

this provision contradicts the arm's length coordination rules for QCSAs because the treatment of stock-based compensation by unrelated parties is considered relevant for purposes of the comparable profits method but not relevant for purposes of QCSAs.

No revision was made in response to this comment. Treasury and the IRS believe that the rule provided in the proposed regulations with respect to the application of the comparable profits method is appropriate because the financial data with respect to similar business activities that generally is used as a reference point for that method is subject to adjustment to ensure comparability.

*H. Effective Date and Transition Rules—§ 1.482–7(k) and (d)(2)(iii)(B)(2)*

The provisions of the proposed regulations applicable to QCSAs would apply to stock-based compensation granted in taxable years beginning on or after publication of final regulations. Participants in a QCSA in existence on the effective date may, on a one-time basis, amend their agreement to elect the grant-date method of measurement without the Commissioner's consent. The election with respect to existing QCSAs must be made not later than the latest due date, without regard to extensions, for an income tax return of a controlled participant for the first taxable year beginning after the effective date of final regulations.

One commentator stated that the prospective effective date does not afford taxpayers a reasonable time to amend their cost sharing agreements or restructure complex international operations. A transition period of two years after the publication of final regulations was suggested.

This suggestion was not adopted. Treasury and the IRS consider the period stated in the proposed regulations adequate for the initial planning and recordkeeping that may be occasioned by the final regulations.

With respect to the special transition rule permitting taxpayers to elect the grant-date method of measurement by amendment of an existing written cost sharing agreement no later than the latest due date of an income tax return of a controlled participant, one commentator suggested that the due date should not disregard filing extensions. The commentator maintained that fairness dictates affording taxpayers this extra time for the analysis needed to make this significant decision.

In response to this comment, the final regulations provide that the due date for amendments to existing cost sharing

agreements is determined with regard to filing extensions.

Some commentators urged Treasury and the IRS to postpone finalization of the proposed regulations until the OECD completes its ongoing consideration of the treatment of stock options for transfer pricing purposes and an international consensus begins to form so that the potential for international disputes and resulting negative effects on U.S. business can be minimized. Similarly, a commentator suggested that the effects of applying the principles of the proposed regulations to other areas of transfer pricing should be thoroughly studied and harmonized before finalizing the regulations to avoid creating traps for the unwary or other unforeseen consequences.

These suggestions were not implemented. Treasury and the IRS do not believe that international discussion of issues compels the suspension of the regulatory process. Also, Treasury and the IRS believe that it is important to provide timely guidance on issues such as those addressed by the proposed and final regulations.

Finally, the preamble to the proposed regulations states that the proposed regulations clarify that stock-based compensation must be taken into account in the QCSA context. Several commentators interpreted this language as in effect requiring the new rules to be applied retroactively. These commentators urged that the final regulations contain further assurances of prospective intent and explicitly recognize that these regulations represent a fundamental change to the traditional approach to section 482.

No revisions were made in light of these comments. As noted earlier, Treasury and the IRS believe that requiring stock-based compensation to be taken into account in the QCSA context is consistent with the arm's length standard and long-standing policies underlying section 482. The final regulations, like the proposed regulations, clearly specify that the specific rules provided therein are prospective in application. Moreover, as stated in the proposed regulations, while taxpayers may rely on the proposed regulations until the effective date of the final regulations, no inference is intended with respect to the treatment of stock-based compensation granted in taxable years beginning before the effective date of these final regulations.

*I. Paperwork Reduction Act and Regulatory Flexibility Act*

One commentator expressed the view that the compliance burden imposed by

the proposed regulations on each taxpayer will significantly exceed the two to seven hours estimated under the Paperwork Reduction Act. The commentator also asserted that the estimated number of taxpayers affected by the rules was too low.

The burden estimates as stated in the final regulations reflect no change. Treasury and the IRS reviewed the estimates made in the proposed regulations and concluded that they are reasonable.

Similarly, with respect to the Regulatory Flexibility Act, the commentator challenged the statement in the preamble of the proposed regulations that the new regulatory requirements will not have a significant economic impact on a substantial number of small entities. Upon review of available information, Treasury and the IRS found no basis for a change in the statement or in the operative finding that the economic impact of the collections of information in the proposed regulations is not significant with respect to small entities.

*J. Documentation Requirements and Other Provisions on Which No Comments Received*

Section 1.482–7(j)(2)(i)(F) of the proposed regulations requires that controlled participants maintain specific documentation to establish the amount attributable to stock-based compensation that is taken into account in determining the costs to be shared, including the method of measurement and timing used with respect to that amount. No comments were received on this particular provision, and it is retained in the final regulations.

Treasury and the IRS intend that this provision will require controlled participants that use the elective method of measurement to maintain documentation establishing compliance with the requirements of § 1.482–7(d)(2)(iii)(B). For example, documentation should establish that applicable financial statements reflecting the value of stock options with respect to which the elective method is used, as well as applicable accounting principles under which such financial statements are prepared, are in conformity with the fair-value and reconciliation requirements adopted in the final regulations with respect to GAAP other than U.S. GAAP.

Several other provisions of the proposed regulations similarly were not commented upon and have been adopted without modification in the final regulations. These provisions include § 1.482–7(d)(2)(iii)(A)(2), relating to deductions of foreign