to use the professional athletes under contract with USP in SportMart advertisements featuring AA merchandise (subject to approval of content by USP).

(iii) Assume that it is possible to segregate all transactions by XSub that involve distribution of merchandise acquired from uncontrolled distributors (non-controlled transactions). In addition, assume that, apart from the activities undertaken by USP and XSub to promote AA apparel in Country X, the arm’s length compensation for other functions performed by USP and XSub in the Country X market in years 1 and following can be reliably determined. At issue in this Example 12 is the application of the residual profit split analysis to determine the appropriate division between USP and XSub of the balance of the operating profits from the Country X market, that is the portion attributable to nonroutine contributions to the marketing and promotional activities.

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

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

Examples 13 through 18. [Reserved] For further guidance, see §1.482-9T(b) Examples 13 through 18.

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

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


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

(a) [Reserved]. For further guidance, see §1.482-8(a).

(b) Examples 1 through 12. [Reserved]

For further guidance, see §1.482-9(b) Examples 1 through 12.

Example 13. Preference for acquisition price method. (i) USP develops, manufacturers, and distributes pharmaceutical products. USP and FS, USP’s wholly-owned subsidiary, enter into a CSA to develop a new oncological drug, Oncol. Immediately prior to entering into the CSA, USP acquires Company X, an unrelated U.S. pharmaceutical company. Company X is solely engaged in oncological pharmaceutical research, and its only significant resources and capabilities are its workforce and its sole patent, which is associated with Compound X, a promising molecular compound derived from a rare plant, which USP reasonably anticipates will contribute to developing Oncol. All of Company X researchers will be engaged solely in research that is reasonably anticipated to contribute to developing Oncol as well. The rights in the Compound X and the commitment of Company X’s researchers to the development of Oncol are platform contributions for which compensation is due from FS as part of a PCT.

(ii) In this case, the acquisition price method, based on the lump sum price paid by USP for Company X, is likely to provide a more reliable measure of an arm’s length PCT Payment due to USP than the application of any other method. See §§1.482-4(c)(2) and 1.482-7T(c)(5)(iv)(A).

Example 14. Preference for market capitalization method. (i) Company X is a publicly traded U.S. company solely engaged in oncological pharmaceutical research and its only significant resources and capabilities are its workforce and its sole patent, which is associated with Compound Y, a promising molecular compound derived from a rare plant. Company X has no marketable products. Company X enters into a CSA with FS, a newly-formed foreign subsidiary, to develop a new oncological drug, Oncol, derived from Compound Y. Compound Y is reasonably anticipated to contribute to developing Oncol. All of Company X researchers will be engaged solely in research that is reasonably anticipated to contribute to developing Oncol under the CSA. The rights in Compound Y and the commitment of Company X’s researchers are platform contributions.
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for which compensation is due from FS as part of a PCT.

(ii) In this case, given that Company X’s platform contributions covered by PCTs relate to its entire economic value, the application of the market capitalization method, based on the market capitalization of Company X, provides a reliable measure of an arm’s length result for Company X’s PCTs to the CSA. See §§1.482–4(c)(2) and 1.482–TT(g)(6)(v)(A).

Example 15. Preference for market capitalization method. (i) MicroDent, Inc. (MDI) is a publicly traded company that developed a new dental surgical microscope ScopeX–1, which drastically shortens many surgical procedures. On January 1 of Year 1, MDI entered into a CSA with a wholly-owned foreign subsidiary (FS) to develop ScopeX–2, the next generation of ScopeX–1. In the CSA, divisional interests are divided on a territorial basis. The rights associated with ScopeX–1, as well as MDI’s research capabilities are reasonably anticipated to contribute to the development of ScopeX–2 and are therefore platform contributions for which compensation is due from FS as part of a PCT. At the time of the PCT, MDI’s only product was the ScopeX–1 microscope, although MDI was in the process of developing ScopeX–2. Concurrent with the CSA, MDI separately transfers exclusive and perpetual exploitation rights associated with ScopeX–1 to FS in the same territory as assigned to FS in the CSA.

(ii) Although the transactions between MDI and FS under the CSA are distinct from the transactions between MDI and FS relating to the exploitation rights for ScopeX–1, it is likely to be more reliable to evaluate the combined effect of the transactions than to evaluate them in isolation. This is because the combined transactions between MDI and FS relate to all of the economic value of MDI (that is, the exploitation rights and research rights associated with ScopeX–1, as well as the research capabilities of MDI). In this case, application of the market capitalization method, based on the enterprise value of MDI on January 1 of Year 1, is likely to provide a reliable measure of an arm’s length payment for the aggregated transactions. See §§1.482–4(c)(2) and 1.482–TT(g)(6)(v)(A).

(iii) Notwithstanding that the market capitalization method provides the most reliable measure of the aggregated transactions between MDI and FS, see §1.482–TT(g)(2)(iv) for further considerations of when further analysis may be required to distinguish between the remuneration to MDI associated with PCTs under the CSA (for research rights and capabilities associated with ScopeX–1) and the remuneration to MDI for the exploitation rights associated with ScopeX–1.

Example 16. Income method (applied using CPM) preferred to acquisition price method. The facts are the same as Example 13, except that the acquisition occurred significantly in advance of formation of the CSA, and reliable adjustments cannot be made for this time difference. In addition, Company X has other valuable molecular patents and associated research capabilities, apart from Compound X, that are not reasonably anticipated to contribute to the development of Oncol and that cannot be reliably valued. The CSA divides divisional interests on a territorial basis. Under the terms of the CSA, USP will undertake all R&D (consisting of laboratory research and clinical testing) and manufacturing associated with Oncol, as well as the distribution activities for its territory (the United States). FS will distribute Oncol in its territory (the rest of the world). FS’s distribution activities are routine in nature, and the profitability from its activities may be reliably determined from third-party comparables. FS does not furnish any platform contributions. At the time of the PCT, reliable (ex ante) financial projections associated with the development of Oncol and its separate exploitation in each of USP’s and FSub’s assigned geographical territories are undertaken. In this case, application of the income method using CPM is likely to provide a more reliable measure of an arm’s length result than application of the acquisition price method based on the price paid by USP for Company X. See §1.482–TT(g)(4)(v) and (g)(5)(iv)(C).

Example 17. Evaluation of alternative methods. (i) The facts are the same as Example 13, except that the acquisition occurred sometime prior to the CSA, and Company X has some areas of promising research that are not reasonably anticipated to contribute to developing Oncol. For purposes of this example, the CSA is assumed to divide divisional interests on a territorial basis. In general, the Commissioner determines that the acquisition price data is useful in informing the arm’s length price, but not necessarily determinative. Under the terms of the CSA, USP will undertake all R&D (consisting of laboratory research and clinical testing) and manufacturing associated with Oncol, as well as the distribution activities for its territory (the United States). FS will distribute Oncol in its territory (the rest of the world). FS’s distribution activities are routine in nature, and the profitability from its activities may be reliably determined from third-party comparables. At the time of the PCT, financial projections associated with the development of Oncol and its separate exploitation in each of USP’s and FSub’s assigned geographical territories are undertaken.

(ii) Under the facts, it is possible that the acquisition price method or the income method using CPM might reasonably be applied. Whether the acquisition price method
or the income method provides the most reliable evidence of the arm’s length price of USP’s contributions depends on a number of factors, including the reliability of the financial projections, the reliability of the discount rate chosen, and the extent to which the acquisition price of Company X can be reliably adjusted to account for changes in value over the time period between the acquisition and the formation of the CSA and to account for the value of the in-process research done by Company X that does not constitute platform contributions to the CSA. See §1.482-7T(g)(4)(v), (g)(5)(iv), and (g)(7)(iv).

(c) Effective/applicability date. Paragraph (b) Examples 13 through 18 of this section are generally applicable on January 5, 2009.

(d) Expiration date. The applicability of paragraph (b) Examples 13 through 18 of this section expires on or before December 30, 2011.


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

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

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

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

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

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

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

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

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

(b) Services cost method—(1) In general. The services cost method evaluates