



Internal Revenue Service

DEPARTMENT OF THE TREASURY

LB&I International Practice Service Transaction Unit

Shelf		Business Inbound		
Volume	6	Inbound Income Shifting	UIL Code	9422
Part	6.9	Other Transfer Pricing Issues	Level 2 UIL	9422.09
Chapter	6.9.1	Services Cost Method for Low Value Services	Level 3 UIL	N/A
Sub-Chapter	N/A	N/A		

Unit Name	Services Cost Method (Inbound Services)
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Issue and Transaction Overview

Services Cost Method (Inbound Services)

The Services Cost Method (“SCM”) is a specified transfer pricing method for which “covered services” can be charged out at cost. The SCM is an elective method and Taxpayers are permitted to utilize other methods under the regulations to determine the arm’s length compensation for covered services. The Taxpayer must maintain books and records. It is important to note that the Internal Revenue Service (“IRS”) cannot require a Taxpayer to use the SCM.

Covered services include specified covered services, provided in Rev. Proc. 2007-13, and low margin services. Low margin services are controlled services transactions for which the median comparable markup on total services cost is 7 percent or less.

These types of low value added services are often provided by parent companies to more than one related party and may be covered by a Shared Services Arrangement (“SSA”).

The covered services cannot be an excluded activity listed in Treasury Regulation Section 1.482-9(b)(4). Also, a service cannot constitute a covered service unless the taxpayer reasonably concludes in its business judgment that the services do not contribute significantly to key competitive advantages, core capabilities, or fundamental risks of success or failure in one or more trades or businesses of the controlled group.

T TREATY IMPLICATION: Taxpayer may have access to the Mutual Agreement Process (“MAP”) under Article 25 of an applicable treaty if FP is resident in a jurisdiction with a tax treaty with the U.S. Consult with the Advance Pricing and Mutual Agreement Program (“APMA”) if you have questions and to understand how MAP should be considered in analyzing any proposed adjustment.

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Transaction and Fact Pattern

Services Cost Method (Inbound Services)

Diagram of Transaction	Facts
<p>The diagram illustrates the transaction flow between three entities: FP (Foreign Parent), FC (Foreign Company), and USS (United States Subsidiary). FP is positioned at the top, FC at the bottom left, and USS at the bottom right. A central box labeled 'Services' is connected to FP, FC, and USS. Green arrows indicate the flow of services from FP to both FC and USS. A large green arrow on the right side, labeled 'Fees at Cost', points from the FC and USS area back up to FP, representing the flow of fees from the subsidiaries back to the parent.</p>	<ul style="list-style-type: none"> Foreign Parent (“FP”) wholly owns United States Subsidiary (“USS”). FP wholly owns Foreign Company (“FC”) located in Country B. FP is located in Country A and is providing services to USS and FC. USS is compensating FP for the services at cost. FP has entered into a Shared Services Arrangement with USS and FC.

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Summary of Potential Issues

Services Cost Method (Inbound Services)

Issue 1	Has FP engaged in a “controlled services activity” that has resulted in a “benefit” to USS?
Issue 2	Are the services “covered services”?
Issue 3	Did the Taxpayer meet the requirements to enter into a Shared Services Arrangement?

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All Issues, Step 1: Initial Factual Development

Services Cost Method (Inbound Services)

Taxpayers may elect the Services Cost Method because it offers relative certainty. Often these services are provided to all related entities and the entities enter into a Shared Services Arrangement. It is important to establish the facts and supporting documentation that substantiates that services are being performed and a benefit is derived from the services.

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> Does Form 5472 represent that services are being provided? 	<ul style="list-style-type: none"> Form 5472 	
<ul style="list-style-type: none"> Does the Taxpayer's IRC 6662 documentation (Transfer Pricing Study) represent that services are being provided under a Shared Service Agreement? 	<ul style="list-style-type: none"> Transfer Pricing Study 	

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Issue 1, Step 2: Review Potential Issues

Services Cost Method (Inbound Services)

Issue 1

Has FP engaged in a “controlled services activity” that has resulted in a “benefit” to USS?

Explanation of Issue	Resources	6103 Protected Resources
<p>In order to have a controlled services transaction, you must have an activity by one member of the controlled group (renderer or FP) that results in a benefit to one or more members of the controlled group (recipient or USS).</p> <p>An activity is considered to confer a benefit if an uncontrolled taxpayer in circumstances comparable to the recipient would be willing to pay an uncontrolled party to perform the same or similar activity on either a fixed or contingent basis, or if the recipient would have performed for itself the same activity or a similar activity.</p> <p>Determine if there is a service and did that service result in a benefit. Be aware that not all activities result in a benefit for which a payment needs to be made. Additionally, payment cannot be for the use of intangible property developed by FP.</p>	<ul style="list-style-type: none"> Treas. Reg. §1.482-1(i)(7), transaction defined Treas. Reg. §1.482-9(l)(1), (2), and (3) for controlled services transaction defined, activity defined, and benefit defined 	
<p>T TREATY IMPLICATION: Tax treaty implications for withholding tax issues may apply for payments for the use of intangible property.</p>	<ul style="list-style-type: none"> Refer to Specific United States – Foreign Parent Country Income Tax Treaty Contact the Tax Treaty IPN 	

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Issue 1, Step 3: Additional Factual Development

Services Cost Method (Inbound Services)

Issue 1

Has FP engaged in a “controlled services transaction” that has resulted in a “benefit” to USS?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ What activities are being provided by FP to USS? <ul style="list-style-type: none"> – Performance of functions; – Assumptions of risks; and/or – Use by USS of tangible or intangible property or other resources, capabilities or knowledge ▪ Is there a benefit to USS being derived by the activity provided from FP? <ul style="list-style-type: none"> – Does the benefit result in a reasonably identifiable increment of economic or commercial value that enhances the recipient’s commercial position? 	<p><i>Request and/or Review the following:</i></p> <ul style="list-style-type: none"> ▪ Organizational Chart, Legal and Tax ▪ Transfer Pricing Studies ▪ Contracts ▪ Intercompany Agreements ▪ Invoices or a Sample of Invoices ▪ Functional Analysis ▪ Taxpayer’s Financial Statements ▪ Transfer Pricing Roadmap 	


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

Services Cost Method (Inbound Services)

Issue 1

Has FP engaged in a “controlled services transaction” that has resulted in a “benefit” to USS?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Must establish the nature of the activities and determine if the activities are of a routine nature. ▪ Are the activities highly technical or of some other type of service which gives a competitive advantage to USS? ▪ Are the activities indirect or remote, duplicative in nature, shareholder activities or passive association? 	<p><i>Request and/or Review the following:</i></p> <ul style="list-style-type: none"> ▪ Organizational Chart, Legal and Tax ▪ Transfer Pricing Studies ▪ Contracts ▪ Intercompany Agreements ▪ Invoices or a Sample of Invoices ▪ Functional Analysis ▪ Taxpayer’s Financial Statements ▪ Transfer Pricing Roadmap ▪ IPS Unit: Foreign Shareholder Activities and Duplicative Services, ISI/944.09_01(2013) 	
 <p>CONSULTATION: The Transfer Pricing Practice or an economist should be consulted if the team has questions regarding the nature of the activities or taxpayer benefits derived.</p>		


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Issue 1, Step 4: Develop Arguments

Services Cost Method (Inbound Services)

Issue 1

Has FP engaged in a “controlled services transaction” that has resulted in a “benefit” to USS?

Explanation of Approach	Resources	6103 Protected Resources
<p>Whether there is a controlled services transaction is based on the facts and circumstances of your specific case.</p> <p>You need to establish that there is a controlled services transaction pursuant to Treas. Reg. Sec. 1.482-9(l)(1). There must be an activity being provided by FP to USS which results in a benefit to USS. In your analysis, you must determine what type of service activity is being provided and if a benefit was received.</p> <p>You also need to verify that these activities are not shareholder services and/or duplicate activities..</p>	<ul style="list-style-type: none"> ▪ Treas. Reg. §1.482-1(i)(7) ▪ Treas. Reg. §1.482-1(i)(8) ▪ Treas. Reg. §1.482-9(l)(1), (2), and (3) ▪ Treas. Reg. §1.482-9(l)(3)(iii) ▪ Treas. Reg. §1.482-9(l)(3)(iv) 	
 <p>DECISION POINT: Determine whether to proceed to Issue 2 based on the results of whether there is a controlled service activity.</p>		

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Issue 2, Step 2: Review Potential Issues

Services Cost Method (Inbound Services)

Issue 2

Are the services “covered services”?

Explanation of Issue	Resources	6103 Protected Resources
<p>The Services Cost Method (“SCM”) evaluates whether the amount charged for certain services is arm’s length by reference to the total services costs with no mark-up. Taxpayers are allowed to elect this method for certain services that are “covered services.” There are two types of covered services: “specified covered services” and “low margin” covered services.</p> <p>Specified covered services are controlled services transactions identified within Rev. Proc. 2007-13. Low margin covered services are controlled service transactions for which the median total mark-up on total service costs is less than or equal to 7 percent.</p> <p>Additionally, if it is determined that the service contributes to key competitive advantages, core capabilities or fundamental risks of success or failure of the business under the business judgment rule, SCM cannot be used.</p> <p>If the service is an excluded activity the SCM cannot be elected. Taxpayer must also maintain adequate books and records to elect the SCM. If the Taxpayer elects and applies the method in accordance with the rules, it will be considered the best method.</p>	<p>Treas. Reg. §1.482-9 :</p> <ul style="list-style-type: none"> ▪ Treas. Reg. Sec. 1.482-9(b)(1), in general ▪ Treas. Reg. Sec. 1.482-9(b)(2), eligibility ▪ Treas. Reg. 1.482-9(b)(5), business judgment rule ▪ Treas. Reg. Sec. 1.482-9(b)(4), excluded services ▪ Treas. Reg. Sec. 1.482-9(b)(6), adequate books and records ▪ Rev. Proc. 2007-13, 2007-1 C.B. 295, describes covered services 	


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

Services Cost Method (Inbound Services)

Issue 2

Are the services “covered services”?

Explanation of Issue	Resources	6103 Protected Resources
 <p>CONSULTATION: You should consult with the Transfer Pricing Practice, an economist and/or engineer to determine if the SCM is applicable based on the facts and circumstances developed.</p>		

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Issue 2, Step 3: Additional Factual Development

Services Cost Method (Inbound Services)

Issue 2

Are the services “covered services”?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Are the services being provided “specified covered services” pursuant to Treas. Reg. Sec. 1.482-9(b)(3)(i)? ▪ Are the services “low margin covered services”? <ul style="list-style-type: none"> – Is the median comparable mark-up on total service costs equal to or less than 7% pursuant to Treas. Reg. Sec. 1.482-9(b)(3)(ii)? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Studies ▪ Contracts ▪ Intercompany Agreements ▪ Invoices or Sample of Invoices ▪ Workpapers with supporting computations ▪ Transfer Pricing Roadmap ▪ Rev. Proc. 2007-13, 2007-1 C.B. 295 comparison of services 	

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

Services Cost Method (Inbound Services)

Issue 2

Are the services “covered services”?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Are the services precluded by the business judgment rule? <ul style="list-style-type: none"> – Do the services relate to a key competitive advantage? – Do the services relate to core capabilities? – Do the services contribute to the fundamental risks of success or failure of the business? – Are the services performed being done by highly skilled or non skilled employees of FP? – If highly skilled employees provide the services does this suggest these are high value services? – Would comparable service transactions have a mark up of 7 percent or less? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Studies ▪ Annual Reports with references to FP involvement with taxpayer ▪ Interview key employees ▪ Securities and Exchange Commission (SEC) Filings and comments about taxpayer’s business segments ▪ Press Releases – Joint Efforts w/FP ▪ Capital IQ – Research Market Studies as well as competitors ▪ Internet Searches on taxpayer and industry – does taxpayer have a competitive advantage? ▪ Company website 	

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

Services Cost Method (Inbound Services)

Issue 2

Are the services “covered services”?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> • Are the services an excluded activity? 	<ul style="list-style-type: none"> ▪ Transfer Pricing Studies ▪ Interview key employees ▪ Securities and Exchange Commission (SEC) Filings ▪ Press Releases ▪ Capital IQ ▪ Internet Searches ▪ Company website 	
<ul style="list-style-type: none"> ▪ Does the Taxpayer have adequate books and records to apply the SCM? <ul style="list-style-type: none"> – Statement evidencing Taxpayer’s intention to apply the SCM – Description of services – Identification of Renderer and Recipient – Sufficient documentation to allow verification of the methods used to allocate and apportion costs 	<ul style="list-style-type: none"> ▪ Trial Balance ▪ Journal Entries ▪ Invoices ▪ Cost Breakdown by type ▪ Workpapers with Supporting Computation 	

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Issue 2, Step 4: Develop Arguments

Services Cost Method (Inbound Services)



Issue 2

Are the services “covered services”?

Explanation of Approach	Resources	6103 Protected Resources
<p>After establishing that there is a controlled services transaction, it is important to determine if the services being provided are specified covered services under Treas. Reg. Sec. 1.482-9(b)(3)(i) or low margin covered services under Treas. Reg. Sec. 1.482-9(b)(3)(ii).</p> <p>Rev. Proc. 2007-13 is used to determine whether a service is a specified covered transaction.</p> <p>For low margin covered services, the median comparable mark-up on total services costs must be equal to or less than seven percent.</p> <p>Additionally, the services cannot relate to key competitive advantages, core capabilities or contribute to fundamental risks of success or failure of the business (business judgment rule); or be an excluded activity.</p>	<p>Treas. Reg. §1.482-9 :</p> <ul style="list-style-type: none"> ▪Treas. Reg. Sec. 1.482-9(b)(2) ▪Treas. Reg. Sec. 1.482-9(b)(3)(i) ▪Treas. Reg. Sec. 1.482-(b)(3)(ii) ▪Treas. Reg. Sec. 1.482-9(b)(4) ▪Treas. Reg. Sec. 1.482-9(b)(5) ▪Treas. Reg. Sec. 1.482-9(b)(6) ▪Rev. Proc. 2007-13, 2007-1 C.B. 295 	


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

Services Cost Method (Inbound Services)		
Issue 2		
Are the services “covered services”?		
Explanation of Approach	Resources	6103 Protected Resources
<p>Has the Taxpayer elected to apply the services cost method to these services? Has Taxpayer complied with the requirements of Treas. Reg. Sec. 1.482-9(b)(2), meeting all the eligibility requirements?</p> <p> DECISION POINT: Decide whether the services are covered and the eligibility requirements have been met.</p>	<p>Treas. Reg. §1.482-9 :</p> <ul style="list-style-type: none"> ▪Treas. Reg. Sec. 1.482-9(b)(2) ▪Treas. Reg. Sec. 1.482-9(b)(3)(i) ▪Treas. Reg. Sec. 1.482-(b)(3)(ii) ▪Treas. Reg. Sec. 1.482-9(b)(4) ▪Treas. Reg. Sec. 1.482-9(b)(5) ▪Treas. Reg. Sec. 1.482-9(b)(6) ▪Rev. Proc. 2007-13, 2007-1 C.B. 295 	
<p> CONSULTATION: Please consult with an economist, engineer or Transfer Pricing Practice if you have questions about the application of the SCM. An economist or engineer report should be referenced and incorporated into the Facts, Law and Analysis sections of the Notice of Proposed Adjustment (“NOPA”).</p>		

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Issue 3, Step 2: Review Potential Issues

Services Cost Method (Inbound Services)			
Issue 3			
Did the Taxpayer meet the requirements to enter into a Shared Services Arrangement?			
Explanation of Issue	Resources	6103 Protected Resources	
<p>Generally, if routine services are being provided for more than one member of the controlled group, there may be a Shared Services Arrangement (SSA). The SSA must include two or more controlled taxpayers, describe what services are being provided, the benefit derived from such services, and how the total costs will be allocated among the participants.</p> <p>The allocation of total services costs needs to be allocated on a reasonable basis given the facts and circumstances. It is important to note that the total services costs must be allocated to participants based on their respective share of reasonably anticipated benefits (RAB) whether or not these benefits are realized.</p> <p>Additionally, the Taxpayer must maintain sufficient documentation to support the arrangement.</p> <p>At this point, you should have already established that a specified covered service or a low-margin service is being provided and that a benefit is being derived.</p>	<p>Treas. Reg. §1.482-9 :</p> <ul style="list-style-type: none"> ▪Treas. Reg. Sec. 1.482-9(b)(7)(ii)(A), SSAs ▪Treas. Reg. Sec. 1.482-9(b)(7)(ii)(B), RAB Share ▪Treas. Reg. Sec. 1.482-9(b)(7)(C), documentation requirements 		
<div style="display: flex; align-items: flex-start;">  <div> <p>CONSULTATION: The Transfer Pricing Practice can be consulted regarding questions concerning SSAs.</p> </div> </div>			


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Issue 3, Step 3: Additional Factual Development

Services Cost Method (Inbound Services)

Issue 3

Did the Taxpayer meet the requirements to enter into a Shared Services Arrangement?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Are there two or more participants? ▪ Are all controlled taxpayers that reasonably anticipate a benefit included as participants in the Shared Services Arrangement? ▪ How are the total services costs allocated? ▪ Does the allocation reasonably reflect each participant's reasonably anticipated benefits ("RAB")? <p> CONSULTATION: Consult with a Computer Audit Specialist regarding complicated general ledger systems with computerized allocations.</p>	<p><i>Request and Review the following:</i></p> <ul style="list-style-type: none"> ▪ Organizational Chart, Legal and Tax ▪ Transfer Pricing Studies ▪ Contracts ▪ Intercompany Agreements ▪ Workpapers with Supporting Computations ▪ Transfer Pricing Roadmap 	

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

Services Cost Method (Inbound Services)

Issue 3

Did the Taxpayer meet the requirements to enter into a Shared Services Arrangement?

Fact Element	Resources	6103 Protected Resources
<ul style="list-style-type: none"> ▪ Did the Taxpayer maintain sufficient documentation? ▪ Have the requirements for a Shared Services Arrangement been met? 	<ul style="list-style-type: none"> ▪ Written Statement ▪ List of Participants ▪ Basis for Allocation ▪ Description of Covered Services ▪ Transfer Pricing Studies ▪ Transfer Pricing Roadmap ▪ Organizational Chart ▪ Contracts ▪ Intercompany Agreements ▪ Invoices or Sample of Invoices ▪ Functional Analysis ▪ Taxpayer's Financial Statements 	

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Issue 3, Step 4: Develop Arguments

Services Cost Method (Inbound Services)

Issue 3

Did the Taxpayer meet the requirements to enter into a Shared Services Arrangement?

Explanation of Approach	Resources	6103 Protected Resources
<p>If the Taxpayer meets the requirements to have a Shared Services Arrangement and elects the SCM, then the SCM will be respected as the best method.</p> <p>The allocation of total services costs needs to be allocated on a reasonable basis given the facts and circumstances. It is important to note that the total services costs must be allocated to participants based on their respective share of reasonably anticipated benefits (RAB) whether or not these benefits are realized.</p>	<p>Treas. Reg. §1.482-9 :</p> <ul style="list-style-type: none"> ▪ Treas. Reg. Sec. 1.482-9(b)(7)(ii) ▪ Treas. Reg. Sec. 1.482-9(b)(7)(B) ▪ Treas. Reg. Sec. 1.482-9(j) ▪ Treas. Reg. Sec. 1.482-9(k)(2)(i) and (ii) 	


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Issue 3, Step 4: Develop Arguments (cont'd)

Services Cost Method (Inbound Services)

Issue 3

Did the Taxpayer meet the requirements to enter into a Shared Services Arrangement?

Explanation of Approach	Resources	6103 Protected Resources
<p>If the taxpayer reasonably concludes that the SSA allocated the total services costs on the basis that reliably reflects the participants respective share of RAB, then the Service will not adjust the taxpayer's allocation.</p> <div style="margin-top: 20px;">  <p>DECISION POINT: Did the taxpayer meet the eligibility and documentation requirements necessary to have a valid SSA?</p> </div>	<p>Treas. Reg. §1.482-9 :</p> <ul style="list-style-type: none"> ▪ Treas. Reg. Sec. 1.482-9(b)(7)(ii) ▪ Treas. Reg. Sec. 1.482-9(b)(7)(B) ▪ Treas. Reg. Sec. 1.482-9(j) ▪ Treas. Reg. Sec. 1.482-9(k)(2)(i) and (ii) 	

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Training and Additional Resources

Chapter 6.9.1 Services Cost Method for Low Value Services

Type of Resource	Description(s) and/or Instructions for Accessing	References
CENTRA sessions	<ul style="list-style-type: none"> ▪ FY 2012 Transfer Pricing Introduction to 482. ▪ FY 2013 IRC 482 Overview. 50767 (HLL028040) ▪ FY 2012 Services – High Value. ▪ FY 2013 How to Examine IRC 482 Area and Develop Facts (QLM462916) ▪ FY 2013 Functional Analysis (LMT059368) 	<ul style="list-style-type: none"> ▪ Transfer Pricing Intro to 482 Overview and Introduction to IRC Sec 482 FINAL with BR 6 revisions.ppt (QRP785958) ▪ 2012 (TPO) CPE CENTRA - High Value Services (HVH248923)
Issue Toolkits	<ul style="list-style-type: none"> ▪ IRM 4.61.3-4 Functional Analysis Questionnaire ▪ Checklist - IRC 482 Transfer Pricing Case Development Tool ▪ IRM 4.61.3 Development of IRC section 482 Cases 	

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Training and Additional Resources (cont'd)

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Type of Resource	Description(s) and/or Instructions for Accessing	References
Other Training Materials	<ul style="list-style-type: none"> ▪ International Examiner Phase III Training, Module E-1, Overview of IRC 482 ▪ International Examiner Phase II Training, Lesson 3, Controlled Services Transactions ▪ 2012 (TPO) Economist Phase V Training-Legal Matters ▪ Bittker and Lokken, Fundamentals of International Taxation, Chapter 79,: Reallocation of Income and Deductions ▪ OECD Transfer Pricing Guidelines 	

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Glossary of Terms and Acronyms

Acronym	Definition
APMA	Advance Pricing and Mutual Agreement Program
CFC	Controlled Foreign Corporation
CPE	Continued Professional Education
FC	A Foreign Controlled Subsidiary
FP	Foreign Parent
IBC	International Business Compliance
IPN	International Practice Network
IRC	Internal Revenue Code
IRM	Internal Revenue Manual
IRS	Internal Revenue Service
ISI	Income Shifting Inbound
LB&I	Large Business & International
NOPA	Notice of Proposed Adjustment
OECD	Organization for Economic Co-operation and Development

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Glossary of Terms and Acronyms (cont'd)

Acronym	Definition
RAB	Reasonably Anticipated Benefits
SCM	Services Cost Method
SEC	Securities and Exchange Commission
SSA	Shared Services Arrangement
TPO	Transfer Pricing Operations
UIL	Uniform Issue List
US	United States
USS	A Foreign-owned United States Subsidiary

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Comparability	9422.07	IPS Unit: Comparability Analysis for Tangible Goods Transactions Inbound ISI/9422.07_01 thru _06(2013)
Functional Analysis	9422.07	IPS Unit: Comparability/Functional Analysis of a U.S. Distributor, ISI/9422.07_01 [Under Development]
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MAP Procedural Issues	9450.12	IPS Unit Coming Soon

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Penalties-Gross	9560.12	Gross Penalties Defined