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From:

Sent: Tuesday, January 27, 2009 8:49:21 AM

To:

Cc:

Subject: RE: ACTION: RESPONSE DUE FEBRUARY 5, 2009: TEI Liaison Meetings

Attached are some slides. Probably more than you need. If you'd like, we could try to brainstorm what might be likely Q's TEI folk might raise. Perhaps at the same time that is set up for our call re DC Transfer Pricing Conference.

Let me know.

Regards,

Attachment

Current Developments in Transfer Pricing

TRANSFER PRICING

Goal – Arm’s Length Compensation for Offshore Transfer of Intangible Value, however Effected

- Fully developed intangibles
- By license/sale
- Embedded in services
- By incorp/reorg
- §§1.482-4 thru -6
- §§1.482-2(b), -9T
- §§367(d), 1.367(d)-1T

Goal – Arm’s Length Compensation for Offshore Transfer of Intangible Value, however Effected

- Intangibles in process
- Contract R&D
- JV arrangements
- R&D cost sharing
- §§1.482-2(b), -9T
- §§1.482-4 thru -6, -9T
- §1.482-7T

COST SHARING

- Background
- Income Method and Other Specified methods
- Commensurate With Income (CWI)
- Comparability
- Synergy/Aggregation
- Nonconforming Arrangements
- Transition Rules

COST SHARING SCENARIOS

- US operations
- R&D
- “Crown Jewel” product platform intangibles
- US operating intangibles
 - Mfg. process
 - Mktg., e.g., USGWGCV

- Foreign operations
- Early Stage
 - “Cash box”
 - No intangibles
- Mature Stage
 - “Cash box” +
 - Foreign operating intangibles
 - Mfg. process
 - Mktg., e.g., FGWGCV

INCOME METHOD

- Determines the “buy-in” or “PCT” as net present value of expected income ceded to the cost sharing licensee
- Projections for window period
 - e.g., R&D costs, sales, COGS, other operating expenses
- Terminal growth rate beyond the projection window
- Risky discount rates (including betas, etc.)
- Returns to routine functions
- Arm’s length range
 - generated based on variable market-based input parameters
- Pre-/post-tax adjustments
- Conversion among different payment forms
 - fixed lump sum, royalty contingent on sales or profits, etc.

OTHER SPECIFIED METHODS

- Residual profit split method
- Acquisition price method
- Market capitalization method

CWI/PERIODIC ADJUSTMENTS

- CWI triggered if actual results diverge from projected results by a factor of 1.5 (reduced from a factor of 2 under the 2005 prop regs)
- CWI/periodic adjustments effectively revalue the buy-in as of the time of the IRS examination, as an antidote to “information asymmetry”
- To reconcile with the arm’s length standard, a taxpayer may “prove out” of CWI/periodic adjustments
 - Show to the satisfaction of the Commissioner that outsized returns were the result of factors beyond the taxpayer’s control and not reasonably expected at the time of the transfer
 - APA

COMPARABILITY

- §482 generally sets prices by reference to comparable uncontrolled transactions (CUTs)
- CSAs typically cover all the “crown jewels” for the long term

- Thus, tend not to be any CUTs

SYNERGY/AGGREGATION

- “Patent pool paradox”
- Controversial cases tend to involve interrelated nonroutine contributions such as:
 - crown jewel platform intangible, plus
 - expert R&D team, plus
 - marketing, manufacturing process, and other operating contributions
 - income method is a “full value” method
- Carve-out for goodwill, going concern, or so-called business opportunity?
 - foreign startup cannot have much goodwill
 - functional whole must be valued in the aggregate

NONCONFORMING ARRANGEMENTS

- Nonconforming arrangements -including partnerships – not subject to §1.482-7T, but
- “Reglets” under §1.482-4T (transfers of intangibles) and §1.482-9T (services) provide that such arrangements are subjected to a similar analysis, adjusted appropriately
- Those provisions require “consideration of the principles, methods, comparability, and reliability considerations set forth in §1.482-7T. . . .”

TRANSITION RULES

- Generally, old CSAs will be deemed to meet the requirements of the temp regs, provided they conform with the requirements by 7/6/09
- For this purpose, certain temp reg requirements do not apply to old CSAs
- Special rule for CWI: temp reg CWI rules do not apply to a PCT under an old CSA unless
 - the PCT occurs after the date of a material change in the scope of the CSA from its scope on 1/5/09

SERVICES

- Simplified Cost Method
- Other Specified methods for Risky Services
- Contingent Payment Arrangements
- Imputation of Contractual Terms Based Upon Economic Substance
- “Sunset” in July 2009

SERVICES COST METHOD

- Specified Covered Services Rev Proc – Rev Proc 2007-13
- Low-Margin (7%) Covered Services
- Shared Services Arrangements
- Business Judgment/Excluded Services
- Total Services Costs/Stock-Based Comp
- Benefit
- Competent Authority

**2007 TRANSITIONAL YEAR –
NOTICE 2007-5**

- One-year grandfather of 1.482-2(b), subject to business judgment rule
- Services Cost Method is elective
- SCM documentation need not be generated contemporaneously
- Shared services arrangements possible for non-SCM services under robust generally applicable 482 rules

TAXPAYER'S EXPERIENCE ?

- Taxpayer's have a couple years under belt working with 2006 temp regs
- "Back Office"/SCM – experience? ways to improve user-friendliness?
 - Specified covered services RP?
 - Shared services arrangements?
- "Benefit" rules?
- Timing – sunset in July 2009