Internal Revenue Service
DEPARTMENT OF THE TREASURY

LB&I Virtual Library
Transaction Unit

Library Level	Number	Title
Shelf		Business Outbound
Volume	1	Income Shifting (Business Outbound)
Part	1.1	Cost Sharing Arrangements
Chapter	1.1.1	Pricing of Platform Contribution Transactions (PCT)
Subchapter		

Unit Name	IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)	
Primary UIL Code	9411.01-01	Determination of buy-in/buy-out amounts

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Issue and Transaction Overview

IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)

Strategic global deployment of high value intangibles has become a frequent form of global tax management. Such intangibles are typically transferred to a related party located in a jurisdiction that imposes little, if any, tax burden on the income from the intangibles. Some United States (U.S.) taxpayers that own high value intangibles may transfer them offshore as part of a strategy to reduce their effective tax rate (ETR) for financial statement purposes.

For example, a U.S. taxpayer may enter into a cost sharing arrangement (CSA) with its controlled foreign corporation (CFC) in a low or no tax jurisdiction and contribute resources, capabilities, and rights (platform contributions) to the CSA. A platform contribution is any resource, capability, or right that a controlled participant has developed, maintained, or acquired externally to the intangible development activity (whether prior to or during the course of the CSA) that is reasonably anticipated to contribute to developing cost shared intangibles. Platform contributions can include, but are not limited to, intangibles defined in IRC 936(h)(3)(B). When the U.S. taxpayer has a platform contribution, the CFC is required to make an arm's length payment to the U.S. parent (USP) for the platform contribution. This transaction is called a platform contribution transaction (PCT).

Simultaneously with or shortly before entering into a CSA under Treas. Reg. 1.482-7 and providing platform contributions as defined in Treas. Reg. 1.482-7(c)(1), some taxpayers transfer certain intangible property, as defined in IRC 936(h)(3)(B) (IP), to their CFC through an IRC 351 or IRC 361 transaction, which is a taxable transaction under IRC 367(d) (IRC 367(d) Transaction). Under Treas. Reg. 1.367(d)-1T(c)(1), the transferor must report income that "represents an appropriate arms-length charge for the use of the property" as "determined in accordance with the provisions of IRC 482 and the regulations thereunder." These taxpayers may value the IP transferred in the IRC 367(d) Transaction separately from the PCTs that are required under the CSA, even though the IP conveyed in the IRC 367(d) Transaction and the platform contributions will be exploited on a combined basis. Based on the aggregation principles in Treas. Reg. 1.482-1(f)(2)(i), -1T(f)(2)(i), and -7(g)(2)(iv), such non-aggregate approach may not provide an arm's length result for the IRC 367(d) Transaction and the PCTs. For example, a platform contribution consisting of the collective knowledge and skill of an R&D team may have value in isolation, but may have greater value when used in combination with in-process R&D transferred in a 367(d) Transaction.

Issue and Transaction Overview (cont'd)

IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)

The Preamble to the final cost sharing regulations specifically mentions the potential need to aggregate IRC 367(d) Transactions with PCTs, stating:

> "The combined effect of multiple contributions, potentially including controlled transactions outside of the CSA (for example, make-or-sell licenses, or intangible transfers governed by IRC 367(d)), may need to be evaluated on an aggregate basis, where that approach provides the most reliable method of an arm's length result."

Treasury Decision (TD) 9568

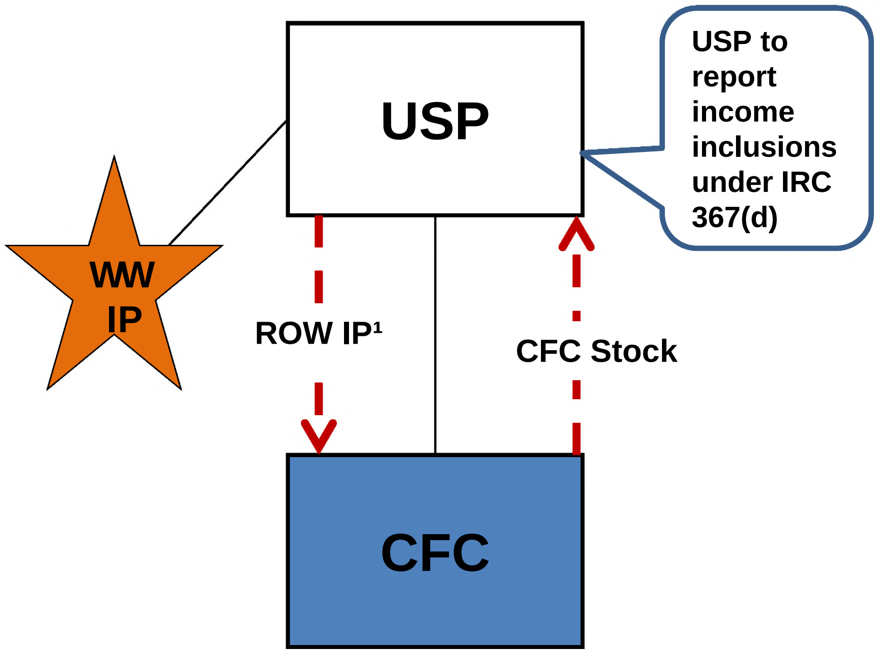
Taxpayers may also contend that less overall compensation is due for the IRC 367(d) Transaction (as compared to the alternative of transferring the IP in a PCT) because the scope of intangible property for purposes of IRC 367(d) is not as broad as the scope of a PCT, which includes any resource, capability, or right that is transferred to a CSA. The IRS believes that the category of intangible property under IRC 367(d) is nevertheless quite broad, and that regardless of whether the taxpayer structures the outbound transfer of rights as a PCT or an IRC 367(d) Transaction, it should receive in return arm's length compensation that reflects the value of the rights transferred. We illustrate this point in this Unit's fact pattern where we describe the transferor and transferee entering into a CSA shortly after the IRC 367(d) Transaction.

In addition, Treas. Reg. 1.482-1T(f)(2)(i), which applies to tax years ending on or after September 14, 2015, provides additional guidance for coordinating the application of IRC 482 with other Code and regulatory provisions, including IRC 367(d). Treas. Reg. 1.482-1T(f)(2)(i)(A) specifically provides that an that arm's length amount of compensation determined under the best method rule of Treas. Reg. 1.482-1(c) must be consistent with, and must account for all of, the value provided between the parties in a controlled transaction without regard to the form or character of the transaction. Treas. Reg. 1.482-1T(f)(2)(i)(B) further clarifies that the aggregation principle applies for purposes of an analysis under multiple provisions of the Code or regulations. The temporary regulations also contain examples that specifically address aggregation issues related to IRC 367(d) Transactions and PCTs.

CONSULTATION: Economists, counsel, Practice Network (PN), and Transfer Pricing Practice (TPP) should be consulted when working this issue as there may be both economic and legal issues related to this type of transaction.

Transaction and Fact Pattern

IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)

Diagram of Transaction	Facts
	▪ USP is a multinational manufacturing company that sells widgets to customers worldwide. ▪ USP has successfully developed valuable manufacturing and marketing IP and has a team of highly skilled R&D employees who developed that IP. ▪ In 2012, USP makes plans to enter into a CSA with CFC for all future research and development (R&D) of the manufacturing and marketing IP to be developed under the CSA. USP and CFC will use USP's previously developed IP. ▪ Under the CSA, USP will have the US rights to the manufacturing and marketing IP to be developed under the CSA and CFC will have the rest of the world (ROW) rights to the developed manufacturing and marketing IP to be developed under the CSA. ▪ On January 1, 2013, USP forms CFC in Country X, a low tax jurisdiction, in a IRC 351 transfer of a portion of the ROW rights to the manufacturing and marketing IP that USP has previously developed (ROW IP[1]) for CFC stock. USP includes deemed payments in income pursuant to IRC 367(d)(2)(A)(ii)(I). ▪ All significant functions, including manufacturing, R&D, marketing, and distribution, as well as the management and control thereof, are performed by USP.

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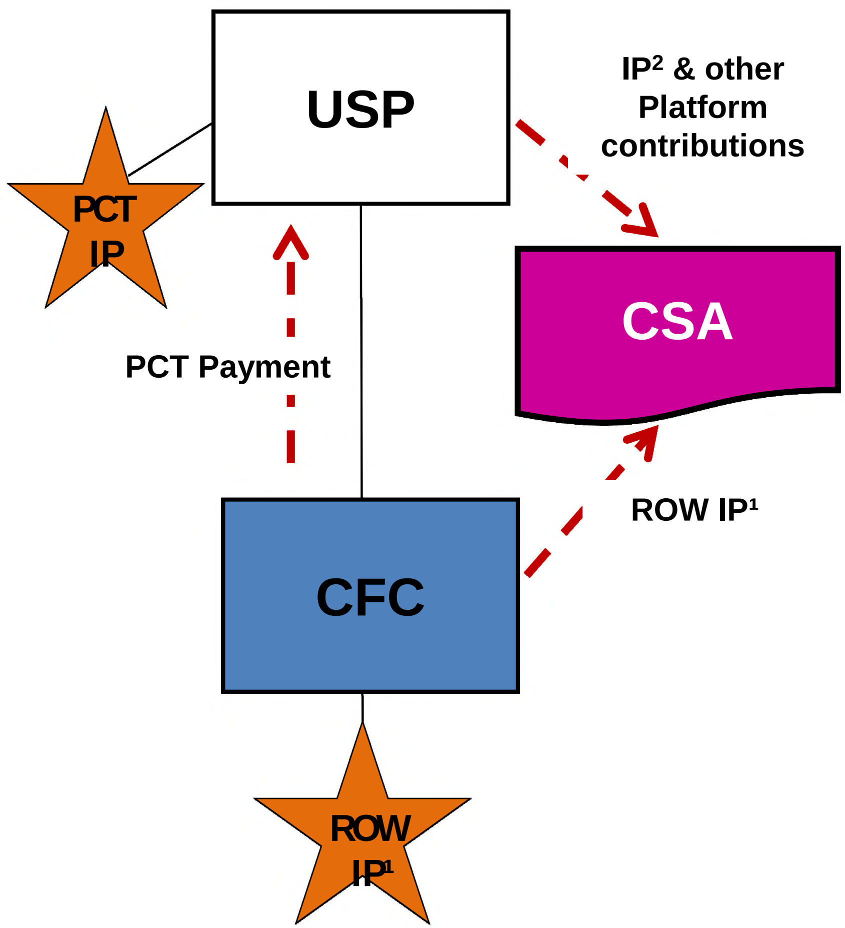
Transaction and Fact Pattern (cont'd)

IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)

Diagram of Transaction



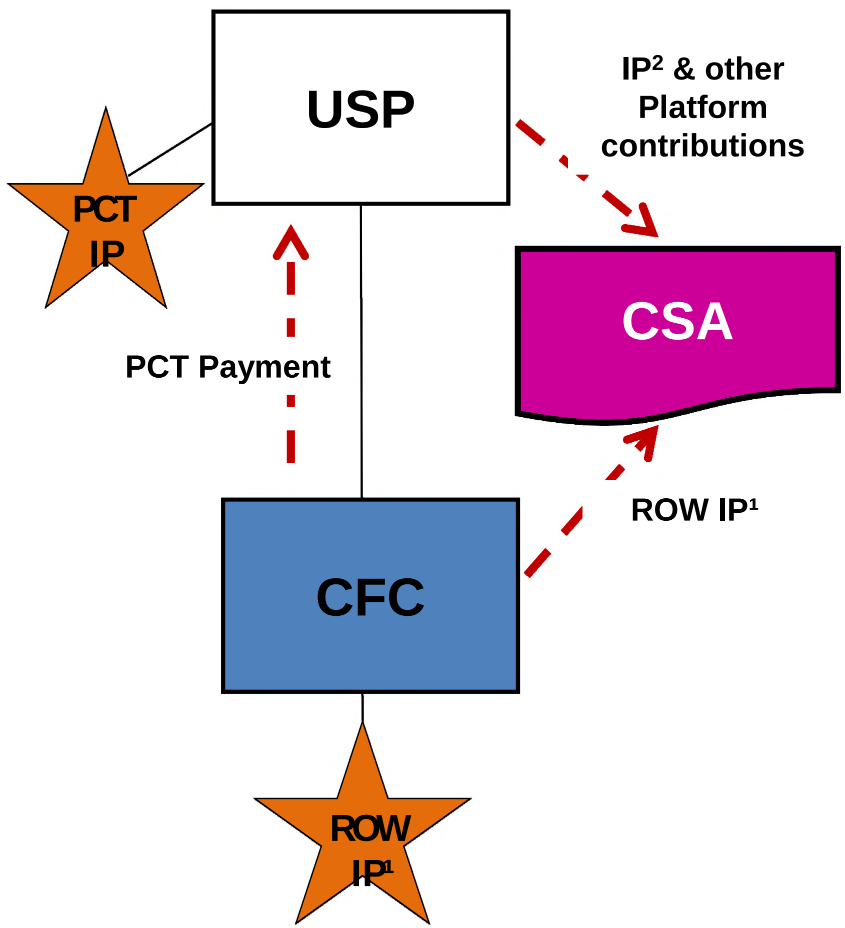
Facts

- The next day on January 2, 2013, USP enters into a CSA with CFC including PCTs in which it contributes the remaining manufacturing and marketing IP rights (i.e., the remaining ROW IP rights to USP's already developed manufacturing and marketing IP as well as all of the US rights to USP's already developed manufacturing and marketing IP, collectively (IP^{2})) and any other platform contributions. CFC does not need to make a payment for ROW IP^{1} because it was already transferred to CFC and is being paid for under IRC 367(d).
- The R&D under the CSA will be conducted by USP's team of highly-skilled R&D employees, who will make use of the IP that they had developed before the start of the CSA. Provision of that team is a contribution by USP to the CSA. The compensation and overhead costs of the team are considered intangible development costs (IDCs) paid by USP under the CSA. To the extent that the team is anticipated to provide value to the CSA in excess of its compensation and overhead costs, USP's provision of the research team is also a platform contribution.
- The CSA specifies sharing IDCs based on revenues. Accordingly, CFC reimburses USP for its share of IDCs based on CFC's reasonably anticipated benefits (RAB) share, with benefit shares measured by revenues.

Transaction and Fact Pattern (cont’d)

IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)

Diagram of Transaction



Facts

- This unit will discuss the fact pattern just presented.
- Other fact patterns are possible. For example, a taxpayer may claim to transfer the ROW rights to all of USP’s IP in a transaction under IRC 367(d) before forming a CSA, and may claim that, therefore, CFC owes no PCT Payment under the CSA. Some general considerations for this alternate fact pattern are:
  - Because platform contributions are not limited to intangible property described in section 936(h)(3)(B), USP could still have one or more platform contributions for which CFC owes a PCT Payment.
  - The compensation due to USP from CFC for the various IP transfers under IRC 367(d), as well as for any platform contributions, might be most reliably valued on an aggregate basis. See the discussion of aggregate valuation later in this unit.
- Any fact pattern claimed by the taxpayer is subject to verification.
  - Are the taxpayer’s claimed facts consistent with the contractual documentation?
  - Are the taxpayer’s claimed facts consistent with the parties’ conduct?
  - Are the taxpayer’s descriptions of its resources, capabilities, and rights (including any IP transferred under section 367(d)) realistic?

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Effective Tax Rate Overview

IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)

ETR of Company

- When a U.S. taxpayer transfers a significant amount of its income producing intangibles from the U.S. to a low tax jurisdiction for inadequate consideration (including transferring IP that is subject to IRC 367(d) or contributing valuable rights, resources, and capabilities to a CSA or some combination thereof), then the taxpayer's worldwide effective tax rate ("ETR") may decrease substantially. This occurs because the income streams from these intangibles remain offshore where they may indefinitely escape U.S. taxation.

ETR Impact of Adjustment

- An adjustment to increase the IRC 367(d) income inclusions and/or the PCT payments pursuant to IRC 482 will increase taxable income for the U.S. taxpayer and will therefore increase the ETR. The ETR impact may affect one or more taxable years depending in part on the taxpayer's form of payment (e.g., lump sum, installment, or contingent royalty).

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Summary of Potential Issues

IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)	
Issue 1	How is the arm's length price determined for ROW IP[1], which USP transferred to CFC under IRC 367(d), IP[2], and any other resources, capabilities, and rights which USP contributed to the CSA in PCTs on the next day?

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All Issues, Step 1: Initial Factual Development

IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)

How is the arm's length price determined for ROW IP[1], which USP transferred to CFC under IRC 367(d), IP[2], and any other resources, capabilities, and rights which USP contributed to the CSA in PCTs on the next day?

Fact Element	Resources
▪ Confirm USP transferred intangible property to CFC pursuant to IRC 367(d).	▪ Transfer Pricing Documentation ▪ Organization Chart ▪ Form 926, Part III, Intangible Property ▪ Form 926, Part IV, line 17a ▪ Form 5471, Schedule O, Section E ▪ Form 1120, Disclosures, IRC 6038B
▪ Confirm that the transferred intangibles were relevant to the CSA.	▪ Transfer Pricing Documentation ▪ Background documents

Issue 1, Step 2: Review Potential Issues

IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)
Issue 1
How is the arm's length price determined for ROW IP[1], which USP transferred to CFC under IRC 367(d), IP[2], and any other resources, capabilities, and rights which USP contributed to the CSA in PCTs on the next day?

Explanation of Issue	Resources
▪ In many instances, the exam team will need to consider the combined effect of multiple transactions, potentially including controlled transactions outside of the CSA (for example, intangible transfers governed by IRC 367(d)) which may need to be evaluated on an aggregate basis, where that approach provides the most reliable measure of an arm's length result. − Example – If a taxpayer, like USP in this fact pattern, transfers intangibles (e.g., knowhow, patents, etc.) in a transaction governed by IRC 367(d) and contributes resources, capabilities or rights related to those same intangibles to a CSA in a PCT, then the pricing of the intangibles under IRC 367(d) may need to be evaluated in combination with the pricing of all contributions in connection with the CSA on an aggregate basis, where that approach provides the most reliable measure of an arm's length result. In some instances, an R&D team (which might be the subject of a PCT) is significantly more valuable when evaluated on an aggregate basis with the technology being developed by that team (which might be the subject of an IRC 367(d) Transaction).	▪ Treas. Reg. 1.482-7(a)(2), (b)(1)(ii), (c), and see (j)(3)(ii) – Requirements for PCTs ▪ Treas. Reg. 1.482-7(g)(2)(iv), 1.482-1(f)(2)(i), and 1.482-1T(f)(2)(i) – Aggregation of Transactions ▪ IRC 367(d) – *Special Rules Relating to Transfers of Intangibles* ▪ Treas. Reg. 1.367(d)-1T(c) – Appropriate arm's length charge is determined under IRC 482 and regulations thereunder.

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

IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)
Issue 1

Explanation of Issue	Resources
▪ In the present case, USP transferred ROW IP^1 to CFC in a prior IRC 367(d) Transaction in lieu of a PCT. The primary issue is how to compute the arm's length compensation for the combination of ROW IP^1, IP^2, and any other resources, capabilities, and rights that USP contributed to the CSA.	

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Issue 1, Step 3: Additional Factual Development

IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)
Issue 1

Fact Element	Resources
▪ Determine whether or not to aggregate the IRC 367(d) Transaction with the PCT.	▪ Functional Analysis Questionnaire ▪ Transaction Documents ▪ IDR responses ▪ Interviews
▪ Identify any additional resources, capabilities, or rights of USP (including intangible property and provisions of services) that are reasonably anticipated to facilitate developing cost shared intangibles at any time. ▪ Include newly identified resources, capabilities, or rights in the aggregate valuation.	▪ Transaction Documents ▪ Functional Analysis Questionnaire ▪ Interviews

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

IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)
Issue 1

Fact Element	Resources
▪ Understand the anticipated use and expectations for USP's IP and other platform contributions to the CSA, on the one hand, and the cost shared intangibles developed under the CSA, on the other hand.	▪ Transfer Pricing Documentation ▪ Interview key employees ▪ Functional analysis ▪ Economist/Engineer/Outside Expert ▪ Valuation study ▪ Annual Reports / SEC filings
▪ Analyze the taxpayer's results for consistency with the future income anticipated to be generated by the resulting cost shared intangibles.	▪ Treas. Reg. 1.482-7(g)(1) ▪ Transfer Pricing Documentation ▪ Economist/Engineer/Outside Expert

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

IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)
Issue 1

Fact Element	Resources
▪ Determine whether the combined amount of the income inclusions pursuant to IRC 367(d)(2)(A)(ii)(I) and the PCT payments reflects the aggregate value of ROW IP^1, IP^2, and any other resources, capabilities, and rights which USP contributed to the CSA in PCTs on the next day?	▪ CSA ▪ IRC 351 Contribution Agreement ▪ PCT Agreement ▪ USP Transfer Pricing Documentation ▪ Other related agreements
CONSULTATION: Consult with Counsel, Economist, PN, and TPP	

Issue 1, Step 4: Develop Arguments

IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)
Issue 1

Explanation of Adjustment	Resources
Develop the facts of the IRC 367(d) transfer of ROW IP¹ in combination with the PCTs through a detailed functional analysis to fully understand the nature of ROW IP¹, IP², and any other resources, capabilities, or rights contributed to the CSA. When valuing ROW IP¹ under IRC 367(d) and IP², and any other resources, capabilities, or rights contributed to the CSA as part of a PCT, the selected method or methods must consider all the future income anticipated to be generated by the resulting cost shared intangibles. Therefore, any projections used under the selected best method should extend out for the period of time the cost shared intangibles are expected to generate income. Therefore, apply the investor model and realistic alternative principles when valuing and pricing ROW IP¹, IP², and any other resources, capabilities, or rights that are contributed to the CSA.	▪ Treas. Reg. 1.482-7(g)(1) – *In General* ▪ Treas. Reg. 1.482-7(g)(2)(ii) – Investor Model ▪ Treas. Reg. 1.482-7(g)(2)(iii) – Realistic Alternatives ▪ *VERITAS v. Commissioner*, 2010 AOD LEXIS 4; 2010 WL 4531284

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

IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)
Issue 1

Explanation of Adjustment	Resources
Based upon the facts, USP may have attempted to minimize the PCT Payment by separately valuing the section 367(d) Transaction and the PCTs. You should consider focusing on all the facts and circumstances of the transaction in the aggregate. In many cases, items and transactions are so interrelated that the method that provides the most reliable measure of an arm's length charge is a method applied on an aggregate basis. In this case, USP contributed valuable IP and other interrelated resources, capabilities, or rights for use in the CSA, so it likely will be more reliable to value them together as a group instead of valuing them separately.	▪ Treas. Reg. 1.482-7(a)(2), (b)(1)(ii), (c), and see (j)(3)(ii) – Requirements for PCTs ▪ Treas. Reg. 1.482-7(g)(2)(iv), 1.482-1(f)(2)(i), and 1.482-1T(f)(2)(i) – Aggregation of Transactions ▪ IRC 367(d) **–** *Special Rules Relating to Transfers of Intangibles* ▪ Treas. Reg. 1.367(d)-1T(c) – Appropriate arm's length charge determined under IRC 482 and provisions.
CONSULTATION: Appropriate expertise must be utilized to develop the facts. The PN can be a resource for these issues. Besides an economist, Counsel is necessary to review any relevant agreements.	

Index of Referenced Resources

IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)
IRC 367(d)
IRC 482
IRC 936(h)(3)(B)
Treas. Reg. 1.367(d)-1T
Treas. Reg. 1.482-1T
Treas. Reg. 1.482-1
Treas. Reg. 1.482-7
TD 9568
VERITAS v. Commissioner, 2010 AOD LEXIS 4; 2010 WL 4531284

Training and Additional Resources

IRC 367(d) Transactions in Conjunction with Cost Sharing Arrangements (CSA)	
Type of Resource	
SABA Sessions	▪ Cost Sharing: Advanced Issues and New Developments – 2012 CPE CENTRA ▪ IRC 367(d) Special Rule Relating to Transfer of IP – 2012 CPE CENTRA

Glossary of Terms and Acronyms

Term/Acronym	Definition
CFC	Controlled Foreign Corporation
CSA	Cost Sharing Arrangement
DCN	Document Control Number
ETR	Effective Tax Rate
IDC	Intangible Development Costs
IP	Intangible Property
IRC	Internal Revenue Code
PCT	Platform Contribution Transaction
PN	Practice Network
R&D	Research and Development
RAB	Reasonably Anticipated Benefits
ROW	Rest of the World
SEC	Securities and Exchange Commission
TD	Treasury Decision

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Glossary of Terms and Acronyms (cont'd)

Term/Acronym	Definition
TPP	Transfer Pricing Practice
Treas. Reg.	Treasury Regulation
U.S.	United States
USP	U.S. Parent
WW	Worldwide

Index of Related Practice Units

Associated UIL(s)	Related Practice Unit	DCN
9411.01	Pricing of Platform Contribution Transaction (PCT) in Cost Sharing Arrangements (CSA) – Initial Transaction	DCN: ISO/T/01_01_01-02 (formerly ISO/9411.01_01 (2013))
9411.01	Pricing of Platform Contribution Transaction (PCT) in Cost Sharing Arrangements (CSA) – Acquisition of Subsequent IP	DCN: ISO/T/01_01_01-03 (formerly ISO/9411.01_02(2013))
9411.02	Distinguishing Between Sales, License and Other Transfers of Intangibles to CFCs by U.S. Transferors	DCN: ISO/T/01_02-04 (formerly ISO/9411.02_02(2013))
9411.02-02	Deemed Annual Royalty Income Under IRC 367(d)	ISO/T/01_02_02-01 (formerly ISO/9411.02_01 (2013))