

DEPARTMENT OF THE TREASURY**Internal Revenue Service****26 CFR Parts 1 and 31****[REG-146893-02, REG-115037-00]****RIN 1545-BB31, 1545-AY38****Treatment of Services Under Section 482; Allocation of Income and Deductions From Intangibles****AGENCY:** Internal Revenue Service (IRS), Treasury.**ACTION:** Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that provide guidance regarding the treatment of controlled services transactions under section 482 and the allocation of income from intangibles, in particular with respect to contributions by a controlled party to the value of an intangible that is owned by another controlled party. These proposed regulations potentially affect controlled taxpayers within the meaning of section 482. The proposed regulations provide updated guidance that is necessary to reflect economic and legal developments since the issuance of the current guidance. This document also provides a notice of public hearing on these proposed regulations.

DATES: Written or electronic comments must be received December 9, 2003. Outlines of topics to be discussed at the public hearing scheduled for January 14, 2004, at 10 a.m. must be received by December 23, 2003.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG-146893-02 and REG-115037-00), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-146893-02 and REG-115037-02), Courier's desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20044. Alternatively, taxpayers may submit electronic comments directly to the IRS Internet site at www.irs.gov/reg. The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT:

Concerning the proposed regulations, J. Peter Luedtke or Helen Hong-George, (202) 435-5265; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Sonya M. Cruse, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:**Background**

Section 482 of the Internal Revenue Code generally provides that the Secretary may allocate gross income, deductions and credits between or among two or more taxpayers owned or controlled by the same interests in order to prevent evasion of taxes or to clearly reflect income of a controlled taxpayer. Comprehensive regulations under section 482 published in the **Federal Register** (33 FR 5849) on April 16, 1968, provided guidance with respect to a wide range of controlled transactions, including transfers of tangible and intangible property and the provision of services. Revised and updated transfer pricing regulations were published in the **Federal Register** (59 FR 34971, 60 FR 65553 and 61 FR 21955) on July 8, 1994, December 20, 1995, and May 13, 1996.

A. Services Transactions

While comprehensive in other respects, the regulations issued in the mid-1990s did not modify substantively the 1968 regulations relating to controlled services transactions. The current services regulations at § 1.482-2(b) provide generally that where one member of a controlled group performs services for the benefit of another member without charge, or at a charge that is not equal to an arm's length charge, the Commissioner may make appropriate allocations to reflect an arm's length charge for such services. The determination of the arm's length charge depends on whether the services transaction is an "integral part" of the business of the renderer or recipient of the services. The current services regulations provide several overlapping quantitative and qualitative tests to determine whether a services transaction is integral.

Under the current services regulations, the arm's length charge for non-integral services is deemed to be equal to the "costs or deductions" incurred with respect to the services, unless the taxpayer establishes that another charge is more appropriate. General guidance is provided regarding the definition of cost and the appropriate allocation of costs to particular services.

The arm's length charge for integral services under the current services regulations is "the amount which was charged or would have been charged for the same or similar services in independent transactions with or between unrelated parties under similar circumstances considering all relevant facts." No guidance is provided

regarding the methods that may be used to determine whether a charge is consistent with an arm's length charge.

B. Income Attributable to Intangibles

The Treasury Department and the IRS issued final regulation § 1.482-4(f)(3) as part of the 1994 regulations. The preamble to those regulations states that the rules of § 1.482-4(f)(3) were necessary in order "to identify the controlled taxpayer that should recognize the income attributable to intangible property." Section 1.482-4(f)(3) identifies that party by providing rules to determine the owner, for section 482 purposes, of the rights to exploit an intangible to which income was attributable. Under those rules, the legal owner of an intangible, the taxpayer with a right to exploit the intangible, and even a taxpayer that contributes to the development or enhancement of the intangible could be deemed "owners" of that intangible, entitled to a portion of the income attributable to the intangible.

Explanation of Provisions**A. Overview**

These proposed regulations provide updated guidance under section 482 that replaces existing guidance under § 1.482-2(b) relating to controlled services transactions and existing guidance under § 1.482-4(f)(3) relating to the allocation of income attributable to intangible property. These proposed regulations also make conforming and other changes to provisions of the current regulations under sections 482 and 6662 that are related to this guidance.

1. Services Transactions

These proposed regulations provide updated guidance under section 482 relating to controlled services transactions. The Treasury Department and the IRS believe that such guidance is necessary to reflect economic and legal developments since the issuance of the 1968 regulations. In the last 35 years, cross-border services have become an increasingly large and important segment of the U.S. and global economies. In particular, cross-border services transactions make up an increasingly significant segment of cross-border transactions among members of controlled groups.

Legal developments in the transfer pricing area since 1968 include the amendment of section 482 in 1986 to provide for the commensurate with income standard in the context of transfers of intangible property and the issuance in the mid-1990s of updated