

evidence, the reliability of the analysis may be affected.

(C) *Adjustments for differences between the controlled and uncontrolled transactions.* If there are material differences between the controlled and uncontrolled transactions that would affect the gross services profit markup, adjustments should be made to the gross services profit markup earned in the comparable uncontrolled transaction according to the provisions of § 1.482-1(d)(2). For this purpose, consideration of the comparable transactional costs associated with the functions performed and risks assumed may be necessary, because differences in the functions performed are often reflected in these costs. If there are differences in functions performed, however, the effect on gross services profit of such differences is not necessarily equal to the differences in the amount of related comparable transactional costs. Specific examples of the factors that may be particularly relevant to this method include—

- (1) The complexity of the services;
- (2) The duration or quantitative measure of services;
- (3) Contractual terms (e.g., scope and terms of warranties or guarantees provided, volume, credit and payment terms, allocation of risks, including any contingent-payment terms);
- (4) Economic circumstances; and
- (5) Risks borne.

(iii) *Data and assumptions—(A) In general.* The reliability of the results derived from the cost of services plus method is affected by the completeness and accuracy of the data used and the reliability of the assumptions made to apply this method. See § 1.482-1(c) (Best method rule).

(B) *Consistency in accounting.* The degree of consistency in accounting practices between the controlled transaction and the uncontrolled comparables that materially affect the gross services profit markup affects the reliability of the results under this method. Thus, for example, if differences in cost accounting practices would materially affect the gross services profit markup, the ability to make reliable adjustments for such differences would affect the reliability of the results obtained under this method. Further, reliability under this method depends on the extent to which the controlled and uncontrolled transactions reflect consistent reporting of comparable transactional costs. For purposes of this paragraph (d)(3)(iii)(B), the term comparable transactional costs includes the cost of acquiring tangible property that is transferred (or used) with the services, to the extent that the

arm's length price of the tangible property is not separately evaluated as a controlled transaction under another provision.

(4) *Examples.* The principles of this paragraph (d) are illustrated by the following examples:

*Example 1. Internal comparable.* (i) Company A designs and assembles information-technology networks and systems. When Company A renders services for uncontrolled parties, it receives compensation based on time and materials spent on the project. This fee includes the cost of hardware and software purchased from uncontrolled vendors and incorporated in the final network or system. Reliable accounting records maintained by Company A indicate that Company A earned a gross services profit markup of 10% on its time and materials in providing design services during the year under examination on information technology projects for uncontrolled entities.

(ii) Company A designed an information-technology network for its Country X subsidiary, Company B. The services rendered to Company B are similar in scope and complexity to services that Company A rendered to uncontrolled parties during the year under examination. Using Company A's accounting records (which are determined to be reliable under paragraph (d)(3) of this section), it is possible to identify the comparable transactional costs involved in the controlled services transaction with reference to the costs incurred by Company A in rendering similar design services to uncontrolled parties. Company A's records indicate that it does not incur any additional types of costs in rendering similar services to uncontrolled customers. The data available are sufficiently complete to conclude that it is likely that all material differences between the controlled and uncontrolled transactions have been identified and adjusted for. Based on the gross services profit markup data derived from Company A's uncontrolled transactions involving similar design services, an arm's length result for the controlled services transaction is equal to the price that will allow Company A to earn a 10% gross services profit markup on its comparable transactional costs.

*Example 2. Inability to adjust for differences in comparable transactional costs.* The facts are the same as in *Example 1*, except that Company A's staff that rendered the services to Company B consisted primarily of engineers in training status or on temporary rotation from other Company A subsidiaries. In addition, the Company B network incorporated innovative features, including specially designed software suited to Company B's requirements. The use of less-experienced personnel and staff on temporary rotation, and the special features of the Company B network significantly increased the time and costs associated with the project, as compared to time and costs associated with similar projects completed for uncontrolled customers. These factors constitute material differences between the controlled and the uncontrolled transactions that affect the

determination of Company A's comparable transactional costs associated with the controlled services transaction, as well as the gross services profit markup. Moreover, it is not possible to perform reliable adjustments for these differences, on the basis of the available accounting data. Under these circumstances, the reliability of the cost of services plus method as a measure of an arm's length price is substantially reduced.

*Example 3. Operating loss by reference to total services costs.* The facts and analysis are the same as in *Example 1*, except that available information indicates that there may be material differences between the controlled and uncontrolled services transactions, and that these differences may not be reflected in the comparable transactional costs. Accordingly, the taxpayer performs additional analysis pursuant to paragraph (d)(3)(ii) of this section, and restates the results in *Example 1* (in which the arm's length charge was determined by reference to 10% gross services profit markup on comparable transactional costs) in the form of a markup on total services costs. This analysis by reference to total services costs shows that Company A generated an operating loss on the controlled services transaction, which indicates that material differences likely exist between the total services costs in the controlled and uncontrolled transactions, other than the costs that are identified as comparable transactional costs. Upon further scrutiny, the presence of such material differences between the controlled and uncontrolled transactions may indicate that the cost of services plus method does not provide the most reliable measure of an arm's length result under the facts and circumstances.

*Example 4. Internal comparable.* (i) Company A, a U.S. corporation, and its subsidiaries perform computer consulting services relating to systems integration and networking for business clients in various countries. Company A and its subsidiaries render only consulting services and do not manufacture or distribute computer hardware or software to clients. The controlled group is organized according to industry specialization, with key industry specialists working for Company A. These personnel typically form the core consulting group that teams with consultants from the local-country subsidiaries to serve clients in the subsidiaries' respective countries.

(ii) On some occasions, Company A and its subsidiaries undertake engagements directly for clients. On other occasions, they work as subcontractors for uncontrolled parties on more extensive supply-chain consulting engagements for clients. In undertaking the latter engagements with third-party consultants, Company A typically prices its services at four times the compensation costs of its consultants, defined as the consultants' base salary plus estimated fringe benefits, as defined in the table below:

*Category/Rates*

Project managers—\$100 per hour  
Technical staff—\$75 per hour

(iii) In uncontrolled transactions, Company A also charges the customer, at no markup, for out-of-pocket expenses such as travel,