

transfer pricing regulations addressing transactions other than services transactions. In addition, also in the mid-1990s, the OECD published updated transfer pricing guidelines for use by countries in the resolution of transfer pricing cases in mutual agreement proceedings under tax treaties.

These proposed regulations provide generally that the arm's length amount charged in a controlled services transaction must be determined under one of the transfer pricing methods provided for or referenced in the proposed regulations. The guidance regarding transfer pricing methods provided for in the proposed regulations generally is consistent with the current regulatory guidance regarding the transfer pricing methods applicable to transfers of tangible or intangible property and is consistent with international standards in this area. In addition, the proposed regulations provide a new cost-based method that may be used to price low-margin controlled services transactions that meet certain quantitative and qualitative conditions and requirements. This simplified cost-based method generally requires a less robust analysis of services transactions within its scope than would be required under the other pricing methods. The simplified method is intended to preserve aspects of the current rules that provide appropriately reduced administrative and compliance burdens for low-margin services while bringing the current rules more into line with the arm's length standard and eliminating aspects of the current rules that have proved problematic.

The proposed regulations provide updated guidance consistent with international standards in this area on the threshold issue of whether activities constitute the rendering of services for the benefit of another member of a controlled group.

The proposed regulations provide guidance to better coordinate and harmonize the rules applicable to services transactions with the rules for other types of transactions under section 482, in particular transfers of intangible property. The Treasury Department and the IRS believe that such guidance is necessary to mitigate the extent to which the form or characterization of a transfer of intangibles as the rendering of services can lead to inappropriate results. The Treasury Department and the IRS believe that the transfer pricing rules should reach similar results in the case of economically similar transactions, regardless of the characterization or structuring of such transactions. Thus, several provisions of

the proposed regulations are intended to minimize or to eliminate the differences between the transfer pricing analysis of services transactions related to intangibles and the analysis of transfers of intangible property. In particular, the proposed regulations provide that the arm's length result for a services transaction that effects the transfer of intangible property must be determined or corroborated by an analysis under the transfer pricing rules for transfers of intangible property. In addition, the proposed regulations limit the use of the simplified cost-based method in the case of services that involve the use of valuable intangibles. The proposed regulations also provide guidance regarding the use or imputation of contingent-payment arrangements in the context of services transactions, and provide generally applicable guidance on the application of the residual profit split method to make that method more suitable to the analysis of services transactions where appropriate. The cumulative effect of these provisions is to make available in connection with the transfer pricing of controlled services relating to intangibles the analytical tools that are available in connection with the transfer pricing of transfers of intangible property, including the possibility of analyzing transactions as multi-year arrangements in which the consideration for services rendered in one tax accounting period may be due in later periods.

2. Income Attributable to Intangibles

These proposed regulations also update guidance under existing § 1.482-4(f)(3) relating to the allocation of income attributable to intangible property. The Taxpayers and other commentators have criticized the framework of § 1.482-4(f)(3). In particular, commentators have questioned the use of ownership for purposes of section 482, as distinct from legal ownership or ownership for tax purposes more generally, as an analytical tool for determining the appropriate allocation of income attributable to an intangible. The Treasury Department and the IRS believe that existing § 1.482-4(f)(3), when properly applied, generally reaches appropriate results in allocating income attributable to intangible property. However, the Treasury Department and the IRS are concerned that the regulation may be misapplied to reach "all or nothing" results based on a determination of ownership in cases where an arm's length analysis in accordance with the section 482 regulations would require that the income attributable to an intangible be

divided among the controlled taxpayers that made significant contributions to develop or enhance that intangible, and that hold legal rights with respect to that intangible.

As a result, the Treasury Department and the IRS believe that the analytical framework of § 1.482-4(f)(3) should be modified. The rules for determining the ownership of an intangible generally should be distinct from the rules for determining the allocation of income from an intangible. The income attributable to an intangible should be allocated among controlled taxpayers under the arm's length standard, in accordance with each party's contributions to the development or enhancement of that intangible and its ownership interests (if any). This analysis generally will preclude "all or nothing" results. The proposed modifications to § 1.482-4(f)(3) are possible because of proposed changes to the treatment of controlled services transactions, in particular the conditions and requirements on the use of the simplified cost-based method and the provisions intended to better coordinate and harmonize the rules applicable to services transactions with the rules for transfers of intangible property (including guidance on services that effect transfers of intangible property and guidance on the residual profit split method and contingent payment arrangements).

B. Services Transactions—§ 1.482-9

1. General Rule—§ 1.482-9(a)

Consistent with the rules governing transfers of tangible and intangible property under existing §§ 1.482-3 and 1.482-4, respectively, proposed § 1.482-9(a) provides that the arm's length amount charged in a controlled services transaction must be determined under one of the methods described or referenced in the proposed regulations. Also consistent with the rules governing transfers of tangible and intangible property, the proposed regulations provide guidance concerning selection and application of the appropriate method by explicitly incorporating the general rules in § 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)) of the existing regulations.

The proposed regulations specify six methods applicable to controlled services transactions. Proposed § 1.482-9(a) sets out four new methods applicable to services: the comparable uncontrolled services price method, the gross services margin method, the cost of services plus method, and the