

## LB&I Transaction Unit Knowledge Base – International

Library Level	Number	Title
Shelf		Business Inbound
Book	6	Income Shifting (Business Inbound)
Chapter	6.5	Services
Section		
Subsection		

<b>Unit Name</b>	High Value Services: Technical and Marketing Fees – Inbound	
<b>Primary UIL Code</b>	9422.05	Provision of High Value Services

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# Issue and Transaction Overview

## High Value Services: Technical and Marketing Fees - Inbound

Multinational enterprises (MNEs) may seek to maximize after tax profits by shifting income from a high-tax jurisdiction to a lower-tax jurisdiction via controlled party transactions that are not priced at arm's length. Income shifting may be achieved through the provision of services between controlled parties at prices that are not arm's length. An activity performed by one controlled party for the benefit of another controlled party is referred to as a "controlled service transaction."

A foreign parent (FP) may decentralize service functions and have subsidiaries perform such functions for affiliates of its controlled group. For example, FP may own a U.S. subsidiary (USS). USS may perform services for FP and then bill FP in exchange for performing the service. The regulations under Internal Revenue Code (IRC) 482 generally require USS to charge an arm's length price for these services.

In general, the price of services in a service transaction involving two uncontrolled parties is determined by market conditions and is assumed to be at arm's length. However, in a transaction between controlled parties, the price is not determined by market conditions and may be manipulated in order to shift income to minimize taxes.

The IRC 482 transfer pricing services regulations, set forth in Treas. Reg. 1.482-9, provide several different transfer pricing methods (TPMs). In addition, the services regulations require use of the "best method" rule and comparability analysis to determine which method should be used in any particular situation. The services cost method (SCM) differs from the other specified methods in that it is the only method that applies at the election of the taxpayer and that deems cost reimbursement to be an arm's length price.

The SCM allows for certain services to be billed out at total services costs without a profit mark-up. The SCM applies only to certain low value services. If the SCM does not apply or USS does not elect to apply the SCM, an arm's length service fee must be determined under another method. If the rate determined by USS under another method is not arm's length under the facts and circumstances, an adjustment may be necessary.

# Issue and Transaction Overview (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

The TPMs (other than the SCM) are the:

- Comparable Uncontrolled Services Price
- Gross Services Margin
- Cost of Services Plus
- Comparable Profits
- Profit Split
- Unspecified

This unit will analyze transactions within a controlled group where the U.S. subsidiaries provide services to other members of the group. The types of services discussed in this unit will be marketing services and technical services. These types of services commonly may not qualify for the SCM and may require an arm's length mark-up on the cost of the services.

Further specialized training for service transactions with valuable intangible property can be found in the Practice Unit, *Accounting for Intangibles and Services Associated with the Sale of Tangible Property*.

# Issue and Transaction Overview (cont'd)

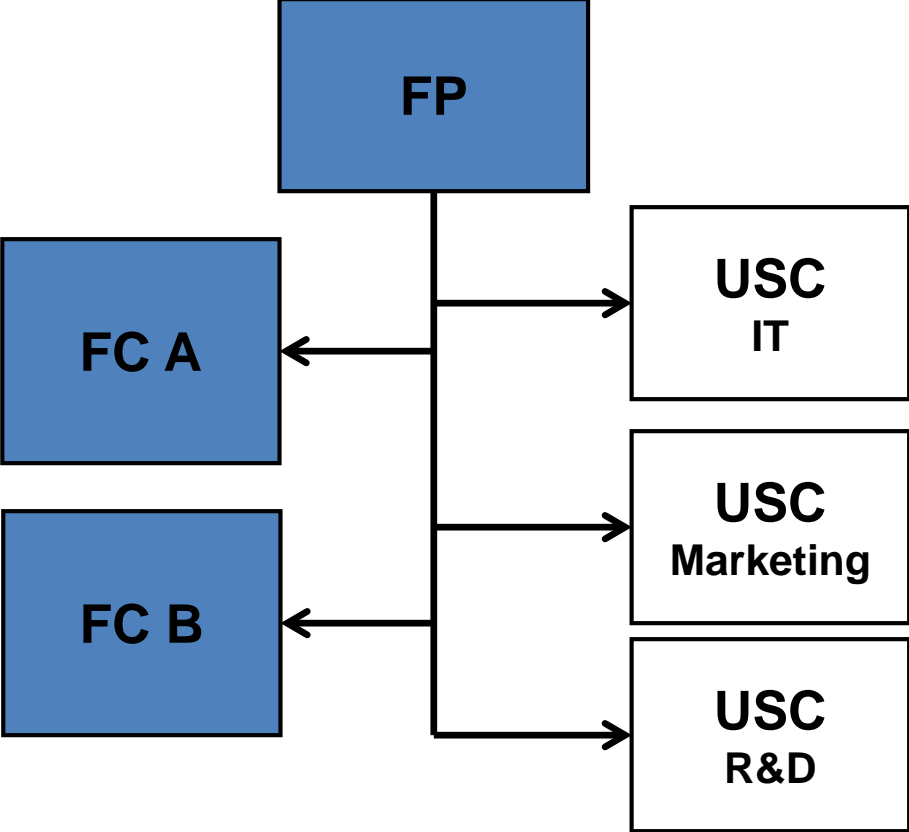
## High Value Services: Technical and Marketing Fees - Inbound

Helpful Foundation Units to read:

- Practice Unit, *Overview of IRC Section 482*, provides basic conceptual knowledge regarding IRC 482.
- Practice Unit, *Arms Length Standard*, provides information on the arm's length standard.
- Practice Unit, *Foreign Shareholder Activities and Duplicative Activities*, provides the definition of a controlled service transaction and how to determine if a benefit has been derived from a controlled services transaction. The unit also discusses duplicative activities and shareholder activities.
- Practice Unit, *Services Cost Method Inbound Services*, provides the conceptual knowledge of the SCM for a controlled services transaction.

# Transaction and Fact Pattern

## High Value Services: Technical and Marketing Fees - Inbound

Diagram of Transaction	Facts
 <pre> graph TD     FP[FP] --&gt; FCA[FC A]     FP --&gt; FCB[FC B]     FP --&gt; USC_IT[USC IT]     FP --&gt; USC_Marketing[USC Marketing]     FP --&gt; USC_RnD[USC R&amp;D]     </pre>	<ul style="list-style-type: none"> <li>▪ Foreign Parent (FP) is the global parent of a multinational organizational structure.</li> <li>▪ FP wholly owns the following companies:             <ul style="list-style-type: none"> <li>– Foreign Corporation A (FC A)</li> <li>– Foreign Corporation B (FC B)</li> <li>– U.S. Corporation IT (USC - IT)</li> <li>– U.S. Corporation Marketing (USC - Marketing)</li> <li>– U.S. Corporation Technical (USC – R&amp;D)</li> </ul> </li> <li>▪ FC A is a manufacturer of Product X and it sells the product in the geographic territory of Europe. FC A does not have its own IT, marketing, or technical departments.</li> <li>▪ FC B is also a manufacturer of Product X and sells the product in the geographic territory of North America. FC B does not have its own IT, marketing, or technical departments.</li> </ul>

# Transaction and Fact Pattern (cont'd)

High Value Services: Technical and Marketing Fees - Inbound	
Diagram of Transaction	Facts
<p>The diagram illustrates the flow of information technology (IT) services. At the top is a blue box labeled 'FP'. Below it are two blue boxes labeled 'FC A' and 'FC B'. To the right of these are three white boxes stacked vertically: 'USC IT', 'USC Marketing', and 'USC R&amp;D'. Green arrows point from 'USC IT' to 'FC A' and from 'USC Marketing' to 'FC B'.</p>	<p>Legend:</p> <p>The green arrows signify information technology (IT) services performed by USC – IT on behalf of FC A and FC B.</p> <p>USC – IT elects the SCM for all of the IT services provided to FC A and FC B. Therefore, the amounts are billed at total services cost with no mark-up.</p> <p>FC A and FC B pay USC – IT for the services.</p> <p>The exam team determined that FC A and FC B received a benefit from the IT services and would be willing to pay a third party to perform these services if USC – IT did not perform the services.</p>

# Transaction and Fact Pattern (cont'd)

High Value Services: Technical and Marketing Fees - Inbound	
Diagram of Transaction	Facts
<p>The diagram illustrates the flow of services and fees. At the top is a blue box labeled 'FP'. Below it are two blue boxes labeled 'FC A' and 'FC B'. To the right of these are three white boxes stacked vertically: 'USC IT', 'USC Marketing', and 'USC R&amp;D'. Two purple arrows originate from the 'USC Marketing' box and point to 'FC A' and 'FC B' respectively, indicating marketing services provided to them.</p>	<p>Legend:</p> <p>The purple arrows signify marketing services performed by USC – Marketing on behalf of FC A and FC B.</p> <p>USC – Marketing includes a mark-up of 2% on all marketing services billed to FC A and FC B.</p> <p>The exam team determined that FC A and FC B received a benefit from the marketing services and would be willing to pay a third party to perform these services if USC – Marketing did not perform the services.</p>



# Transaction and Fact Pattern (cont'd)

High Value Services: Technical and Marketing Fees - Inbound	
Diagram of Transaction	Facts
<p>The diagram illustrates the flow of technical and marketing services. At the top is a blue box labeled 'FP'. Below it are two blue boxes labeled 'FC A' and 'FC B'. To the right of these are three white boxes with black borders: 'USC IT', 'USC Marketing', and 'USC R&amp;D'. Orange arrows point from 'USC R&amp;D' to both 'FC A' and 'FC B'. Another orange arrow points from 'USC Marketing' to 'FC A'.</p>	<p>Legend:</p> <p>The orange arrows signify technical services performed by USC – R&amp;D on behalf of FC A and FC B. The technical services include engineering and research and development (R&amp;D).</p> <p>USC – R&amp;D includes a mark-up of 8% on all technical services billed to FC A and FC B.</p> <p>FC A and FC B pay USC – R&amp;D for the services.</p> <p>The exam team determined that FC A and FC B received a benefit from the R&amp;D services and would be willing to pay a third party to perform these services if USC – R&amp;D did not perform the services.</p>

# Effective Tax Rate Overview

## High Value Services: Technical and Marketing Fees - Inbound

### ETR of Company

- USC will have the option of filing on a stand alone basis or on a consolidated basis. Depending on the ownership structure and regulatory requirements, USC may not provide its ETR calculation in its financial statements. You can compute this rate if it is not provided by using the reported accounting data.

### ETR Impact of Adjustment

- If you determine that the services are more valuable than what was charged, you would increase USC's gross income and taxable income through an adjustment. This would have the effect of also increasing USC's ETR.

# Summary of Potential Issues

## High Value Services: Technical and Marketing Fees - Inbound

<a href="#"><u>Issue 1</u></a>	Are the IT service fees charged by USC – IT eligible for the SCM? If not, is USC – IT charging an arm’s length price for the IT services provided to the foreign affiliates?
<a href="#"><u>Issue 2</u></a>	Is USC – Marketing charging an arm's length price for the marketing services provided to the foreign affiliates?
<a href="#"><u>Issue 3</u></a>	Is USC – R&D charging an arm’s length price for the R&D services provided to the foreign affiliates?

# All Issues, Step 1: Initial Factual Development


## High Value Services: Technical and Marketing Fees - Inbound

Taxpayers may improperly shift income outside the U.S. by understating the value of services provided by U.S. controlled entities to foreign affiliates. The service fee charged for the service may not be an arm's length price. All the facts and circumstances related to the provision of services must be gathered. The type of service provided must be identified and the supporting documentation related to the service should be obtained.

Fact Element	Resources
<ul style="list-style-type: none"> <li>▪ What type of intercompany services are being provided?                             <ul style="list-style-type: none"> <li>– Review the financial statements, books and records and tie them to the tax return.</li> <li>– Review the Form 10-K filing and other publically filed reports (Form 20-F, if any).</li> <li>– Review the taxpayer website(s).</li> </ul> </li> <li>▪ Where are the services provided?                             <ul style="list-style-type: none"> <li>– Issue IDRs, questionnaires and perform interviews, if necessary.</li> </ul> </li> <li>▪ Are intercompany services reported on the Form 5472?</li> <li>▪ Did any affiliates file U.S. returns reporting effectively connected U.S. income?</li> <li>▪ Are there intercompany agreements for the intercompany services provided?</li> </ul>	<ul style="list-style-type: none"> <li>▪ IDR - Mandatory Transfer Pricing Information Document Request</li> <li>▪ Audit Tool - Transfer Pricing Roadmap/Timeline</li> <li>▪ Form 5472, Part IV, Lines 6 and 7</li> <li>▪ Form 1120Fs (if any)</li> <li>▪ IRM 4.61.3.5.1 – <i>Functional Analysis</i></li> </ul>


# All Issues, Step 1: Initial Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

Fact Element	Resources
<ul style="list-style-type: none"><li>▪ What are the contractual terms of the agreement?</li><li>▪ Is there a global tax and legal organizational chart?</li><li>▪ Do the USC entities or foreign affiliates have transfer pricing studies for the intercompany service transactions?</li></ul> <p> <b>CONSULTATION:</b> The Income Shifting Practice Network (PN) can provide guidance on applicable training tools, audit tools, and audit techniques.</p>	<ul style="list-style-type: none"><li>▪ IDR - Mandatory Transfer Pricing Information Document Request</li><li>▪ Audit Tool - Transfer Pricing Roadmap/Timeline</li><li>▪ IRM Exhibit 4.61.3.5.1 – <i>Functional Analysis</i></li></ul>

# All Issues, Step 1: Initial Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

Fact Element	Resources
<ul style="list-style-type: none"> <li>▪ Did the USC entities or foreign affiliates prepare a comparability analysis as part of its Transfer Pricing Study?                             <ul style="list-style-type: none"> <li>- Functions performed</li> <li>- Contractual terms</li> <li>- Risks Assumed</li> <li>- Economic Conditions</li> <li>- Property or Services</li> </ul> </li> </ul> <p> <b>CONSULTATION:</b> A computer audit specialist referral may be helpful when auditing computerized books and records involving cost centers and computer generated cost allocations keys.</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.482-1(d)(3)(i) – <i>Functional Analysis</i></li> <li>▪ Treas. Reg. 1.482-1(d)(3)(ii) – <i>Contractual Terms</i></li> <li>▪ Treas. Reg. 1.482-1(d)(3)(iii) – <i>Risks Assumed</i></li> <li>▪ Treas. Reg. 1.482-1(d)(3)(iv) – <i>Economic Conditions</i></li> <li>▪ Treas. Reg. 1.482-1(d)(3)(v) – <i>Property or Services</i></li> <li>▪ Audit Tool – Checklist &amp; Audit Tool for Developing Transfer Pricing Issues</li> <li>▪ IRM 4.61.3 – <i>Development of IRC Section 482 Cases</i></li> <li>▪ IRM Exhibit 4.61.3-4 - <i>Transfer Pricing Functional Analysis Questionnaire</i></li> </ul>

# All Issues, Step 1: Initial Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

Fact Element	Resources
<ul style="list-style-type: none"><li>▪ How much did it cost the U.S. entity to perform the services?<ul style="list-style-type: none"><li>– Utilize the general ledger and request related spreadsheets to understand the cost of the services.</li><li>– Review cost accounting records to distinguish marketing costs.</li><li>– Review cost center allocation keys to see which costs, including general and administrative costs, are being allocated to the transaction (and which are not).</li></ul></li><li>▪ Who pays for the intercompany services that the USC entities provide to the foreign affiliates?</li><li>▪ Ask the USC entities to explain the billing process.<ul style="list-style-type: none"><li>– Questionnaires and interviews can be used to gather any facts that were not provided as part of the Mandatory Transfer Pricing IDR.</li></ul></li><li>▪ Are there any billing manuals?</li></ul>	<ul style="list-style-type: none"><li>▪ Audit Tool – Checklist &amp; Audit Tool for Developing Transfer Pricing Issues</li><li>▪ IRM 4.61.3 – <i>Development of IRC Section 482 Cases</i></li><li>▪ IRM Exhibit 4.61.3-4 – <i>Transfer Pricing Functional Analysis Questionnaire</i></li></ul>

# All Issues, Step 1: Initial Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

Fact Element	Resources
<ul style="list-style-type: none"><li>▪ What are the payment terms of the services transactions?<ul style="list-style-type: none"><li>– Review the intercompany agreements and the terms on the invoices.</li><li>– Trace transactions through from start to finish to identify whether the payment terms are being respected.</li></ul></li><li>▪ Are there any overdue payments?<ul style="list-style-type: none"><li>– What are the terms for overdue payments?</li><li>– Is interest accruing?</li></ul></li><li>▪ What currency is used for payment?</li><li>▪ Does the amount billed cover all of the USC entities' costs?</li><li>▪ Has the taxpayer improperly assumed that all services are low value services and improperly compensated with a cost-based method (namely, at cost or cost plus a mark-up)?</li></ul>	<ul style="list-style-type: none"><li>▪ Audit Tool – Checklist &amp; Audit Tool for Developing Transfer Pricing Issues</li><li>▪ IRM 4.61.3 – <i>Development of IRC Section 482 Cases</i></li><li>▪ IRM Exhibit 4.61.3-4 – <i>Transfer Pricing Functional Analysis Questionnaire</i></li></ul>



# All Issues, Step 1: Initial Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

Fact Element	Resources
<ul style="list-style-type: none"><li>▪ Do the services costs include stock-based compensation (SBC) expenses?<ul style="list-style-type: none"><li>- Request the stock-based compensation documentation and examine the allocation of the costs.</li></ul></li><li>▪ Where appropriate, are expenses allocated based on reasonable allocation keys?<ul style="list-style-type: none"><li>- Examine the cost center accounting records to distinguish the service costs.</li><li>- Examine the cost center allocation keys to see which general and administrative expenses are being allocated to the transaction.</li></ul></li></ul>	<ul style="list-style-type: none"><li>▪ Audit Tool – Checklist &amp; Audit Tool for Developing Transfer Pricing Issues</li><li>▪ IRM 4.61.3 – <i>Development of IRC Section 482 Cases</i></li><li>▪ IRM Exhibit 4.61.3-4 – <i>Transfer Pricing Functional Analysis Questionnaire</i></li></ul>

# Issue 1, Step 2: Review Potential Issues

## High Value Services: Technical and Marketing Fees - Inbound

### Issue 1

Are the IT service fees charged by USC – IT eligible for the SCM? If not, is USC – IT charging an arm’s length price for the IT services provided to the foreign affiliates?

Explanation of Issue	Resources
<p>USC – IT is providing IT services to FC A and FC B. USC – IT has elected the SCM for these services. The SCM election allows taxpayers to charge cost with no mark-up for certain low-margin intercompany services. Therefore, USC – IT bills the amounts at cost with no mark-up. A full explanation of the SCM can be found in the Practice Unit, <i>Services Cost Method Inbound</i>.</p> <p>Some IT services may be eligible for the SCM while other IT services are excluded from the SCM. For example, engineering, scientific, R&amp;D, and experimentation activities are all excluded activities. IT services can describe a vast array of technology services. As a result, it is important to understand what IT services USC – IT provides in order to verify whether such IT services are eligible for the SCM.</p> <p>Certain “specified covered services” are eligible for the SCM. Specified covered services are services that the Commissioner has specified in Rev. Proc. 2007-13 to be support services common among taxpayers across industry sectors and generally do not involve a significant median comparable mark-up on total services costs. For example, the compiling of data for use in statistical studies is a specified covered service under the SCM. Also listed is supporting company wide computer systems, maintaining and repairing IT systems, and providing technical assistance and training to users of computer systems.</p>	<ul style="list-style-type: none"> <li>▪ IRC 482</li> <li>▪ Treas. Reg. 1.482-9(l)(1) – defines a controlled services transaction</li> <li>▪ Treas. Reg. 1.482-9(l)(2) – defines an activity</li> <li>▪ Treas. Reg. 1.482-9(l)(3) – defines when an activity provides a benefit</li> <li>▪ Treas. Reg. 1.482-9(b) – <i>Services Cost Method</i></li> <li>▪ Treas. Reg. 1.482-9(b)(2) – <i>Eligibility for the SCM</i></li> <li>▪ Treas. Reg. 1.482-9(b)(3)(ii) – <i>Low Margin Covered Services</i></li> <li>▪ Treas. Reg. 1.482-9(b)(4) – <i>Excluded Activities</i></li> <li>▪ Rev. Proc. 2007-13 – defines services that might qualify for the SCM and other costs that would be excluded from the SCM</li> </ul>

# Issue 1, Step 2: Review Potential Issues (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### Issue 1

Explanation of Issue	Resources
<p>You will need to determine USC – IT’s eligibility to use the SCM based on the SCM regulations.</p> <p>If USC – IT is not eligible for the SCM you will need to determine the arm’s length price for the intercompany services provided. To determine the arm’s length price, USC – IT may use one of the other six methods listed in Treas. Reg. 1.482-9(a) applicable to controlled service transactions. However, the transfer pricing method used must adhere to the best method rule. The best method is the method that will result in the most reliable measure of an arm’s length result. You will need to identify all the facts and circumstances of the intercompany IT services provided to determine the best method. You will employ a comparability analysis to analyze the facts, circumstances, and potential comparable uncontrolled transactions.</p> <p>The arm’s length price for IT services will vary depending on the type and extent of IT services provided. The arm’s length price for this transaction is the rate that an uncontrolled party would pay for the same or similar services under the same or similar circumstances. USC – IT may be providing a valuable service which requires a significant mark-up on costs in order to be considered arm’s length.</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.482-1(b)(1) – <i>Arm’s Length Standard</i></li> <li>▪ Treas. Reg. 1.482-1(c) – <i>Best Method Rule</i></li> <li>▪ Treas. Reg. 1.482-1(d) – <i>Comparability</i></li> <li>▪ Treas. Reg. 1.482-1(e) – <i>Arm’s Length Range</i></li> <li>▪ Treas. Reg. 1.482-9(a) – discusses the best method rule, comparability analysis, and the arm’s length range as applied to controlled service transactions.</li> </ul>

# Issue 1, Step 2: Review Potential Issues (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 1](#)

Explanation of Issue	Resources
<p>The SCM looks at total services costs, defined as all costs of rendering the services and includes all costs, in cash and in kind (including stock based compensation), that are directly identified with, or reasonably allocated to the services. Therefore, you will need to use the facts and circumstances to determine the total services costs.</p> <p>Sometimes, IT services will have valuable intangibles associated with the services. Intangibles such as these may include patented or unpatented computer systems or software programs.</p>	<ul style="list-style-type: none"><li>▪ <i>Treas. Reg. 1.482-9(j) – Total Services Costs</i></li></ul>

# Issue 1, Step 3: Additional Factual Development

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 1](#)

Fact Element	Resources
<ul style="list-style-type: none"><li>▪ What types of IT services are provided per the contract(s)?</li><li>▪ Are these services included in the specified covered services of Rev. Proc. 2007-13?</li><li>▪ Are any of the IT services “excluded services” as set forth in Treas. Reg. 1.482-9(b)(4)?</li><li>▪ Does the taxpayer have documentation related to the median comparable mark-up on total IT service costs?<ul style="list-style-type: none"><li>– If the taxpayer has not provided the back up documentation to the functional/comparative analysis and the transactions chosen as comparative transactions, request it in a separate IDR.</li><li>– Verify who the personnel are that provide the services and request position descriptions.</li><li>– Questionnaires and interviews may be necessary.</li></ul></li></ul>	<ul style="list-style-type: none"><li>▪ Audit Tool – Checklist &amp; Audit Tool for Developing Transfer Pricing Issues</li><li>▪ IRM 4.61.3 – <i>Development of IRC Section 482 Cases</i></li><li>▪ IRM Exhibit 4.61.3-4 – <i>Transfer Pricing Functional Analysis Questionnaire</i></li></ul>

# Issue 1, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### Issue 1

Fact Element	Resources
<ul style="list-style-type: none"> <li>▪ Do the IT services qualify as low-margin services for purposes of the SCM such that they have a median comparable mark-up on total services costs of less than or equal to 7%?                             <ul style="list-style-type: none"> <li>- Government industry studies and statistics, as well as Capital IQ statistics and research will help you determine the arm's length price.</li> <li>- Taxpayer and competitor websites will also provide data.</li> </ul> </li> <li>▪ Are the IT services provided to FC A and FC B routine, low-margin services or are the services more complex, high-profit margin services?</li> <li>▪ How often are the services provided?</li> <li>▪ What is the level of education of USC – IT personnel who perform the services?</li> </ul>	
<ul style="list-style-type: none"> <li>▪ Does USC – IT perform the IT service activities or does it subcontract out the services to another party?                             <ul style="list-style-type: none"> <li>- In the case of outsourcing, the factual inquiry described here also applies to the subcontractors performing services on USC-IT's behalf.</li> <li>- Request the outsourcing agreement.</li> </ul> </li> <li>▪ Does USC – IT provide IT services to third parties?                             <ul style="list-style-type: none"> <li>- Request the third party agreements.</li> </ul> </li> <li>▪ Does USC – IT ever “loan” or second any of its personnel to FC A or FC B?                             <ul style="list-style-type: none"> <li>- Request the secondment agreements.</li> </ul> </li> </ul>	

# Issue 1, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound


### Issue 1

Fact Element	Resources
<ul style="list-style-type: none"> <li>▪ What assets are utilized in performing the IT services and where are they located?                             <ul style="list-style-type: none"> <li>– Tours, questionnaires and interviews may be necessary.</li> <li>– Utilize our internal programs for identifying property records.</li> <li>– Utilize government websites for researching ownership of patents and intangibles.</li> </ul> </li> <li>▪ Are you able to identify any valuable assets utilized, especially intangible assets, such as software programs?                             <ul style="list-style-type: none"> <li>– Read the taxpayer’s Form 10-K, website, and promotional materials to identify any valuable assets.</li> </ul> </li> <li>▪ What are the risks related to USC – IT’s services?</li> </ul>	
<ul style="list-style-type: none"> <li>▪ What are the contract termination and modification rights? If a software program is used as part of providing the services, are upgrades automatically provided to FC A or FC B at no extra cost?</li> <li>▪ Are there any guarantees provided related to the services provided? For example, guarantees that the system will not go down, reimbursements if the system does go down, or guarantees of no lost data.</li> <li>▪ Do FC A’s or FC B’s manufactured products have any direct relationship to the USC – IT provided services? For example is there a USC - IT intangible included in the product?</li> </ul>	

# Issue 1, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 1](#)


Fact Element	Resources
<ul style="list-style-type: none"><li>▪ Does USC - IT give FC A or FC B a competitive advantage?<ul style="list-style-type: none"><li>– Research the taxpayer’s competitors. Standard Industry Codes and North American Industry Classification System may help you find standard industry information and identify competitors.</li><li>– Industry studies and statistics are available for many industries through government websites, Capital IQ and other websites.</li></ul></li><li>▪ Ask USC-IT: Within your industry, and as compared to your competitors, how would you rate the quality of the IT services that USC-IT provides?</li><li>▪ Who are USC – IT’s competitors?</li></ul> <p> <b>CONSULTATION:</b> You may consider consulting with an economist to assist in determining the value of the IT services.</p>	



# Issue 1, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound



### Issue 1

Fact Element	Resources
<ul style="list-style-type: none"><li>▪ Is there a third party that could provide the IT services to the foreign affiliates?</li><li>▪ Why was the transaction structured the way it was? Determine the motivations for the structure.</li><li>▪ Does the form of the transaction (including written contractual terms) follow the substance (including actual conduct) of the transaction?<ul style="list-style-type: none"><li>- Trace the transaction through the books and records.</li></ul></li></ul> <p> <b>CONSULTATION:</b> Consult with your local Counsel before imputing contract terms.</p>	
<ul style="list-style-type: none"><li>▪ Regarding all of the facts gathered, are there any industry deviations between what would be expected of a company in this industry and practices USC – IT is utilizing?</li><li>▪ Are the uncontrolled comparables USC – IT used in its transfer pricing study actually comparable to the USC - IT transaction?</li></ul>	

# Issue 1, Step 4: Develop Arguments

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 1](#)

Explanation of Adjustment	Resources
<p>At this point you will have gathered all the facts and circumstances regarding the IT services USC – IT provided to FC A and FC B. You will need to make a determination:</p> <p> <b>DECISION POINT:</b> Were the IT services USC – IT provided to FC A and FC B eligible for the SCM?</p> <p> <b>CONSULTATION:</b> If questions of law arise, be sure to consult with local field counsel.</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.482-9(b) – <i>Services Cost Method</i></li> <li>▪ Treas. Reg. 1.482-9(b)(2) – <i>Eligibility for the Services Cost Method</i></li> <li>▪ Treas. Reg. 1.482-9(b)(3)(ii) – <i>Low Margin Covered Services</i></li> <li>▪ Treas. Reg. 1.482-9(b)(4) – <i>Excluded Activities</i></li> <li>▪ Treas. Reg. 1.482-9(b)(2)(iii) – <i>Business Judgment Rule</i></li> <li>▪ Treas. Reg. 1.482-9(b)(2)(iv) – <i>Adequate Books and Records</i></li> </ul>

# Issue 1, Step 4: Develop Arguments (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 1](#)

Explanation of Adjustment	Resources
<p>The IT services could be ineligible for the SCM because of any of the following reasons:</p> <ul style="list-style-type: none"><li>▪ The services are an excluded activity from the SCM.</li><li>▪ The services are not “specified covered services” as set forth in Rev. Proc. 2007-13.</li><li>▪ The services are not low-margin services (median comparable markup on total services costs is less than or equal to seven percent).</li><li>▪ The business judgment rule precludes the use of the SCM.</li><li>▪ The taxpayer did not keep adequate books and records to qualify for the SCM.</li></ul>	<ul style="list-style-type: none"><li>▪ Treas. Reg. 1.482-9(b) – <i>Services Cost Method</i></li><li>▪ Treas. Reg. 1.482-9(b)(2) – <i>Eligibility for the Services Cost Method</i></li><li>▪ Treas. Reg. 1.482-9(b)(3)(ii) – <i>Low Margin Covered Services</i></li><li>▪ Treas. Reg. 1.482-9(b)(4) – <i>Excluded Activities</i></li><li>▪ Treas. Reg. 1.482-9(b)(2)(iii) – <i>Business Judgment Rule</i></li><li>▪ Treas. Reg. 1.482-9(b)(2)(iv) – <i>Adequate Books and Records</i></li></ul>

# Issue 1, Step 4: Develop Arguments (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 1](#)

Explanation of Adjustment	Resources
<p><u>Best Practice Tip!</u></p> <ul style="list-style-type: none"> <li>▪ The facts you have gathered should be provided to the taxpayer in an IDR. The taxpayer should be asked to confirm the facts and to correct any facts in the IDR with which it disagrees. The taxpayer should also be asked to provide an explanation of why it disagrees with any facts stated in the IDR.</li> </ul> <p><u>Best Practice Tip!</u></p> <ul style="list-style-type: none"> <li>▪ The results of your examination should be shared and discussed with the taxpayer before your Notice of Proposed Adjustment (NOPA) is finalized.</li> <li>▪ You will need to verify that the method the taxpayer selected was the best method. If the facts and circumstances gathered support another method as the best method, then you will need to gather this evidence and utilize the economist's report to make the argument of why another method is the best method.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.482-9(a) – Methods</li> </ul>
<ul style="list-style-type: none"> <li>▪ If you agree with the taxpayer's transfer pricing method, you may determine that the transfer pricing method has an incomplete or incorrect comparables set.</li> <li>▪ If you disagree with the taxpayer's transfer pricing method, the use of a different transfer pricing method may require the use of a different comparability set.</li> </ul> <p>If the IT services do not qualify for the SCM for any or all of the above reasons, you should discuss your findings with USC - IT.</p>	

# Issue 1, Step 4: Develop Arguments (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### Issue 1

Explanation of Adjustment	Resources
<p>In your NOPA, clearly state the reasons USC – IT does not qualify for the SCM. You will utilize the economist’s report to make the argument of why another method is the best method. You will utilize the economist developed comparable data to clearly state the arm’s length price for the intercompany services transactions at issue.</p> <p>If you determine USC - IT does not qualify for the SCM you must determine what the arm’s length price is for the IT services provided to FC A and FC B. The arm’s length price should fall within the arm’s length results for transactions between uncontrolled parties under the same or similar circumstances. The facts you gathered in your comparability analysis will be utilized to determine which transfer pricing method is the best method.</p>	<ul style="list-style-type: none"> <li>▪ <i>Treas. Reg. 1.482-1(b)(1) – Arm’s Length Standard</i></li> </ul>
<p>You may need to utilize an economist to develop a set of comparables. Share this list of comparables with USC - IT before issuing the NOPA. Sharing your findings with USC – IT may generate additional facts to consider that USC – IT had not previously shared with you. Make sure to fully develop the case factually before you finalize the NOPA.</p> <p><u>Best Practice Tip!</u></p> <ul style="list-style-type: none"> <li>▪ The economist report and the NOPA analysis must agree. Attach the economist report as an Exhibit/Appendix to the NOPA.</li> </ul>	<ul style="list-style-type: none"> <li>▪ <i>Treas. Reg. 1.482-1(b)(1) – Arm’s Length Standard</i></li> </ul>

# Issue 2, Step 2: Review Potential Issues

## High Value Services: Technical and Marketing Fees - Inbound

### Issue 2

Is USC – Marketing charging an arm’s length price for the marketing services provided to the foreign affiliates?

Explanation of Issue	Resources
<p>USC – Marketing is charging a 2% profit mark-up on its total costs for the intercompany marketing services provided to FC A and FC B. The issue is whether a 2% profit mark-up on cost is the arm’s length price based on the services USC – Marketing provides to its foreign affiliates.</p> <p>The arm’s length price for marketing services will vary depending on the type and extent of marketing services provided. The arm’s length price for this transaction is the rate that an uncontrolled party would pay for the same or similar services under the same or similar circumstances. It is possible that marketing services may be high-value services requiring a significant profit (or loss) element in order to be considered arm’s length.</p> <p>To determine the arm’s length price, USC – Marketing may use the methods listed in Treas. Reg. 1.482-9(a) applicable to controlled services transactions. However, the transfer pricing method used must adhere to the best method rule. The best method is the method that will result in the most reliable measure of an arm’s length result.</p>	<ul style="list-style-type: none"> <li>▪ IRC 482</li> <li>▪ Treas. Reg. 1.482-1(b)(1) – <i>Arm’s Length Standard</i></li> <li>▪ Treas. Reg. 1.482-1(c) – <i>Best Method Rule</i></li> <li>▪ Treas. Reg. 1.482-1(d) – <i>Comparability</i></li> <li>▪ Treas. Reg. 1.482-1(e) – <i>Arm’s Length Range</i></li> <li>▪ Treas. Reg. 1.482-9(a) – discusses the best method rule, comparability analysis, and the arm’s length range as applied to controlled service transactions.</li> </ul>

# Issue 2, Step 2: Review Potential Issues (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 2](#)

Explanation of Issue	Resources
<p>You will need to identify all the facts and circumstances associated with the intercompany marketing services provided to determine the best method. You will employ a comparability analysis to evaluate the facts, circumstances, and comparable uncontrolled transactions.</p> <p>Unlike with the SCM and the comparable profits method contained in the -9 services regulations, which uses the ratio of operating profits to total services costs as the profit level indicator, the other transfer pricing methods require a factual determination of which costs to take into account. As a result, you will need to determine what bucket of costs is appropriate for your taxpayer's facts and circumstances under the transfer pricing method selected as the best method.</p> <p>Sometimes marketing services will have valuable marketing intangibles associated with the services. Intangibles such as these may include trade names, trademarks, customer lists, and package design, etc.</p>	<ul style="list-style-type: none"><li>▪ IRC 482</li><li>▪ Treas. Reg. 1.482-1(b)(1) – <i>Arm's Length Standard</i></li><li>▪ Treas. Reg. 1.482-1(c) – <i>Best Method Rule</i></li><li>▪ Treas. Reg. 1.482-1(d) – <i>Comparability</i></li><li>▪ Treas. Reg. 1.482-1(e) – <i>Arm's Length Range</i></li><li>▪ Treas. Reg. 1.482-9(a) – discusses the best method rule, comparability analysis, and the arm's length range as applied to controlled service transactions.</li></ul>

# Issue 2, Step 3: Additional Factual Development

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 2](#)

Fact Element	Resources
<ul style="list-style-type: none"><li>▪ Does USC – Marketing carry out its own marketing activities?<ul style="list-style-type: none"><li>– Does the general ledger activity show marketing expenses? As a seller of goods, you would expect to see these expenses.</li><li>– Do their personnel records show marketing department employees?</li><li>– Does the general ledger support a reimbursement to another entity for marketing services (third party or related entity)?</li><li>– If there are no marketing expenses, how is the activity performed and by what entity?</li><li>– Use questionnaires and interviews to uncover the facts.</li><li>– In the case of outsourcing, the factual inquiry described herein also applies to the subcontractors performing services on USC-Marketing’s behalf.</li></ul></li></ul>	<ul style="list-style-type: none"><li>▪ Audit Tool – Checklist &amp; Audit Tool for Developing Transfer Pricing Issues</li><li>▪ IRM 4.61.3 – <i>Development of IRC Section 482 Cases</i></li><li>▪ IRM Exhibit 4.61.3-4 – <i>Transfer Pricing Functional Analysis Questionnaire</i></li></ul>



# Issue 2, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 2](#)

Fact Element	Resources
<ul style="list-style-type: none"><li>▪ Does USC – Marketing provide marketing services to third parties?<ul style="list-style-type: none"><li>– If so, obtain the agreement as this may be a comparable uncontrolled transaction.</li></ul></li><li>▪ Does USC – Marketing use key marketing personnel to provide the services to FC A or FC B?<ul style="list-style-type: none"><li>– Obtain the position description of marketing personnel.</li><li>– Consider questionnaires and interviews.</li></ul></li><li>▪ Does USC – Marketing ever “loan” or second key marketing personnel to FC A or FC B?<ul style="list-style-type: none"><li>– Request any secondment agreements.</li></ul></li><li>▪ Are the marketing services provided to FC A and FC B routine, low-margin services or are the services more complex, high-profit margin services?<ul style="list-style-type: none"><li>– Research the industry.</li></ul></li></ul>	

# Issue 2, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 2](#)

Fact Element	Resources
<ul style="list-style-type: none"><li>▪ Do the marketing services give FC A or FC B a competitive advantage?<ul style="list-style-type: none"><li>- The Form 10-K may detail competitive advantages to the investors.</li><li>- Analyst phone calls may provide insight.</li><li>- Compare to industry competitors identified earlier in the examination.</li></ul></li><li>▪ Do any other controlled parties provide marketing on the behalf of USC – Marketing, FC A or FC B?<ul style="list-style-type: none"><li>- Review the Form 5472, Part IV.</li><li>- Trace activity through the financial statements and general ledger.</li><li>- Consider questionnaires and interviews.</li></ul></li></ul>	

# Issue 2, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound


### [Issue 2](#)

Fact Element	Resources
<ul style="list-style-type: none"> <li>▪ What types of marketing and advertising does USC – Marketing prepare for FC A and FC B? Follow up on trade shows, product brochures, specifications sheets, etc.</li> <li>▪ What marketing functions are performed as a result of each of these types of marketing/advertising performed for FC A and FC B?</li> <li>▪ How often does USC – Marketing perform services for FC A and FC B?</li> <li>▪ What assets does USC – Marketing utilize in performing the marketing services?</li> <li>▪ Are you able to identify any valuable intangible assets associated with the marketing services?</li> <li>▪ If valuable intangible assets are identified, have these intangibles been paid for at an arm's length price?</li> </ul>	
<ul style="list-style-type: none"> <li>▪ Why was the transaction structured the way it was? Determine the motivations for the structure of the transaction.</li> <li>▪ Ask USC- Marketing: Within your industry, and as compared to your competitors, how would you rate the quality of the marketing services USC – Marketing provides?               <ul style="list-style-type: none"> <li>– Review analyst reports, if available, and other publically available information.</li> </ul> </li> <li>▪ What are the risks related to USC – Marketing's services?</li> <li>▪ What are the contract termination and modification rights? Are upgrades related to services automatic?               <ul style="list-style-type: none"> <li>– If the details of the terms are not disclosed in the intercompany agreement, then consider interviews.</li> </ul> </li> </ul>	

# Issue 2, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 2](#)

Fact Element	Resources
<ul style="list-style-type: none"> <li>▪ Are there any guarantees provided related to the marketing services provided?</li> <li>▪ Does the form of the transaction (including written contractual terms) follow the substance (including actual conduct) of the transaction?                             <ul style="list-style-type: none"> <li>- Trace the transaction through the general ledger.</li> </ul> </li> </ul> <p> <b>CONSULTATION:</b> Consult with your local Counsel before imputing contract terms.</p>	
<ul style="list-style-type: none"> <li>▪ Does USC – Marketing require any head office approvals in regard to the marketing services provided to FC A or FC B?</li> <li>▪ Who assesses demand in foreign markets for the multinational enterprise/controlled group?</li> <li>▪ Who pays for market demand studies/statistics for foreign markets, in particular markets covered by FC A or FC B?</li> <li>▪ Who formulates the marketing budget for USC –Marketing, FC A and FC B?</li> <li>▪ Does USC – Marketing formulate sales projections or set sales targets for FC A or FC B?</li> <li>▪ Does USC – Marketing formulate pricing of products for FC A or FC B?</li> </ul>	

# Issue 2, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 2](#)

Fact Element	Resources
<ul style="list-style-type: none"> <li>▪ Regarding all of the facts gathered, are there any industry deviations between what would be expected of a company in this industry and practices USC – Marketing is utilizing?                             <ul style="list-style-type: none"> <li>– Standard Industry Codes and North American Industry Classification System may help you find standard industry information.</li> <li>– Industry studies and statistics are available for many industries through government websites, Capital IQ and other websites.</li> </ul> </li> </ul>	
<ul style="list-style-type: none"> <li>▪ What transfer pricing method is USC – Marketing using?                             <ul style="list-style-type: none"> <li>– Comparable Uncontrolled Services Price Method</li> <li>– Gross Services Margin Method</li> <li>– Cost of Services Plus Method</li> <li>– Comparable Profits Method</li> <li>– Profit Split Method</li> <li>– Unspecified Methods</li> </ul> </li> <li>▪ Is the transfer pricing method USC – Marketing utilizes the best method?                             <ul style="list-style-type: none"> <li>– Review the transfer pricing discussion on why other methods were rejected and why the method used was selected.</li> </ul> </li> <li>▪ Are the marketing services provided being compensated at an arm's length price?</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.482-1(c) – <i>Best Method Rule</i></li> <li>▪ Treas. Reg. 1.482-1(d) – <i>Comparability</i></li> </ul>

# Issue 2, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound


### [Issue 2](#)

Fact Element	Resources
<ul style="list-style-type: none"><li>▪ Who are USC – Marketing’s competitors?<ul style="list-style-type: none"><li>– Standard Industry Codes and North American Industry Classification System may help you find competitors.</li><li>– Industry studies and statistics are available for many industries through government websites, Capital IQ and other websites. These statistics may help you identify competitors.</li></ul></li><li>▪ Are the uncontrolled comparables USC – Marketing used in its transfer pricing study actually comparable to the USC - Marketing transaction?</li><li>▪ Are the functions performed similar?</li><li>▪ Are the contractual terms similar?</li><li>▪ Are the risks assumed similar?</li><li>▪ Are the economic conditions similar?</li><li>▪ Are the property or services similar?</li></ul>	

# Issue 2, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound



### [Issue 2](#)

Fact Element	Resources
<ul style="list-style-type: none"><li>▪ Is segmented data available to remove any dissimilar items?</li><li>▪ Did USC – Marketing make any adjustments to the comparables selected as uncontrolled comparables?<ul style="list-style-type: none"><li>– Were all material differences identified?</li><li>– Does each material difference have a definite and reasonably ascertainable effect on the price or profit of the services USC – Marketing provides?</li><li>– Does the adjustment eliminate the effect of the material difference(s)?</li></ul></li></ul> <p> <b>CONSULTATION:</b> You may consider consulting with an economist.</p>	<ul style="list-style-type: none"><li>▪ Treas. Reg. 1.482-1(d)(2) – <i>Standards of Comparability</i></li><li>▪ Treas. Reg. 1.482-1(e)(2)(ii) – <i>Selection of Comparables</i></li></ul>

# Issue 2, Step 4: Develop Arguments

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 2](#)

Explanation of Adjustment	Resources
<p>At this point you will have gathered all the facts and circumstances regarding the marketing services USC – Marketing provided to FC A and FC B. You will need to make a determination:</p> <p> <b>DECISION POINT:</b> Was the cost plus 2% mark-up an arm's length price for the marketing services provided?</p> <p><u>Best Practice Tip!</u></p> <ul style="list-style-type: none"><li>▪ The facts you have gathered should be provided to the taxpayer in an IDR. The taxpayer should be asked to confirm the facts and to correct any facts in the IDR with which it disagrees. The taxpayer should also be asked to provide an explanation of why it disagrees with any facts stated in the IDR.</li></ul> <p> <b>CONSULTATION:</b> If questions of law arise, be sure to consult with local field counsel.</p>	



# Issue 2, Step 4: Develop Arguments (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 2](#)

Fact Element	Resources
<p><u>Best Practice Tip!</u></p> <ul style="list-style-type: none"><li>▪ The results of your examination should be shared and discussed with the taxpayer before your (NOPA) is finalized.</li><li>▪ You will need to verify whether the method the taxpayer selected was the best method. If the facts and circumstances gathered support another method as the best method, then you will need to use this evidence and the economist's report to make the argument of why another method is the best method.<ul style="list-style-type: none"><li>– If you agree with the taxpayer's transfer pricing method, you may determine that the transfer pricing method has an incomplete or incorrect comparables set.</li><li>– If you disagree with the taxpayer's transfer pricing method, the use of a different transfer pricing method may require the use of a different comparability set.</li></ul></li></ul>	

# Issue 2, Step 4: Develop Arguments (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 2](#)

Fact Element	Resources
<p>If you disagree with the taxpayer's comparables, you will need to provide the reason for the additions or deletions to the comparable set.</p> <p>If the comparables are missing adjustments that will make the comparables set more reliable, explain why the adjustment is materially significant and how it makes the comparables more reliable. Address in the NOPA:</p> <ul style="list-style-type: none"><li>▪ That the data was used to ascertain with sufficient accuracy that the adjustment improved the reliability of the results.</li><li>▪ Explain any commercial practices, economic principles or statistical analysis used to compute the adjustments.</li></ul>	
<p>If these items are discussed in detail in the economist report, briefly summarize the discussion in the NOPA and refer to the appropriate page number in the economist report.</p> <p><u>Best Practice Tip!</u></p> <ul style="list-style-type: none"><li>▪ The economist report and the NOPA analysis must agree. Attach the economist report as an Exhibit/Appendix to the NOPA.</li></ul>	

# Issue 3, Step 2: Review Potential Issues

## High Value Services: Technical and Marketing Fees - Inbound

### Issue 3

Is USC – R&D charging an arm’s length price for the R&D services provided to the foreign affiliates?

Explanation of Issue	Resources
<p>USC – R&amp;D is charging an 8% mark-up on its total costs for the intercompany R&amp;D services provided to FC A and FC B. The issue is whether an 8% mark-up on the total costs is the arm’s length price.</p> <p>The arm’s length price for R&amp;D services will vary depending on the type and extent of the R&amp;D services provided. The arm’s length price for this transaction is the rate that an uncontrolled party would pay for the same or similar services under similar circumstances. (e.g., functions, terms and conditions, risks assumed, etc.).</p> <p>R&amp;D services often involve highly technical services such as engineering and scientific services. These services can be more valuable than non-technical services like general administration or accounting services.</p> <p>To determine the arm’s length price, USC – R&amp;D may use one of the methods under Treas. Reg. 1.482-9(a) applicable to controlled service transactions. However, the transfer pricing method used must comply with the best method rule. The best method is the method that will result in the most reliable measure of an arm’s length result.</p> <p>In addition, methods that are specified with respect to cost sharing arrangements, such as the income method, may be particularly appropriate pursuant to Treas. Reg. 1.482-9(m)(3).</p>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.482-1(b)(1) – <i>Arm’s Length Standard</i></li> <li>▪ Treas. Reg. 1.482-1(c) – <i>Best Method Rule</i></li> <li>▪ Treas. Reg. 1.482-1(d) – <i>Comparability</i></li> <li>▪ Treas. Reg. 1.482-1(e) – <i>Arm’s Length Range</i></li> <li>▪ Treas. Reg. 1.482-9(a) – discusses the best method rule, comparability analysis, and the arm’s length range</li> <li>▪ Treas. Reg. 1.482-9(m)(3) – references the relevance of the method, principles, comparability, and reliability considerations set forth in Treas. reg. 1.482-7</li> </ul>

# Issue 3, Step 2: Review Potential Issues (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 3](#)

Explanation of Issue	Resources
<p>Note that R&amp;D, engineering, or scientific services are explicitly excluded from the SCM under Treas. Reg. 1.482-9(b)(4).</p> <p>You will need to gather all the facts and circumstances of the intercompany R&amp;D services provided to determine the best method. You will employ comparability analysis to uncover the facts, circumstances, and comparable uncontrolled transactions.</p>	<ul style="list-style-type: none"><li>▪ Treas. Reg. 1.482-1(b)(1) – <i>Arm’s Length Standard</i></li><li>▪ Treas. Reg. 1.482-1(c) – <i>Best Method Rule</i></li><li>▪ Treas. Reg. 1.482-1(d) – <i>Comparability</i></li><li>▪ Treas. Reg. 1.482-1(e) – <i>Arm’s Length Range</i></li><li>▪ Treas. Reg. 1.482-9(a) – Discusses the best method rule, comparability analysis, and the arm’s length range</li><li>▪ Treas. Reg. 1.482-9(b) – <i>Services Cost Method</i></li><li>▪ Treas. Reg. 1.482-9(b)(4) – <i>Excluded Activity (SCM)</i></li></ul>

# Issue 3, Step 3: Additional Factual Development

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 3](#)

Fact Element	Resources
<ul style="list-style-type: none"> <li>▪ Does USC – R&amp;D have a departmental personnel chart/list for the relevant department(s)?</li> <li>▪ Does USC – R&amp;D outsource any of its R&amp;D activities to third parties?                             <ul style="list-style-type: none"> <li>– In the case of outsourcing, the factual inquiry described here also applies to any subcontractors performing services on USC-R&amp;D’s behalf.</li> </ul> </li> <li>▪ Does USC – R&amp;D provide R&amp;D (or sufficiently similar engineering) services to third parties?                             <ul style="list-style-type: none"> <li>– If so, obtain the agreement as this may be a comparable uncontrolled transaction.</li> </ul> </li> <li>▪ Does USC – R&amp;D ever loan or second key R&amp;D personnel to FC A and/or FC B?                             <ul style="list-style-type: none"> <li>– Request any secondment agreements.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Audit Tool – Checklist &amp; Audit Tool for Developing Transfer Pricing Issues</li> <li>▪ IRM 4.61.3 – <i>Development of IRC Section 482 Cases</i></li> <li>▪ IRM Exhibit 4.61.3-4 – <i>Transfer Pricing Functional Analysis Questionnaire</i></li> </ul>
<ul style="list-style-type: none"> <li>▪ What are the contractual terms and conditions of the R&amp;D services? For example, IP ownership rights, contract cancellation rights, payment terms including frequency of billings, currency, terms of settlement, modification terms.</li> <li>▪ Is USC – R&amp;D’s service fees contingent on the success or failure of the R&amp;D activities?                             <ul style="list-style-type: none"> <li>– Consult the intercompany agreement, as well as observe actual transaction.</li> </ul> </li> <li>▪ Do any other controlled parties provide R&amp;D services on behalf of USC – R&amp;D, FC A or FC B?                             <ul style="list-style-type: none"> <li>– Request related intercompany agreements.</li> </ul> </li> </ul>	

# Issue 3, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 3](#)

Fact Element	Resources
<ul style="list-style-type: none"><li>▪ How does USC – R&amp;D determine its services costs?<ul style="list-style-type: none"><li>– Utilize the general ledger and request related spreadsheets to understand the cost of the services.</li><li>– Review cost accounting records to distinguish marketing costs.</li><li>– Review cost center allocation keys to see which costs, including general and administrative costs, are being allocated to the transaction (and which are not).</li></ul></li><li>▪ Does USC – R&amp;D's services give FC A or FC B a competitive advantage?<ul style="list-style-type: none"><li>– The Form 10-K may detail competitive advantages to the investors.</li><li>– Analyst phone calls may provide insight.</li><li>– Compare to industry competitors identified earlier in the examination.</li></ul></li></ul>	

# Issue 3, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 3](#)

Fact Element	Resources
<ul style="list-style-type: none"><li>▪ What are the risks related to US – R&amp;D's services provided to FC A and FC B?</li><li>▪ Are there any guarantees provided by the R&amp;D services?</li><li>▪ Who incurs the risk of loss in the event the R&amp;D activity fails (or does not yield the desirable results)?</li><li>▪ What assets (tangible and intangible) does USC – R&amp;D employ to perform the R&amp;D services? Are the costs of these assets able to be recovered from the R&amp;D service billings to the foreign affiliates?<ul style="list-style-type: none"><li>– Tours, questionnaires and interviews may be necessary.</li><li>– Utilize our internal programs for identifying property records.</li><li>– Utilize government websites for researching ownership of patents and intangibles.</li></ul></li></ul>	

# Issue 3, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 3](#)


Fact Element	Resources
<ul style="list-style-type: none"><li>▪ Who determines the R&amp;D activities (or projects) to be performed by USC – R&amp;D?</li><li>▪ Does USC – R&amp;D require head office approvals in regard to the R&amp;D services provided to FC A and/or FC B?<ul style="list-style-type: none"><li>– Determine who controls the transaction. Interview appropriate personnel.</li><li>– Request management agreements, if any.</li></ul></li><li>▪ Who determines and approves the R&amp;D budget for USC – R&amp;D, FC A and FC B?</li><li>▪ Who decides what R&amp;D to pursue, how much to spend, etc.?</li><li>▪ Who are USC – R&amp;D's competitors?<ul style="list-style-type: none"><li>– Standard Industry Codes and North American Industry Classification System may help you find competitors.</li><li>– Utilize Capital IQ, the taxpayer's website and competitors websites.</li></ul></li></ul>	



# Issue 3, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 3](#)

Fact Element	Resources
<ul style="list-style-type: none"><li>▪ Regarding all of the facts gathered, are there any industry deviations between what would be expected of a company in this industry and practices USC – R&amp;D is utilizing?<ul style="list-style-type: none"><li>– Standard Industry Codes and North American Industry Classification System may help you find standard industry information.</li></ul></li><li>▪ Why was the transaction structured the way it was? Determine the motivations of the structuring.</li><li>▪ Does the form of the transaction (including written contract terms) follow the substance (including actual conduct) of the transaction?<ul style="list-style-type: none"><li>– Trace the transaction through the books and records.</li></ul></li></ul> <p> <b>CONSULTATION:</b> Consult with your local Counsel before imputing contract terms.</p>	

# Issue 3, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound


### [Issue 3](#)

Fact Element	Resources
<ul style="list-style-type: none"> <li>▪ What transfer pricing method is USC – R&amp;D using?                             <ul style="list-style-type: none"> <li>– Comparable Uncontrolled Services Price Method</li> <li>– Gross Services Margin Method</li> <li>– Cost of Services Plus Method</li> <li>– Comparable Profits Method</li> <li>– Profit Split Method</li> <li>– Unspecified Methods</li> </ul> </li> <li>▪ Is the transfer pricing method utilized by USC – R&amp;D the best method?</li> <li>▪ Are the total R&amp;D services fees determined in accordance with the intercompany agreement and contemporaneous transfer pricing study?</li> </ul>	<ul style="list-style-type: none"> <li>▪ Treas. Reg. 1.482-1(c) – <i>Best Method Rule</i></li> <li>▪ Treas. Reg. 1.482-1(d) – <i>Comparability</i></li> <li>▪ IRM 4.61.3.5.1 – <i>Functional Analysis</i></li> <li>▪ IRM Exhibit 4.61.3-4 - <i>Transfer Pricing Functional Analysis Questionnaire</i></li> </ul>

# Issue 3, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound


### [Issue 3](#)

Fact Element	Resources
<ul style="list-style-type: none"><li>▪ Are the uncontrolled comparables USC – R&amp;D used in its transfer pricing study actually comparable to the USC – R&amp;D controlled transaction?</li><li>▪ Are the functions performed similar?</li><li>▪ Are the contractual terms similar?</li><li>▪ Are the risks assumed similar?</li><li>▪ Are the economic conditions similar?</li><li>▪ Are the property or services similar?</li><li>▪ Are the geographic locations of USC – R&amp;D and uncontrolled comparable companies similar?</li></ul> <p> <b>CONSULTATION:</b> You may consider consulting with an economist.</p>	<ul style="list-style-type: none"><li>▪ <i>Treas. Reg. 1.482-1(d) – Comparability</i></li><li>▪ <i>IRM 4.61.3.5.1 – Functional Analysis</i></li><li>▪ <i>IRM Exhibit 4.61.3-4 - Transfer Pricing Functional Analysis Questionnaire</i></li></ul>

# Issue 3, Step 3: Additional Factual Development (cont'd)

## High Value Services: Technical and Marketing Fees - Inbound



### [Issue 3](#)

Fact Element	Resources
<ul style="list-style-type: none"><li>▪ Is segmented data available to remove any dissimilar items?</li><li>▪ Did USC – R&amp;D make any adjustments to the comparables selected as uncontrolled comparables?<ul style="list-style-type: none"><li>– Are all material differences identified?</li><li>– Does each material difference have a definite and reasonably ascertainable effect on the price or profit of the services USC – R&amp;D provides?</li><li>– Does the adjustment eliminate the effect of the material difference(s)?</li></ul></li></ul> <p> <b>CONSULTATION:</b> You may want to consider consulting with an economist.</p>	<ul style="list-style-type: none"><li>▪ Treas. Reg. 1.482-1(d)(2), <i>Standards of Comparability</i></li><li>▪ Treas. Reg. 1.482-1(e)(2)(ii), <i>Selection of Comparables</i></li></ul>

# Issue 3, Step 4: Develop Arguments

## High Value Services: Technical and Marketing Fees - Inbound

### [Issue 3](#)

Explanation of Adjustment	Resources
<p>At this point you will have gathered all the facts and circumstances regarding the services USC – R&amp;D provided to FC A and FC B. You will need to make a determination:</p> <p> <b>DECISION POINT:</b> Was the cost plus 8% mark-up an arm's length price for the R&amp;D services provided?</p> <p> <b>CONSULTATION:</b> If questions of law arise, be sure to consult with local field counsel.</p> <p>See slides 28-29 for procedures and best practice tips regarding NOPA preparation.</p>	

# Index of Referenced Resources

## High Value Services: Technical and Marketing Fees - Inbound

IRC 482

Treas. Reg. 1.482-1

Treas. Reg. 1.482-9

Rev. Proc. 2007-13

IRM 4.61.3 – *Development of IRC Section 482 Cases*

IRM Exhibit 4.61.3-4 – *Transfer Pricing Functional Analysis Questionnaire*

IRM 4.61.3.5.1 – *Functional Analysis*

Form 5472, Part IV, Lines 6 and 7

Audit Tool – Checklist & Audit Tool for Developing Transfer Pricing Issues

Audit Tool – Transfer Pricing Roadmap/Timeline

IDR – Mandatory Transfer Pricing Information Document Request

# Training and Additional Resources

High Value Services: Technical and Marketing Fees - Inbound	
Type of Resource	Description(s)
Saba Meeting Sessions	<ul style="list-style-type: none"> <li>▪ <i>Overview and Introduction to IRC 482 – 2012 CENTRA</i></li> <li>▪ <i>High Value Services – 2012 CPE CENTRA</i></li> </ul>
Podcasts / Videos	<ul style="list-style-type: none"> <li>▪ <i>High Value Services – 2012 CPE CENTRA</i></li> </ul>
Other Training Materials	<ul style="list-style-type: none"> <li>▪ <i>Bittker and Lokken – Fed. Tax'n of Corps and Shareholders Fundamentals of International Taxation, Chapter 79: Reallocation of Income and Deductions Among Related Taxpayers</i></li> <li>▪ <i>BNA Tax Management Int'l Portfolio 889-2nd Sec. I-IV, Intercompany Service Transactions</i></li> <li>▪ <i>BNA Tax Management Int'l Portfolio 889-2nd Sec. I-III, Intercompany Pricing of Intangibles</i></li> <li>▪ <i>BNA Tax Management Int'l Portfolio 890, WS 1, Sample Questionnaire for Intercompany Transactions</i></li> </ul>

# Glossary of Terms and Acronyms

Term/Acronym	Definition
CSA	Cost Sharing Arrangement
DCN	Document Control Number
ETR	Effective Tax Rate
FC	Foreign Corporation
FP	Foreign Parent
IP	Intangible Property
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
ISI	Income Shifting Inbound
ISO	Income Shifting Outbound
IT	Information Technology
LB&I	Large Business & International
MNE	Multinational Enterprise
NOPA	Notice of Proposed Adjustment
OECD	Organisation for Economic Cooperation and Development
PN	Practice Network



# Glossary of Terms and Acronyms (cont'd)

Term/Acronym	Definition
R&D	Research and Development
SBC	Stock-based Compensation
SCM	Services Cost Method
TPM	Transfer Pricing Method
USC	U.S. Corporation
USS	U.S. Subsidiary

# Index of Related Practice Units

Associated UIL(s)	Related Practice Unit	DCN
9411	<i>Overview of IRC Section 482</i>	ISO/T/01-01 (formerly ISO/9411.07_01(2013))
9411.02	<i>Distinguishing Between Sale License and other Transfers of Intangibles to CFCs by U.S. Transferors</i>	ISO/T/01_02-04 (formerly ISO/9411.02_02(2013))
9411.02-01	<i>Accounting for Intangibles and Services Embedded in the Sale of Tangible Property - Outbound</i>	ISO/T/01_02_01-02 (formerly ISO/9411.04_02(2014))
9411.03	<i>Outbound Services by U.S. Companies to CFCs</i>	ISO/T/01_03-01 (formerly ISO/9411.07_02(2013))
9422	<i>Arm's Length Standard</i>	DCN: ISI/T/06-03 (formerly ISI/9422.09_06(2013))
9422.05	<i>Management Fees</i>	ISI/T/06_05-01 (formerly ISI/9422.05_01(2013))
9422.05	<i>Services Cost Method Inbound Services</i>	ISI/T/06_05-03 (formally ISO/9422.09_05 (2013))
9422-05	<i>Foreign Shareholder Activities and Duplicative Activities</i>	ISI/T/06_05-04 (formerly ISI/9422.09_01(2014))
9422.07	<i>Comparability Analysis for Tangible Goods Transactions - Inbound</i>	ISO/P/06_07-01 (formerly ISO/PUO/V_6_01(2014))
9422.07	<i>Best Method Determination for an Inbound Distributor</i>	ISI/T/06_07-03 (formerly ISI/9422.09_04(2013))