

Part IV - Items of General Interest

Announcement that identifies specified covered services eligible for services cost method under section 482 regulations

Announcement 2006-50

BACKGROUND

In 2003, the Treasury Department issued proposed section 482 regulations that set forth a simplified cost based method (SCBM). Prop. § 1.482-9(f). That method was intended to preserve the salutary aspects of the cost safe harbor in current § 1.482-2(b) while at the same time eliminating problematic features of those rules. In light of public comments, however, the Treasury Department has issued temporary and proposed regulations, concurrently with this announcement, that eliminate the SCBM and replace it with the services cost method (SCM). According to these temporary and proposed regulations, two categories of covered services, “specified covered services” and “low margin covered services,” are eligible for the SCM. This announcement relates to “specified covered services,” which are support services identified in a revenue procedure published by the IRS.

Included with this announcement is the proposed revenue procedure identifying specified covered services. The Service invites comments from interested members of the public prior to publishing the revenue procedure. The temporary regulations have a

delayed effective date for tax years beginning after December 31, 2006. It is contemplated that a final revenue procedure will be issued after taking into account comments on this announcement and that this final revenue procedure will be effective concurrent with the effective date of the temporary regulations.

Comments (eight copies) should be sent to Associate Chief Counsel (International) CC:INTL:FO, Internal Revenue Service, 1111 Constitution Avenue, NW, Room 4554, Washington, DC, 20224, making reference in the comments to Control Number NOT-127827-06. To ensure that comments are given full consideration, they should be submitted by October 6, 2006.

Despite substantial changes over the past 30 years in the nature of services performed by controlled parties, the existing cost safe harbor for services in current § 1.482-2(b) has not been modified since its original adoption in 1968. The Treasury Department in 2003 issued proposed regulations that set forth a simplified cost based method (SCBM) intended to preserve some benefits of the current § 1.482-2(b) cost safe harbor, such as appropriately reduced administrative and compliance burdens for low margin services. At the same time, the SCBM was intended to bring existing rules more in line with the arm's length standard and to eliminate some of the problematic features of those rules.

A number of commentators suggested that the SCBM was counterproductive to its stated goals. Namely, commentators contended that to apply the SCBM, taxpayers would potentially need to expend substantial sums to prepare comparability studies, perhaps separately for each of numerous back office services. They contended that,

although taxpayers have in-depth knowledge concerning their businesses and the relative value added by their back offices, the SCBM called for quantitative judgments that business people are not qualified to make by themselves, especially in the prevailing compliance environment. As a matter of proper accountability, taxpayers would be required as a practical matter to devote significant compliance resources to enlist outside consultants or otherwise to develop support for those judgments.

In light of the extensive public comments concerning the SCBM, the Treasury Department and the IRS have substantially redesigned the relevant provisions. Recognizing that the section 482 services regulations potentially affect a large volume of intragroup back office services that are common across many industries, it is in the interest of sound tax administration to minimize the compliance burdens applicable to such services, which would typically bear low arm's length markups.

Accordingly, the temporary and proposed regulations eliminate the SCBM and replace it with the services cost method (SCM), as set forth in §1.482-9T(b). The SCM evaluates whether the price for covered services, as defined, is arm's length by reference to the total services costs with no markup. Where the conditions on application of the method are met, the SCM will be considered the best method for purposes of §1.482-1(c).

Section 1.482-9T(b)(4) provides for two categories of covered services eligible for the SCM, if the other conditions on application of the method are met. The first category consists of specified covered services identified in a revenue procedure published by the IRS. These specified covered services are so identified because they

constitute support services of a type common across industry sectors that generally do not involve a significant arm's length markup on total services costs. A second category of services, low margin covered services, constitutes services that have a median comparable arm's length markup on total services costs of less than or equal to 7 percent.

The identification of specific activities that qualify for the SCM as a threshold matter should assist in maintaining appropriately reduced administrative burdens for low margin services. Since the Government has made the initial determination that these specified covered services are eligible to be priced under the SCM, taxpayers may rely upon this listing and need not perform their own independent analysis of comparable service providers.

Although specified covered services cover a wide range of support activities, the Treasury Department and the IRS recognize that the listing may not include the entire universe of low margin services. In the case of other low margin services, taxpayers may seek to demonstrate that the services qualify under the alternative mechanism in §1.482-9T(b)(4)(ii), as services with a median comparable arm's length markup on total services costs of less than or equal to 7 percent. Both specified covered services and low margin covered services must also meet the requirements of §1.482-9T(b)(2) (services that the taxpayer reasonably concludes in its business judgment do not contribute significantly to the fundamental risks of success or failure) and must not be identified in §1.482-9T(b)(3)(ii) (excluded transactions).

As explained above, this announcement contains an initial listing of specified

covered services. The Treasury and the IRS solicit public input both on whether the list of services sufficiently covers the full range of back office services typical within multinational groups, as well as on the descriptions provided for these covered services. It is contemplated that a final revenue procedure, reflecting revisions based on comments received, will be issued to coincide with the effective date of the temporary and proposed regulations for taxable years beginning after December 31, 2006.

DRAFTING INFORMATION

The principal author of this announcement is Thomas A. Vidano of the Office of Associate Chief Counsel (International). For further information regarding this announcement contact Thomas A. Vidano at (202) 435-5265 (not a toll-free call).

Part III

Administrative, Procedural, and Miscellaneous

[26 CFR 1.482-9T]: Methods to determine taxable income in connection with a controlled services transaction

(Also:)

Rev. Proc. [2006-XX]

SECTION 1. PURPOSE

This revenue procedure identifies specified covered services within the meaning of Section 1.482-9T(b)(4)(i). The activities identified in this revenue procedure are support services common among taxpayers in a variety of industry sectors, and generally do not involve a significant arm's length markup on total services costs. Services identified in this revenue procedure must meet the other conditions set forth in Section 1.482-9T(b) to be evaluated under the services cost method.

SECTION 2. BACKGROUND

The section 482 regulations provide pricing methods for transactions between controlled parties, including transactions involving services. The existing regulations for

transactions involving services were issued in 1968. Section 1.482-2(b) of the existing regulations provides a “cost safe harbor” that permits certain “non-integral” services to be priced at cost. In 2003, the Treasury Department and IRS issued proposed regulations that set forth a simplified cost based method (SCBM) intended to preserve some benefits of the current § 1.482-2(b) cost safe harbor. A number of commentators noted that SCBM called for quantitative judgments that business people are not qualified to make by themselves. As a practical matter, taxpayers would be required to devote significant compliance resources to enlist outside consultants or otherwise to develop support for those judgments.

In 2006, the Treasury Department and the IRS issued temporary regulations that eliminated the SCBM and replaced it with the services cost method (SCM), as set forth in §1.482-9T(b). The Treasury Department and IRS recognized that because the section 482 services regulations potentially affect a large volume of intragroup back office services that are common across many industries, it is in the interest of sound tax administration to minimize the compliance burden of such services, which would typically bear low arm’s length markups.

The SCM evaluates whether the price for covered services, as defined, is arm’s length by reference to the total services costs with no markup. Section 1.482-9T(b)(4) provides for two categories of covered services eligible for the SCM. The first category consists of specified covered services that will be identified in this revenue procedure. These specified covered services are so identified because they constitute support services of a type common across industry sectors that generally do not involve a

significant arm's length markup on total services costs. A second category of services, low margin covered services, not addressed in this revenue procedure have a median comparable arm's length markup on total services costs of less than or equal to 7 percent.

SECTION 3. SCOPE

The following categories of services are eligible for treatment under section 1.482-9T(b)(4)(i):

Payroll:

1. Compiling and posting employee time and other information needed to calculate periodic compensation to employees. Computing employees' time worked, production, and commissions. Computing and posting wages and deductions to appropriate accounting records. Preparing paychecks, travel reimbursement and expense reimbursement.
2. Preparing payroll tax forms (such as the preparation of Forms 940, 941 and W-2 in order to comply with U.S. requirements or similar requirements under another country's laws).

Premiums for Unemployment, Disability and Workers Compensation:

3. Processing employees' unemployment insurance premiums, disability premiums and workers compensation premiums.

Accounts Receivable:

4. Compiling, analyzing and recording current credit data and other financial information regarding individuals or firms (including preparing reports with this information for use in decisionmaking).
5. Compiling and recording billing, accounting and other numerical data for billing purposes. Preparing billing invoices for services rendered or for delivery or shipment of goods.
6. Locating and notifying customers of delinquent accounts by mail (either electronic or otherwise) or telephone to solicit payment. Receiving payment from customers and posting payment to customer's account. If customer fails to respond, preparing statements to credit department, initiating repossession proceedings or service disconnection. Keeping records of collection activities and status of accounts.

Accounts Payable:

7. Compiling information and records to draw up purchase orders for procurement of materials and services.
8. Making payment to vendors and posting payment to status of accounts.

General Administrative:

9. Performing clerical and administrative functions such as drafting correspondence, scheduling appointments, and organizing and maintaining paper and electronic files.

10. Performing data entry through use of a keyboard or scanning device, including verifying data and preparing materials for printing.
11. Using a word processor/computer or typewriter to generate (without substantial modification) letters, reports, forms, or other material from another person's rough draft, corrected copy, or voice recording.
12. Performing duties relating to office management systems and procedures, such as answering telephones, bookkeeping, typing, word processing, office machine operation, and filing.
13. Operating any of the following office machines: photocopying, scanning and facsimile machines.

Public Relations:

14. Preparation and distribution of internal and external corporate communications.

Meeting Coordination:

15. Coordinating activities of staff and convention personnel to make arrangements for group meetings and conventions.

Accounting and Auditing:

16. Gathering and reviewing information in accounting records for use in preparing financial statements.
17. Computing, classifying, and recording numerical data to maintain accurate and complete financial records, performing any combination of calculating, posting, and verifying duties to obtain primary financial data for use in maintaining accounting

records, checking the accuracy of figures, calculations, and postings pertaining to business transactions recorded by other workers.

Tax:

18. Processing tax payments according to prescribed laws and regulations.
19. Gathering information from accounting records and including that information in the preparation of income, property, sales/use, VAT, excise and other tax returns.

Compliance:

20. Gathering information and preparing documentation relating to eligibility for or compliance with laws and regulations governing contracts, licenses and permits.
21. Gathering information, verifying data and preparing documentation relating to compliance with laws and regulations governing financial and securities institutions and financial and real estate transactions. Examining and verifying correctness of, or establishing authenticity of records.

Budgeting:

22. Compiling data for use by cost estimators in determining cost projections and in preparing budget estimates, including verifying information for completeness, accuracy, and conformance with internal procedures and regulations.
23. Compiling data to prepare budget and accounting reports for management.

Treasury Activities:

24. Establishing bank accounts and lockboxes for use by controlled parties, including overdraft facilities and lines of credit.

Statistical Assistance:

25. Compiling data for use in statistical studies.

Staffing, Recruiting and Related Services:

26. Providing staffing support that includes creating job announcements, determining eligibility, evaluating qualifications of candidates, conducting background checks on final candidates, verifying references, developing performance evaluation procedures and forms, and conducting exit interviews for departed employees.
27. Coordinating with temporary employment agencies, applicants, and management throughout the recruiting process.
28. Providing information to applicants regarding open positions, the application and recruiting process, and employment policies.
29. Providing administrative support that includes sourcing and processing resumes, arranging interview schedules for open positions, preparing offer letters, and entering new employee information into the human resource system.
30. Establishing and maintaining employee files relating to payroll, performance and other personnel issues.
31. Assisting with new employee orientations and paperwork.
32. Implementing recruiting plan and locating potential candidates by working with professional search firms, colleges, universities and professional associations.
Organizing and attending job fairs and other recruitment events.
33. Developing recruiting and marketing materials and assisting in developing and maintaining content for recruiting website.

34. Analyzing recruiting data and review all job analysis, promotion and placement products.
35. Posting job opening advertisements in appropriate markets through publications, journals and other media.
36. Managing company-wide job postings and employee referral program.

Training Services:

37. Assisting in training of personnel including assessing development and training needs, creating and conducting internal development and training programs and communicating training opportunities to personnel.
38. Arranging for management training on employment law compliance, employer liability avoidance, interviewing, hiring, terminations, promotions, performance reviews, safety, and sexual harassment.

Benefit Services:

39. Implementing employee compensation and benefits including healthcare, life insurance, 401(k), pension, worker's compensation, unemployment, dental, profit sharing, employee incentive compensation, and employee assistance programs.
40. Providing guidance and direction to employees regarding elections for benefits, applications for benefits and receipt of benefits (including providing assistance to employees in completing all necessary forms).
41. Arranging annual benefit enrollment meetings and employee benefit seminars.
42. Processing employee benefits inquiries and complaints, and reconciling billing issues.

43. Coordinating with hospitals, physicians, insurers, employees, and beneficiaries to facilitate proper and complete utilization of benefits for all employees.

Computer Support:

44. Providing technical assistance to users of computer systems and other information technology devices. Answering questions or resolving technical problems relating to computer systems and other information technology devices in person, via telephone or from remote location. Providing assistance concerning the use of computer hardware and software, including printing, installation, word processing, electronic mail, and operating systems.

Database Administration:

45. Maintaining and testing existing computer databases (including implementing security measures to safeguard computer databases), but not to include analyzing user needs or developing hardware or software solutions (such as systems integration, website design, writing computer programs, modifying general applications software, or recommending the purchase of commercially available hardware or software).

Network and Computer System Administration:

46. Supporting an organization's existing local area network (LAN), wide area network (WAN), and Internet system or a segment of a network system, regular maintenance of network hardware and software, monitoring network to ensure network availability to all system users and performing necessary maintenance to support network availability, supervising other network support and client server

specialists (including implementing network security measures), but not to include analyzing user needs or developing hardware or software solutions (such as systems integration, website design, writing computer programs, modifying general applications software, or recommending commercially available software).

Legal Services:

47. General legal services performed on behalf of the taxpayer by in-house legal counsel, including but not limited to, drafting and review of contracts, legal documents, and opinions, representation and advocacy before courts, administrative agencies, arbitrators, legislatures, or other bodies. Support and administrative functions associated with the above activities (legal research, secretarial, filing and document retrieval, etc.).

Insurance Claims Management:

48. Coordination with third party insurers, including preparing claims for submission to such third party insurers.

SECTION 4. APPLICATION

The services cost method (SCM) as set forth in §1.482-9T(b) evaluates whether the price for covered services, as defined, is arm's length by reference to the total services costs with no markup. Two categories of covered services are eligible for the SCM. The first category, specified covered services, is described in §1.482-9T(b)(i) and is limited to services that are described in this revenue procedure. The second category, low margin covered services, is not described in this revenue procedure.

SECTION 5. EFFECTIVE DATE

This revenue procedure is generally effective for taxable years beginning after December 31, 2006. Taxpayers may elect to apply retroactively the provisions of §1.482-9T to certain taxable years. See §1.482-9T(n)(1). In the case of a valid election, this revenue procedure would also apply to the taxable years subject to such an election.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Thomas A. Vidano of the Office of Associate Chief Counsel (International). For further information regarding this revenue procedure contact Thomas A. Vidano at (202) 435-5265 (not a toll free call).