

simplified cost-based method. The first three methods are direct analogs of methods provided for transfers of tangible property under existing § 1.482-3, tailored to account for particular circumstances in services transactions. The fourth method, the simplified cost-based method, is set forth in proposed § 1.482-9(f). Proposed § 1.482-9(a) also specifies that the comparable profits method under existing § 1.482-5 and the profit split methods under existing § 1.482-6, as modified by proposed § 1.482-9(e) and (g) respectively, are applicable to services. Finally, proposed § 1.482-9(a)(7) indicates that unspecified methods also may be used in appropriate circumstances, as prescribed by proposed § 1.482-9(h).

Proposed § 1.482-9(a)(1) provides that the general rules under § 1.482-1 of the existing regulations, including the best method rule of existing § 1.482-1(c), the comparability standards of existing § 1.482-1(d), and the rules regarding determination of an arm's length range under existing § 1.482-1(e), generally apply to the determination of an appropriate arm's length charge for controlled services transactions. The best method rule under existing § 1.482-1(c) provides that an arm's length result must be determined under the method that, given the facts and circumstances, provides the most reliable measure of an arm's length result. Existing § 1.482-1(c)(2) provides two primary factors to consider in determining which method is the most reliable: the degree of comparability between the controlled transactions and any uncontrolled comparables, and the quality of data and assumptions used in the analysis.

The proposed regulations incorporate the comparability factors in existing § 1.482-1(d) because these factors generally are relevant under all methods. In addition, the description of each of the methods set out in the proposed regulations provides other comparability factors that may be of particular importance in the context of that method as applied to a controlled services transaction.

2. Comparable Uncontrolled Services Price Method—§ 1.482-9(b)

Proposed § 1.482-9(b) sets forth the comparable uncontrolled services price method. This method evaluates whether a controlled services transaction satisfies the arm's length standard by comparing the price of a controlled services transaction with the price charged in a comparable uncontrolled services transaction. This method is analogous to the comparable uncontrolled price method of § 1.482-

3(b) in the context of transfers of tangible property. Proposed § 1.482-9(b)(1) provides that this method ordinarily is used where the controlled services are identical to or have a high degree of similarity to the services in the uncontrolled transaction.

The proposed regulations provide that all of the comparability factors described in existing § 1.482-1(d) must be considered, but emphasize that similarity in the nature of the services and valuable intangibles used, if any, in providing the services are the most important factors in determining comparability under this method. Consistent with the best method rule, proposed § 1.482-9(b)(2)(ii) provides that the comparable uncontrolled services price method generally provides the most direct and reliable measure of an arm's length result if an uncontrolled transaction either has no differences from the controlled services transaction or has only minor differences that have a definite and reasonably ascertainable effect on price, and appropriate adjustments may be made for such differences. Proposed § 1.482-9(b)(4) provides several examples that illustrate the application of the comparable uncontrolled services price method to cases in which the comparable uncontrolled transactions are internal or external.

The Treasury Department and the IRS recognize that, under certain circumstances, uncontrolled parties may use proprietary pricing models or other indirect methods to establish the price charged to uncontrolled parties in a services transaction. Proposed § 1.482-9(b)(5) provides that such data may be used as indirect evidence of a comparable uncontrolled services price if certain requirements are met. This provision is analogous to the provision regarding indirect evidence of comparable uncontrolled prices in § 1.482-3(b)(5) in the context of transfers of tangible property.

3. Gross Services Margin Method—§ 1.482-9(c)

Proposed § 1.482-9(c) sets forth the gross services margin method. This method evaluates the arm's length price charged in a controlled services transaction by reference to the gross services profit margin realized in uncontrolled transactions that involve similar services. Similar to the resale price method provided for in § 1.482-3(c) in the context of transfers of tangible property, the charge under this method is calculated based on the price paid in an underlying and related uncontrolled transaction undertaken by the controlled group.

Proposed § 1.482-9(c)(1) provides guidance regarding the circumstances in which this method ordinarily would be used. This method ordinarily is used in cases where a controlled taxpayer performs functions or services in connection with a "related uncontrolled transaction" between a member of the controlled group and an uncontrolled taxpayer. For example, this method may be used where a controlled taxpayer renders services (agent services) to another member of the controlled group in connection with a transaction between that other member and an uncontrolled taxpayer. This method also may be used in cases where a controlled taxpayer contracts to provide services to an uncontrolled taxpayer (intermediary function) and another member of the controlled group actually performs the services provided.

Proposed § 1.482-9(c)(2)(i) provides that the gross services margin method evaluates whether the price charged or amount retained by a controlled taxpayer is arm's length by determining the "appropriate gross services profit" of the controlled taxpayer. If one controlled taxpayer renders services to another member of a controlled group with respect to a transaction between that other member of the controlled group and an uncontrolled taxpayer, the price charged to the other member under the gross services margin method is the appropriate gross services profit of the controlled taxpayer that performed the agent services. In cases where one controlled taxpayer contracts to provide services to an uncontrolled taxpayer and another member of the controlled group actually performs those services, the price charged to the controlled intermediary under the gross services margin method is determined by subtracting from the "applicable uncontrolled price" the appropriate gross services profit of the intermediary controlled taxpayer.

Proposed § 1.482-9(c)(2)(ii) and (iii) define the terms "related uncontrolled transaction," "applicable uncontrolled price" and "appropriate gross services profit," which are necessary to determine the arm's length price under proposed § 1.482-9(c)(2)(i). The related uncontrolled transaction is a transaction between a member of the controlled group and an uncontrolled taxpayer as to which a controlled taxpayer performs agent services or an intermediary function. The applicable uncontrolled price is the final sales price paid by the uncontrolled party in the related uncontrolled transaction. Proposed § 1.482-9(c)(2)(iii) provides that the appropriate gross services profit is calculated by multiplying the applicable