

LB&I Transaction Unit

Unit Name	Cost Sharing Arrangement With Stock Based Compensation	
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Chapter	Evaluation of Costs in Cost Pools

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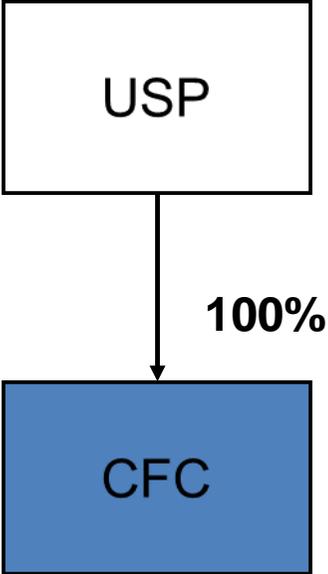
Issue and Transaction Overview

Cost Sharing Arrangements With Stock Based Compensation

- Under the U.S. cost sharing rules, parties under common control may enter into a cost sharing arrangement (CSA) which allows the parties to share the costs and risks of developing one or more intangibles (cost shared intangibles) in proportion to each party's share of reasonably anticipated benefits (RAB) expected to result from use of the cost shared intangibles. A payment is required for the contribution by a party of any resource, capability, or right to the CSA that it has developed, maintained, or acquired externally to the intangible development activity (IDA) if it is reasonably anticipated to contribute to the development of the cost shared intangibles. Any such contribution is a platform contribution transaction (PCT), and the related payment is a PCT payment. Please review the Practice Unit entitled "Pricing of PCT in CSAs - Initial Transaction" for more information on the initial PCT.
- A CSA produces results that are consistent with an arm's length result if, and only if, each controlled participant's intangible development cost (IDC) share is proportionate to its RAB share, each controlled participant compensates its RAB share of the value of all platform contributions by other controlled participants, and all other requirements of the cost sharing regulations are satisfied. Costs included in IDCs are determined by reference to the scope of the IDA. IDA means the activity under the CSA of developing or attempting to develop reasonably anticipated cost shared intangibles. The scope of the IDA includes all of the controlled participants' activities that could reasonably be anticipated to contribute to developing the reasonably anticipated cost shared intangibles.
- IDCs mean all costs, in cash or in kind (including stock based compensation (SBC)), but excluding acquisition costs for land or depreciable property, in the ordinary course of business after the formation of a CSA that, based on analysis of the facts and circumstances, are directly identified with, or are reasonably allocable to, the IDA. Thus, IDCs include costs incurred in attempting to develop reasonably anticipated cost shared intangibles regardless of whether such costs ultimately lead to development of those intangibles, other intangibles developed unexpectedly, or no intangibles. Reference to generally accepted accounting principles (GAAP) or federal income tax accounting rules may provide a useful starting point but will not be conclusive regarding inclusion of costs in IDCs.
- All controlled participants must commit to, and in fact, engage in cost sharing transactions (CST). In CSTs, the controlled participants make payments to each other (CST Payments) as appropriate, so that in each taxable year each controlled participant's IDC share is in proportion to its respective RAB share.
- Many U.S. companies enter into a CSA with a controlled foreign corporation (CFC) in a low or no tax jurisdiction. However, the issues discussed in this Practice Unit could also take place with a CFC in a non-low-tax jurisdiction and an adjustment may also be required if a payment is not arm's length.
- This Practice Unit will focus on including the appropriate amount of SBC in IDCs.

Transaction and Fact Pattern

Cost Sharing Arrangements With Stock Based Compensation

Diagram of Transaction	Facts
 <p>The diagram illustrates a 100% ownership relationship. At the top is a white rectangular box labeled 'USP'. A vertical arrow points downwards from the bottom center of the 'USP' box to the top center of a blue rectangular box labeled 'CFC'. To the right of the arrow, the text '100%' is written in a bold, black font.</p>	<ul style="list-style-type: none"> ▪ U.S. Parent Corporation (USP) reports SBC on its Form 1120. There are various places on the federal income tax return where SBC could be reported. On its attached Form 5471, it reports that it is a participant in a CSA. ▪ USP and CFC enter into a CSA to develop a new patent. USP assigns employees to perform research and development (R&D) to develop the new patent. This same R&D will also be used to develop a patent that is outside the scope of the CSA. These R&D employees solely work on developing the patent and do not work on any other projects. ▪ During the year covered by the CSA, USP pays these employees cash salaries and SBC. ▪ USP and CFC determine that the economic value attributable to the R&D should be allocated 75% to the CSA patent and 25% to the patent outside the CSA. ▪ USP allocates 75% of the cash salaries to CSA IDCs and CFC makes a CST payment equal to its RAB share to USP. ▪ USP does not allocate any SBC to the CSA IDCs.

Effective Tax Rate Overview

Cost Sharing Arrangements With Stock Based Compensation

ETR of Company

- USP's IDCs create a deduction on its U.S. tax return, decreasing the effective tax rate (ETR). However, the CFC must reimburse USP for its RAB share of USP's IDCs. This creates income to USP and increases its ETR.
- USP must also reimburse the CFC for USP's RAB share of the CFC's IDCs. This will create a deduction and decrease USP's ETR.

ETR Impact of Adjustment

- An adjustment to increase the CFC's share of USP's IDCs will increase USP's income and ETR.
- An affirmative adjustment, may increase USP's share of the CFC's IDCs and decrease USP's income and ETR.

Summary of Potential Issues

Cost Sharing Arrangements With Stock Based Compensation

[Issue 1](#)

Does USP have SBC that could be a CSA IDC?

[Issue 2](#)

Did the CFC reimburse USP for its RAB share related to the SBC that must be included in USP's IDCs?

[Issue 3](#)

What if USP claims during the examination that CFC incurred its own SBC costs related to the CSA?

All Issues, Step 1: Initial Factual Development

Cost Sharing Arrangements With Stock Based Compensation

The examination team will need to determine if USP is a party to a CSA. Use the following resources to develop the facts.

Fact Element	Resources
<ul style="list-style-type: none"> ▪ Review Form 5471, Schedule G, regarding the line item where USP discloses it is or is not a party to a CSA and Schedule M for CST receipts and payments. 	<ul style="list-style-type: none"> ▪ Form 5471, Schedule G - <i>Other Information</i> ▪ Form 5471, Schedule M - <i>Transactions Between Controlled Foreign Corporation and Shareholders or Other Related Persons</i> ▪ Auditor's Workbench ▪ Audit Tool – Identifying Stock Based Compensation for Cost Sharing Arrangements
<ul style="list-style-type: none"> ▪ Review USP's Form 10-K for CSA disclosures or adjustments to tax reserves for SBC. 	<ul style="list-style-type: none"> ▪ EDGAR
<ul style="list-style-type: none"> ▪ Review Schedule UTP, if filed, regarding uncertain tax positions to check for any disclosures related to the CSA. 	<ul style="list-style-type: none"> ▪ Form 1120 - Schedule UTP, <i>Uncertain Tax Position Statement</i>
<ul style="list-style-type: none"> ▪ Review Forms 8275 or 8275-R, if filed, to check for any disclosures of tax positions related to the CSA. 	<ul style="list-style-type: none"> ▪ Form 8275 - <i>Disclosure Statement</i> ▪ Form 8275-R - <i>Regulation Disclosure Statement</i>

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

Cost Sharing Arrangements With Stock Based Compensation

Fact Element	Resources
<ul style="list-style-type: none"> ▪ Review Form 1120 to see if a required CSA annual statement is attached to the return. 	<ul style="list-style-type: none"> ▪ IRC 482 - <i>Allocation of Income and Deductions Among Taxpayers</i> ▪ Treas. Reg. 1.482-7(k)(4) - CSA reporting requirements
<ul style="list-style-type: none"> ▪ Issue initial transfer pricing documentation information document request (IDR). 	<ul style="list-style-type: none"> ▪ Audit Tool - Initial Transfer Pricing Documentation IDR ▪ IRM 4.61.3 - Development of IRC 482 Cases
<ul style="list-style-type: none"> ▪ Attend USP's opening conference and transfer pricing presentation related to all controlled transactions. 	<ul style="list-style-type: none"> ▪ Audit Tool - Transfer Pricing Examination Process (TPEP) ▪ IRM 4.61.3.3.11 - Opening Conference ▪ Audit Tool - IRC 482 Toolkit

Issue 1, Step 2: Review Potential Issues

Cost Sharing Arrangements With Stock Based Compensation

Issue 1:

Does USP have SBC that could be a CSA IDC?

Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ The term SBC includes any compensation paid to an employee, director, or independent contractor that is based on the value of the corporation's stock. A stock option is the right to purchase a given number of shares of stock at a given price within a specified time. ▪ This includes non-statutory stock options (NSO), incentive stock options (ISO), employee stock purchase plans (ESPP), restricted stock awards, restricted stock units (RSUs), stock appreciation rights (SAR) and phantom stock arrangements. ▪ There are two general types of stock options: statutory options and non-statutory stock options. ▪ ISOs and ESPPs may be granted only to employees, while NSOs may also be granted to non-employees such as directors and outside contractors or advisors. ▪ The taxation and deduction of options is dependent on the type of option. ▪ IRC 83(h) requires the matching of the employer's deduction and the employee's income inclusion. <p> CONSULTATION: The Compensation and Benefits Practice Network has training materials, proforma IDRs, and audit tools/job aids regarding SBC. Consult the Compensation and Benefits shelf within the Corporate/Business Issues & Credits Knowledge Base in the IRS Virtual Library for the general calculation, deduction and taxation of SBC.</p>	<ul style="list-style-type: none"> ▪ IRC 83 - <i>Property transferred in connection with performance of services</i> ▪ IRC 421 - <i>General Rules</i> ▪ IRC 422 - <i>Incentive stock options</i> ▪ IRC 423 - <i>Employee stock purchase plans</i> ▪ IRC 424 - <i>Definitions and special rules</i>

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

Cost Sharing Arrangements With Stock Based Compensation

Issue 1

Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ Examiners should determine if USP has incurred SBC and if the SBC is attributable to CSA IDCs. 	
<ul style="list-style-type: none"> ▪ For purposes of Treas. Reg. 1.482-7, the term SBC means any compensation provided by a controlled participant to an employee or independent contractor in the form of equity instruments, options to acquire stock (stock options), or rights with respect to (or determined by reference to) equity instruments or stock options, including but not limited to property to which IRC 83 applies and stock options to which IRC 421 applies, regardless of whether ultimately settled in the form of cash, stock, or other property. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-7(d)(3) - <i>Stock-based Compensation</i> ▪ Treas. Reg. 1.482-7(d)(3)(i) - <i>In General</i>
<ul style="list-style-type: none"> ▪ Cost sharing participants are required to include SBC as IDCs, if such costs are directly identified with, or reasonably allocable to, the IDA of the CSA. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-7(d)(1)(iii) - <i>Costs included in IDCs</i> ▪ Treas. Reg. 1.482-7(d)(2) - <i>Allocation of costs</i> ▪ Treas. Reg. 1.482-7(d)(3) - <i>Stock-based compensation</i> ▪ <i>Altera Corp. v. Commissioner</i> - 926 F.3d 1061, 9th Cir., June 07, 2019 reversing 145 T.C. 91 (2015), cert. denied 2020 U.S. 3288 (U.S. June 22, 2020) (U.S. No. 19-1009)

Issue 1, Step 3: Additional Factual Development

Cost Sharing Arrangements With Stock Based Compensation

Issue 1

Fact Element	Resources
<ul style="list-style-type: none"> ▪ Does USP report SBC on its Form 10-K or book financial statements? 	<ul style="list-style-type: none"> ▪ EDGAR
<ul style="list-style-type: none"> ▪ Does USP report SBC on its Form 1120? 	<ul style="list-style-type: none"> ▪ Form 1120, Page 1 - ▪ Form 1120, Schedule M-3 - <i>Net Income (Loss) Reconciliation for Corporations With Total Assets of \$10 Million or More</i>
<ul style="list-style-type: none"> ▪ Request copies of any plan documents pursuant to which SBC is granted. 	<ul style="list-style-type: none"> ▪ Audit Tool - Compensation and Benefits Practice Network SBC Proforma Lead Sheets & IDRs
<ul style="list-style-type: none"> ▪ Issue an IDR to determine if the taxpayer incurred any SBC, the department that handles SBC, what data is available and the personnel names who handle the taxpayer's SBC data records and calculations. The examination team may want to sample the calculation of the SBC to ensure the calculations are correct before using the data for CSA purposes. This ensures the examination team is starting with the correct number before any allocations to the CSA. Request the cost center keys to trace the amounts to the financial statements and to the tax return. 	<ul style="list-style-type: none"> ▪ Audit Tool - Compensation and Benefits Practice Network SBC Proforma Lead Sheets & IDRs
<ul style="list-style-type: none"> ▪ Review the transfer pricing documentation for the treatment of SBC related to IDCs. Request background documentation, including but not limited to IDC pools, IDC allocation workpapers, SBC allocation workpapers, etc., as appropriate. 	<ul style="list-style-type: none"> ▪ Audit Tool - Initial Transfer Pricing Documentation IDR

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

Cost Sharing Arrangements With Stock Based Compensation

[Issue 1](#)

Fact Element	Resources
<ul style="list-style-type: none">Identify the employees associated with the SBC and determine if these employee's costs are part of USP's IDCs. This may require a mix of issuing IDRs, questionnaires, and/or interviews. Examiners may want to sample the general SBC calculations to determine that it was calculated correctly before allocating SBC to the IDCs. It is important to start with the right number to be allocated to the CSA.	<ul style="list-style-type: none">Form 4564 - <i>Information Document Request</i>
<ul style="list-style-type: none">Use UIL Code 9411.01-02 - Evaluation of costs (including SBC) in a cost pool if a CSA SBC issue is opened during the examination.	<ul style="list-style-type: none">Issue Management System (IMS)Uniform Issue List (UIL)

Issue 1, Step 4: Develop Arguments

Cost Sharing Arrangements With Stock Based Compensation

[Issue 1](#)

Explanation of Adjustment	Resources
<ul style="list-style-type: none">▪ Collect the necessary documentation and verify the data. Begin developing the data and legal arguments to include all SBC attributable to CSA IDCs.	
 CONSULTATION: Consult with the Compensation and Benefits Practice Network regarding general SBC computation questions. Consult with Counsel regarding legal questions. The Transfer Pricing Practice Network is available regarding any CSA questions.	

Issue 2, Step 2: Review Potential Issues

Cost Sharing Arrangements With Stock Based Compensation

Issue 2

Did the CFC reimburse USP for its RAB share related to the SBC that must be included in USP's IDCs?

Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ Controlled participants are required to share IDCs in proportion to their RAB shares. ▪ If a particular cost is directly identified with, or reasonably allocable to, a function the results of which will benefit both the IDA and other business activities, the cost must be allocated on a reasonable basis between the IDA and other business activities in proportion to the relative economic value that the IDA and other business activities are anticipated to derive from the results. ▪ A controlled participant's IDC share for a taxable year is equal to the controlled participant's cost contribution for the taxable year divided by the sum of all IDCs for the taxable year. ▪ A controlled participant's cost contribution for a taxable year means all of the IDCs initially borne by the controlled participant, plus all of the CST payments that the participant makes to other controlled participants, minus all of the CST payments that the participant receives from other controlled participants. ▪ A controlled participant's RAB share is equal to its RAB divided by the sum of the RABs of all the controlled participants. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-7(a)(1) - <i>RAB Share Method for CSTs</i> ▪ Treas. Reg. 1.482-7(d)(2) - <i>Allocation of Costs</i> ▪ Treas. Reg. 1.482-7(d)(4) - <i>IDC Share</i> ▪ Treas. Reg. 1.482-7(e) - <i>Reasonably Anticipated Benefits Share</i> ▪ Treas. Reg. 1.482-7(e)(1)(i) - <i>In General</i>
<ul style="list-style-type: none"> ▪ The determination of whether SBC is directly identified with, or reasonably allocable to, the IDA is made as of the date that the SBC is granted. Accordingly, all SBC that is granted during the term of the CSA and, at date of grant, is directly identified with, or reasonably allocable to, the IDA is included as an IDC. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-7(d)(3)(ii) - <i>Identification of stock-based Compensation With the IDA</i>

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

Cost Sharing Arrangements With Stock Based Compensation

[Issue 2](#)

Explanation of Issue	Resources
<ul style="list-style-type: none">▪ Generally, the cost attributable to SBC is equal to the amount allowable to the controlled participant as a deduction for federal income tax purposes with respect to that SBC and is taken into account as an IDC for the taxable year for which the deduction is allowable.	<ul style="list-style-type: none">▪ <i>Treas. Reg. 1.482-7(d)(3)(iii) - Measurement and Timing of Stock-based Compensation IDC</i>
<ul style="list-style-type: none">▪ IRC 421(a) provides a general rule that no deduction is allowable under IRC 162 for shares of stock transferred that meet the requirements to be an ISO under IRC 422(a) or an option granted under an ESPP pursuant to IRC 423(a). However, solely for purposes of <i>Treas. Reg. 1.482-7(d)(3)(iii)(A)</i>, IRC 421 does not apply to the transfer of stock pursuant to the exercise of an option that meets the requirements of IRCs 422(a) or 423(a). This means that ISOs and ESPPs governed by IRC 421(a) must be included in the cost pool even though IRC 421(a) does not allow a federal income tax deduction for these options.▪ In addition, an amount is treated as an allowable deduction of a foreign controlled participant to the extent that a deduction would be allowable to a U.S. taxpayer.	<ul style="list-style-type: none">▪ <i>Treas. Regs. 1.482-7(d)(3)(iii)(A)(1) - Transfers to Which Section 421 Applies</i>▪ <i>Treas. Regs. 1.482-7(d)(3)(iii) (A)(2) - Deductions of Foreign Controlled Participants</i>

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

Cost Sharing Arrangements With Stock Based Compensation

[Issue 2](#)

Explanation of Issue	Resources
<ul style="list-style-type: none">▪ In the case of a repricing or other modification of a stock option, the determination of whether the repricing or other modification constitutes the grant of a new stock option for purposes of Treas. Reg. 1.482-7(d)(3)(ii) will be made in accordance with the rules of IRC 424(h) and related regulations.	<ul style="list-style-type: none">▪ Treas. Regs. 1.482-7(d)(3)(ii) - <i>Identification of Stock-based Compensation With the IDA</i>
<ul style="list-style-type: none">▪ Solely for purposes of Treas. Reg. 1.482-7(d)(3)(iii)(A) for the purpose of determining the amount and timing of SBC IDCs:<ul style="list-style-type: none">– If the repricing or other modification of a stock option is determined, under Treas. Reg. 1.482-7(d)(3)(ii), to constitute the grant of a new stock option not identified with, or reasonably allocable to, the IDA, the stock option that is repriced or otherwise modified will be treated as being exercised immediately before the modification, provided that the stock option is then exercisable and the fair market value of the underlying stock then exceeds the price at which the stock option is exercisable. Accordingly, the amount of the deduction that would be allowable (or treated as allowable) to the controlled participant upon exercise of the stock option immediately before the modification must be taken into account as an IDC as of the date of the modification.	<ul style="list-style-type: none">▪ Treas. Reg. 1.482-7(d)(3)(iii)(A)(3) - <i>Modification of Stock Option</i>

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

Cost Sharing Arrangements With Stock Based Compensation

Issue 2

Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ If an item of SBC identified with, or reasonably allocable to, the IDA is not exercised during the term of a CSA, that item of SBC will be treated as being exercised immediately before the expiration or termination of the CSA, provided that the SBC is then exercisable and the fair market value of the underlying stock then exceeds the price at which the SBC is exercisable [solely for purposes of Treas. Reg. 1.482-7(d)(3)(iii)(A)]. Accordingly, the amount of the deduction that would be allowable to the controlled participant upon exercise of the SBC must be taken into account as an IDC as of the date of the expiration or termination of the CSA. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-7(d)(3)(iii)(A)(4) - <i>Expiration or Termination of CSA</i>
<ul style="list-style-type: none"> ▪ A taxpayer election is available with respect to options on publicly traded stock. The controlled participants in a CSA may elect to take into account all IDCs attributable to options on publicly traded stock in the same amount, and as of the same time, as the fair value of the stock options reflected as a charge against income in audited financial statements or disclosed in footnotes to the financial statements, provided that the statements are prepared in accordance with U.S. GAAP by or on behalf of the company issuing the publicly traded stock. The term publicly traded stock means stock that is regularly traded on an established U.S. securities market and is issued by a company whose financial statements are prepared in accordance with U.S. GAAP for the taxable year. Notice 2005-99 extends this election to certain restricted shares and restricted share units. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-7(d)(3)(iii)(B) - <i>Election With Respect to Options on Publicly Traded Stock</i> ▪ Treas. Reg. 1.482-7(d)(3)(iii)(B)(1) - <i>In General</i> ▪ Treas. Reg. 1.482-7(d)(3)(iii)(B)(2) - <i>Publicly Traded Stock</i> ▪ See Treas. Reg. 1.482-7(d)(3)(iii)(B)(4) for the time and manner of making the election. ▪ Notice 2005-99 - <i>Guidance On Valuation Of Stock-Based Compensation For Purposes Of Qualified Cost Sharing Arrangements</i>

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

Cost Sharing Arrangements With Stock Based Compensation

[Issue 2](#)

Explanation of Issue	Resources
<ul style="list-style-type: none"> ▪ A financial statement prepared in accordance with a comprehensive body of GAAP other than U.S. GAAP is considered to be prepared in accordance with U.S. GAAP provided that either: <ul style="list-style-type: none"> – The fair value of the stock options under consideration is reflected in the reconciliation between such other accounting principles and U.S. GAAP required to be incorporated into the financial statement by the securities laws governing companies whose stock is regularly traded on U.S. securities markets; or – In the absence of a reconciliation between such other accounting principles and U.S. GAAP that reflects the fair value of the stock options under consideration, the other accounting principles require that the fair value of the stock options under consideration be reflected as a charge against income in audited financial statements or disclosed in footnotes to such statements. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-7(d)(3)(iii)(B)(3) - <i>Generally Accepted Accounting Principles</i>
<ul style="list-style-type: none"> ▪ Consistency is generally required for all controlled participants in a CSA taking options on publicly traded stock under Treas. Reg. 1.482-7(d)(3)(ii), (d)(3)(iii)(A), or (d)(3)(iii)(B) provisions. CSA participants must use the same method of identification, measurement and timing for all options on publicly traded stock with respect to that CSA. A change in method requires consent of the Commissioner. 	<ul style="list-style-type: none"> ▪ Treas. Reg. 1.482-7(d)(3)(iii)(C) - <i>Consistency</i>

Issue 2, Step 3: Additional Factual Development

Cost Sharing Arrangements With Stock Based Compensation

[Issue 2](#)

Fact Element	Resources
<ul style="list-style-type: none"> A taxpayer's transfer pricing documentation may provide the SBC amounts, calculation of the SBC attributable to the IDCs, and RAB share allocation. In this transaction, USP did not include SBC as an IDC so the information will need to be obtained via an IDR. The examination team will need to work with the taxpayer to determine the amount of SBC that should have been included in the CSA cost pool. 	<ul style="list-style-type: none"> Form 4564 - <i>Information Document Request</i>
<ul style="list-style-type: none"> Request a list of personnel in the R&D department attributable to the CSA patent. Also, be mindful that non-R&D personnel may generate IDC costs and may have received SBC that must be allocated to IDCs. Collaborate with other examination team members, as they may also be examining the SBC deductible amount. 	
<ul style="list-style-type: none"> Verify the calculation of the SBC. If the data is voluminous, consider using a sample.  CONSULTATION: Use Computer Audit Specialists (CAS) to prepare statistical samples.	<ul style="list-style-type: none"> IRM 4.47.3.2.4 - <i>Requests for Assistance from CAS</i>
<ul style="list-style-type: none"> Request USP's RAB share documentation if it was not provided as part of the transfer pricing documentation. Review and verify the RAB share determination is correct and apply it to the SBC. Allocate the SBC to the IDCs. Confirm consistent treatment of SBC IDCs year to year. 	

Issue 2, Step 4: Develop Arguments

Cost Sharing Arrangements With Stock Based Compensation

Issue 2

Explanation of Adjustment	Resources
<ul style="list-style-type: none"> ▪ At this point all facts should have been gathered regarding the CSA and SBC. <p> DECISION POINT: Did USP properly include SBC in the IDCs and has CFC paid the IDCs?</p> <p> CONSULTATION: Consult with Counsel about questions of law and statute extensions. The practice networks are available for consultations.</p>	
<ul style="list-style-type: none"> ▪ Per the facts, USP incurred SBC in relation to IDCs and did not include the SBC as CSA IDCs. The examination team should: <ul style="list-style-type: none"> - verify the amount of SBC deducted on the Form 1120 for the tax year, - calculate the amount of SBC that must be included in IDCs based on the employees engaged in R&D activity and confirm that no other employees related to IDCs have SBC that must be allocated to the CSA, - review and verify the RAB share allocation/determination, - allocate the SBC attributable to the IDCs among USP and CFC based on their RAB shares. - make an adjustment to USP's income tax return so it reflects only USP's IDC share for the SBC attributable to the IDCs. The income adjustment will reflect CFC's CST payment that should have been made on USP's original income tax return. ▪ The examination team should follow Best Practices in developing the issue and the Notice of Proposed Adjustment (NOPA). 	<ul style="list-style-type: none"> ▪ Audit Tool - Transfer Pricing Examination Process (TPEP) ▪ IRM 4.61.3 - <i>Development of IRC 482 Cases</i> ▪ IRM 4.46.4.10 - <i>Written Acknowledgement of the Facts (AOF)</i> ▪ Audit Tool - NOPA Best Practices ▪ Form 5701 - <i>Notice of Proposed Adjustment</i>

Issue 2, Step 4: Develop Arguments

Cost Sharing Arrangements With Stock Based Compensation

[Issue 2](#)

Explanation of Adjustment	Resources
<p>Best Practice Tips:</p> <p>The facts gathered should be provided to USP in an Acknowledgement of Facts (AOF) IDR. USP should be asked to confirm the facts and to correct any facts in the IDR with which it disagrees. USP should also be asked to provide an explanation of why it disagrees with any facts stated in the IDR. Generally, USP will be provided with a draft NOPA as part of the AOF IDR. The results of the examination should be shared and discussed with USP before the NOPA is finalized.</p>	<ul style="list-style-type: none">▪ Audit Tool - Transfer Pricing Examination Process (TPEP)▪ IRM 4.61.3 - <i>Development of IRC 482 Cases</i>▪ IRM 4.46.4.10 - <i>Written Acknowledgement of the Facts (AOF)</i>▪ Audit Tool - NOPA Best Practices

Issue 3, Step 2: Review Potential Issues

Cost Sharing Arrangements With Stock Based Compensation

Issue 3

What if USP claims during the examination that CFC incurred its own SBC costs related to the CSA?

Explanation of Issue	Resources
<ul style="list-style-type: none">While a more common issue is a U.S. cost sharing participant having SBC costs that it did not share, sometimes the taxpayer will assert that a foreign participant had SBC costs that need to be addressed. If you encounter this situation, contact Counsel. <p> CONSULTATION: Consult with Counsel.</p>	<ul style="list-style-type: none">Rev. Proc. 2005-46 - <i>Examination of Returns and Claims for Refund, Credit, or Abatement; Determination Of Correct Tax Liability</i>Treas. Reg. 1.482-1(a)(3) - <i>Taxpayer's Use of Section 482</i>

Issue 3, Step 3: Additional Factual Development

Cost Sharing Arrangements With Stock Based Compensation

[Issue 3](#)

Fact Element	Resources
 CONSULTATION: Consult with Counsel.	▪ Form 4564 - <i>Information Document Request</i>

Issue 3, Step 4: Develop Arguments

Cost Sharing Arrangements With Stock Based Compensation

[Issue 3](#)

Explanation of Adjustment	Resources
 CONSULTATION: Consult with Counsel.	
<ul style="list-style-type: none">▪ Use Best Practices for processing.	<ul style="list-style-type: none">▪ Audit Tool - Transfer Pricing Examination Process (TPEP)▪ IRM 4.61.3 - <i>Development of IRC 482 Cases</i>▪ IRM 4.46.4.10 - <i>Written Acknowledgement of the Facts (AOF)</i>▪ Audit Tool - NOPA Best Practices

Index of Referenced Resources

Cost Sharing Arrangements With Stock Based Compensation

IRC 83 – Property Transferred in Connection with Performance of Services

IRC 421 - *General Rules*

IRC 422 - *Incentive Stock Options*

IRC 423 - *Employee Stock Purchase Plans*

IRC 424 - *Definitions and Special Rules*

IRC 482 - *Allocation of Income and Deductions Among Taxpayers*

Treas. Reg. 1.482-1 - *Allocation of Income and Deductions Among Taxpayers*

Treas. Reg. 1.482-7 - *Methods to Determine Taxable Income in Connection with a Cost Sharing Arrangement*

Form 1120 - *U.S. Corporate Income Tax Return*

Form 1120, Schedule M-3 - *Net Income (Loss) Reconciliation for Corporations With Total Assets of \$10 Million or More*

Form 1120, Schedule UTP - *Uncertain Tax Positions*

Form 4564 - *Information Document Request*

Form 5471, Schedule G - *Other Information*

Form 5471, Schedule M - *Transactions Between Controlled Foreign Corporations and Stakeholders or Other Related Persons*

Form 5701 - *Notice of Proposed Adjustment*

Form 8275 - *Disclosure Statement*

Form 8275-R - *Regulation Disclosure Statement*

Index of Referenced Resources (cont'd)

Cost Sharing Arrangements With Stock Based Compensation

IRM 4.46.4.10 - *Written Acknowledgement of the Facts (AOF)*

IRM 4.47.3.2.4 - *Request for Assistance from CAS*

IRM 4.61.3 - *Development of IRC 482 Issues*

IRM 25.6.22 - *Extension of Assessment Statute of Limitations By Consent*

Altera Corp. v. Commissioner - 926 F.3rd 1061, 9th Cir., June 7, 2019, reversing 145 T.C. 91 (2015)), cert. denied 2020 U.S. 3288 (U.S. June 22, 2020) (U.S. No. 19-1009)

Audit Tool - NOPA Best Practices

Training and Additional Resources

Cost Sharing Arrangements With Stock Based Compensation	
Type of Resource	Description(s)
Issue Toolkits	<ul style="list-style-type: none"> ▪ Audit Tool - IRC 482 Audit Toolkit ▪ Audit Tool - Initial Transfer Pricing Documentation IDR ▪ Audit Tool - Transfer Pricing Examination Process (TPEP) ▪ Audit Tool - Compensation and Benefits Practice Network SBC Proforma Lead Sheets & IDRs
Databases/Research Tools	<ul style="list-style-type: none"> ▪ EDGAR ▪ Issue Management System ▪ Issue Practice Service Virtual Library ▪ International Knowledge Base, Transfer Pricing Outbound Book ▪ Corporate/Business Issues & Credits Knowledge Base - Compensation and Benefits Shelf ▪ Uniform Issue List
Other Training Materials	<ul style="list-style-type: none"> ▪ Community Meeting 1/23/13 - Compensation and Benefits Practice Network ▪ <i>Stock-Based Compensation</i> - ELMS Course 11368 ▪ <i>Cost Sharing - Advanced Issues & New Developments</i> - 2012 CPE Centra

Glossary of Terms and Acronyms

Term/Acronym	Definition
AOF	Acknowledgement of Facts
CAS	Computer Audit Specialist
CFC	Controlled Foreign Corporation
CSA	Cost Sharing Arrangement
CST	Cost Sharing Transactions
ESPP	Employee Stock Purchase Plans
ETR	Effective Tax Rate
GAAP	Generally Accepted Accounting Principles
IDA	Intangible Development Activity
IDC	Intangible Development Costs
IDR	Information Document Request
IMS	Issue Management System
IRM	Internal Revenue Manual
ISO	Incentive Stock Options
NOPA	Notice of Proposed Adjustment
NSO	Non-statutory stock options

Glossary of Terms and Acronyms (cont'd)

Term/Acronym	Definition
PCT	Platform Contribution Transaction
RAB	Reasonably Anticipated Benefits
R&D	Research and Development
RSU	Restricted Stock Units
SAR	Stock Appreciation Rights
SBC	Stock Based Compensation
TPEP	Transfer Pricing Examination Process
UIL	Uniform Issue List
USP	U.S. Parent Corporation
UTP	Uncertain Tax Position

Index of Related Practice Units

Associated UIL(s)	Related Practice Unit
9422.01-01	<i>Cost Sharing Arrangement vs Licensing Alternative</i>
9422.01-01	<i>Pricing of Platform Contribution Transaction in Cost Sharing Arrangements Initial Transaction</i>
9422.01-01	<i>Pricing of Platform Contribution Transaction (PCT) in Cost Sharing Arrangement (CSA) Acquisition of Subsequent IP</i>
9422.01-01	<i>IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements</i>
9422.01-04	<i>Change in Participation in a Cost Sharing Arrangement Controlled Transfer or Interests and Capability Variations</i>