

markup on total services costs exceeds the markup charged by the taxpayer on total services costs in the controlled transaction by at least the applicable number of percentage points described in paragraph (f)(2)(ii) of this section. For purposes of this paragraph (f), the arm's length markup on total services costs means the excess of the arm's length price of the controlled services transaction determined in accordance with the applicable rules under the section 482 regulations, without regard to this paragraph (f), over total services costs (as defined in paragraph (j) of this section), expressed as a percentage of total services costs.

(ii) *Applicable number of percentage points.* The applicable number of percentage points is six if the amount

charged by the taxpayer is equal to total services costs, and the applicable number of percentage points declines ratably to zero by one percentage point for every increase of two percentage points in the markup on total services costs charged in the controlled transaction.

(iii) *Method inapplicable to high-margin transactions.* The simplified cost-based method may not be used if the arm's length markup on total services costs exceeds 10%.

(iv) *Measurement of limitation on allocations.* The rules of paragraphs (f)(2)(i) and (ii) of this section are expressed in this paragraph in equations and a table. The minimum arm's length markup necessary for an allocation by the Commissioner ("Z") is the sum of

the markup charged by the taxpayer ("X") and the applicable number of percentage points determined under paragraph (f)(2)(ii) of this section ("Y"). This minimum arm's length markup necessary for allocation by the Commissioner ("Z") also equals the lesser of—

(A) The sum of six percentage points and half of the markup charged by the taxpayer ("X"); and

(B) Ten percentage points, where the markup charged by the taxpayer is not less than zero. Thus:

$$Z = X + Y = \min((6\% + 0.5 \times X), 10\%) \text{ where } X \geq 0.$$

(C) The following table illustrates the results of these calculations in representative cases:

Markup charged by taxpayer (X)	0%	1%	2%	3%	4%	5%	6%	7%	8%	9%
Applicable number of percentage points (Y)	6	5.5	5	4.5	4	3.5	3	2.5	2	n/a
Arm's length markup necessary for allocation by the Commissioner (Z).	6%	6.5%	7%	7.5%	8%	8.5%	9%	9.5%	10%	10%

(v) *Scope of limitation on allocations by the Commissioner—(A) Loss transactions and transactions priced in excess of arm's length.* Nothing in this paragraph (f) shall limit the authority of the Commissioner to make an allocation where—

(1) The amount charged by the taxpayer is less than the total services costs with respect to the services; or

(2) The markup on total services costs charged by the taxpayer in the controlled transaction exceeds the arm's length markup on total services costs.

(B) *Allocation and apportionment of costs.* Nothing in this paragraph (f) limits the authority of the Commissioner to determine the total services costs in the controlled services transaction where the taxpayer's method of allocating and apportioning total services costs to the controlled service is not consistent with the method used to allocate and apportion total services costs in determining the arm's length markup, or otherwise does not constitute a reasonable method of allocation and apportionment, based on all the facts and circumstances.

(3) *Conditions on application of simplified cost-based method.* The arm's length amount charged in a controlled services transaction may be evaluated under the simplified cost-based method only if the following conditions are met.

(i) *Adequate books and records.* Permanent books of account and records must be maintained throughout the time when costs with respect to the controlled services are incurred by the renderer. Such books and records must be adequate to permit verification by the

Commissioner of the total services costs incurred by the renderer, including verification of the methods used to allocate and apportion such costs to the services in question.

(ii) *Written contract—(A) In general.* A written contract must be in place throughout the time when costs with respect to the controlled services are incurred by the renderer and must provide the following—

(1) That the controlled recipient of such services becomes unconditionally obligated at the time the renderer incurs costs to pay the renderer an amount equal to total costs plus, to the extent provided in such contract, any markup on total services costs; and

(2) A general description of the classes of controlled services transactions subject to the contract.

(B) *De minimis exception.* A written contract need not be in place if the conduct of the controlled taxpayers is consistent with the terms described in paragraph (f)(3)(ii)(A) of this section and, for the taxable year at issue, the controlled taxpayer rendering the services establishes to the satisfaction of the Commissioner that—

(1) The aggregate gross income of the members controlled group consisting of taxpayers that are United States persons (as defined in § 7701(a)(30)) is less than \$200 million; or

(2) The aggregate costs of such controlled group members evaluated under the simplified cost-based method are less than \$10 million.

(4) *Transactions not eligible for simplified cost-based method—(i) Services similar to services provided by*

renderer or recipient to uncontrolled parties. The arm's length charge in a controlled services transaction may not be determined under the simplified cost-based method where the renderer, the recipient, or another controlled taxpayer in the same controlled group renders, or has rendered, similar services to one or more uncontrolled taxpayers (unless such services are rendered on a *de minimis* basis).

(ii) *Services rendered to a recipient that receives services from controlled taxpayers in significant amounts.* The arm's length charge in a controlled services transaction may not be determined under the simplified cost-based method where the services are rendered to a recipient that receives services from controlled taxpayers in significant amounts. A recipient may be presumed to receive services in significant amounts unless the controlled taxpayer rendering the services establishes, to the satisfaction of the Commissioner, that the aggregate amount paid or accrued by the recipient of the controlled services to the renderer or renderers with respect to such services during a taxable year of the recipient is less than an amount equal to 50% of the total costs of the recipient in that taxable year. For purposes of this paragraph (f)(4)(ii), the total costs of the recipient exclude any amounts paid or accrued for materials that are properly reflected in the recipient's cost of goods sold.

(iii) *Services involving the use of intangible property.* The arm's length charge in a controlled services