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Date:
October 15, 2024

Legend

ForeignOpCo =
ForeignHoldCo =
USHoldCo =
USR&DCo1 =

USR&DCo2 =
USDistributor =
Country A =

Dear :

This responds to your authorized representative's letter dated April 10, 2024, supplemented with a letter dated July 25, 2024. You have requested a ruling on whether certain income earned from providing research and development services (the "R&D Services") constitutes foreign-derived deduction eligible income ("FDDEI") in full for purposes of section 250(b)(4)(B) and the accompanying regulations. The material submitted in that request and information provided in later correspondences is summarized below.

The ruling contained in this letter is based on information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for a ruling, it is subject to verification on examination.

This office expresses no opinion as to the overall tax consequences of the R&D Services described in this letter or as to any issue not specifically addressed by the ruling below.

SUMMARY OF FACTS

ForeignOpCo is a corporation organized under the laws of Country A and has been in existence for a substantial number of years. ForeignOpCo develops, manufactures, and distributes pharmaceutical products, medical devices, and other biotechnology products worldwide. ForeignHoldCo is a publicly traded corporation organized under the laws of Country A that owns all the stock of ForeignOpCo and is the parent of the worldwide group. ForeignOpCo owns certain intangible property that it uses to manufacture finished products for distribution (the "Product IP"). ForeignOpCo maintains offices and factories in Country A and does not have any significant operations outside of Country A. Any group operations outside of Country A are conducted through local subsidiaries or third parties.

USR&DCo1 and USR&DCo2 (or, collectively, the "USR&DCos") are domestic corporations that have been in existence for over a decade, and are wholly owned by USHoldCo, a domestic corporation that is wholly owned by ForeignOpCo. ForeignOpCo has entered into Master Services Agreements ("MSAs") with the USR&DCos to provide R&D Services for the development of the Product IP. In some cases, the USR&DCos may subcontract certain of the R&D services to third party R&D service providers.

Under the MSAs, ForeignOpCo directs product development, which includes basic research and clinical studies. All rights and title with respect to any IP that is developed, including any trademarks, vest solely in ForeignOpCo. ForeignOpCo pays the USR&DCos a service fee equal to their direct and indirect costs plus a fixed markup on certain of those costs. None of ForeignOpCo's other US or foreign affiliates are directly involved in the supply chain relating to the Product IP or pay any of the costs of developing the Product IP. Once the Product IP is developed, ForeignOpCo manufactures the products using the Product IP, sometimes via third party contract manufacturers. These products are then distributed through various channels.

ForeignOpCo has a distribution agreement with USDistributor, a domestic corporation that was established several decades ago, and is also wholly owned by USHoldCo. USDistributor purchases all products incorporating the Product IP from ForeignOpCo and distributes them solely in the United States. ForeignOpCo grants USDistributor a royalty-free license to use its trademark rights, which USDistributor exercises at its own risk and expense, such as by bearing all costs of packaging the products sold in the United States.

USDistributor does not obtain any ownership rights in the Product IP and does not bear any risk of loss with respect to unsuccessful R&D Services that do not result in finished products reaching the US market. ForeignOpCo and USDistributor apply the comparable profits method ("CPM") to determine an appropriate operating margin (i.e., operating profit divided by sales revenue) with respect to the distribution of the products. USDistributor generally earns a cost-plus markup on the operating margin for each

product. ForeignOpCo and USDistributor may terminate the distribution agreement at will.

REPRESENTATIONS

1. The Product IP constitutes intangible property under section 367(d)(4).

2. ForeignOpCo solely possesses all rights and ownership with respect to the IP created or enhanced by the R&D Services.

3. ForeignOpCo has operations only outside the United States and does not maintain an office or fixed place of business in the United States.

4. ForeignOpCo does not provide services to business recipients or consumers located in the United States, as such terms are defined in Treas. Reg. § 1.250(b)-5(c)(3) and (4), respectively.

5. The R&D Services provided by USR&DCo1 and USR&DCo2 are general services under Treas. Reg. § 1.250(b)-5(c)(6).

6. The substantiation requirements contained in Treas. Reg. § 1.250(b)-5(e)(4) will be satisfied with respect to the R&D Services income earned by USR&DCo1 and USR&DCo2.

7. ForeignOpCo pays an arm's-length fee to USR&DCo1 and USR&DCo2 for the provision of the R&D Services, as determined under section 482 and the regulations thereunder.

8. USDistributor pays an arm's-length price for the products purchased from ForeignOpCo, as determined under section 482 and the regulations thereunder.

LAW

Section 250 of the Code provides a deduction for foreign-derived intangible income ("FDII") of a domestic corporation and the global intangible low-taxed income ("GILTI") that is included in the gross income of such domestic corporation under section 951A. For taxable years beginning after December 31, 2017, and before January 1, 2026, section 250(a)(1) allows a deduction in an amount equal to the sum of (i) 37.5 percent of the taxpayer's FDII plus (ii) 50 percent of the sum of the taxpayer's GILTI and the associated section 78 gross-up. For taxable years beginning after December 31, 2025, section 250 allows a deduction in an amount equal to the sum of (i) 21.875 percent of the FDII plus (ii) 37.5 percent of the GILTI plus the associated section 78 gross-up.

Section 250(b)(1) and Treas. Reg. § 1.250(b)-1(b) define FDII as the product of the domestic corporation's deemed intangible income ("DII") for the year multiplied by a

fraction (the “foreign derived ratio”), the denominator of which is the corporation’s deduction eligible income (“DEI”) and the numerator of which is its FDDEI (defined below). Treas. Reg. § 1.250(b)-1(c)(13). Section 250(b)(2)(A) and Treas. Reg. § 1.250(b)-1(c)(3) provide that DII is equal to the corporation’s DEI less its deemed tangible income return (section 250(b)(2)(B) and Treas. Reg. § 1.250(b)-1(c)(4)), which is an amount equal to 10 percent of the corporation’s qualified business asset investment.

Section 250(b)(3) and Treas. Reg. § 1.250(b)-1(c)(2) provide that DEI means, with respect to any domestic corporation, the excess (if any) of the corporation’s gross income, with certain adjustments, over the deductions properly allocable to such gross income. For this purpose, Treas. Reg. § 1.250(b)-1(c)(15) provides that gross income is determined without regard to the following items: (i) any amount included in the gross income of such corporation under section 951(a)(1); (ii) the GILTI included in the gross income of such corporation under Treas. Reg. § 1.951A-1(c); (iii) any financial services income (as defined in section 904(d)(2)(D)) and Treas. Reg. § 1.904-4(e)(1)(ii)) of such corporation; (iv) any dividend received from a corporation which is a controlled foreign corporation of such domestic corporation; (v) any domestic oil and gas extraction income of such corporation; and (vi) any foreign branch income (as defined in section 904(d)(2)(J) and Treas. Reg. § 1.904-4(f)(2)).

Section 250(b)(4) defines the term FDDEI to mean, with respect to any taxpayer for any taxable year, any DEI of such taxpayer which is derived in connection with (A) property, which is sold by the taxpayer to any person who is not a United States person, and which the taxpayer establishes to the satisfaction of the Secretary is for a foreign use, or (B) services provided by the taxpayer which the taxpayer establishes to the satisfaction of the Secretary are provided to any person, or with respect to property, not located within the United States.

Treas. Reg. § 1.250(b)-5(b) provides that if only a portion of a service is treated as provided to a person, or with respect to property, outside the United States, the provision of the service is a FDDEI service only to the extent of the gross income derived with respect to such portion. Treas. Reg. § 1.250(b)-5(b) breaks services into five specified categories to determine whether the provision of a service generates FDDEI. One such category is general services provided to business recipients located outside the United States.

A business recipient is a recipient other than an individual consumer and includes all related parties of the recipient, but cannot include the service renderer. Treas. Reg. § 1.250(b)-5(c)(3) and (4). Treas. Reg. § 1.250(b)-5(e)(1) provides that a general service provided to a business recipient generates FDDEI to the extent the service confers a benefit on the business recipient’s operations outside the United States. Under the general rule of Treas. Reg. § 1.250(b)-5(e)(1), in determining the location of the benefit, the place of residence, incorporation or formation of the business recipient is not relevant. Rather, the rule depends on the location of the business operations that

benefit from the service. Under Treas. Reg. § 1.250(b)-5(e)(3)(i), a business recipient is treated as having operations where it maintains an office or other fixed place of business.

Treas. Reg. § 1.250(b)-5(e)(2) provides that the principles of Treas. Reg. § 1.482-9 apply for purposes of determining which operations of the business recipient (and its related parties located outside the United States) benefit from a general service. The determination under Treas. Reg. § 1.482-9 is made by treating the service renderer as one controlled taxpayer, and the business recipient's operations within and outside the United States as separate controlled taxpayers respectively. The extent to which a business recipient's operations within or outside of the United States are treated as one or more separate controlled taxpayers is determined under any reasonable method, consistent with the principles of Treas. Reg. § 1.482-9(k), treating the service renderer's gross income from the services provided to the business recipient as if it were a "cost" as that term is used in § 1.482-9(k). Reasonable methods may include, for example, allocations based on time spent or costs incurred by the renderer or sales, profits, or assets of the business recipient. The determination is made when the service is provided based on information obtained from the business recipient or on the renderer's own records (such as time spent working with the business recipient's offices located outside the United States).

For this purpose, the term "benefit" is defined in Treas. Reg. § 1.482-9(l)(3)(i), which provides that an activity is considered to provide a benefit to the recipient if the activity directly results in a reasonably identifiable increment of economic or commercial value that enhances the recipient's commercial position, or that may reasonably be anticipated to do so. An activity is generally considered to confer a benefit if, taking into account the facts and circumstances, an uncontrolled taxpayer in circumstances comparable to those of the recipient would be willing to pay an uncontrolled party to perform the same or similar activity on either a fixed or contingent-payment basis, or if the recipient otherwise would have performed for itself the same activity or a similar activity. A benefit may result to an owner of intangible property if the renderer engages in an activity that is reasonably anticipated to result in an increase in the value of that intangible property.

Under Treas. Reg. § 1.482-9(l)(3)(ii), an activity is not considered to provide a benefit to a recipient if, at the time the activity is performed, the present or reasonably anticipated benefit is so indirect or remote that the recipient would not be willing to pay for the activity and would not be willing to perform the activity itself. Further, under Treas. Reg. § 1.482-9(l)(3)(iii), (iv) and (v), recipients are not treated as benefitting from duplicative activities, shareholder activities or from passive association. If an activity performed by a controlled taxpayer duplicates an activity that is performed, or that reasonably may be anticipated to be performed, by another controlled taxpayer on or for its own account, the activity is generally not considered to provide a benefit to the recipient. A shareholder activity also does not provide a benefit if the sole effect is either to protect the renderer's capital investment in the recipient or in other members of the controlled

group, or to facilitate compliance by the renderer with reporting, legal, or regulatory requirements applicable specifically to the renderer, or both. With respect to passive association, a controlled taxpayer generally is not considered to obtain a benefit if that benefit results from the controlled taxpayer's status as a member of a controlled group.

ANALYSIS

USR&DCo1 and USR&DCo2 provide general services to ForeignOpCo, a business recipient as defined in Treas. Reg. § 1.250(b)-5(c)(3). As a related party of ForeignOpCo that is not rendering the service, USDistributor is also potentially a business recipient (subject to whether it receives a benefit from the R&D Services). The USR&DCos are not the recipients of services but only render services.

ForeignOpCo has a fixed place of business in Country A, and is a business recipient under Treas. Reg. § 1.250(b)-5(e)(3)(i), treated as having operations solely in Country A. ForeignOpCo has been operating in Country A for many years, maintains offices and factories in Country A, and has no significant operations outside of Country A. ForeignOpCo’s manufacturing and other activities are conducted outside of the United States, while USDistributor performs its marketing and distribution activities solely within the United States. The group’s operations outside of Country A are conducted through local subsidiaries or third parties, including for example, using the USR&DCos to perform the R&D Services or third party manufacturers in some instances to manufacture the products outside of Country A. Therefore, under Treas. Reg. § 1.250(b)-5(e), the R&D Services may be treated as FDDEI services (at least in part, per Treas. Reg. § 1.250(b)-5(b)).

In determining which operations of the two potential business recipients, ForeignOpCo and USDistributor, benefit from the R&D Services, USDistributor is treated as a separate controlled taxpayer from ForeignOpCo applying the principles of Treas. Reg. § 1.482-9. To determine whether a business recipient’s operations are treated as one or more separate controlled taxpayers, Treas. Reg. § 1.250(b)-5(e)(2) provides that any reasonable method may be applied, provided it is consistent with the principles of Treas. Reg. § 1.482-9(k).

In this case, ForeignOpCo contracts with the USR&DCos for the R&D Services. ForeignOpCo directs the development of the products and is the sole owner of the Product IP that is developed or enhanced by the R&D services. ForeignOpCo pays an arm’s length price for the R&D services and uses the Product IP developed from the R&D Services to manufacture products for distribution. ForeignOpCo, USR&DCos and USDistributor are the only parties directly involved in the supply chain relating to the development of the Product IP and its distribution. No other US or foreign affiliates are directly involved or pay any of the costs for developing the Product IP. The R&D Services, therefore, directly result in a reasonably identifiable increment of economic or commercial value that enhances ForeignOpCo’s commercial position under Treas. Reg. § 1.482-9(l)(3)(i), and confer a benefit on its operations.

The principles of Treas. Reg. § 1.482-9 also apply to determine whether the R&D Services provide any benefit to USDistributor. The R&D Services performed by the USR&DCos would confer a benefit on USDistributor if they directly result in a reasonably identifiable increment of economic or commercial value that enhances USDistributor's commercial position, or that may reasonably be anticipated to do so under Treas. Reg. § 1.482-9(l)(3)(i); or generally, if taking into account the facts and circumstances, an uncontrolled taxpayer in circumstances comparable to those of USDistributor would be willing to pay an uncontrolled party to perform the R&D Services on either a fixed or contingent-payment basis (or if USDistributor would have performed the R&D Services for itself).

Under the facts as represented, the R&D Services provided by the USR&DCos do not directly result in any benefit to USDistributor under the principles of Treas. Reg. § 1.482-9(l)(3). USDistributor pays ForeignOpCo an arm's length price for finished products developed from the Product IP. Also, all rights and title to the Product IP created or enhanced by the R&D Services vest solely in ForeignOpCo. ForeignOpCo grants to USDistributor a royalty-free license to use its trademarks, but solely for purposes of distributing products in the United States. The distribution agreement is also terminable at will by both ForeignOpCo and USDistributor. Thus, as a limited-risk distributor of the finished products, USDistributor does not obtain any ownership rights or title in the IP that is (or is reasonably anticipated to be) directly enhanced by the R&D Services, nor does it bear any risk of loss with respect to unsuccessful R&D Services that do not result in finished products reaching the US market.

Under these circumstances, any benefit that USDistributor may receive as a distributor of the ultimate products that result from the R&D Services is only indirect because the R&D Services do not result in a reasonably identifiable increment of economic or commercial value that enhances its commercial position, applying the principles of Treas. Reg. § 1.482-9. Based on these particular facts, USDistributor's operations are no different from that of an uncontrolled taxpayer purchasing products at arm's length from an unrelated party (with no ownership rights in IP incorporated in such products) and distributing those products to unrelated US customers. Under those circumstances, an uncontrolled taxpayer would not receive any direct benefit from IP incorporated in the purchased products.

Applying the principles of Treas. Reg. § 1.482-9, USDistributor's operations are not considered to benefit from the R&D Services and, as a result, the costs of the R&D Services are not allocated between ForeignOpCo and USDistributor under Treas. Reg. § 1.482-9(k). ForeignOpCo, whose operations are entirely outside of the United States, is therefore the sole business recipient of the R&D Services under Treas. Reg. § 1.250(b)-5(c)(3). Thus, for purposes of Treas. Reg. § 1.250(b)-5(e)(2), the R&D Services may be treated as FDDEI services in full.

RULING

Accordingly, based solely on the facts and representations stated above, we rule as follows:

The income earned by USR&DCo1 and USR&DCo2 solely from the provision of the R&D Services to ForeignOpCo may be treated as gross FDDEI in full under section 250(b)(4)(B) and the accompanying regulations.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent. Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter, or facts resulting from the proposed transactions that are not specifically covered by the above ruling.

Sincerely,

Brad McCormack
Senior Technical Reviewer, Branch 6
(International)

Enclosures (2)
Copy of this letter
Copy for § 6110 purposes

cc: