

LB&I International Practice Service Transaction Unit

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Part	1.2	Intangible Property Transfers Without Cost Sharing	Level 2 UIL	9411.2
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Unit Name	Accounting for Intangibles and Services Associated with the Sale of Tangible Property– Outbound
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Issue and Transaction Overview

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

United States (U.S.) multinational enterprises (MNE) may seek to maximize after tax profits by shifting income from a high tax affiliate to a lower tax affiliate via controlled party transactions that are not priced at arm's length. Income shifting may be achieved through the sale of tangible goods, provision of services, loans, leases and the license or transfer of intangibles between related parties at prices that are not arm's length.

In general, the price of goods in a sales transaction involving two uncontrolled parties is determined by market conditions and is assumed to be at arm's length. However, in a transaction between controlled parties, the price of goods is not determined by market conditions and may be manipulated in order to shift income to minimize taxes. Internal Revenue Code (IRC) 482 provides that the pricing for transactions between controlled parties involving goods, services, intangible property (IP), rents, and loans should fall within the arm's length results for transactions between uncontrolled parties under the same or similar circumstances.

The degree of comparability between controlled and uncontrolled transactions requires a comparison of the functions performed, contractual terms used, risks borne, economic conditions encountered, and the property and services employed by the parties to each transaction. This analysis is a prerequisite to identifying and selecting transactions comparable to the ones under examination in order to determine the arm's length price. A key part of this analysis is the determination of whether there are any valuable intangibles and services relevant to the tangible property transaction that are not identified and priced by the taxpayer. These valuable intangibles and services may constitute comparability factors that may require additional compensation because the value of the tangible property is enhanced by their presence.

The regulations provide for both specified and unspecified Transfer Pricing Methods (TPM) but requires use of the "best method" rule and comparability analysis to determine which method should be used in any particular situation. The evaluation of the pricing may also depend on whether the recipient of the tangible property also receives the right to exploit the associated intangible property (other than by merely reselling tangible property that incorporates the intangible property).

Issue and Transaction Overview (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

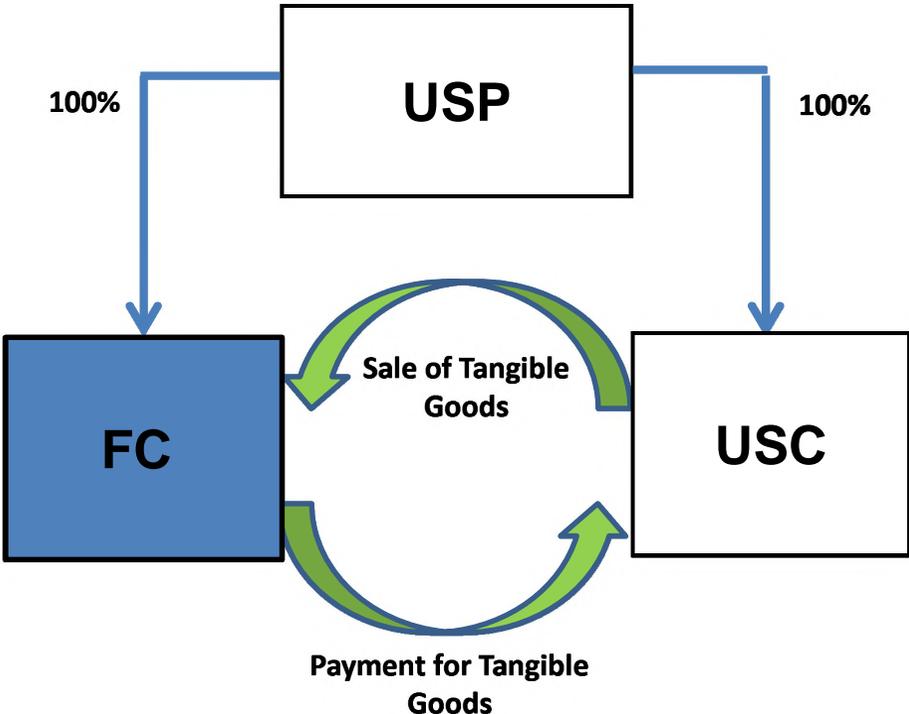
This unit will review tangible property transactions that have intangibles or services associated with the sale of the tangible property. This unit will also discuss audit techniques for reviewing these types of tangible property transactions, as well as the valuation rules applicable to such transactions.

Helpful Foundation Units to review are:

- *Controlled Transactions – Inbound*: DCN: ISO/CU/V_1_02(2014). This unit provides information on how to determine if you have a controlled transaction.
- *Arm's Length Standard*: DCN: ISI/9422.09_06(2013). This unit provides information on determining the arm's length standard.
- *Overview of IRC Section 482*: DCN: ISO/9411.07_01(2013). This unit provides basic concept knowledge regarding IRC 482.

Transaction and Fact Pattern

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Diagram of Transaction	Facts
 <p>The diagram illustrates the relationship between three entities: USP (United States Parent), FC (Foreign Subsidiary), and USC (United States Subsidiary). USP is at the top, with two blue arrows pointing down to FC (left) and USC (right), both labeled '100%'. Below USP, there are two circular arrows between FC and USC. The top arrow, pointing from FC to USC, is labeled 'Sale of Tangible Goods'. The bottom arrow, pointing from USC to FC, is labeled 'Payment for Tangible Goods'.</p>	<ul style="list-style-type: none"> ▪ U.S. Parent (USP) wholly owns United States Subsidiary (USC), a U.S. corporation, and Foreign Subsidiary (FC), a foreign corporation. ▪ USC is located in the U.S. and is engaged in research, design, and manufacturing of tangible goods. FC operates as a distributor in a foreign country. ▪ USC sells tangible goods (Product A) to FC. This is the only intercompany transaction reported by USC. ▪ FC pays USC for the tangible goods. ▪ USC affixes its trademark to Product A. ▪ Assume that the distributor would be the tested party. ▪ Note: This unit would also apply to any outbound organization structure as long as FC and USC are part of a “controlled” structure.

Effective Tax Rate Overview

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

ETR of Company

- The Effective Tax Rate (ETR) is a U.S. Generally Accepted Accounting Principle financial statement concept that is the company's financial statement income tax expense divided by its pre-tax earnings. This is not the same as the federal income or foreign tax actually paid by the corporate group due to various tax deferrals and timing items. A U.S. MNE with an ETR lower than the statutory U.S. corporate tax rate often has income taxed in foreign subsidiaries at lower tax rates which is treated as "permanently reinvested" offshore with U.S. tax deferred until repatriation. MNEs generally report their income on a worldwide consolidated basis.
- If the U.S. company is a public company, the Form 10-K will provide the information regarding the ETR. If the U.S. company is not a public company, the company may not provide its ETR calculation in financial statements. You can compute this rate, if it is not provided, through the use of the accounting data.

ETR Impact of Adjustment

- If you determine that the sale of the tangible goods involved a service or intangible property, and these services or intangibles were not considered in the pricing, then you would increase the U.S. taxpayer's gross income and taxable income through an adjustment. This would have the effect of also increasing the taxpayer's ETR.

Summary of Potential Issues

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

<u>Issue 1</u>	Is any valuable USC-owned intangible property embedded in Product A or conveyed to FC (other than FC's right to resell the tangible property)? If so, is USC charging an arm's length price reflecting all the value of both the tangible and intangible property?
<u>Issue 2</u>	Are any valuable services provided by USC in connection with the sale of Product A? If services are involved, is USC charging an arm's length price for the interrelated sales and services?

All Issues, Step 1: Initial Factual Development

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Taxpayers may shift income outside the U.S. on controlled sales of tangible goods to related parties by failing to properly take into account associated intangibles or services. The price charged may not be an arm's length price if an embedded intangible is not taken into account during taxpayer's comparability analysis, or if a separate, but closely related transfer of intangibles or provision of services is not taken into account in addition to the sale of tangible property. In certain cases, the component parts of the integrated transaction must be bifurcated and valued separately. In any event, all of the facts and circumstances related to the transaction must be gathered.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ What intercompany agreements exist? ▪ What intercompany transactions are reported on the tax returns or other financial data? ▪ What are the key value drivers in the industry? 	<ul style="list-style-type: none"> ▪ Mandatory Transfer Pricing IDR ▪ Transfer Pricing Roadmap/Timeline ▪ Form 1120 & Form 1120F's (if any) ▪ Form 5471, Schedule M ▪ Organization Chart (Tax and Legal) ▪ Intercompany Agreements ▪ Financial Statements/Books and Records ▪ Public Reports, Security and Exchange Commission (SEC) Filings, Edgar: 10K ▪ Capital IQ and Standard & Poor's (S&P) Filings & Statistics: 10K ▪ Taxpayer Websites ▪ Tour of Business 	

All Issues, Step 1: Initial Factual Development (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Taxpayers may shift income outside the U.S. on controlled sales of tangible goods to related parties by failing to properly take into account associated intangibles or services. The price charged may not be an arm's length price if an embedded intangible is not taken into account during taxpayer's comparability analysis, or if a separate, but closely related transfer of intangibles or provision of services is not taken into account in addition to the sale of tangible property. In certain cases, the component parts of the integrated transaction must be bifurcated and valued separately. In any event, all of the facts and circumstances related to the transaction must be gathered.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Does USC have any transfer pricing studies detailing intercompany transactions and the calculation of the arm's length price? ▪ Did USC prepare a comparability analysis as part of its transfer pricing study? <ul style="list-style-type: none"> – Functions Performed – Contractual Terms – Risks Assumed – Economic Conditions – Property or Services 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study and Functional Analysis 	

Issue 1, Step 2: Review Potential Issues

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 1

Is any valuable USC-owned intangible property embedded in Product A or conveyed to FC (other than FC's right to resell the tangible property)? If so, is USC charging an arm's length price reflecting all the value of both the tangible and intangible property?

Fact Element	Resources	6103 Protected Resources
<p>When USC sells tangible property to FC the value of the transferred goods could potentially be affected by the value of intangible property embedded within the sale of tangible goods. The intangible could have a significant impact on the transfer price of the controlled transaction. For example, the sale of a non-branded (generic) product may carry a lesser value than the sale of a branded (trademarked) product.</p> <p>The facts contained in slide 5 state that a trademark is affixed on the Product A tangible property. In addition, you should look for any other valuable intangibles the value of which may have been incorporated into Product A (such as patents or knowhow used in the manufacturing process). You will need to perform a comparability analysis to determine the appropriate arm's length result for the intercompany intangible transaction(s) discovered.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-1(b)(1) - <i>Arm's Length Standard</i> ▪ Treas. Reg. 1.482-1(d) - <i>Comparability</i> 	

Issue 1, Step 2: Review Potential Issues (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 1

Is any valuable USC-owned intangible property embedded in Product A or conveyed to FC (other than FC's right to resell the tangible property)? If so, is USC charging an arm's length price reflecting all the value of both the tangible and intangible property?

Fact Element	Resources	6103 Protected Resources
<p>If the transfer of tangible property from USC to FC conveys a right to exploit a valuable intangible asset (e.g., trademark), an arm's length remuneration for the intangible property is required in addition to the remuneration for the tangible property.</p> <p>A valuable trademark will impact the uncontrolled comparables selected since tangible property with a valuable trademark is not comparable to generic, unbranded tangible property.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-1(f)(2)(i) - <i>Aggregation of Transactions</i> ▪ Treas. Reg. 1.482-3(f) - <i>Coordination with Intangible Property Rules</i> 	

Issue 1, Step 2: Review Potential Issues (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 1

Is any valuable USC-owned intangible property embedded in Product A or conveyed to FC (other than FC's right to resell the tangible property)? If so, is USC charging an arm's length price reflecting all the value of both the tangible and intangible property?

Fact Element	Resources	6103 Protected Resources
<p>You may encounter transfer pricing studies that provide an aggregated price for intercompany transactions, rather than individually pricing each separate component of the intercompany transaction. For example, in some cases it will be more reliable to price both the transfer of Product A and the separate transfer of intangible property in the aggregate by reference to uncontrolled transactions that were priced in the aggregate, whereas in other cases, it will be more reliable to price the two transactions separately.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-1(f)(2)(i) - <i>Aggregation of Transactions</i> ▪ Treas. Reg. 1.482-3(f) - <i>Coordination with Intangible Property Rules</i> 	

Issue 1, Step 2: Review Potential Issues (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 1

Is any valuable USC-owned intangible property embedded in Product A or conveyed to FC (other than FC's right to resell the tangible property)? If so, is USC charging an arm's length price reflecting all the value of both the tangible and intangible property?

Fact Element	Resources	6103 Protected Resources
<p>Generally, the transfer of tangible property with an embedded intangible will not be considered a transfer of the intangible if the controlled purchaser does not acquire any rights to exploit the intangible property other than rights relating to the resale of the tangible property under normal commercial practices. In this case, the transfer of the property may be valued solely using one of the tangible property transfer pricing methods under Treas. Reg. 1.482-3. In any case, the embedded intangible must be accounted for in evaluating the comparability of the controlled transaction and uncontrolled transaction. Therefore, any comparable and economic analysis included in the taxpayer's transfer pricing report should account for the embedded intangible. In plain language, comparables must truly be comparable.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-1(f)(2)(i) - <i>Aggregation of Transactions</i> ▪ Treas. Reg. 1.482-3(f) - <i>Coordination with Intangible Property Rules</i> 	

Issue 1, Step 2: Review Potential Issues (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 1

Is any valuable USC-owned intangible property embedded in Product A or conveyed to FC (other than FC's right to resell the tangible property)? If so, is USC charging an arm's length price reflecting all the value of both the tangible and intangible property?

Fact Element	Resources	6103 Protected Resources
<p>Generally, multiple transactions may only be aggregated when they involve related products or services. For products and services to be related, they must reflect reasonable accounting, marketing or other business practices within the industries in which the related parties operate.</p> <p>You will need to evaluate the transfer pricing method (TPM) USC used in its transfer pricing study and evaluate any aggregation of transactions. The TPM must conform to the best method rule. The best method is the method that will result in the most reliable measure of an arm's length result.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-3 - <i>Methods to Determine Taxable Income in Connection with a Transfer of Tangible Property</i> ▪ Treas. Reg. 1.482-4 - <i>Methods to Determine Taxable Income in Connection with a Transfer of Intangible Property</i> ▪ Treas. Reg. 1.482-9 - <i>Methods to Determine Taxable Income in Connection with a Controlled Services Transaction</i> ▪ Treas. Reg. 1.482-1(c) - <i>Best Method Rule</i> ▪ Treas. Reg. 1.482-1(e) - <i>Arm's Length Range</i> 	

Issue 1, Step 3: Additional Factual Development

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 1

Is any valuable USC-owned intangible property embedded in Product A or conveyed to FC (other than FC's right to resell the tangible property)? If so, is USC charging an arm's length price reflecting all the value of both the tangible and intangible property?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Does the transfer pricing study identify any valuable intangible assets that are connected to the sale of tangible property to FC or part of another transaction? ▪ Who owns the intangible asset and who holds the legal rights to the asset? ▪ Are there any distribution agreements related to the sale of tangible property to FC? ▪ Is the licensing of the intangible property included in the distribution agreement? ▪ What is the remuneration for the intangible property and the payment terms? Are there any overdue payments? What currency is used? ▪ Are there any guarantees related to the performance of the intangible assets? Sliding scale royalty rates based on sales, etc.? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study ▪ Annual Report/Financial Books & Records ▪ Audit Tool – Checklist & Audit Tool for Developing Transfer Pricing Issues ▪ IRM 4.61.3 - <i>Development of IRC 482 Issues</i> ▪ Intercompany Agreements ▪ Invoices ▪ Legal Documentation of Ownership <p> CONSULTATION: The Income Shifting IPN can provide guidance on applicable training tools, audit tools and audit techniques.</p>	

Issue 1, Step 3: Additional Factual Development (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 1

Is any valuable USC-owned intangible property embedded in Product A or conveyed to FC (other than FC's right to resell the tangible property)? If so, is USC charging an arm's length price reflecting all the value of both the tangible and intangible property?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ What are the contract termination and modification rights? ▪ What is the royalty rate charged and terms? ▪ Does FC receive the right to exploit the intangible assets (e.g., trademarks)? In what territories? ▪ Does USC sell Product A under comparable terms and circumstances to unrelated third parties? ▪ Does FC license any trademarks from third parties? ▪ If FC licenses trademarks from third parties, are these third party trademarks similar to the USC trademark? ▪ Who are USC's and FC's competitors? ▪ How important are the intangible assets in USC's industry? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study, plus any other relevant related party transfer pricing studies ▪ Third Party Agreements ▪ Intercompany Agreements ▪ Annual Report/Financial Books & Records ▪ Questionnaires and Interviews ▪ Capital IQ and Compustat can be utilized to access financial records, statistics, competitors financials and certain industry studies and statistics ▪ Government Industry Studies and Statistics ▪ Taxpayer Website ▪ Competitors' Websites 	

Issue 1, Step 3: Additional Factual Development (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 1

Is any valuable USC-owned intangible property embedded in Product A or conveyed to FC (other than FC's right to resell the tangible property)? If so, is USC charging an arm's length price reflecting all the value of both the tangible and intangible property?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Do the intangible assets provide FC with a competitive advantage in the applicable market(s)? ▪ Within USC's industry, and as compared to its competitors, what is the quality of the intangible asset USC provides? ▪ Are there any deviations between the controlled transactions and what would be customarily expected of companies in this industry? ▪ Did FC help develop the intangible assets? ▪ Is there a Cost Sharing Arrangement? ▪ Does the form of the transaction (including written contract terms) follow the substance (including actual conduct) of the transaction? ▪ Why the transaction was structured the way it was? Was there a business purpose? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study, taxpayer's comparables selected as well as rejected comparables ▪ Agreements ▪ Questionnaires and Interviews ▪ Annual Report/Financial Reports ▪ Taxpayer Websites ▪ Competitors' Websites ▪ Standard Industry Codes and North American Industry Classification System will help locate competitors ▪ Capital IQ and Compustat ▪ Industry Studies and Statistics ▪ Form 5471, Schedule G, Question 4 and 5 regarding cost sharing 	

Issue 1, Step 3: Additional Factual Development (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 1

Is any valuable USC-owned intangible property embedded in Product A or conveyed to FC (other than FC's right to resell the tangible property)? If so, is USC charging an arm's length price reflecting all the value of both the tangible and intangible property?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none">▪ Did the controlled purchaser of the tangible products acquire any right to exploit the intangible property other than the rights relating to the resale of the tangible property under normal circumstances?	<ul style="list-style-type: none">▪ Transfer Pricing Study▪ Intercompany Agreements	

Issue 1, Step 3: Additional Factual Development (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 1

Is any valuable USC-owned intangible property embedded in Product A or conveyed to FC (other than FC's right to resell the tangible property)? If so, is USC charging an arm's length price reflecting all the value of both the tangible and intangible property?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Are the uncontrolled comparables used in the transfer pricing study comparable to the controlled transaction between USC and FC? <ul style="list-style-type: none"> – Are the functions performed similar? – Are the contractual terms similar? – Are the risks assumed similar? – Are the economic conditions similar? – Is the property similar? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study ▪ Taxpayer's comparable search criteria and all the relevant appendices thereto ▪ Comparability Analysis ▪ Taxpayer Websites ▪ Competitors' Websites ▪ Annual Report/Financial Reports ▪ Capital IQ and Compustat ▪ Edgar 	

Issue 1, Step 3: Additional Factual Development (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 1

Is any valuable USC-owned intangible property embedded in Product A or conveyed to FC (other than FC's right to resell the tangible property)? If so, is USC charging an arm's length price reflecting all the value of both the tangible and intangible property?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Did the transfer pricing study make any adjustments to the comparables selected as uncontrolled comparables? <ul style="list-style-type: none"> – Were all material differences identified? – Does each material difference have a definite and reasonable ascertainable effect on the price or profit of the intercompany tangible property transaction? – Does the adjustment eliminate the effect of the material difference(s)? – Are any other adjustments necessary?  CONSULTATION: You may consider consulting with an economist.	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-1(d)(2) - <i>Standards of Comparability</i> ▪ Treas. Reg. 1.482-1(e)(2)(ii) - <i>Selection of Comparables</i> ▪ Treas. Reg. 1.482-3(b)(2)(ii)(B) - <i>Adjustments for differences between controlled and uncontrolled transactions</i> ▪ Transfer Pricing Study ▪ Taxpayer's comparable search criteria and all the relevant appendices thereto 	

Issue 1, Step 3: Additional Factual Development (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 1

Is any valuable USC-owned intangible property embedded in Product A or conveyed to FC (other than FC's right to resell the tangible property)? If so, is USC charging an arm's length price reflecting all the value of both the tangible and intangible property?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ What TPM was used to price the transfer of tangible property? <ul style="list-style-type: none"> – Comparable Uncontrolled Price Method – Resale Price Method – Cost-Plus Method – Comparable Profits method – Profit Split method – Unspecified method ▪ Was the value of the intangible property taken into account in the transfer pricing study? ▪ Is the TPM the best method? ▪ Is the tangible property compensated at an arm's length price given the presence of the intangible property? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study discussion on method selected ▪ IDR Questionnaires or Interviews ▪ USC's Comparables ▪ Comparability Analysis ▪ IRM 4.61.3-4 Exhibit - Transfer Pricing Functional Analysis Questionnaire. 	

Issue 1, Step 4: Develop Arguments

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 1

Is any valuable USC-owned intangible property embedded in Product A or conveyed to FC (other than FC's right to resell the tangible property)? If so, is USC charging an arm's length price reflecting all the value of both the tangible and intangible property?

Fact Element	Resources	6103 Protected Resources
<p>At this point you will have gathered all the facts and circumstances regarding the sale of the tangible goods with the included trademark. You will need to make a determination:</p> <p> DECISION POINT:</p> <ul style="list-style-type: none"> ▪ Should the intangible value be priced separately from the sale of the tangible property, or considered in aggregate with the sale of the tangible property? ▪ Did the original transfer pricing study consider the value of the intangible assets when selecting the uncontrolled comparables and calculating the arm's length price? 	<p> CONSULTATION: If questions of law arise be sure to consult with local field counsel.</p>	

Issue 1, Step 4: Develop Arguments (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 1

Is any valuable USC-owned intangible property embedded in Product A or conveyed to FC (other than FC's right to resell the tangible property)? If so, is USC charging an arm's length price reflecting all the value of both the tangible and intangible property?

Fact Element	Resources	6103 Protected Resources
<p>Best Practice Tip! The facts you have gathered should be provided to USC in an IDR. Then, USC should be asked to confirm the facts and to correct any facts in the IDR with which it disagrees. USC should also be asked to provide an explanation of why it disagrees with any facts stated in the IDR.</p> <p>Best Practice Tip! The results of the examination should be shared and discussed with USC before the Notice of Proposed Adjustment (NOPA) is finalized.</p> <p>You will need to verify that the method USC selected was the best method. If the facts and circumstances gathered support another method as the best method, then you will need to gather this evidence and utilize the economist's report to make the argument of why another method is the best method.</p>	<ul style="list-style-type: none"> ▪ Economist's Report 	

Issue 1, Step 4: Develop Arguments (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 1

Is any valuable USC-owned intangible property embedded in Product A or conveyed to FC (other than FC's right to resell the tangible property)? If so, is USC charging an arm's length price reflecting all the value of both the tangible and intangible property?

Fact Element	Resources	6103 Protected Resources
<p>At this point you will either agree or disagree with USC's TPM.</p> <p> DECISION POINT:</p> <ul style="list-style-type: none"> ▪ If you agree with USC's TPM, you may determine that the TPM has an incomplete or incorrect set of comparables. ▪ If you disagree with USC's TPM, the use of a different TPM may require the use of a different set of comparables. <p>If you disagree with any of USC's comparables, then the NOPA or Economist Report will need to provide the reasons for additions to or deletions from USC's set of comparables after discussing the items with USC.</p>	<ul style="list-style-type: none"> ▪ Economist Report ▪ Capital IQ and Compustat 	

Issue 1, Step 4: Develop Arguments (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 1

Is any valuable USC-owned intangible property embedded in Product A or conveyed to FC (other than FC's right to resell the tangible property)? If so, is USC charging an arm's length price reflecting all the value of both the tangible and intangible property?

Fact Element	Resources	6103 Protected Resources
<p>If the comparables are missing adjustments that will make the comparable set more reliable, explain why the adjustment is materially significant and how it makes the comparables more reliable. Address the following in the NOPA:</p> <ul style="list-style-type: none"> ▪ That the data was used to ascertain with sufficient accuracy that the adjustment improved the reliability of the results. ▪ Explain any commercial practices, economic principles, or statistical analysis used to compute the adjustments. <p>If these items are discussed in detail in the economist report, briefly summarize the discussion in the NOPA and refer to the appropriate page number in the economist report. Best Practice Tip! The economist report and the NOPA analysis must agree. Attach the economist report as an Exhibit/Appendix to the NOPA.</p>	<ul style="list-style-type: none"> ▪ Economist Report ▪ Capital IQ and Compustat 	

Issue 2, Step 2: Review Potential Issues

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 2

Are any valuable services provided by USC in connection with the sale of Product A? If so, is USC charging an arm's length price for the interrelated sales and services?

Fact Element	Resources	6103 Protected Resources
<p>If USC has provided valuable services embedded directly into the sale of Product A, and USC did not consider the value of these services when determining the arm's length price of Product A to FC, then USC may be undercharging FC for Product A. This would result in a shifting of income to FC, and an understatement of U.S. taxes by USC.</p> <p>With sales of tangible property between affiliates, it is important to look at the functions performed, contractual terms, risks assumed, economic conditions, and property or services provided in the transaction. Through this fact gathering process, you may uncover valuable services that may not have been considered in the transfer pricing study.</p> <p>The fact pattern transaction that will be discussed for this issue involves marketing services provided by USC to FC that are directly related to the sale of the tangible property.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-1(b)(1) - <i>Arm's Length Standard</i> ▪ Treas. Reg. 1.482-1(d) - <i>Comparability</i> ▪ Treas. Reg. 1.482-9(m) - <i>Coordination with Transfer Pricing Rules for Other Transactions</i> 	

Issue 2, Step 2: Review Potential Issues (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 2

Are any valuable services provided by USC in connection with the sale of Product A? If so, is USC charging an arm's length price for the interrelated sales and services?

Fact Element	Resources	6103 Protected Resources
<p>You will also be looking for any other services that also might be provided by USC to FC that are directly related to the sale of the tangible property. Most of the audit steps in this presentation can be applied to other types of provided services (e.g., engineering, testing, quality control, IT, management fees, etc.).</p> <p>Generally, services transactions are governed by Treas. Reg. 1.482-9 and, as stated earlier, Treas. Reg. 1.482-3 lists the transfer pricing methods used for tangible property transactions. A tangible property transaction may also include valuable services.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-9 - <i>Methods to determine taxable income in connections with a controlled service transaction</i> ▪ Treas. Reg. 1.482-3 - <i>Method to determine taxable income in connection with a transfer of tangible property</i> ▪ Treas. Reg. 1.482-9(m) - <i>Coordination with Transfer Pricing Rules for Other Transactions</i> 	

Issue 2, Step 2: Review Potential Issues (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 2

Are any valuable services provided by USC in connection with the sale of Product A? If so, is USC charging an arm's length price for the interrelated sales and services?

Fact Element	Resources	6103 Protected Resources
<p>Generally, a single transfer pricing method may be applied to an integrated transaction containing both tangible property and services, and the services transaction does not need to be separately analyzed from the tangible property transaction. It is important to note that the services component must be accounted for in evaluating the comparability of the controlled and uncontrolled transactions in order to properly determine the arm's length result. <u>See</u> Treas. Reg. 1.482-9(m)(4).</p> <p>However, if the transfer pricing method does not produce the most reliable measure of an arm's length result in evaluating the transactions in the aggregate, then the transaction must be bifurcated into its component transactions consisting of a (1) transfer of a tangible asset and (2) the provision of services.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-1(f)(2)(i) - <i>Aggregation of Transactions</i> ▪ Treas. Reg. 1.482-1(c) - <i>Best Method Rule</i> ▪ Treas. Reg. 1.482-1(e) - <i>Arm's Length Range</i> 	

Issue 2, Step 2: Review Potential Issues (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 2

Are any valuable services provided by USC in connection with the sale of Product A? If so, is USC charging an arm's length price for the interrelated sales and services?

Fact Element	Resources	6103 Protected Resources
<p>Each transaction is then priced separately according to the methods governing those types of transactions as set forth in the Treasury Regulations. <u>See</u> Treas. Reg. 1.482-9(m)(5).</p> <p>Once all intercompany transactions between USC and FC are identified, you must determine whether the price charged for the transactions is the same as the price charged for uncontrolled transactions under the same or similar circumstances. You will need to evaluate the TPM used by USC in its transfer pricing study, as well as any aggregation of transactions. The TPM must conform to the best method rule and produce the most reliable measure of an arm's length result.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-1(f)(2)(i) - <i>Aggregation of Transactions</i> ▪ Treas. Reg. 1.482-1(c) - <i>Best Method Rule</i> ▪ Treas. Reg. 1.482-1(e) - <i>Arm's Length Range</i> 	

Issue 2, Step 3: Additional Factual Development

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 2

Are any valuable services provided by USC in connection with the sale of Product A? If so, is USC charging an arm's length price for the interrelated sales and services?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Does the transfer pricing study identify any marketing services provided by USC to FC? ▪ Does FC carry out its own marketing activities? ▪ Does FC ever outsource any of the marketing services to third parties? <p> CONSULTATION: The Income Shifting IPN can provide guidance on applicable training tools, audit tools and audit techniques.</p>	<ul style="list-style-type: none"> ▪ Transfer Pricing Study ▪ Audit Tool - Checklist & Audit Tool for Developing Transfer Pricing Issues found on the Income Shifting IPN ▪ IRM 4.61.3 - <i>Development of IRC 482 Issues</i> 	

Issue 2, Step 3: Additional Factual Development (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 2

Are any valuable services provided by USC in connection with the sale of Product A? If so, is USC charging an arm's length price for the interrelated sales and services?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Does USC ever provide marketing services to FC as part of the sales agreement regarding Product A? ▪ Does USC ever provide similar marketing services to third parties? ▪ Does USC use key marketing personnel to provide marketing services to FC? ▪ Does USC ever “loan” or second key marketing personnel to FC? ▪ Are the marketing services provided to FC routine, low margin services or are the services more complex, high profit margin services? ▪ Do marketing services provided by USC give FC a competitive advantage? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study ▪ Intercompany Agreements ▪ Invoices; verify terms listed on the invoice match the contract terms ▪ Third Party Agreements ▪ Personnel Chart ▪ Secondment Agreements ▪ Questionnaires and Interviews ▪ Capital IQ and Compustat can be utilized to assess financial records, statistics, competitors financials and certain industry studies and statistics ▪ Government Industry Studies and Statistics ▪ Taxpayer Website 	

Issue 2, Step 3: Additional Factual Development (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 2

Are any valuable services provided by USC in connection with the sale of Product A? If so, is USC charging an arm's length price for the interrelated sales and services?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Do any other related parties perform valuable marketing services on behalf of USC or FC? ▪ What forms of marketing and advertising does USC prepare for FC? For example: trade shows, brochures, specifications sheets, etc. <ul style="list-style-type: none"> – What marketing functions are performed as a result of each of these forms of marketing/advertising? ▪ How often does USC perform services for FC? ▪ Where does USC perform services for FC? ▪ What assets does USC utilize in performing the marketing services? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study related to FC ▪ Inquire into other relevant related party transfer pricing studies ▪ Intercompany Agreement with FC and inquire into other relevant intercompany agreements ▪ Questionnaires and Interviews ▪ Invoices ▪ Financial books and ledgers regarding intercompany accounts; income, expense, receivables and payables 	

Issue 2, Step 3: Additional Factual Development (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 2

Are any valuable services provided by USC in connection with the sale of Product A? If so, is USC charging an arm's length price for the interrelated sales and services?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Within USC's industry, and as compared to its competitors, what is the quality of the marketing services USC provides? ▪ What are the risks related to USC's marketing services? ▪ What are the contract termination and modification rights? ▪ Are there any guarantees provided related to the services provided? ▪ Does the form of the transaction (including written contract terms) follow the substance (including actual conduct) of the transaction? ▪ Why was the transaction structured the way it was? Was there a business purpose? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study ▪ Intercompany Agreements ▪ Third Party Agreements ▪ Questionnaires and Interviews ▪ Invoices ▪ Capital IQ and Compustat can be utilized to access financial records, statistics, competitors financials and certain industry studies and statistics ▪ Government Industry Studies and Statistics ▪ Financial books and ledgers regarding intercompany accounts; trace the actual conduct 	

Issue 2, Step 3: Additional Factual Development (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 2

Are any valuable services provided by USC in connection with the sale of Product A? If so, is USC charging an arm's length price for the interrelated sales and services?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ How much did it cost USC to perform the services? ▪ What is the billing process? ▪ Are there any billing manuals? ▪ What are the payment terms? ▪ Are there any overdue payments? ▪ What currency is used to pay the bills? ▪ Does the amount billed cover all of USC's costs? <p> CONSULTATION: A computer audit specialist referral may be helpful when auditing computerized books and records involving cost centers and computer generated cost allocations keys.</p>	<ul style="list-style-type: none"> ▪ Transfer Pricing Study ▪ Questionnaires and Interviews ▪ Invoices ▪ Credit Applications ▪ Credit Terms ▪ Billing/Invoicing Manuals ▪ Financial books and ledgers; intercompany accounts; income, expense, receivables and payables ▪ Cost center accounting records to distinguish the marketing costs ▪ Cost center allocation keys to see which general and administrative expenses are being allocated to the transaction. 	

Issue 2, Step 3: Additional Factual Development (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 2

Are any valuable services provided by USC in connection with the sale of Product A? If so, is USC charging an arm's length price for the interrelated sales and services?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Does USC require any head office approvals in regard to the marketing services provided to FC? ▪ Who assesses demand in FC's markets? ▪ Who pays for market demand studies/statistics for FC's markets? ▪ Who formulates the marketing budget for FC? ▪ Does USC formulate sales projections or sets sales targets for FC? ▪ Does USC formulate pricing of products for FC? ▪ Are there any deviations between the controlled transactions and what would be expected of companies in this industry? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study ▪ Intercompany Agreements ▪ Management Agreements ▪ Personnel Charts ▪ Questionnaires and Interviews ▪ Comparability Analysis ▪ Standard Industry Codes and North American Industry Classification System may help you find standard industry information ▪ Capital IQ and Compustat ▪ Industry Studies and Statistics ▪ Taxpayer Websites 	

Issue 2, Step 3: Additional Factual Development (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 2

Are any valuable services provided by USC in connection with the sale of Product A? If so, is USC charging an arm's length price for the interrelated sales and services?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ What TPM was used to price the transfer of tangible property? <ul style="list-style-type: none"> – Comparable Uncontrolled Price Method – Resale Price Method – Cost-Plus Method – Comparable Profits Method – Profit Split Method – Unspecified Methods ▪ Were the value of the services taken into account in the transfer pricing study? ▪ Is the TPM the best method? ▪ Is the tangible property compensated at an arm's length price given the services associated with the sale? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Study discussion on method selected ▪ IDRs, Questionnaires or Interviews ▪ USC's Comparables ▪ Comparability Analysis ▪ IRM 4.61.3-4 Exhibit - <i>Transfer Pricing Functional Analysis Questionnaire</i> 	

Issue 2, Step 3: Additional Factual Development (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 2

Are any valuable services provided by USC in connection with the sale of Product A? If so, is USC charging an arm's length price for the interrelated sales and services?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Who are USC's and FC's competitors? ▪ Are the uncontrolled comparables used in the transfer pricing study actually comparable to the USC/FC transaction? ▪ Are the functions performed similar? ▪ Are the contractual terms similar? ▪ Are the risks assumed similar? ▪ Are the economic conditions similar? ▪ Are the property or services similar? <p> CONSULTATION: You may consider consulting with an economist.</p>	<ul style="list-style-type: none"> ▪ Transfer Pricing Study, taxpayer's comparables selected as well as rejected comparables ▪ Comparability Analysis ▪ Annual Report/Financial Reports ▪ Taxpayer Websites ▪ Competitors' Websites ▪ Standard Industry Codes and North American Industry Classification System will help locate competitors ▪ Capital IQ and Compustat ▪ Industry Studies and Statistics 	

Issue 2, Step 3: Additional Factual Development (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 2

Are any valuable services provided by USC in connection with the sale of Product A? If so, is USC charging an arm's length price for the interrelated sales and services?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Did the transfer pricing study make any adjustments to the comparables selected as uncontrolled comparables? <ul style="list-style-type: none"> – Were all material differences identified? – Does each material difference have a definite and reasonably ascertainable effect on the price or profit of the intercompany marketing services transaction? – Does the adjustment eliminate the effect of the material difference(s)? – Are any other adjustments necessary? <p> CONSULTATION: You may consider consulting with an economist.</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-1(d)(2) - <i>Standards of Comparability</i> ▪ Treas. Reg. 1.482-1(e)(2)(ii) - <i>Selection of Comparables</i> ▪ Treas. Reg. 1.482-3(b)(2)(ii)(B) - <i>Adjustments for differences between controlled and uncontrolled transactions</i> ▪ Taxpayer's selected comparables as well as rejected comparables ▪ Annual Report/Financial Reports ▪ Capital IQ and Compustat ▪ Edgar 	

Issue 2, Step 4: Develop Arguments

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 2

Are any valuable services provided by USC in connection with the sale of Product A? If so, is USC charging an arm's length price for the interrelated sales and services?

Fact Element	Resources	6103 Protected Resources
<p>At this point, you will have gathered all the facts and circumstances regarding the sale of the tangible goods with the included marketing services. You will need to make a determination:</p> <p> DECISION POINT:</p> <ul style="list-style-type: none"> ▪ Should the services transaction be priced separately from the sale of the tangible property, or considered in aggregate with the sale of the tangible property? ▪ Did the original transfer pricing study consider the value of the services in the selection of the uncontrolled comparables and the calculation of the arm's length price? 	<p> CONSULTATION: If questions of law arise be sure to consult with your local counsel.</p> <ul style="list-style-type: none"> ▪ Utilize the Best Practice Tips on Slide 22 and 24. 	

Issue 2, Step 4: Develop Arguments (cont'd)

Accounting for Intangibles and Services Associated with the Sale of Tangible Property - Outbound

Issue 2

Are any valuable services provided by USC in connection with the sale of Product A? If so, is USC charging an arm's length price for the interrelated sales and services?

Fact Element	Resources	6103 Protected Resources
<p>At this point, you will either agree or disagree with USC's TPM.</p> <p> DECISION POINT:</p> <ul style="list-style-type: none"> ▪ If you agree with USC's TPM, you may determine that the TPM has an incomplete or incorrect set of comparables. ▪ If you disagree with USC's TPM, the use of a different TPM may require the use of a different set of comparables. <p>If you disagree with any of USC's comparables, then the NOPA or Economist Report will need to provide the reasons for additions to or deletions from USC's set of comparables.</p>	<ul style="list-style-type: none"> ▪ Economist Report ▪ Capital IQ and Compustat ▪ Utilize the steps in Slide 25 regarding comparables and adjustments. 	

Training and Additional Resources

Chapter 1.2.1 License or Sale		
Type of Resource	Description(s) and/or Instructions for Accessing	References
CENTRA sessions	<ul style="list-style-type: none"> ▪ 2012 (TPO) CENTRA – Overview and Introduction of IRC 482 ▪ 2012 (TPO) CPE CENTRA - High Value Services 	
Issue Toolkits	<ul style="list-style-type: none"> ▪ IRM 4.61.3-4 - <i>Functional Analysis Questionnaire</i> ▪ Audit Toolkit - Checklist & Audit Tool for Developing Transfer Pricing Issues ▪ IRM 4.61.3 - <i>Development of IRC section 482 Cases</i> 	
Podcasts / Videos	<ul style="list-style-type: none"> ▪ 2012 (TPO) CPE CENTRA - High Value Services 	
Other Training Materials	<ul style="list-style-type: none"> ▪ Bittker and Lokken – Fundamentals of International Taxation, Chapter 79: <i>Reallocation of Income and Deductions</i> ▪ OECD Transfer Pricing Guidelines ▪ BNA Tax Management Int'l Portfolio 889 Sec. I-IV <i>Intercompany Service Transactions</i> ▪ BNA Tax Management Int'l Portfolio 889 Sec. I-III <i>Intercompany Pricing of Intangibles</i> ▪ BNA Tax Management Int'l Portfolio 890, WS 1, <i>Sample Questionnaire for Intercompany Transactions</i> 	

Glossary of Terms and Acronyms

Acronym	Definition
DCN	Document Control Number
ETR	Effective Tax Rate
FC	Foreign Corporation
IP	Intangible Property
IPN	International Practice Network
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
ISI	Income Shifting Inbound
ISO	Income Shifting Outbound
LB&I	Large Business & International
MNE	Multinational Enterprise
S&P	Standard & Poor
TPM	Transfer Pricing Method
USC	U.S. Corporation
USP	U.S. Parent

Index of Related Issues

Issue	Associated UIL(s)	References
Comparability Analysis For Tangible Goods Transactions	9411	Practice Unit, “Comparability Analysis For Tangible Goods Transactions,” DCN: ISO/POU/V_1_01(2014)
Distinguishing Between Sale License and other Transfers of Intangibles to CFCs by U.S. Transferors	9411.02	Practice Unit, “Distinguishing Between Sale License and other Transfers of Intangibles to CFCs by U.S. Transferors,” DCN: ISO/9411.02_02(2013)
Outbound Services by U.S. Companies to CFCs	9411.07	Practice Unit, “Outbound Services by U.S. Companies to CFCs,” DCN: ISO/9411.07_02(2013)
High Value Services: Technical and Marketing Fees	9422.05	Practice Unit, “High Value Services: Technical and Marketing Fees,” DCN: ISI/9422.05_02(2014)
Management Fees	9422.05	Practice Unit, “Management Fees,” DCN: ISI/9422.05_01(2013)
Best Method Determination for an Inbound Distributor	9422.09	Practice Unit, “Best Method Determination for an Inbound Distributor,” DCN: ISI/9422.09_04(2013)
Service Cost Method Inbound Services	9422.09	Practice Unit, “Service Cost Method Inbound Services,” DCN: ISI/9422.09_05(2013)