

in providing such agent services is 3% of total fees charged in Company B's related uncontrolled transactions, then the appropriate gross services profit that Company B may retain as compensation for performing an intermediary function (and the amount, therefore, that is deducted from the applicable uncontrolled price to arrive at the arm's length price that Company A may charge Company B for performing consulting services on Company B's behalf) is equal to this comparable gross services margin (3%), multiplied by the applicable uncontrolled price charged by Company B in its contract to provide services to the uncontrolled party.

Example 5. External comparable. (i) The facts are the same as in *Example 4*, except that neither Company A nor Company B engage in transactions with third parties that facilitate similar consulting engagements.

(ii) Analysis of the relative contributions of Companies A and B in obtaining and undertaking the contract indicates that Company B's role was primarily to facilitate the consulting arrangement between Company A and the Country X client. Although no reliable internal data are available regarding comparable transactions with uncontrolled entities, reliable data exist regarding commission rates for similar facilitating services between uncontrolled parties. These data indicate that a 3% commission (3% of total engagement fee) is charged in such transactions. Information regarding the uncontrolled comparables is sufficiently complete to conclude that it is likely that all material differences between the controlled and uncontrolled transactions have been identified and adjusted for. If the appropriate gross services profit margin is 3% of total fees, then an arm's length result of the controlled services transaction is for Company B to retain an amount equal to 3% of total fees paid to it.

(d) *Cost of services plus method*—(1) *In general.* The cost of services plus method evaluates whether the amount charged in a controlled services transaction is arm's length by reference to the gross services profit markup realized in comparable uncontrolled transactions. The cost of services plus method is ordinarily used in cases where the controlled service renderer provides the same or similar services to both controlled and uncontrolled parties. This method is ordinarily not used in cases where the controlled services transaction involves a contingent-payment arrangement, as described in paragraph (i)(2) of this section.

(2) *Determination of arm's length price*—(i) *In general.* The cost of services plus method measures an arm's length price by adding the appropriate gross services profit to the controlled taxpayer's comparable transactional costs.

(ii) *Appropriate gross services profit.* The appropriate gross services profit is computed by multiplying the controlled taxpayer's comparable transactional

costs by the gross services profit markup, expressed as a percentage of the comparable transactional costs earned in comparable uncontrolled transactions.

(iii) *Comparable transactional costs.* Comparable transactional costs consist of the costs of providing the services under review that are taken into account as the basis for determining the gross services profit markup in comparable uncontrolled transactions. Depending on the facts and circumstances, such costs typically include all compensation attributable to employees directly involved in the performance of such services, materials and supplies consumed or made available in rendering such services, and other costs of rendering the services. Comparable transactional costs must be determined on a basis that will facilitate comparison with the comparable uncontrolled transactions. For that reason, comparable transactional costs may not necessarily equal total services costs, as defined in paragraph (j) of this section, and in appropriate cases may be a subset of total services costs. Generally accepted accounting principles or Federal income tax accounting rules (where Federal income tax data for comparable transactions or business activities is available) may provide useful guidance, but will not conclusively establish the appropriate comparable transactional costs for purposes of this method.

(iv) *Arm's length range.* See § 1.482-1(e)(2) for determination of an arm's length range.

(3) *Comparability and reliability considerations*—(i) *In general.* Whether results derived from the application of this method are the most reliable measure of the arm's length result must be determined using the factors described under the best method rule in § 1.482-1(c).

(ii) *Comparability*—(A) *Functional comparability.* The degree of comparability between controlled and uncontrolled transactions is determined by applying the comparability provisions of § 1.482-1(d). A service renderer's gross services profit provides compensation for performing services related to the controlled services transaction under review, including an operating profit for the service renderer's investment of capital and assumptions of risks. Therefore, although all of the factors described in § 1.482-1(d)(3) must be considered, comparability under this method is particularly dependent on similarity of services or functions performed, risks borne, intangibles (if any) used in providing the services or functions, and

contractual terms, or adjustments to account for the effects of any such differences. For purposes of evaluating functional comparability, it may be necessary to consider the results under this method expressed as a markup on total services costs of the controlled taxpayer and comparable uncontrolled parties, because differences in functions performed may be reflected in differences in service costs other than those included in comparable transactional costs. If possible, the appropriate gross services profit markup should be derived from comparable uncontrolled transactions of the same taxpayer participating in the controlled services transaction, because similar characteristics are more likely to be found among services provided by the same service provider than among services provided by other service providers. In the absence of such services transactions, an appropriate gross services profit markup may be derived from comparable uncontrolled services transactions of other service providers.

(B) *Other comparability factors.* Comparability under this method is less dependent on close similarity between the services provided than under the comparable uncontrolled services price method. Substantial differences in the services may, however, indicate significant functional differences between the controlled and uncontrolled taxpayers. Thus, it ordinarily would be expected that the controlled and uncontrolled transactions would involve services of the same general type (e.g., information-technology systems design). Furthermore, if a significant amount of the controlled taxpayer's comparable transactional costs consists of service costs incurred in a tax accounting period other than the tax accounting period under review, the reliability of the analysis would be reduced. In addition, significant differences in the value of the services rendered, due for example to the use of valuable intangibles, may also affect the reliability of the comparison. Finally, the reliability of profit measures based on gross services profit may be adversely affected by factors that have less effect on prices. For example, gross services profit may be affected by a variety of other factors, including cost structures or efficiency-related factors (for example, differences in the level of experience of the employees performing the service in the controlled and uncontrolled transactions). Accordingly, if material differences in these factors are identified based on objective