

simplified cost-based method for the logistics services, and determines the amount charged as P's total cost of providing the services, plus a markup of 4%. Based on an application of the section 482 regulations without regard to this paragraph (f), the Commissioner determines that the interquartile range of arm's length markups on total services costs is between 3% and 11%, and the median is 8.5%. Given that the arm's length markup on total services costs (8.5%) exceeds the markup applied by the taxpayer (4%) by more than the applicable number of percentage points (4), the limitations imposed by this rule on the Commissioner's authority to make an allocation do not apply. With respect to the application of the arm's length range, see § 1.482-1(e).

Example 8. Company P provides administrative services to Company S. Company P uses the simplified cost-based method for the administrative services, and determines the amount charged as Company P's total cost of providing the services, plus a markup of 4%. The taxpayer allocates and apportions to the administrative services total services costs of 300x, and reports a total price of 312x. Based on an application of the section 482 regulations without regard to this paragraph (f), the Commissioner determines that the interquartile range of arm's length markups on total services costs is between 3% and 6%, and the median is 4%. Because the arm's length markup on total services costs (4%) is equivalent to the markup on total services costs applied by the taxpayer (4%), the simplified cost-based method would generally prevent an allocation by the Commissioner based on the amount of markup charged. On examination, the Commissioner determines that the taxpayer should have allocated and apportioned total services costs of 325x to the administrative services, rather than 300x. Because the taxpayer's method of allocation and apportionment was not reasonable under the facts and circumstances, the Commissioner may make an allocation to reflect application of the markup on total services costs claimed by the taxpayer to the correct base of costs.

Example 9. Company P provides administrative services to Company S. Company P uses the simplified cost-based method for the administrative services, and determines the amount charged as Company P's total cost of providing the services, with a 4% markup. The taxpayer allocates and apportions to the administrative services total services costs of 300x. Based on an application of the section 482 regulations without regard to this paragraph (f), the Commissioner determines that the interquartile range of arm's length markups on total services costs is between 3% and 6%, and the median is 4%. Because the arm's length markup on total services costs (4%) is equivalent to the markup on total services costs applied by the taxpayer (4%), the simplified cost-based method would generally prevent an allocation by the Commissioner based on the amount of markup charged. On examination, the Commissioner determines that the taxpayer should have allocated and apportioned total

services costs of 280x to the administrative services, rather than 300x. Because the taxpayer's method of allocation and apportionment was not reasonable under the facts and circumstances, the Commissioner may make an allocation to reflect application of the markup on total services costs claimed by the taxpayer to the correct base of costs.

Example 10. Company P performs supply-chain management services for its subsidiaries, including Company S. Company P uses the simplified cost-based method for these supply-chain services, and determines the amount charged as the total costs of providing the services plus a markup of 8%. Based on an application of the section 482 regulations without regard to this paragraph (f), the Commissioner determines that the interquartile range of arm's length markups is between 7% and 25%, and the median is 18%. Because the arm's length markup on total services costs is more than 10%, the simplified cost-based method is not applicable.

(g) *Profit split method*—(1) *In general.* The profit split method evaluates whether the allocation of the combined operating profit or loss attributable to one or more controlled transactions is arm's length by reference to the relative value of each controlled taxpayer's contribution to that combined operating profit or loss. The relative value of each controlled taxpayer's contribution is determined in a manner that reflects the functions performed, risks assumed and resources employed by such controlled taxpayer in the relevant business activity. The profit split method is ordinarily used in controlled services transactions involving high-value services or transactions that are highly integrated and that cannot be reliably evaluated on a separate basis. For application of the profit split method (both the comparable profit split and the residual profit split), see § 1.482-6.

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

Example 1. Residual profit split. (i) Company A, a corporation resident in Country X, auctions spare parts by means of an interactive database. Company A maintains a database that lists all spare parts available for auction. Company A developed the software used to run the database. Company A's database is managed by Company A employees in a data center located in Country X, where storage and manipulation of data also takes place. Company A has a wholly owned subsidiary, Company B, located in Country Y. Company B performs marketing and advertising activities to promote Company A's interactive database. Company B solicits unrelated companies to auction spare parts on Company A's database, and solicits customers interested in purchasing spare parts online. Company B owns and maintains a computer server in Country Y, where it receives information on spare parts available

for auction. Company B has also designed a specialized communications network that connects its data center to Company A's data center in Country X. The communications network allows Company B to enter data from uncontrolled companies on Company A's database located in Country X. Company B's communications network also allows uncontrolled companies to access Company A's interactive database and purchase spare parts. Company B bore the risks and cost of developing this specialized communications network. Company B enters into contracts with uncontrolled companies and provides the companies access to Company A's database through the Company B network.

(ii) Analysis of the facts and circumstances indicates that both Company A and Company B possess valuable intangibles that they use to conduct the spare parts auction business. Company A bore the economic risks of developing and maintaining software and the interactive database. Company B bore the economic risks of developing the necessary technology to transmit information from its server to Company A's data-center, and to allow uncontrolled companies to access Company A's database. Company B helped to enhance the value of Company A's trademark and to establish a network of customers in Country Y. In addition, because the transactions between Company A and Company B are highly integrated, it is difficult to reliably evaluate them separately. Given the facts and circumstances, the Commissioner determines that a residual profit split method will provide the most reliable measure of an arm's length result.

(iii) Under the residual profit split method, profits are first allocated based on the routine contributions of each taxpayer. Routine contributions include general sales, marketing or administrative functions performed by Company B for Company A for which it is possible to identify market returns. Any residual profits will be allocated based on the nonroutine contributions of each taxpayer. Since both Company A and Company B provided nonroutine contributions, the residual profits are allocated based on these contributions.

Example 2. Residual profit split. (i) Company A, a U.S. corporation, is a large multinational corporation engaged in oil and mineral exploration, development and extraction/mining. In performing these functions, Company A uses teams of specialists who are drawn from its employees and employees of two of its wholly owned subsidiaries, Company B and Company C. Company B is a U.S. corporation engaged in the business of providing general construction contracting services. Company C is a mining/extraction subsidiary of Company A and is located in Country C.

(ii) Through its long-term relationship with the Country C government, Company C obtains drilling rights on a tract of land for which it already owns mining rights. Because Company C lacks the expertise and personnel to perform oil exploration, Company C enters into an agreement with Companies A and B to provide certain services to facilitate exploration for oil on the tract. Specifically, Company A provides management services and Company B provides all necessary labor