

uncontrolled price by the gross services profit margin earned in comparable uncontrolled services transactions. The gross services profit margin takes into account all functions performed by other members of the controlled group and any other relevant factors.

The proposed regulations incorporate the general comparability factors of existing § 1.482-1(d) in determining comparability under this method. Proposed § 1.482-9(c)(3)(ii)(A) emphasizes that comparability under the gross services margin method is particularly dependent on similarity of functions performed, risks borne, intangibles used (if any), and contractual terms, as all these factors may materially affect the gross services profit margin.

In determining comparability, the proposed regulations state that where the controlled taxpayer provides services similar to a sales or purchasing agent, this method is less dependent on close similarity in the underlying property transferred or the services provided to the uncontrolled party. However, substantial differences in the nature of the property transferred or the services provided to the uncontrolled party may indicate significant differences in the functions performed by the controlled taxpayer. Thus, it ordinarily would be expected that the controlled and uncontrolled transactions would involve agent or intermediary services involving the transfer of goods within the same product categories, or the provision of services of the same general type.

In addition, the proposed regulations provide that if the functions performed by a controlled taxpayer are similar to those performed by an uncontrolled taxpayer, then the gross profit margin earned by the uncontrolled taxpayer may be used as a comparable gross services profit margin regardless of the structure of the uncontrolled services transaction. For example, proposed § 1.482-9(c)(3)(ii)(D) provides that if a controlled taxpayer that functions as a sales or purchasing agent for transfers of tangible property is comparable to a distributor that takes title to goods and resells them (*i.e.*, a buy-sell distributor), then the gross profit margin earned by the uncontrolled distributor on sales, stated as a percentage of the uncontrolled price paid for the goods, may be used as the comparable gross services profit margin.

Proposed § 1.482-9(c)(4) provides examples that illustrate various aspects of the application of the gross services margin method.

4. Cost of Services Plus Method—§ 1.482-9(d)

Proposed § 1.482-9(d) sets forth the cost of services plus method. This method evaluates whether the amount charged in a controlled services transaction is arm's length by reference to the gross services profit markup in comparable uncontrolled services transactions. The proposed regulations provide that this method is most reliably applied when the renderer in the controlled services transaction provides the same or similar services to both controlled and uncontrolled parties.

The cost of services plus method under proposed § 1.482-9(d) is similar to the cost plus method applicable to transfers of tangible property under existing § 1.482-3(d). The proposed regulations, however, incorporate certain modifications that are necessary because the manner in which the costs of providing services are presented for financial accounting purposes is less uniform than the manner in which costs of goods sold are presented for such purposes. The proposed regulations refer to the costs to be taken into account in evaluating controlled services transactions as "comparable transactional costs." Proposed § 1.482-9(d)(2)(ii) defines comparable transactional costs to include all costs of providing the services that are taken into account as the basis for determining the gross services profit markup in comparable uncontrolled services transactions. The Treasury Department and the IRS intend this definition to be flexible to ensure that reasonably equivalent categories of costs will be used to determine gross services profit in particular cases. Consequently, the proposed regulations provide that in some circumstances comparable transactional costs may constitute a subset of the total services costs (as defined in proposed § 1.482-9(j)). Generally accepted accounting principles or income tax accounting rules (where income tax data for comparable transactions are available) may provide a useful starting point but will not be conclusive.

The proposed regulations incorporate the general comparability factors of existing § 1.482-1(d) and provide several specific rules to ensure appropriate results under this method. For example, proposed § 1.482-9(d)(3)(ii)(A) provides that in determining functional comparability between the tested transaction and uncontrolled transactions, it may be necessary to consider the charge determined under the cost of services

plus method expressed in the form of a markup on total services costs of the controlled taxpayer and uncontrolled parties. The Treasury Department and the IRS believe that this confirming analysis will prevent inappropriate results where the uncontrolled transactions incorporate functional differences that are reflected in costs that are not included in comparable transactional costs. In addition, proposed § 1.482-9(d)(3)(ii)(B) states that reliability under this method will be reduced if a significant amount of the controlled taxpayer's comparable transactional costs consists of costs incurred in a tax accounting period other than the period under review. The Treasury Department and the IRS believe that in such cases application of this method may produce unreliable results.

The proposed regulations further provide that if, in applying this method, the controlled taxpayer and the comparable parties do not state their respective costs of providing the services on an equivalent basis, adjustments will be necessary to ensure reliability of the results. Proposed § 1.482-9(d)(3)(iii)(B) notes that where such adjustments are not possible, the reliability of the results determined under this method will be reduced.

Proposed § 1.482-9(d)(4) provides examples that illustrate various aspects of the application of the cost of services plus method.

5. Comparable Profits Method—§ 1.482-9(e)

The proposed regulations specify that the comparable profits method may be applied to controlled services. The comparable profits method evaluates whether the amount charged in a controlled services transaction is arm's length based on analysis of objective measures of profitability (profit level indicators) derived from financial information regarding uncontrolled taxpayers that engage in similar business activities under similar circumstances.

The proposed regulations provide that the guidance in existing § 1.482-5 generally is applicable to controlled services transactions. Proposed § 1.482-9(e) provides specific guidance that tailors the application of § 1.482-5 in cases in which the tested party under existing § 1.482-5(b)(2) is the renderer of the services under review. In all other cases, including cases in which the tested party is the recipient of controlled services, the provisions of existing § 1.482-5 apply without regard to § 1.482-9(e).