

controlled group, to use tangible property, such as laboratory equipment, in connection with B's development of an intangible that B owns. By furnishing tangible property, A makes a contribution to the development of an intangible owned by another controlled taxpayer, B. Pursuant to paragraph (f)(4)(i) of this section, the arm's length charge for A's furnishing of tangible property will be determined under the rules for use of tangible property in § 1.482-2(c).

Example 2. (i) *Facts.* FP, a foreign producer of wristwatches, is the registered holder of the YY trademark in the United States and in other countries worldwide. FP enters into a five-year, renewable distribution agreement with its newly organized U.S. subsidiary, USSub. The contractual terms of the agreement grant USSub the right to sell trademark YY wristwatches in the United States, obligate USSub to pay a fixed price per wristwatch throughout the entire term of the contract, and obligate both FP and USSub to undertake without separate compensation specified types and levels of marketing activities.

(ii) The consideration for FP's and USSub's marketing activities, as well as the consideration for the license to sell YY trademarked merchandise, are embedded in the transfer price paid for the wristwatches. Accordingly, pursuant to paragraph (f)(4)(i) of this section, ordinarily no separate allocation would be appropriate with respect to these embedded contributions.

(iii) Whether an allocation is warranted with respect to the transfer price for the wristwatches is determined under § 1.482-1 and §§ 1.482-3 through 1.482-6. The comparability analysis would include consideration of all relevant factors, including the nature of the intangible embedded in the wristwatches and the nature of the marketing activities required under the contract. This analysis would also take into account that the compensation for the activities performed by USSub and FP, as well as the consideration for USSub's use of the YY trademark, is embedded in the transfer price for the wristwatches, rather than provided for in separate agreements. *See* § 1.482-3(f) and 1.482-9(m)(4). If it is not possible to identify uncontrolled transactions that incorporate a similar range of interrelated elements and there are nonroutine contributions by each of FP and USSub, then the most reliable measure of the arm's length price for the wristwatches may be the residual profit split method. The analysis would take into account routine and nonroutine contributions by USSub and FP in order to determine an appropriate allocation of the combined operating profits from the sale of the wristwatches and related activities.

Example 3. (i) *Facts.* FP, a foreign producer of athletic gear, is the registered holder of the AA trademark in the United States and in other countries. In Year 1, FP licenses to a newly organized U.S. subsidiary, USSub, the exclusive rights to use certain manufacturing and marketing intangibles to manufacture and market athletic gear in the United States under the AA trademark. The license agreement obligates USSub to pay a royalty based on sales of trademarked merchandise.

The license agreement also obligates FP and USSub to perform without separate compensation specified types and levels of marketing activities. In Year 1, USSub manufactures and sells athletic gear under the AA trademark in the United States.

(ii) The consideration for FP's and USSub's respective marketing activities is embedded in the contractual terms of the license for the AA trademark. Accordingly, pursuant to paragraph (f)(4)(i) of this section, ordinarily no separate allocation would be appropriate with respect to the embedded contributions in Year 1. *See* § 1.482-9(m)(4).

(iii) Whether an allocation is warranted with respect to the royalty under the license agreement would be analyzed under § 1.482-1 and this section through § 1.482-6. The comparability analysis would include consideration of all relevant factors, such as the term and geographical exclusivity of the license, the nature of the intangibles subject to the license, and the nature of the marketing activities required to be undertaken pursuant to the license. Pursuant to paragraph (f)(4)(i) of this section, the analysis would also take into account the fact that the compensation for the marketing services is embedded in the royalty for the AA trademark, rather than provided for in a separate services agreement. If it is not possible to identify uncontrolled transactions that incorporate a similar range of interrelated elements and there are nonroutine contributions by each of FP and USSub, then the most reliable measure of the arm's length royalty for the AA trademark may be the residual profit split method. The analysis would take into account routine and nonroutine contributions by USSub and FP in order to determine an appropriate allocation of the combined operating profits from the sale of the AA trademarked merchandise and related activities.

Example 4. (i) *Facts.* The Year 1 facts are the same as in *Example 3*, with the following exceptions. In Year 2, USSub undertakes certain incremental marketing activities, in addition to those required by the contractual terms of the license for the AA trademark. The parties do not execute a separate agreement with respect to the incremental marketing activities performed by USSub. The license agreement executed in Year 1 is of sufficient duration that it is reasonable to anticipate that USSub will obtain the benefit of its incremental activities, in the form of increased sales or revenues of trademarked products in the U.S. market.

(ii) To the extent that it was reasonable to anticipate that USSub's incremental marketing activities would increase the value only of USSub's intangible (that is, USSub's license to use the AA trademark for a specified term), and not the value of the AA trademark owned by FP, USSub's incremental activities do not constitute a contribution for which an allocation is warranted under paragraph (f)(4)(i) of this section.

Example 5. (i) *Facts.* The Year 1 facts are the same as in *Example 3*. In Year 2, FP and USSub enter into a separate services agreement that obligates USSub to perform certain incremental marketing activities to promote AA trademark athletic gear in the

United States, beyond the activities specified in license agreement. In Year 2, USSub begins to perform these incremental activities, pursuant to the separate services agreement with FP.

(ii) Whether an allocation is warranted with respect to USSub's incremental marketing activities covered by the separate services agreement would be evaluated under §§ 1.482-1 and 1.482-9, including a comparison of the compensation provided for the services with the results obtained under a method pursuant to § 1.482-9, selected and applied in accordance with the best method rule of § 1.482-1(c).

(iii) Whether an allocation is warranted with respect to the royalty under the license agreement is determined under § 1.482-1 and this section through § 1.482-6. The comparability analysis would include consideration of all relevant factors, such as the term and geographical exclusivity of the license, the nature of the intangibles subject to the license, and the nature of the marketing activities required to be undertaken pursuant to the license. The comparability analysis would take into account that the compensation for the incremental activities by USSub is provided for in the separate services agreement, rather than embedded in the royalty for the AA trademark. If it is not possible to identify uncontrolled transactions that incorporate a similar range of interrelated elements and there are nonroutine contributions by each of FP and USSub, then the most reliable measure of the arm's length royalty for the AA trademark may be the residual profit split method. The analysis would take into account routine and nonroutine contributions by USSub and FP in order to determine an appropriate allocation of the combined operating profits from the sale of the AA trademarked merchandise and related activities.

Example 6. (i) *Facts.* The Year 1 facts are the same as in *Example 3*. In Year 2, FP and USSub enter into a separate services agreement that obligates FP to perform incremental marketing activities by advertising AA trademarked athletic gear in selected international sporting events, such as the Olympics and the soccer World Cup. FP's corporate advertising department develops and coordinates these special promotions. The separate services agreement obligates USSub to pay an amount to FP for the benefit to USSub that may reasonably be anticipated as the result of FP's incremental activities. The separate services agreement is not a qualified cost sharing arrangement under § 1.482-7. FP begins to perform the incremental activities in Year 2 pursuant to the separate services agreement.

(ii) Whether an allocation is warranted with respect to the incremental marketing activities performed by FP under the separate services agreement would be evaluated under § 1.482-9. Under the circumstances, it is reasonable to anticipate that FP's activities would increase the value of USSub's license as well as the value of FP's trademark. Accordingly, the incremental activities by FP may constitute in part a controlled services transaction for which USSub must compensate FP. The analysis of whether an