Strafford Publications

New IRS Rules for Transfer Pricing of Services Teleconference

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I. Five Named Methods In Regulations

- CUSP: Analogous to CUP
  - Price-to-price comparison (fee-to-fee)
  - Potentially an absolute amount
  - Realistically payment per unit
    - Hour
    - Person-years
    - Volume performed
    - Task

I. Five Named Methods In Regulations

- Gross services margin markup: Analogous to resale price
  - Comparison of transactional margins — not from full company/CPM data
  - Need to isolate only costs and revenues associated with the service
  - Inapplicable if “reseller” only consumes the service
  - Potentially applicable if reseller sells the same service
    - Markups with prime contractors and subcontractors
    - Costs paid to employees per hour vs. amount charged to clients

I. Five Named Methods In Regulations

- Cost of services plus markup: Analogous to cost-plus
  - Comparison of transactional margins — not from full company/CPM data
  - Need to isolate only costs and revenues associated with the service
  - With the potential for different intangibles inherent in different services, choice of transactional benchmarks is important

I. Five Named Methods In Regulations

- Profitability approaches
  - Similar issues with CPM and profit split
    - Do both sides have valuable intangibles?
    - Is there enough profit in the system to matter?
    - What process is used to split profits?
    - Choice of comparable companies
      - Sets of companies typically differ by economist
      - Ranges of results are typically similar

I. Five Named Methods In Regulations

- Observations
  - Specifies methods
  - Describes method applications
  - Defines best method rule
  - However,
    - No priority of methods
    - Method definitions are inclusive enough that a typical “unspecified” could be classified as a specified method
  - Application
    - May be difficult to isolate services and services methods
    - May often be combined with tangible and intangible transfers

II. Documentation

- Documentation rules apply to services as well
- Many services will continue to be part of tangibles and intangibles
- Stand-alone services need their own contemporaneous documentation

III. What To Use If Named Methods Don't Work

- Most methods will have an element of one of the five named methods
- If no service-specific comparables exist, pricing may be easier/more justifiable if service can be (pricing) combined with tangibles or intangibles
- Profit-split options
  - Application is generally relatively easy
    - Pool profits of service provider and receiver
    - Split "pie" in one or two steps
  - Difficulty in finding benchmarks for split shares

III. What To Use If Named Methods Don't Work

- Interactions of multiple transfers
  - Embedded intangibles or services
  - Round-trip transactions
  - Set-off of payments

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Brian C. Becker is the President of Precision Economics, LLC (precisionecon.com), a Washington D.C.-headquarted litigation and regulatory economics firm. His areas of expertise include transfer pricing, valuation, damage estimation, intellectual property, and international trade.

Dr. Becker has worked regularly with taxpayers, the Internal Revenue Service, and the tax units of foreign governments on issues of transfer pricing and business valuation. Dr. Becker has published more than a dozen articles in these areas, including six papers on cost sharing buy-ins. He has also authored the cost sharing chapter in The Transfer Pricing Handbook and The Transfer Pricing Sourcebook. Dr. Becker has provided expert deposition or trial testimony at U.S. Tax Court, The U.S. International Trade Commission, The Canadian International Trade Tribunal, U.S. Bankruptcy Court, U.S. District Court, Delaware Chancery Court, and in Arbitration.

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