transactions in which a seller of merchandise renders services similar to the ongoing services rendered by Company X to Company Y. In such a case, the incremental services in connection with ongoing use of the equipment could not be taken into account as a comparability factor because they are not similar to the services rendered in connection with sales of similar tangible property. Accordingly, it may be necessary to evaluate separately the transfer price for such services under this section in order to produce the most reliable measure of an arm's length result. Alternatively, it may be possible to apply the comparable profits method of § 1.482-5 to evaluate the arm's length profit of Company X or Company Y from the integrated controlled transaction. The comparable profits method may provide the most reliable measure of an arm's length result if uncontrolled parties are identified that perform the combined functions of selling equipment and rendering ongoing after-sale services associated with such

equipment. In that case, it would not be necessary to separately evaluate the transfer price for the controlled services under this section.

*Example 4.* (i) Company X, a U.S. corporation, and Company Y, a foreign corporation, are members of a controlled group. Both companies perform research and development activities relating to integrated circuits. In addition, Company Y manufactures integrated circuits. In years 1 through 3, Company X engages in substantial research and development activities, gains significant know-how regarding the development of a particular high-temperature resistant integrated circuit, and memorializes that research in a written report. In years 1 through 3, Company X generates overall net operating losses as a result of the expenditures associated with this research and development effort. At the beginning of year 4, Company X enters into a technical assistance agreement with Company Y. As part of this agreement, the researchers from Company X responsible for this project meet with the researchers from Company Y and provide them with a copy of the written report. Three months later, the researchers from Company Y apply for a patent for a high-temperature resistant integrated circuit based in large part upon the know-how obtained from the researchers from Company X.

(ii) The controlled services transaction between Company X and Company Y includes an element that constitutes the transfer of intangible property (such as, know-how). Because the element relating to the intangible property is material to the arm's length evaluation, the arm's length result for that element must be corroborated or determined by an analysis under § 1.482-4.

(6) *Global dealing operations.*

[Reserved].

(n) *Effective/applicability date—(1) In general.* This section is generally applicable for taxable years beginning after July 31, 2009. In addition, a person may elect to apply the provisions of this section to earlier taxable years. See paragraph (n)(2) of this section.

(2) *Election to apply regulations to earlier taxable years—(i) Scope of election.* A taxpayer may elect to apply § 1.482-1(a)(1), (b)(2)(i), (d)(3)(ii)(C) *Examples 3 through 6*, (d)(3)(v), (f)(2)(ii)(A), (f)(2)(iii)(B), (g)(4)(i), (g)(4)(iii) *Example 1*, (i), (j)(6)(i) and (j)(6)(ii), § 1.482-2(b), (f)(1) and (2), § 1.482-4(f)(3)(i)(A), (f)(3)(ii) *Examples 1 and 2*, (f)(4), (h)(1) and (2), § 1.482-6(c)(2)(ii)(B)(1), (c)(2)(ii)(D), (c)(3)(i)(A), (c)(3)(i)(B), (c)(3)(ii)(D), and (d), § 1.482-8(b) *Examples 10 through 12*, (c)(1) and (c)(2), § 1.482-9(a) through (m)(2), and (m)(4) through (n)(2), § 1.861-8(a)(5)(ii), (b)(3), (e)(4), (f)(4)(i), (g) *Examples 17, 18, and 30*, § 1.6038A-3(a)(3) *Example 4* and (i), § 1.6662-6(d)(2)(ii)(B), (d)(2)(iii)(B)(4), (d)(2)(iii)(B)(6), and (g), and § 31.3121(s)-1(c)(2)(iii) and (d) of this chapter to any taxable year

beginning after September 10, 2003. Such election requires that all of the provisions of such sections be applied to such taxable year and all subsequent taxable years (earlier taxable years) of the taxpayer making the election.

(ii) *Effect of election.* An election to apply the regulations to earlier taxable years has no effect on the limitations on assessment and collection or on the limitations on credit or refund (see Chapter 66 of the Internal Revenue Code).

(iii) *Time and manner of making election.* An election to apply the regulations to earlier taxable years must be made by attaching a statement to the taxpayer's timely filed U.S. tax return (including extensions) for its first taxable year beginning after July 31, 2009.

(iv) *Revocation of election.* An election to apply the regulations to earlier taxable years may not be revoked without the consent of the Commissioner.

■ **Par. 15.** Section 1.482-9T is amended by revising paragraphs (a), (b), (c), (d), (e), (f), (g), (h), (i), (j), (k), (l), (m)(1), (m)(2), (m)(4), (m)(5), and (n), and adding paragraph (o) to read as follows:

**§ 1.482-9T Methods to determine taxable income in connection with a controlled services transaction (temporary).**

(a) through (m)(2) [Reserved]. For further guidance, see § 1.482-9(a) through (m)(2).

(3) \* \* \*

(4) and (m)(5) [Reserved]. For further guidance, see § 1.482-9(m)(4) and (m)(5).

(n) *Effective/applicability date.* Paragraph (m)(3) of this section is generally applicable on January 5, 2009.

(o) *Expiration date.* The applicability of paragraph (m)(3) of this section expires on December 30, 2011.

■ **Par. 16.** Section 1.861-8 is amended by revising paragraphs (a)(5)(ii), (b)(3), (e)(4), (f)(4), (g) *Examples 17, 18 and 30*, and (h) to read as follows:

**§ 1.861-8 Computation of taxable income from sources within the United States and from other sources and activities.**

\* \* \* \* \*

(a) \* \* \*

(5) \* \* \*

(ii) Paragraph (e)(4), the last sentence of paragraph (f)(4)(i), and paragraph (g), *Examples 17, 18, and 30* of this section are generally applicable for taxable years beginning after July 31, 2009. In addition, a person may elect to apply the provisions of paragraph (e)(4) of this section to earlier years. Such election shall be made in accordance with the rules set forth in § 1.482-9(n)(2).

\* \* \* \* \*

(b) \* \* \*

(3) *Supportive functions.* Deductions which are supportive in nature (such as overhead, general and administrative, and supervisory expenses) may relate to other deductions which can more readily be allocated to gross income. In such instance, such supportive deductions may be allocated and apportioned along with the deductions to which they relate. On the other hand, it would be equally acceptable to attribute supportive deductions on some reasonable basis directly to activities or property which generate, have generated or could reasonably be expected to generate gross income. This would ordinarily be accomplished by allocating the supportive expenses to all gross income or to another broad class of gross income and apportioning the expenses in accordance with paragraph (c)(1) of this section. For this purpose, reasonable departmental overhead rates may be utilized. For examples of the application of the principles of this paragraph (b)(3) to expenses other than expenses attributable to stewardship activities, see *Examples 19* through *21* of paragraph (g) of this section. See paragraph (e)(4)(ii) of this section for the allocation and apportionment of deductions attributable to stewardship expenses. However, supportive deductions that are described in § 1.861-14T(e)(3) shall be allocated and apportioned in accordance with the rules of § 1.861-14T and shall not be allocated and apportioned by reference only to the gross income of a single member of an affiliated group of corporations as defined in § 1.861-14T(d).

\* \* \* \* \*

(e) \* \* \*

(4) *Stewardship and controlled services—(i) Expenses attributable to controlled services.* If a corporation performs a controlled services transaction (as defined in § 1.482-9(l)(3)), which includes any activity by one member of a group of controlled taxpayers that results in a benefit to a related corporation, and the rendering corporation charges the related corporation for such services, section 482 and these regulations provide for an allocation where the charge is not consistent with an arm's length result as determined. The deductions for expenses of the corporation attributable to the controlled services transaction are considered definitely related to the amounts so charged and are to be allocated to such amounts.

(ii) *Stewardship expenses attributable to dividends received.* Stewardship expenses, which result from

“overseeing” functions undertaken for a corporation's own benefit as an investor in a related corporation, shall be considered definitely related and allocable to dividends received, or to be received, from the related corporation. For purposes of this section, stewardship expenses of a corporation are those expenses resulting from “duplicative activities” (as defined in § 1.482-9(l)(3)(iii)) or “shareholder activities” (as defined in § 1.482-9(l)(3)(iv)) of the corporation with respect to the related corporation. Thus, for example, stewardship expenses include expenses of an activity the sole effect of which is either to protect the corporation's capital investment in the related corporation or to facilitate compliance by the corporation with reporting, legal, or regulatory requirements applicable specifically to the corporation, or both. If a corporation has a foreign or international department which exercises overseeing functions with respect to related foreign corporations and, in addition, the department performs other functions that generate other foreign-source income (such as fees for services rendered outside of the United States for the benefit of foreign related corporations, foreign-source royalties, and gross income of foreign branches), some part of the deductions with respect to that department are considered definitely related to the other foreign-source income. In some instances, the operations of a foreign or international department will also generate United States source income (such as fees for services performed in the United States). Permissible methods of apportionment with respect to stewardship expenses include comparisons of time spent by employees weighted to take into account differences in compensation, or comparisons of each related corporation's gross receipts, gross income, or unit sales volume, assuming that stewardship activities are not substantially disproportionate to such factors. See paragraph (f)(5) of this section for the type of verification that may be required in this respect. See § 1.482-9(l)(5) for examples that illustrate the principles of § 1.482-9(l)(3). See *Example 17* and *Example 18* of paragraph (g) of this section for the allocation and apportionment of stewardship expenses. See paragraph (b)(3) of this section for the allocation and apportionment of deductions attributable to supportive functions other than stewardship expenses, such as expenses in the nature of day-to-day management, and paragraph (e)(5) of

this section generally for the allocation and apportionment of deductions attributable to legal and accounting fees and expenses.

\* \* \* \* \*

(f) \* \* \*  
 (4) *Adjustments made under other provisions of the Code*—(i) *In general.* If an adjustment which affects the taxpayer is made under section 482 or any other provision of the Code, it may be necessary to recompute the allocations and apportionments required by this section in order to reflect changes resulting from the adjustment. The recomputation made by the Commissioner shall be made using the same method of allocation and apportionment as was originally used by the taxpayer, provided such method as originally used conformed with paragraph (a)(2) of this section and, in light of the adjustment, such method does not result in a material distortion. In addition to adjustments which would be made aside from this section, adjustments to the taxpayer's income and deductions which would not otherwise be made may be required before applying this section in order to prevent a distortion in determining taxable income from a particular source of activity. For example, if an item included as a part of the cost of goods sold has been improperly attributed to specific sales, and, as a result, gross income under one of the operative sections referred to in paragraph (f)(1) of this section is improperly determined, it may be necessary for the Commissioner to make an adjustment to the cost of goods sold, consistent with the principles of this section, before applying this section. Similarly, if a domestic corporation transfers the stock in its foreign subsidiaries to a domestic subsidiary and the parent corporation continues to incur expenses in connection with protecting its capital investment in the foreign subsidiaries (see paragraph (e)(4) of this section), it may be necessary for the Commissioner to make an allocation under section 482 with respect to such expenses before making allocations and apportionments required by this section, even though the section 482 allocation might not otherwise be made.

\* \* \* \* \*

(g) \* \* \*  
*Example 17. Stewardship expenses (consolidation).* (i) (A) *Facts.* X, a domestic corporation, wholly owns M, N, and O, also domestic corporations. X, M, N, and O file a consolidated income tax return. All the income of X and O is from sources within the United States, all of M's income is general category income from sources within South America, and all of N's income is general

category income from sources within Africa. X receives no dividends from M, N, or O. During the taxable year, the consolidated group of corporations earned consolidated gross income of \$550,000 and incurred total deductions of \$370,000 as follows:

	Gross income	Deductions
<b>Corporations:</b>		
X .....	\$100,000	\$50,000
M .....	250,000	100,000
N .....	150,000	200,000
O .....	50,000	20,000
<b>Total ...</b>	<b>550,000</b>	<b>370,000</b>

(B) Of the \$50,000 of deductions incurred by X, \$15,000 relates to X's ownership of M; \$10,000 relates to X's ownership of N; \$5,000 relates to X's ownership of O; and the sole effect of the entire \$30,000 of deductions is to protect X's capital investment in M, N, and O. X properly categorizes the \$30,000 of deductions as stewardship expenses. The remainder of X's deductions (\$20,000) relates to production of United States source income from its plant in the United States.

(ii) (A) *Allocation.* X's deductions of \$50,000 are definitely related and thus allocable to the types of gross income to which they give rise, namely \$25,000 wholly to general category income from sources outside the United States (\$15,000 for stewardship of M and \$10,000 for stewardship of N) and the remainder (\$25,000) wholly to gross income from sources within the United States. Expenses incurred by M and N are entirely related and thus wholly allocable to general category income earned from sources without the United States, and expenses incurred by O are entirely related and thus wholly allocable to income earned within the United States. Hence, no apportionment of expenses of X, M, N, or O is necessary. For purposes of applying the foreign tax credit limitation; the statutory grouping is general category gross income from sources without the United States and the residual grouping is gross income from sources within the United States. As a result of the allocation of deductions, the X consolidated group has taxable income from sources without the United States in the amount of \$75,000, computed as follows:

Foreign source general category gross income (\$250,000 from M + \$150,000 from N) .....	\$400,000
Less: Deductions allocable to foreign source general category gross income (\$25,000 from X, \$100,000 from M, and \$200,000 from N) .....	(325,000)
<b>Total foreign-source taxable income .....</b>	<b>75,000</b>

(B) Thus, in the combined computation of the general category limitation, the numerator of the limiting fraction (taxable income from sources outside the United States) is \$75,000.

*Example 18. Stewardship and supportive expenses.* (i) (A) *Facts.* X, a domestic corporation, manufactures and sells pharmaceuticals in the United States. X's domestic subsidiary S, and X's foreign subsidiaries T, U, and V perform similar functions in the United States and foreign countries T, U, and V, respectively. Each corporation derives substantial net income during the taxable year that is general category income described in section 904(d)(1). X's gross income for the taxable year consists of:

Domestic sales income .....	\$32,000,000
Dividends from S (before dividends received deduction) .....	3,000,000
Dividends from T .....	2,000,000
Dividends from U .....	1,000,000
Dividends from V .....	0
Royalties from T and U .....	1,000,000
Fees from U for services performed by X .....	1,000,000
<b>Total gross income .....</b>	<b>40,000,000</b>

(B) In addition, X incurs expenses of its supervision department of \$1,500,000.

(C) X's supervision department (the Department) is responsible for the supervision of its four subsidiaries and for rendering certain services to the subsidiaries, and this Department provides all the supportive functions necessary for X's foreign activities. The Department performs three principal types of activities. The first type consists of services for the direct benefit of U for which a fee is paid by U to X. The cost of the services for U is \$900,000 (which results in a total charge to U of \$1,000,000). The second type consists of activities described in § 1.482-9(l)(3)(iii) that are in the nature of shareholder oversight that duplicate functions performed by the subsidiaries' own employees and that do not provide an additional benefit to the subsidiaries. For example, a team of auditors from X's accounting department periodically audits the subsidiaries' books and prepares internal reports for use by X's management. Similarly, X's treasurer periodically reviews for the board of directors of X the subsidiaries' financial policies. These activities do not provide an additional benefit to the related corporations. The cost of the duplicative services and related supportive expenses is \$540,000. The third type of activity consists of providing services which are ancillary to the license agreements which X maintains with subsidiaries T and U. The cost of the ancillary services is \$60,000.

(ii) *Allocation.* The Department's outlay of \$900,000 for services rendered for the benefit of U is allocated to the \$1,000,000 in fees paid by U. The remaining \$600,000 in the Department's deductions are definitely related to the types of gross income to which they give rise, namely dividends from subsidiaries S, T, U, and V and royalties from T and U. However, \$60,000 of the \$600,000 in deductions are found to be attributable to the ancillary services and are definitely related (and therefore allocable) solely to royalties received from T and U, while the remaining \$540,000 in deductions are

definitely related (and therefore allocable) to dividends received from all the subsidiaries.

(iii) (A) *Apportionment.* For purposes of applying the foreign tax credit limitation, the statutory grouping is general category gross income from sources outside the United States and the residual grouping is gross income from sources within the United States. X's deduction of \$540,000 for the Department's expenses and related supportive expenses which are allocable to dividends received from the subsidiaries must be apportioned between the statutory and residual groupings before the foreign tax

credit limitation may be applied. In determining an appropriate method for apportioning the \$540,000, a basis other than X's gross income must be used since the dividend payment policies of the subsidiaries bear no relationship either to the activities of the Department or to the amount of income earned by each subsidiary. This is evidenced by the fact that V paid no dividends during the year, whereas S, T, and U paid dividends of \$1 million or more each. In the absence of facts that would indicate a material distortion resulting from the use of such method, the stewardship expenses (\$540,000)

may be apportioned on the basis of the gross receipts of each subsidiary.

(B) The gross receipts of the subsidiaries were as follows:

S .....	\$4,000,000
T .....	3,000,000
U .....	500,000
V .....	1,500,000
	9,000,000
Total .....	9,000,000

(C) Thus, the expenses of the Department are apportioned for purposes of the foreign tax credit limitation as follows:

Apportionment of stewardship expenses to the statutory grouping of gross income: $\$540,000 \times [(\$3,000,000 + \$500,000 + \$1,500,000)/\$9,000,000]$ .....	\$300,000
Apportionment of supervisory expenses to the residual grouping of gross income: $\$540,000 \times [\$4,000,000/9,000,000]$ .....	240,000
	540,000

\* \* \* \* \*

*Example 30. Income taxes.* (i)(A) *Facts.* As in *Example 17* of this paragraph (g), X is a domestic corporation that wholly owns M, N, and O, also domestic corporations. X, M, N, and O file a consolidated income tax return. All the income of X and O is from sources within the United States, all of M's income is general category income from sources within South America, and all of N's income is general category income from sources within Africa. X receives no dividends from M, N, or O. During the taxable year, the consolidated group of corporations earned consolidated gross income of \$550,000 and incurred total deductions of \$370,000. X has gross income of \$100,000 and deductions of \$50,000, without regard to its deduction for state income tax. Of the \$50,000 of deductions incurred by X, \$15,000 relates to X's ownership of M; \$10,000 relates to X's ownership of N; \$5,000 relates to X's ownership of O; and the entire \$30,000 constitutes stewardship expenses. The remainder of X's \$20,000 of deductions (which is assumed not to include state income tax) relates to production of U.S. source income from its plant in the United States. M has gross income of \$250,000 and deductions of \$100,000, which yield foreign-source general category taxable income of \$150,000. N has gross income of \$150,000 and deductions of \$200,000, which yield a foreign-source general category loss of \$50,000. O has gross income of \$50,000 and deductions of \$20,000, which yield U.S. source taxable income of \$30,000.

(B) Unlike *Example 17* of this paragraph (g), however, X also has a deduction of \$1,800 for state A income taxes. X's state A taxable income is computed by first making adjustments to the Federal taxable income of X to derive apportionable taxable income for state A tax purposes. An analysis of state A law indicates that state A law also includes in its definition of the taxable business income of X which is apportionable to X's state A activities, the taxable income of M, N, and O, which is related to X's business. As in *Example 25* of this paragraph (g), the amount of apportionable taxable income attributable to business activities conducted in state A is determined by multiplying apportionable taxable income by a fraction

(the "state apportionment fraction") that compares the relative amounts of payroll, property, and sales within state A with worldwide payroll, property, and sales. Assuming that X's apportionable taxable income equals \$180,000, \$100,000 of which is from sources without the United States, and \$80,000 is from sources within the United States, and that the state apportionment fraction is equal to 10 percent, X has state A taxable income of \$18,000. The state A income tax of \$1,800 is then derived by applying the state A income tax rate of 10 percent to the \$18,000 of state A taxable income.

(ii) *Allocation and apportionment.* Assume that under *Example 29* of this paragraph (g), it is determined that X's deduction for state A income tax is definitely related to a class of gross income consisting of income from sources both within and without the United States, and that the state A tax is apportioned \$1,000 to sources without the United States, and \$800 to sources within the United States. Under *Example 17* of this paragraph (g), without regard to the deduction for X's state A income tax, X has a separate loss of (\$25,000) from sources without the United States. After taking into account the deduction for state A income tax, X's separate loss from sources without the United States is increased by the \$1,000 state A tax apportioned to sources without the United States, and equals a loss of (\$26,000), for purposes of computing the numerator of the consolidated general category foreign tax credit limitation.

■ **Par. 17.** Section 1.861-8T is amended by revising paragraphs (a)(3), (a)(4), (a)(5), (b), (e)(3), (e)(4), (e)(5), (e)(6), (e)(7), (e)(8), (e)(9), (e)(10), (e)(11), (f)(1)(i), (f)(1)(iii), (f)(2), (f)(3), (f)(4), (f)(5), (g) *Examples 1, 2, 3, 4, 5, 6, 7, 8, 9, 10, 11, 12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23, and 30*, and (h) to read as follows:

§ 1.861-8T **Computation of taxable income from sources within the United States and from other sources and activities (temporary).**

\* \* \* \* \*

(a)(3) through (b) [Reserved]. For further guidance, see § 1.861-8(a)(3) through (b).

\* \* \* \* \*

(e) \* \* \*  
(3) through (f)(1)(i) [Reserved]. For further guidance, see § 1.861-8(e)(3) through (f)(1)(i).

\* \* \* \* \*

(f)(1)(iii) through (g) *Examples 1 through 23* [Reserved]. For further guidance, see § 1.861-8(f)(1)(iii) through (g) *Examples 1 through 23*.

\* \* \* \* \*

*Example 30.* [Reserved]. For further guidance, see § 1.861-8(g) *Example 30*.

(h) *Effective/applicability date.* (1) Paragraphs (f)(1)(vi)(E), (f)(1)(vi)(F), and (f)(1)(vi)(G) of this section apply to taxable years ending after April 9, 2008.

(2) Paragraph (e)(4), the last sentence of paragraph (f)(4)(i), and paragraph (g), *Examples 17, 18, and 30* of this section apply to taxable years beginning after July 31, 2009.

(3) Also, see paragraph (e)(12)(iv) of this section and 1.861-14(e)(6) for rules concerning the allocation and apportionment of deductions for charitable contributions.

■ **Par. 18.** Section 1.861-9T(k) is amended by adding new first and second sentences to read as follows:

§ 1.861-9T **Allocation and apportionment of interest expense (temporary).**

\* \* \* \* \*

(k) \* \* \* In general, the rules of this section apply for taxable years beginning after December 31, 1986. Paragraphs (b)(2) (concerning the treatment of certain foreign currency) and (d)(2) (concerning the treatment of interest incurred by nonresident aliens) of this section are applicable for taxable years commencing after December 31, 1988. \* \* \*

■ **Par. 19.** Section 1.861–10T is amended by revising the section heading and adding new paragraph (f) to read as follows:

**§ 1.861–10T Special allocations of interest expense (temporary).**

\* \* \* \* \*

(f) *Effective/applicability date.* (1) In general, the rules of this section apply for taxable years beginning after December 31, 1986.

(2) Paragraphs (b)(3)(ii) (providing an operating costs test for purposes of the nonrecourse indebtedness exception) and (b)(6) (concerning excess collateralization of nonrecourse borrowings) of this section are applicable for taxable years commencing after December 31, 1988.

(3) Paragraph (e) (concerning the treatment of related controlled foreign corporation indebtedness) of this section is applicable for taxable years commencing after December 31, 1987. For rules for taxable years beginning before January 1, 1987, and for later years to the extent permitted by § 1.861–13T, see § 1.861–8 (revised as of April 1, 1986).

■ **Par. 20.** Section 1.861–11T is amended by revising the section heading and adding new paragraph (h) to read as follows:

**§ 1.861–11T Special rules for allocating and apportioning interest expense of an affiliated group of corporations (temporary).**

\* \* \* \* \*

(h) *Effective/applicability date.* The rules of this section apply for taxable years beginning after December 31, 1986.

■ **Par. 21.** Section 1.861–12T is amended by revising the section heading and adding new paragraph (k) to read as follows:

**§ 1.861–12T Characterization rules and adjustments for certain assets (temporary).**

\* \* \* \* \*

(k) *Effective/applicability date.* The rules of this section apply for taxable years beginning after December 31, 1986.

■ **Par. 22.** Section 1.861–14T is amended by adding new paragraph (k) to read as follows:

**§ 1.861–14T Special rules for allocating and apportioning certain expenses (other than interest expense) of an affiliated group of corporations (temporary).**

\* \* \* \* \*

(k) *Effective/applicability date.* The rules of this section apply for taxable years beginning after December 31, 1986.

**§ 1.6038A–1 [Amended]**

■ **Par. 23.** Section 1.6038A–1 is amended by removing paragraph (n)(3) and redesignating paragraphs (n)(4), (n)(5), (n)(6) and (n)(7) as paragraphs (n)(3), (n)(4), (n)(5) and (n)(6), respectively.

■ **Par. 24.** Section 1.6038A–3 is amended by revising paragraphs (a)(3) *Example 4*, and (i) to read as follows:

**§ 1.6038A–3 Record maintenance.**

(a) \* \* \*  
(3) \* \* \*

*Example 4.* S, a U.S. reporting corporation, provides computer consulting services for its foreign parent, X. Based on the application of section 482 and the regulations, it is determined that the cost of services plus method, as described in § 1.482–9(e), will provide the most reliable measure of an arm's length result, based on the facts and circumstances of the controlled transaction between S and X. S is required to maintain records to permit verification upon audit of the comparable transactional costs (as described in § 1.482–9(e)(2)(iii)) used to calculate the arm's length price. Based on the facts and circumstances, if it is determined that X's records are relevant to determine the correct U.S. tax treatment of the controlled transaction between S and X, the record maintenance requirements under section 6038A(a) and this section will be applicable to the records of X.

\* \* \* \* \*

(i) *Effective/applicability date—(1) In general.* This section is generally applicable on December 10, 1990. However, records described in this section in existence on or after March 20, 1990, must be maintained, without regard to when the taxable year to which the records relate began. Paragraph (a)(3) *Example 4* of this section is generally applicable for taxable years beginning after July 31, 2009.

(2) *Election to apply regulation to earlier taxable years.* A person may elect to apply the provisions of paragraph (a)(3) *Example 4* of this section to earlier taxable years in accordance with the rules set forth in § 1.482–9(n)(2).

**§ 1.6038A–3T [Removed]**

■ **Par. 25.** Section 1.6038A–3T is removed.

■ **Par. 26.** Section 1.6662–6 is amended by revising paragraphs (d)(2)(ii)(B), (d)(2)(iii)(B)(4), (d)(2)(iii)(B)(6), and (g) to read as follows:

**§ 1.6662–6 Transactions between persons described in section 482 and net section 482 transfer price adjustments.**

\* \* \* \* \*

(d) \* \* \*  
(2) \* \* \*  
(ii) \* \* \*

(B) *Services cost method.* A taxpayer's selection of the services cost method for certain services, described in § 1.482–9(b), and its application of that method to a controlled services transaction will be considered reasonable for purposes of the specified method requirement only if the taxpayer reasonably allocated and apportioned costs in accordance with § 1.482–9(k), and reasonably concluded that the controlled services transaction satisfies the requirements described in § 1.482–9(b)(2). Whether the taxpayer's conclusion was reasonable must be determined from all the facts and circumstances. The factors relevant to this determination include those described in paragraph (d)(2)(ii)(A) of this section, to the extent applicable.

\* \* \* \* \*

(iii) \* \* \*  
(B) \* \* \*

(4) A description of the method selected and an explanation of why that method was selected, including an evaluation of whether the regulatory conditions and requirements for application of that method, if any, were met;

\* \* \* \* \*

(6) A description of the controlled transactions (including the terms of sale) and any internal data used to analyze those transactions. For example, if a profit split method is applied, the documentation must include a schedule providing the total income, costs, and assets (with adjustments for different accounting practices and currencies) for each controlled taxpayer participating in the relevant business activity and detailing the allocations of such items to that activity. Similarly, if a cost-based method (such as the cost plus method, the services cost method for certain services, or a comparable profits method with a cost-based profit level indicator) is applied, the documentation must include a description of the manner in which relevant costs are determined and are allocated and apportioned to the relevant controlled transaction.

\* \* \* \* \*

(g) *Effective/applicability date—(1) In general.* This section is generally applicable on February 9, 1996. However, taxpayers may elect to apply this section to all open taxable years beginning after December 31, 1993.

(2) *Special rules.* The provisions of paragraphs (d)(2)(ii)(B), (d)(2)(iii)(B)(4) and (d)(2)(iii)(B)(6) of this section are applicable for taxable years beginning after July 31, 2009. However, taxpayers may elect to apply the provisions of paragraphs (d)(2)(ii)(B), (d)(2)(iii)(B)(4) and (d)(2)(iii)(B)(6) of this section to

earlier taxable years in accordance with the rules set forth in § 1.482-9(n)(2).

§ 1.6662-6T [Removed]

■ Par. 27. Section 1.6662-6T is removed.

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT THE SOURCE

■ Par. 28. The authority citation for part 31 continues to read in part as follows:

Authority: 26 U.S.C. 7805 \* \* \*

■ Par. 29. Section 31.3121(s)-1 is amended by revising paragraphs (c)(2)(iii) and (d) to read as follows:

§ 31.3121(s)-1 Concurrent employment by related corporations with common paymaster.

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(iii) Group-wide allocation rules.

Under the group-wide method of allocation, the Commissioner may allocate the taxes imposed by sections 3102 and 3111 in an appropriate manner to a related corporation that remunerates an employee through a common paymaster if the common paymaster fails to remit the taxes to the Internal Revenue Service. Allocation in an appropriate manner varies according to the circumstances. It may be based on sales, property, corporate payroll, or any

other basis that reflects the distribution of the services performed by the employee, or a combination of the foregoing bases. To the extent practicable, the Commissioner may use the principles of § 1.482-2(b) of this chapter in making the allocations with respect to wages paid after December 31, 1978, and on or before July 31, 2009. To the extent practicable, the Commissioner may use the principles of § 1.482-9 of this chapter in making the allocations with respect to wages paid after July 31, 2009.

(d) Effective/applicability date—(1) In general. This section is applicable with respect to wages paid after December 31, 1978. The fourth sentence of paragraph (c)(2)(iii) of this section is applicable with respect to wages paid after December 31, 1978, and on or before July 31, 2009. The fifth sentence of paragraph (c)(2)(iii) of this section is applicable with respect to wages paid after July 31, 2009.

(2) Election to apply regulation to earlier taxable years. A person may elect to apply the fifth sentence of paragraph (c)(2)(iii) of this section to earlier taxable years in accordance with the rules set forth in § 1.482-9(n)(2) of this chapter.

§ 31.3121(s)-1T [Removed]

■ Par. 30. Section 31.3121(s)-1T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

■ Par. 31. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

■ Par. 32. In § 602.101, paragraph (b) is amended by adding an entry for “§ 1.482-9(b)” to the table to read follows:

§ 602.101 OMB Control numbers.

\* \* \* \* \*

(b) \* \* \*

CFR part or section where identified and described	Current OMB control number
* * * * *	*
1.482-9(b) .....	1545-2149
* * * * *	*

Approved: July 25, 2009.

Linda E. Stiff,

Deputy Commissioner for Services and Enforcement.

Michael Mundaca,

Acting Assistant Secretary of the Treasury (Tax Policy).

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