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DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[TD 9738]

RIN 1545-BM72

Clarification of the Coordination of the Transfer Pricing Rules with Other Code Provisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains temporary regulations that clarify the coordination of the application of the arm's length standard and the best method rule under section 482 of the Internal Revenue Code (Code) in conjunction with other provisions of the Code. The text of the temporary regulations also serves in part as the text of the proposed regulations (REG-139483-13) published in the Proposed Rules section of this issue of the **Federal Register**. This document also contains final regulations that add cross-references in the existing final regulations under section 482 to relevant sections of these temporary regulations.

DATES: Effective date: These regulations are effective on September 14, 2015.

Applicability date: For dates of applicability, see §1.482-1T(j)(7)(i).

FOR FURTHER INFORMATION CONTACT: Frank W. Dunham III, (202) 317-6939 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

## **Background**

Regulations under section 482 published in the **Federal Register** (33 FR 5848) on April 16, 1968, provided guidance on methods for applying the arm's length standard to evaluate controlled transactions, including transfers of tangible and intangible property, the provision of services, and loans or advances. Subsequent revisions and updates of the transfer pricing regulations were published in the **Federal Register** on July 8, 1994, Dec. 20, 1995, May 13, 1996, Aug. 26, 2003, Aug. 4, 2009, Dec. 22, 2011, and Aug. 27, 2013 (59 FR 34971, 60 FR 65553, 61 FR 21955, 68 FR 51171, 74 FR 38830, 76 FR 80082, and 78 FR 52854, respectively).

## **Explanation of Provisions**

### I. Overview – Consistent Valuation of Controlled Transactions for All Code Purposes

Section 482 authorizes the Secretary, and the regulations under section 482 authorize the IRS, to adjust the results of controlled transactions to clearly reflect the income of commonly controlled taxpayers in accordance with the arm's length standard and, in the case of the transfer of intangible property (within the meaning of section 936(h)(3)(B)), so as to be commensurate with the income attributable to the intangible. While the determination of arm's length prices for controlled transactions is governed by section 482, the tax treatment of controlled transactions is also governed by other Code and regulatory rules applicable to both controlled and uncontrolled transactions. Controlled transactions always remain subject to section 482 in addition to these generally applicable provisions. These temporary regulations clarify the coordination of section 482 and the regulations thereunder with such other Code and regulatory provisions.

The coordination rules in these temporary regulations apply to controlled transactions, including controlled transactions that are subject in whole or part to both sections 367 and 482. Transfers of property subject to section 367 that occur between controlled taxpayers require a consistent and coordinated application of sections 367 and 482 to the controlled transfer of property and any related transactions between controlled taxpayers. The controlled transactions may include transfers of property subject to section 367(a) or (e), transfers of intangible property subject to section 367(d) or (e), and the provision of services that contribute significantly to maintaining, exploiting, or further developing the transferred properties. All of the transactions (and any elements thereof) must be analyzed and valued on a consistent basis under section 482 in order to achieve the intended purposes of sections 367 and 482.

The consistent analysis and valuation of transactions subject to multiple Code and regulatory provisions is required under the best method rule described in §1.482-1(c). A best method analysis under section 482 begins with a consideration of the facts and circumstances related to the functions performed, the resources employed, and the risks assumed in the actual transaction or transactions among the controlled taxpayers, as well as in any uncontrolled transactions used as comparables. See §1.482-1(c)(2)(i) and (d)(3). For example, if consideration of the facts and circumstances reveals synergies among interrelated transactions, an aggregate evaluation under section 482 may provide a more reliable measure of an arm's length result than a separate evaluation of the transactions. In contrast, an inconsistent or uncoordinated application of section 482 to interrelated controlled transactions that are subject to tax under different Code and regulatory provisions may lead to inappropriate conclusions.

The best method rule requires a determination of the arm's length result of controlled transactions under the method, and particular application of that method, that provides the most reliable measure of an arm's length result. Under the regulations, the reliability of the measure depends on the economics of the controlled transactions, not their formal character. See, e.g., §§1.482-2A(e)(3)(vii) and 1.482-3(c)(3)(ii)(D) (use of sales agent's commission as comparable for reseller's appropriate markup under the resale price method); §§1.482-2A(e)(4)(iv) and 1.482-3(d)(3)(ii)(D) (use of purchasing agent's commission as comparable for producer's appropriate gross profit percentage under the cost-plus method); and §1.482-9(i)(4) and (5), Examples 1 and 3 (reference to charges for transfers of property as relevant to the determination of a contingent-payment services charge). Realistic alternative transactions that, on a risk-adjusted basis, reflect arrangements that are economically equivalent to those in the controlled transactions may provide the basis for application of unspecified methods to determine the most reliable measure of an arm's length result in the controlled transactions. See, e.g., §§1.482-1(f)(2)(ii)(A), 1.482-3(e)(1), 1.482-4(d)(1), 1.482-7(g)(8), and 1.482-9(h). Thus, although a taxpayer may choose among different transactional forms—for example, a long-term license, research and development services, a cost sharing arrangement, or a transfer subject to section 367—specified and unspecified methods applicable to each form will provide consistent arm's length results for economically equivalent transactions.

Based upon taxpayer positions that the IRS has encountered in examinations and controversy, the Treasury Department and the IRS are concerned that certain results reported by taxpayers reflect an asserted form or character of the parties'

arrangement that involves an incomplete assessment of relevant functions, resources, and risks and an inappropriately narrow analysis of the scope of the transfer pricing rules. In particular, the Treasury Department and the IRS are concerned about situations in which controlled groups evaluate economically integrated transactions involving economically integrated contributions, synergies, and interrelated value on a separate basis in a manner that results in a misapplication of the best method rule and fails to reflect an arm's length result. Taxpayers may assert that, for purposes of section 482, separately evaluating interrelated transactions is appropriate simply because different statutes or regulations apply to the transactions (for example, where section 367 and the regulations thereunder apply to one transaction and the general recognition rules of the Code apply to another related transaction). These positions are often combined with inappropriately narrow interpretations of §1.482-4(b)(6), which provides guidance on when an item is considered similar to the other items identified as constituting intangibles for purposes of section 482. The interpretations purport to have the effect, contrary to the arm's length standard, of requiring no compensation for certain value provided in controlled transactions despite the fact that compensation would be paid if the same value were provided in uncontrolled transactions.

As discussed in the following portion of this preamble, these temporary regulations address the aforementioned concerns by clarifying the coordination of the application of section 482 in conjunction with other Code and regulatory provisions in determining the proper tax treatment of controlled transactions.

## II. Detailed Explanation of Provisions

### A. Compensation Independent of the Form or Character of Controlled Transaction – §1.482-1T(f)(2)(i)(A)

New §1.482-1T(f)(2)(i)(A) provides that arm's length compensation must be consistent with, and must account for all of, the value provided between the parties in a controlled transaction, without regard to the form or character of the transaction. For this purpose, it is necessary to consider the entire arrangement between the parties, as determined by the contractual terms, whether written or imputed in accordance with the economic substance of the arrangement, in light of the actual conduct of the parties. This requirement is consistent with the principles underlying the arm's length standard, which require arm's length compensation in controlled transactions equal to the compensation that would have occurred if a similar transaction had occurred between similarly situated uncontrolled taxpayers. See §1.482-1(b)(1). Accordingly, no inference may be drawn from any provision in the section 482 regulations that any transfer of value may be made without arm's length compensation.

**B. Aggregate or Separate Analysis, Depending on Economic Interrelatedness of Controlled Transactions, including Synergies – §1.482-1T(f)(2)(i)(B)**

Section 1.482-1T(f)(2)(i)(B) clarifies §1.482-1(f)(2)(i)(A), which provided that the combined effect of two or more separate transactions (whether before, during, or after the year under review) may be considered if such transactions, taken as a whole, are so interrelated that an aggregate analysis of such transactions provides the most reliable measure of an arm's length result determined under the best method rule of §1.482-1(c). Specifically, a new clause is added to clarify that this aggregation principle also applies for purposes of an analysis under multiple provisions of the Code or regulations. In addition, a new sentence elaborates on the aggregation principle by noting that consideration of the combined effect of two or more transactions may be appropriate to determine whether the overall compensation is consistent with the value provided,

including any synergies among items and services provided. Finally, §1.482-1T(f)(2)(i)(B) does not retain the statement in §1.482-1(f)(2)(i)(A) that transactions generally will be aggregated only when they involve “related products or services, as defined in §1.6038A-3(c)(7)(vii).” The eliminated sentence had the unintended potential to be misconstrued by taxpayers as limiting the aggregation analysis pursuant to the best method rule.

C. Aggregation and Allocation for Purposes of Coordinated Analysis under Multiple Code or Regulatory Provisions – §§1.482-1T(f)(2)(i)(C) and 1.482-1T(f)(2)(i)(D)

Section 1.482-1T(f)(2)(i)(C) provides that, for one or more controlled transactions governed by more than one provision of the Code and regulations, a coordinated best method analysis and evaluation of the transactions may be necessary to ensure that the overall value provided (including any synergies) is properly taken into account. A coordinated best method analysis of the transactions includes a consistent consideration of the facts and circumstances of the functions performed, resources employed, and risks assumed, and a consistent measure of the arm’s length results, for purposes of all relevant Code and regulatory provisions. For example, situations in which a coordinated best method analysis and evaluation may be necessary include (1) two or more interrelated transactions when either all such transactions are governed by one regulation under section 482 or all such transactions are governed by one subsection of section 367, (2) two or more interrelated transactions governed by two or more regulations under section 482, (3) a transfer of property subject to section 367(a) and an interrelated transfer of property subject to section 367(d), (4) two or more interrelated transactions where section 367 applies to one transaction and the general recognition rules of the Code apply to another interrelated transaction, and (5) other

circumstances in which controlled transactions require analysis under multiple Code and regulatory provisions.

Section 1.482-1T(f)(2)(i)(D) provides that it may be necessary to allocate the arm's length result that was properly determined under a coordinated best method analysis described in §1.482-1T(f)(2)(i)(C) among the interrelated transactions. Any such allocation must be made using the method that, under the facts and circumstances, provides the most reliable measure of an arm's length result for each allocated amount.

D. Examples of Coordinated Best Method Analysis under Multiple Code or Regulatory Provisions – §1.482-1T(f)(2)(i)(E)

Section 1.482-1T(f)(2)(i)(E) provides eleven examples to illustrate the guidance in §1.482-1T(f)(2)(i)(A) through (D). Examples 1 through 4 are materially the same as the Examples in §1.482-1(f)(2)(i)(B). The Treasury Department and the IRS do not intend for the revisions to those examples to be interpreted as substantive. The rest of the examples are new.

Section 1.482-1T(f)(2)(ii)(B) replaces §1.482-1(f)(2)(ii)(B). The Example included in §1.482-1T(f)(2)(ii)(B) is materially the same as the old example and has been updated to replace the term "district director" and to include cross-references to Examples 7 and 8 in §1.482-1T(f)(2)(i)(E). The Treasury Department and the IRS do not intend for the revisions to this example to be interpreted as substantive.

No inference is intended as to the application of the provisions amended by these temporary regulations under current law. The IRS may, where appropriate, challenge transactions, including those described in these temporary regulations and

this preamble, under currently applicable Code or regulatory provisions or judicial doctrines.

### **Effective/Applicability Date**

These regulations apply to taxable years ending on or after September 14, 2015.

### **Special Analyses**

Certain IRS regulations, including this one, are exempt from the requirements of Executive Order 12866, as supplemented and reaffirmed by Executive Order 13563. Therefore, a regulatory impact assessment is not required. It has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation. For applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), refer to the cross-referenced notice of proposed rulemaking published elsewhere in this issue of the **Federal Register**. Pursuant to section 7805(f) of the Internal Revenue Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

### **Drafting Information**

The principal author of these regulations is Frank W. Dunham III of the Office of the Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS participated in the development of the regulations.

### **List of Subjects in 26 CFR Part 1**

Income taxes, Reporting and recordkeeping requirements.

### **Amendments to the Regulations**

Accordingly, 26 CFR part 1 is 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 \* \* \*

Sections 1.482-1 and 1.482-1T are also issued under 26 U.S.C. 482. \* \* \*

Par. 2. Section 1.482-0 is amended by revising the entries for §1.482-1(f)(2)(i) and (f)(2)(ii)(B) to read as follows:

§1.482-0 Outline of regulations under section 482.

\* \* \* \* \*

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

\* \* \* \* \*

(f) \* \* \*

(2) \* \* \*

(i) [Reserved]

(ii) \* \* \*

(B) [Reserved]

\* \* \* \* \*

Par. 3. Section 1.482-1 is amended by revising paragraphs (f)(2)(i) and (f)(2)(ii)(B) and adding paragraph (j)(7) to read as follows:

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

\* \* \* \* \*

(f) \* \* \*

(2) \* \* \*

(i)(A) through (E) [Reserved]. For further guidance see §1.482-1T(f)(2)(i)(A) through (E).

(ii) \* \* \*

(B) [Reserved]. For further guidance see §1.482-1T(f)(2)(ii)(B).

\* \* \* \* \*

(j) \* \* \*

(7) [Reserved]. For further guidance see §1.482-1T(j)(7).

Par. 4. Section 1.482-1T is added to read as follows:

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

(a) through (f)(2) [Reserved]. For further guidance see §1.482-1(a) through (f)(2).

(i) Compensation independent of the form or character of controlled transaction--

(A) In general. All value provided between controlled taxpayers in a controlled transaction requires an arm's length amount of compensation determined under the best method rule of §1.482-1(c). Such amount must be consistent with, and must account for all of, the value provided between the parties in the transaction, without regard to the form or character of the transaction. For this purpose, it is necessary to consider the entire arrangement between the parties, as determined by the contractual terms, whether written or imputed in accordance with the economic substance of the arrangement, in light of the actual conduct of the parties. See, e.g., §1.482-1(d)(3)(ii)(B) (identifying contractual terms) and (f)(2)(ii)(A) (regarding reference to realistic alternatives).

(B) Aggregation. The combined effect of two or more separate transactions (whether before, during, or after the year under review), including for purposes of an analysis under multiple provisions of the Code or regulations, may be considered if the transactions, taken as a whole, are so interrelated that an aggregate analysis of the

transactions provides the most reliable measure of an arm's length result determined under the best method rule of §1.482-1(c). Whether two or more transactions are evaluated separately or in the aggregate depends on the extent to which the transactions are economically interrelated and on the relative reliability of the measure of an arm's length result provided by an aggregate analysis of the transactions as compared to a separate analysis of each transaction. For example, consideration of the combined effect of two or more transactions may be appropriate to determine whether the overall compensation in the transactions is consistent with the value provided, including any synergies among items and services provided.

(C) Coordinated best method analysis and evaluation. Consistent with the principles of paragraphs (f)(2)(i)(A) and (B) of this section, a coordinated best method analysis and evaluation of two or more controlled transactions to which one or more provisions of the Code or regulations apply may be necessary to ensure that the overall value provided, including any synergies, is properly taken into account. A coordinated best method analysis would include a consistent consideration of the facts and circumstances of the functions performed, resources employed, and risks assumed in the relevant transactions, and a consistent measure of the arm's length results, for purposes of all relevant statutory and regulatory provisions.

(D) Allocations of value. In some cases, it may be necessary to allocate one or more portions of the arm's length result that was properly determined under a coordinated best method analysis described in paragraph (f)(2)(i)(C) of this section. Any such allocation of the arm's length result determined under the coordinated best method analysis must be made using the method that, under the facts and

circumstances, provides the most reliable measure of an arm's length result for each allocated amount. For example, if the full value of compensation due in controlled transactions whose tax treatment is governed by multiple provisions of the Code or regulations has been most reliably determined on an aggregate basis, then that full value must be allocated in a manner that provides the most reliable measure of each allocated amount.

(E) Examples. The following examples illustrate the provisions of this paragraph (f)(2)(i). For purposes of the examples in this paragraph (E), P is a domestic corporation, and S1, S2, and S3 are foreign corporations that are wholly owned by P.

Example 1. Aggregation of interrelated licensing, manufacturing, and selling activities. P enters into a license agreement with S1 that permits S1 to use a proprietary manufacturing process and to sell the output from this process throughout a specified region. S1 uses the manufacturing process and sells its output to S2, which in turn resells the output to uncontrolled parties in the specified region. In evaluating whether the royalty paid by S1 to P is an arm's length amount, it may be appropriate to evaluate the royalty in combination with the transfer prices charged by S1 to S2 and the aggregate profits earned by S1 and S2 from the use of the manufacturing process and the sale to uncontrolled parties of the products produced by S1.

Example 2. Aggregation of interrelated manufacturing, marketing, and services activities. S1 is the exclusive Country Z distributor of computers manufactured by P. S2 provides marketing services in connection with sales of P computers in Country Z and in this regard uses significant marketing intangibles provided by P. S3 administers the warranty program with respect to P computers in Country Z, including maintenance and repair services. In evaluating whether the transfer prices paid by S1 to P, the fees paid by S2 to P for the use of P marketing intangibles, and the service fees earned by S2 and S3 are arm's length amounts, it would be appropriate to perform an aggregate analysis that considers the combined effects of these interrelated transactions if they are most reliably analyzed on an aggregated basis.

Example 3. Aggregation and reliability of comparable uncontrolled transactions. The facts are the same as in Example 2. In addition, U1, U2, and U3 are uncontrolled taxpayers that carry out functions comparable to those of S1, S2, and S3, respectively, with respect to computers produced by unrelated manufacturers. R1, R2, and R3 constitute a controlled group of taxpayers (unrelated to the P controlled group) that carry out functions comparable to those of S1, S2, and S3 with respect to computers produced by their common parent. Prices charged to uncontrolled customers of the R

group differ from the prices charged to customers of U1, U2, and U3. In determining whether the transactions of U1, U2, and U3, or the transactions of R1, R2, and R3, would provide a more reliable measure of the arm's length result, it is determined that the interrelated R group transactions are more reliable than the wholly independent transactions of U1, U2, and U3, given the interrelationship of the P group transactions.

Example 4. Non-aggregation of transactions that are not interrelated. P enters into a license agreement with S1 that permits S1 to use a proprietary process for manufacturing product X and to sell product X to uncontrolled parties throughout a specified region. P also sells to S1 product Y, which is manufactured by P in the United States and unrelated to product X. Product Y is resold by S1 to uncontrolled parties in the specified region. There is no connection between product X and product Y other than the fact that they are both sold in the same specified region. In evaluating whether the royalty paid by S1 to P for the use of the manufacturing process for product X and the transfer prices charged for unrelated product Y are arm's length amounts, it would not be appropriate to consider the combined effects of these separate and unrelated transactions.

Example 5. Aggregation of interrelated patents. P owns 10 individual patents that, in combination, can be used to manufacture and sell a successful product. P anticipates that it could earn profits of \$25x from the patents based on a discounted cash flow analysis that provides a more reliable measure of the value of the patents exploited as a bundle rather than separately. P licenses all 10 patents to S1 to be exploited as a bundle. Evidence of uncontrolled licenses of similar individual patents indicates that, exploited separately, each license of each patent would warrant a price of \$1x, implying a total price for the patents of \$10x. Under paragraph (f)(2)(i)(B) of this section, in determining the arm's length royalty for the license of the bundle of patents, it would not be appropriate to use the uncontrolled licenses as comparables for the license of the bundle of patents, because, unlike the discounted cash flow analysis, the uncontrolled licenses considered separately do not reliably reflect the enhancement to value resulting from the interrelatedness of the 10 patents exploited as a bundle.

Example 6. Consideration of entire arrangement, including imputed contractual terms--(i) P conducts a business ("Business") from the United States, with a worldwide clientele, but until Date X has no foreign operations. The success of Business significantly depends on intangibles (including marketing, manufacturing, technological, and goodwill or going concern value intangibles, collectively the "IP"), as well as ongoing support activities performed by P (including related research and development, central marketing, manufacturing process enhancement, and oversight activities, collectively "Support"), to maintain and improve the IP and otherwise maximize the profitability of Business.

(ii) On Date X, Year 1, P contributes the foreign rights to conduct Business, including the foreign rights to the IP, to newly incorporated S1. S1, utilizing the IP of which it is now the owner, commences foreign operations consisting of local marketing,

manufacturing, and back office activities in order to conduct and expand Business in the foreign market.

(iii) Later, on Date Y, Year 1, P and S1 enter into a cost sharing arrangement (“CSA”) to develop and exploit the rights to conduct the Business. Under the CSA, P is entitled to the U.S. rights to conduct the Business, and S1 is entitled to the rest-of-the-world (“ROW”) rights to conduct the Business. P continues after Date Y to perform the Support, employing resources, capabilities, and rights that as a factual matter were not contributed to S1 in the Date X transaction, for the benefit of the Business worldwide. Pursuant to the CSA, P and S1 share the costs of P’s Support in proportion to their reasonably anticipated benefit shares from their respective rights to the Business.

(iv) P treats the Date X transaction as a transfer described in section 351 that is subject to 367 and treats the Date Y transaction as the commencement of a CSA subject to section 482 and §1.482-7. P takes the position that the only platform contribution transactions (“PCTs”) in connection with the Date Y CSA consist of P’s contribution of the U.S. Business IP rights and S1’s contribution of the ROW Business IP rights of which S1 had become the owner on account of the prior Date X transaction.

(v) Pursuant to paragraph (f)(2)(i)(A) of this section, in determining whether an allocation of income is appropriate in Year 1 or subsequent years, the Commissioner may consider the economic substance of the entire arrangement between P and S1, including the parties’ actual conduct throughout their relationship, regardless of the form or character of the contractual arrangement the parties have expressly adopted. The Commissioner determines that the parties’ formal arrangement fails to reflect the full scope of the value provided between the parties in accordance with the economic substance of their arrangement. Therefore, the Commissioner may impute one or more agreements between P and S1, consistent with the economic substance of their arrangement, that fully reflect their respective reasonably anticipated commitments in terms of functions performed, resources employed, and risks assumed over time. For example, because P continues after Date Y to perform the Support, employing resources, capabilities, and rights not contributed to S1, for the benefit of the Business worldwide, the Commissioner may impute another PCT on Date Y pursuant to which P commits to so continuing the Support. See §1.482-7(b)(1)(ii). The taxpayer may present additional facts that could indicate whether this or another alternative agreement best reflects the economic substance of the underlying transactions and course of conduct, provided that the taxpayer’s position fully reflects the value of the entire arrangement consistent with the realistic alternatives principle.

Example 7. Distinguishing provision of value from characterization--(i) P developed a collection of resources, capabilities, and rights (“Collection”) that it uses on an interrelated basis in ongoing research and development of computer code that is used to create a successful line of software products. P can continue to use the Collection on such interrelated basis in the future to further develop computer code and, thus, further build on its successful line of software products. Under §1.482-7(g)(2)(ix),

P determines that the interquartile range of the net present value of its own use of the Collection in future research and development and software product marketing is between \$1000x and \$1100x, and this range provides the most reliable measure of the value to P of continuing to use the Collection on an interrelated basis in future research, development, and exploitation. Instead, P enters into an exchange described in section 351 in which it transfers certain intangible property related to the Collection to S1 for use in future research, development, and exploitation but continues to perform the same development functions that it did prior to the exchange, now on behalf of S1, under express or implied commitments in connection with S1's use of the intangible property. P takes the position that a portion of the Collection, consisting of computer code and related instruction manuals and similar intangible property (Portion 1), was transferrable intangible property and was the subject of the section 351 exchange and compensable under section 367(d). P claims that another portion of the Collection consists of items that either do not constitute property for purposes of section 367 or are not transferrable (Portion 2). P then takes the position that the value of Portion 2 does not give rise to income under section 367(d) or gain under section 367(a).

(ii) Under paragraphs (f)(2)(i)(A) and (C) of this section, any part of the value in Portion 2 that is not taken into account in an exchange under section 367 must nonetheless be evaluated under section 482 and the regulations thereunder to determine arm's length compensation for any value provided to S1. Accordingly, even if P's assertion that certain items were either not property or not capable of being transferred were correct, arm's length compensation is nonetheless required for all of the value associated with P's contributions under the section 482 regulations. Alternatively, the Commissioner may determine under all the facts and circumstances that P's assertion is incorrect and that the transaction in fact constitutes an exchange of property subject to, and therefore to be taken into account under, section 367. Thus, whether any item that P identifies as being within Portion 2 is properly characterized as property under section 367 (transferable or otherwise) is irrelevant because any value in Portion 2 that is provided to S1 must be compensated by S1 in a manner consistent with the \$1000x to \$1100x interquartile range of the overall value.

Example 8. Arm's length compensation for equivalent provisions of intangibles under sections 351 and 482. P owns the worldwide rights to manufacturing and marketing intangibles that it uses to manufacture and market a product in the United States ("US intangibles") and the rest of the world ("ROW intangibles"). P transfers all the ROW intangibles to S1 in an exchange described in section 351 and retains the US intangibles. Immediately after the exchange, P and S1 entered into a CSA described in §1.482-7(b) that covers all research and development of intangibles conducted by the parties. A realistic alternative that was available to P and that would have involved the controlled parties performing similar functions, employing similar resources, and assuming similar risks as in the controlled transaction, was to transfer all ROW intangibles to S1 upon entering into the CSA in a platform contribution transaction described in §1.482-7(c), rather than in an exchange described in section 351 immediately before entering into the CSA. Under paragraph (f)(2)(i)(A) of this section, the arm's length compensation for the ROW intangibles must correspond to the value

provided between the parties, regardless of the form of the transaction. Accordingly, the arm's length compensation for the ROW intangibles is the same in both scenarios, and the analysis of the amount to be taken into account under section 367(d) pursuant to §§1.367(d)-1T(c) and 1.482-4 should include consideration of the amount that P would have charged for the realistic alternative determined under §1.482-7(g) (and §1.482-4, to the extent of any make-or-sell rights transferred). See §§1.482-1(b)(2)(iii) and 1.482-4(g).

Example 9. Aggregation of interrelated manufacturing and marketing intangibles governed by different statutes and regulations. The facts are the same as in Example 8 except that P transfers only the ROW intangibles related to manufacturing to S1 in an exchange described in section 351 and, upon entering into the CSA, then transfers the ROW intangibles related to marketing to S1 in a platform contribution transaction described in §1.482-7(c) (rather than transferring all ROW intangibles only upon entering into the CSA or only in a prior exchange described in section 351). The value of the ROW intangibles that P transferred in the two transactions is greater in the aggregate, due to synergies among the different types of ROW intangibles, than if valued as two separate transactions. Under paragraph (f)(2)(i)(B) of this section, the arm's length standard requires these synergies to be taken into account in determining the arm's length results for the transactions.

Example 10. Services provided using intangibles.--(i) P's worldwide group produces and markets Product X and subsequent generations of products, which result from research and development performed by P's R&D Team. Through this collaboration with respect to P's proprietary products, the members of the R&D Team have individually and as a group acquired specialized knowledge and expertise subject to non-disclosure agreements (collectively, "knowhow").

(ii) P arranges for the R&D Team to provide research and development services to create a new line of products, building on the Product X platform, to be owned and exploited by S1 in the overseas market. P asserts that the arm's length charge for the services is only reimbursement to P of its associated R&D Team compensation costs.

(iii) Even though P did not transfer the platform or the R&D Team to S1, P is providing value associated with the use of the platform, along with the value associated with the use of the knowhow, to S1 by way of the services performed by the R&D Team for S1 using the platform and the knowhow. The R&D Team's use of intangible property, and any other valuable resources, in P's provision of services (regardless of whether the service effects a transfer of intangible property or valuable resources and regardless of whether the property is relatively high or low value) must be evaluated under the section 482 regulations, including the regulations specifically applicable to controlled services transactions in §1.482-9, to ensure that P receives arm's length compensation for any value (attributable to such property or services) provided to S1 in a controlled transaction. See §§1.482-4 and 1.482-9(m). Under paragraph (f)(2)(i)(A) of this section, the arm's length compensation for the services performed by the R&D Team for S1 must be consistent with the value provided to S1, including the value of the

knowhow and any synergies with the platform. Under paragraphs (f)(2)(i)(B) and (C) of this section, the best method analysis may determine that the compensation is most reliably determined on an aggregate basis reflecting the interrelated value of the services and embedded value of the platform and knowhow.

(iv) In the alternative, the facts are the same as above, except that P assigns to S1 all or a pertinent portion of the R&D Team and the relevant rights in the platform. P takes the position that, although the transferred platform rights must be compensated, the knowhow does not have substantial value independent of the services of any individual on the R&D Team and therefore is not an intangible within the meaning of §1.482-4(b). In P's view, S1 owes no compensation to P on account of the R&D Team, as S1 will directly bear the cost of the relevant R&D Team compensation. However, in assembling and arranging to assign the relevant R&D Team, and thereby making available the value of the knowhow to S1, rather than other employees without the knowhow, P is performing services for S1 under imputed contractual terms based on the parties' course of conduct. Therefore, even if P's position were correct that the knowhow is not an intangible under §1.482-4(b), a position that the Commissioner may challenge, arm's length compensation is required for all of the value that P provides to S1 through the interrelated provision of platform rights, knowhow, and services under paragraphs (f)(2)(i)(A), (B), and (C) of this section.

Example 11. Allocating arm's length compensation determined under an aggregate analysis --(i) P provides services to S1, which is incorporated in Country A. In connection with those services, P licenses intellectual property to S2, which is incorporated in Country B. S2 sublicenses the intellectual property to S1.

(ii) Under paragraph (f)(2)(i)(B) of this section, if an aggregate analysis of the service and license transactions provides the most reliable measure of an arm's length result, then an aggregate analysis must be performed. Under paragraph (f)(2)(i)(D) of this section, if an allocation of the value that results from such an aggregate analysis is necessary, for example, for purposes of sourcing the services income that P receives from S1 or determining deductible expenses incurred by S1, then the value determined under the aggregate analysis must be allocated using the method that provides the most reliable measure of the services income and deductible expenses.

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

(B) Example. The following example illustrates this paragraph (f)(2)(ii):

Example. P and S are controlled taxpayers. P licenses a proprietary process to S for S's use in manufacturing product X. Using its sales and marketing employees, S sells product X to related and unrelated customers outside the United States. If the license between P and S has economic substance, the Commissioner ordinarily will not restructure the taxpayer's transaction to treat P as if it had elected to exploit directly the manufacturing process. However, because P could have directly exploited the manufacturing process and manufactured product X itself, this realistic alternative may

be taken into account under §1.482-4(d) in determining the arm's length consideration for the controlled transaction. For examples of such an analysis, see Examples 7 and 8 in paragraph (f)(2)(i)(E) of this section and the Example in §1.482-4(d)(2).

(iii) through (j)(6) [Reserved]. For further guidance see §1.482-1(f)(2)(iii) through (j)(6).

(7) Certain effective/applicability dates--(i) Paragraphs (f)(2)(i)(A) through (E) and (f)(2)(ii)(B) of this section apply to taxable years ending on or after September 14, 2015.

(ii) Expiration date. The applicability of paragraphs (f)(2)(i)(A) through (E) and (f)(2)(ii)(B) of this section expires on or before September 14, 2018.

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