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June 3, 2009

Hon. Douglas Shulman
Commissioner
Internal Revenue Service
1111 Constitution Avenue, N.W.
Washington, DC 20224

Re: Comments on Temporary Cost Sharing Regulations

Dear Commissioner Shulman:

Enclosed are comments on the temporary cost sharing regulations. These comments represent the views of the American Bar Association Section of Taxation. They have not been approved by the Board of Governors or the House of Delegates of the American Bar Association, and should not be construed as representing the policy of the American Bar Association.

Sincerely,

Stuart M. Lewis
Chair - Elect, Section of Taxation

Enclosure

cc: Clarissa C. Potter, Acting Chief Counsel, Internal Revenue Service
Michael F. Mundaca, Deputy Assistant Secretary (International Tax Affairs, Department of the Treasury)
John Harrington, International Tax Counsel, Department of the Treasury

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**AMERICAN BAR ASSOCIATION SECTION OF TAXATION
COMMENTS ON TEMPORARY COST SHARING REGULATIONS**

The following comments (“Comments”) are submitted on behalf of the American Bar Association Section of Taxation (“Section”) and have not been approved by the House of Delegates or Board of Governors of the American Bar Association. Accordingly, they should not be construed as representing the position of the American Bar Association.

Principal responsibility for the preparation of these Comments was exercised by Paul Dau, Tracy Gomes, Clisson Rexford, Eric Ryan, and Alan Shapiro. These Comments were reviewed by John Warner, the Chair of the Section’s Committee on Transfer Pricing (the “Committee”), David Canale of the Section’s Committee on Government Submissions, and Stephen E. Shay, the Section’s Council Director for the Committee.

Although many of the members of the Section of Taxation who participated in preparing these Comments have clients who may be affected by the Federal income tax principles addressed by these Comments, no such member (or firm or organization to which each member belongs) has been engaged by a client to make a submission with respect to, or otherwise influence the development or outcome of, the specific subject matter of these Comments.

Contact: John P. Warner
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Date: June 3, 2009

EXECUTIVE SUMMARY

In August, 2005, the Department of the Treasury (“Treasury”) and the Internal Revenue Service (the “Service”) issued a notice of proposed rulemaking (the “Proposed Regulations”)¹ to proposing to amend Regulation section 1.482-7, dealing with cost sharing arrangements (“CSAs”) under section 482.² The Proposed Regulations were lengthy and complex, and introduced new transfer pricing methods, concepts, and new terminology. The Proposed Regulations were the subject of much commentary, including the Section, which identified a substantial number of areas of concern.³

On January 5, 2009, Treasury and the Service issued temporary regulations (collectively with a corresponding notice of proposed rulemaking, the “Temporary Regulations”)⁴ that address a number of the structural issues which commentators identified with the Proposed Regulations. Generally, any CSA arising on or after January 5, 2009, will be subject to concepts, rules, and requirements which are significantly different from those which were generally applied by taxpayers prior to that date. Moreover, the Temporary Regulations require new and substantive conforming changes to, and expanded reporting requirements with respect to, existing CSAs. Although the requirements for some of these changes are ambiguous, all are to be implemented within a relatively short timeframe.

These Comments address the administrative requirements for CSAs set forth in Temporary Regulation section 1.482-7T(k) (“Administrative Requirements”) and the transition rules for CSAs in effect as of January 5, 2009 (“existing CSAs”) in Temporary Regulation section 1.482-7T(m) (“Transition Rules”).⁵ Our principal recommendations may be summarized as follows:

Comments relating to effective dates:

1. We respectfully request a delay in the July 6, 2009, effective date of the required modifications to the written contract provisions, and the date on which an existing CSA must substantially comply with the Temporary Regulations, until December 31, 2009. We request a corresponding delay of the time to file a “Statement of Controlled Participant to §1.482-7T Cost Sharing Arrangement,” as defined in Temporary Regulation section 1.482-7T(k)(4)(i) (a “CSA Statement”), until March 31, 2010.

¹ 70 Fed. Reg. 51116 (Aug. 29, 2005).

² All references to sections are to the Internal Revenue Code of 1986, as amended (the “Code”).

³ ABA Section of Taxation, Comments on Proposed Regulations on Cost Sharing Arrangements, available at <http://www.abanet.org/tax/pubpolicy/2006/120406proposedregscostsharing.pdf> (December 4, 2006).

⁴ 74 Fed. Reg. 340 (Jan. 5, 2009).

⁵ We anticipate submitting a second set of comments at a later date which will address other issues arising under the Temporary Regulations.

Comments relating to Administrative Requirements:

2. The implication that a CSA is comprised of only a single contractual document should be eliminated.
3. Clarification on the definition of participants reasonably anticipated to benefit from the CSA should be provided.
4. There should be no requirement that a CSA provide a list of functions or risks of the parties beyond the required terms of the CSAs themselves.
5. The rule relating to the meaning of “contemporaneous” for written contracts should be modified.
6. The requirement that each controlled participant file a CSA Statement with the Service should be limited to U.S. controlled participants.
7. The “timely update and maintain” documentation requirement should be applied in connection with tax return filing.

Comments relating to Transition Rules:

8. There should be a transition for documentation requirements between those in the cost sharing regulations in effect before promulgation of the Temporary Regulations (to the extent superseded by the Temporary Regulations, the “Former Regulations”) and the Temporary Regulations.
9. There should be continued acceptance of certain “umbrella” CSAs, i.e., CSAs under which overall intangible development costs (IDCs) are divided up into smaller discrete pools, each of which is shared only by those CSA participants that reasonably expect benefits from any intangibles developed from the pool.
10. The requirement under Temporary Regulation section 1.482-7T(k)(1)(ii)(J) to specify the form of payment due under each platform contribution transaction, as defined in Temporary Regulation section 1.482-7T(a)(2) (PCT) in existence at the formation and any revisions of the CSA should be construed as only applying to transactions entered into on or after January 5, 2009.
11. Temporary Regulation section 1.482-7T(m) (the “Transition Rules”), as they relate to documentation requirements for CSAs existing on January 5, 2009, should be substantially broadened.
12. There should be additional guidance relating to the definition of a “material change in scope” under Temporary Regulation section 1.482-7T(m)(3). We provide a series of proposed examples to be incorporated in the Temporary Regulations in order to provide such additional guidance.

DISCUSSION

1. Request for delay in effective date of certain Administrative Requirements.

The Temporary Regulations provide a series of Transition Rules for existing CSAs. While we agree that the Transition Rules are helpful, we request a delay in the deadline for recordation of the revised written contractual agreement and the date on which the activities of the participants must substantially comply with the new provisions from July 6, 2009, until December 31, 2009. We also request a corresponding delay in the deadline for the initial filing of a CSA Statement, as appropriate, from September 2, 2009, to March 31, 2010.

As revised, Temporary Regulation section 1.482-7T(m)(1) would read:

An arrangement in existence on January 5, 2009, will be considered a CSA, as described in paragraph (b) of this section, if prior to such date, it was a qualified cost sharing arrangement under the provisions of §1.482-7 (as contained in 26 CFR part 1 edition revised as of January 1, 1996, hereafter referred to as “former §1.482-7”) but only if the written contract, as described in paragraph (k)(1) of this section, is amended, if necessary to conform with, and only if the activities of the controlled participants substantially comply with, the provisions of this section, as modified by paragraph (m)(2) and (m)(3) of this section, by December 31, 2009.

As revised, Temporary Regulation section 1.482-7T(m)(2)(vi) would read: “The deadline for recordation of the revised written contractual agreement pursuant to paragraph (k)(1)(iii) of this section shall be no later than December 31, 2009.”

The reasons for this additional time are as follows:

- The Temporary Regulations are extremely lengthy, complex, and in some cases, ambiguous. As a result, additional time is required for taxpayers to understand the changes in order to appropriately modify their contracts and comply with the other provisions of the regulations. The Temporary Regulations are over 200 pages in length, and contain a new paradigm for conceptualizing the contributions of the parties. There are new transfer pricing methods, a new commensurate with income test, and new computational approaches for arm’s length ranges, among other changes. Taxpayers will certainly want to review and understand these changes and all the implications they might have on their arrangements, and will need time to properly propose, approve, and coordinate with all controlled participants, all of the fundamental changes before amending their existing CSAs.
- The Temporary Regulations were issued at the end of December 2008. Since then, most calendar year taxpayers have been occupied with issues such as the global economy and the

development of their financial statements, and have not yet had an opportunity to address this tax item. In fact, public forums, some of which have involved representatives from Treasury and the Service, exploring these regulations and their implications did not begin to take place until late February 2009. As a result, the effective time frame for complying with the contractual requirements and other requirements is, in essence, much less than the 180 days that was presumably contemplated to be reasonably necessary.

- Various taxpayers and taxpayer groups, including the Section, will provide comments on the Transition Rules and the Administrative Requirements. In response to such comments, which the Treasury and the Service have invited, it can be anticipated that certain changes may be made to the Transition Rules and the Administrative Requirements. As a result, taxpayers will need additional time after such changes to evaluate, understand, and address those changes.
- In some cases, taxpayers have multiple cost sharing arrangements with multiple entities. Implementing the Transition Rules will require some specific revisions of and necessary reporting with respect to, each existing CSA. All such revisions and reporting requirements will need to be explained and agreed to by all the parties to the arrangements. Obtaining the agreement of all relevant taxpayer personnel to such changes (certain of which may need to obtain upfront agreement from foreign authorities) will require substantial explanation, time, and effort.
- There is no prejudice to the government from a delay until December 31, 2009 in the deadline for recording revised contractual provisions and substantial compliance with the revised substantive rules governing CSAs, because the Former Regulations also focus on memorializing existing CSAs and disclosing such existence through filing appropriate tax return statements. Moreover, the Service will not begin to audit compliance with the Temporary Regulations until 2010 or thereafter.

The Temporary Regulations require a CSA Statement to be filed with the Service no later than 90 days after the last date for recordation of the revised contractual agreement.⁶ We respectfully request that the period for filing a CSA Statement be extended to allow sufficient time for compliance following the revised contractual agreement due date. Accordingly, we request that the final date for the filing of the CSA

⁶ Temp. Reg. § 1.482-7T(k)(4)(iii).

Statement be extended until 90 days after the revised contractual agreement due date of December 31, i.e., March 31, 2010.

Finally, we respectfully request that Treasury and the Service promptly issue a Notice announcing that the effective dates will be delayed. This will allow taxpayers to avoid any inappropriate revisions or other actions while Treasury and the Service consider the comments that they receive on the Administrative Requirements and the Transition Rules. The Notice should also permit those taxpayers that have made revisions or taken other actions during the government's deliberations to modify or rescind those steps without penalty if such steps are rendered unnecessary or inappropriate due to any changes that the Treasury and the Service make after concluding their deliberations.

2. A CSA can be comprised of multiple contracts.

The Administrative Requirements of Temporary Regulation section 1.482-7T(k)(1)(i) provide that, "A CSA must be recorded in writing in a contract that is contemporaneous with the formation (and any revision) of the CSA" This language gives the impression that in fact a CSA is comprised of only one contractual document, which could lead to disputes between the Service and taxpayers whether required contractual provisions were located in the appropriate single document. As a practical matter, CSAs often involve a series of PCTs and a series of CSTs. In many cases, each PCT and CST is the subject of a separate and discrete contractual document that may not have been contemplated at the time the CSA was initiated.

We understand that Treasury and the Service did not intend to limit a taxpayer's flexibility to use multiple contracts. Accordingly, we suggest that the paragraph be amended to clarify that, "A CSA must be recorded in writing, in one or more contracts, which are contemporaneous"

3. Clarification of participants reasonably anticipated to benefit from the CSA.

Temporary Regulation section 1.482-7T(k)(1)(ii)(A) repeats a contractual requirement from the Former Regulations that the arrangement list the participants and any other member of the controlled group that are likely to benefit from the use of the intangibles developed under the CSA, and adds a requirement that the country of organization of each foreign entity that is a participant or that is likely to benefit from the developed intangibles be listed. Since that requirement first appeared in the Former Regulations, many multinational companies have adopted international structures that include entities that are separate juridical entities but are disregarded for U.S. tax purposes. In some cases, these disregarded entities will have a separate binding legal obligation to share costs and will have a separate binding legal right to use the resulting intellectual property.

First, it would appear that these disregarded entities should be considered participants, even though they are not considered separate entities for U.S. tax purposes under current law. Written CSA agreements have effect for foreign, as well as U.S., tax

purposes. Foreign tax authorities look solely to the juridical entity that is a party to the agreement, and not its owner, as the relevant participant. Moreover, the Service typically has a record of the owner of each juridical entity that is disregarded for U.S. tax purposes by virtue of an entity classification election filed on Form 8832. We therefore believe that these contractual provisions should be satisfied by listing the juridical entities that are parties to the contractual documents and their country of incorporation, without regard to who is considered the “taxpayer” under U.S. tax principles by virtue of any entity classification elections.

Second, under the Former Regulations, in practice only CSA participants were considered to benefit from the cost shared the intangibles. However, some have suggested that, by virtue of requiring the listing of “any other members of the controlled group that are reasonably anticipated to benefit from the use of the cost shared intangibles” in addition to the controlled participants, the Temporary Regulations may require that controlled licensees of the cost shared intangibles must be listed. However, because commonly controlled licensees will be obligated to pay arm’s length consideration consistent with the commensurate with income rules of Regulation section 1.482-4, they should not be considered as benefiting from the intangible development within the meaning of the Administrative Requirements. We therefore believe that it would be worthwhile to state explicitly that licensees of intangibles developed under a CSA are not “reasonably anticipated to benefit from the use of the cost shared intangibles,” as that phrase is used in Temporary Regulation section 1.482-7T(k)(1)(ii)(A).

4. The written contract should not include risks and functions unrelated to the terms and conditions of the CSA itself.

The Temporary Regulations add a new contractual provision which requires the controlled participants to a CSA to “Specify the functions and risks that each controlled participant will undertake in connection with the CSA.” It is true that those contracts which comprise a CSA will naturally describe the functions of the parties and identify the risks inherent in their CSA arrangements. However, use of the phrase “will undertake in connection with the CSA” is somewhat ambiguous. Arguably, this could be interpreted broadly to cover relationships and arrangements which are tangential to the CSA itself. For example, if one party is a contract manufacturer for the other, with a separate contract manufacturing agreement, the “in connection with” language could be interpreted as requiring that the particular functions and risks under that contract also be specified in the CSA. Given that such an ancillary contract would be outside of the CSA and would be separately governed by the arm’s length standard of Temporary Regulation section 1.482-1, it would seem inappropriate for the CSA to also attempt to describe all the relationships between the parties inherent in the contract manufacturing arrangement.

We believe that the function and risk specification should apply solely to those terms and conditions which are inherently related to the CSA itself. We suggest that Temporary Regulation section 1.482-7T(k)(1)(ii)(C) should be revised to state, “Specify the functions and risks that each controlled participant will undertake in performing the CSA.”

5. The meaning of contemporaneous should be revised.

The Former Regulations require the parties to a CSA to employ a written document, but there is no explicit deadline for creating such an item. The Temporary Regulations add a requirement that the CSA, and any revision thereof, must be contemporaneous, as that term is defined in Temporary Regulation section 1.482-7T(k)(1)(iii)(A), with the formation of the CSA. That section requires the controlled participants to sign and date the agreement and any amendment no later than 60 days after the first occurrence of any intangible development cost, within the meaning of Temporary Regulation section 1.482-7T(a)(1) (IDC). In addition, Temporary Regulation section 1.482-7T(k)(1)(iii)(B) provides an example of an arrangement under which the governing contract was not entered into until five months after the first IDCs were incurred, with the extreme result that there is no CSA.

While we are in agreement that a reasonable time frame for executing a CSA is appropriate, we believe that the 60 day rule is unnecessarily restrictive for several reasons. First, although an upfront agreement to share the costs of IDA projects is a definitive aspect of cost sharing, an explicit rule regarding the timing of CSA execution is no longer necessary to achieve the important goal of preventing uneconomic migration of intangible property through after-the-fact “cherry picking.” Application of platform contribution concepts, the investor model and the new periodic adjustment regime should sufficiently preclude cost sharing participants from obtaining valuable intangibles at less than arm’s length compensation regardless of when the CSA is signed.

Second, in many cases, it will take more than 60 days to negotiate and finalize all the relevant terms and conditions of a multi-party CSA under the best possible conditions. Indeed, for those foreign CSA participants that must obtain government approval before entering into a CSA, 60 days will not be sufficient time to conclude the arrangement. Moreover, in the context of adding one or more participants following an acquisition, 60 days will not provide sufficient time for determining whether and the extent to which an acquired entity should participate in the CSA, negotiating the necessary changes to the CSA, and documenting those changes in a written amendment.

Third, the 60-day rule is contradictory to the overarching standard of Temporary Regulation section 1.482-7T(k), which requires the controlled participants to *substantially* comply with the contractual, documentation, accounting, and reporting requirements. Unnecessary disputes regarding the precise date of the first occurrence of the IDCs may arise as a result of this overly technical approach. The consequence of such disputes could be potentially catastrophic for taxpayers, since years of CSA transactions might arguably be disregarded upon audit.

For these reasons, we suggest that Temporary Regulation section 1.482-7T(k)(1)(iii) be revised to provide two substantive changes. First, the 60 day period should be extended to 180 days. Second, the term “contemporaneous” should be defined to include all IDCs beginning with a date no earlier than 180 days prior to the execution of the written contract and the sanction for failing to enter into a written CSA within the deadline should not, at least in the case of a mere delay in implementing the parties’

intentions, be disqualification of the arrangement for CSA status, but should be limited to the exclusion from the CSA regime of IDCs incurred more than 180 days before the written CSA was executed. Thus, in the case of purported IDCs which began on March 1, Year 1, and a CSA which was executed on November 1, Year 1, the CSA would be effective only for IDCs beginning approximately May 1, Year 1 (i.e., approximately 180 days prior to November 1, Year 1). The CSA would not be effective for the two month period, March and April, Year 1. However, the “foot fault” for a slight delay in execution of the CSA would not nullify the CSA in its entirety.

6. Eliminate requirement for filing multiple CSA Statements.

Temporary Regulation section 1.482-7T(k)(4) requires all controlled participants to file a CSA Statement signed by an officer under penalties of perjury with the Service in Ogden, Utah. The statement replaces the informational statement called for under the Former Regulations that all U.S. taxpayers participating in CSAs must attach to their returns. In addition to the basic information required under the previous rules regarding the identities of the participants and the period of the CSA, the CSA Statement must also include the controlled participant’s taxpayer identifying number (“TIN”) and information regarding the timing of execution of the CSA and subsequent revisions.

Many foreign companies do not have a TIN and would have to file a form, signed by an officer of the foreign company, in order to obtain one. We question the regulatory benefits of having TINs for all foreign participants and therefore request that the rule be clarified to indicate that those controlled participants that do not otherwise have a TIN are not required to obtain one for the purposes of satisfying the CSA administrative rules.

Consistent with our comments regarding the lack of necessity for a strict rule regarding the timing of CSA execution, we do not believe individual participant CSA Statements concerning CSA contract execution dates are necessary. Moreover, we are unaware in any event of the purpose served by making such an obligation run to all controlled participants rather than only to U.S. participants, particularly because a CSA Statement will list all participants. Given the expected difficulties that U.S. taxpayers will have in ensuring that this requirement is fulfilled by the appropriate officers of their foreign affiliates, it is difficult to see a compelling justification for this aspect of the CSA Statement provisions and, therefore, we recommend that it be eliminated.

7. The “timely update and maintain” documentation requirement should be applied on a tax return filing basis.

Former Regulation section 1.482-7(j)(2)(i) required that CSA participants maintain sufficient documentation to establish that certain requirements were satisfied. Former Temporary Regulation section 1.482-7(j)(2)(ii) stated that satisfaction of the Temporary Regulation section 1.482-7(j)(2)(i) documentation requirements also satisfied the principal documentation requirements under Temporary Regulation section 1.6662-6(d)(2)(iii)(B). Therefore, as a practical matter most taxpayers prepared their cost sharing documentation at the time same time that their other contemporaneous documentation was required to be completed.

Temporary Regulation section 1.482-7T(k)(2)(i) requires taxpayers to “timely update and maintain” sufficient documentation. The regulations do not elaborate on the meaning of “timely update and maintain” other than to provide under Temporary Regulation section 1.482-7T(k)(2)(iii)(B) that taxpayers must provide updated documentation to the Commissioner within 30 days of a request.

Some taxpayers have questioned whether the new “timely update and maintain” rule would require taxpayers to prepare real time documentation for any changes to their CSA. If real time documentation is required, a 2009 calendar year taxpayer would arguably have to prepare documentation satisfying the new rules by July 5, 2009, in order to substantially comply with the requirements of the new rules or otherwise risk failure to qualify as a CSA. That taxpayer would also then be required to update that information at the end of the year in order to comply with the contemporaneous documentation requirements of Regulation section 1.6662-6(d)(2)(iii) or otherwise risk incurring a penalty.⁷ In later years, taxpayers could arguably be required to prepare documentation at the time any change is made in the CSA and also then be required to update that documentation again at the end of its tax year in order to comply with the contemporaneous documentation requirements of Regulation section 1.6662-6(d)(2)(iii).

We believe requiring taxpayers to prepare documentation once each year, specifically by the date prescribed for the completion of documentation under Regulation section 1.6662-6(d), appropriately balances the government’s need for timely and complete information with the burden placed on taxpayers to comply with the documentation requirements. Therefore, we suggest that Temporary Regulation section 1.482-7T(k)(2)(iii)(B) be revised to read in its entirety as follows:

(B) Timely updating, maintenance and production of documentation. For purposes of this section, a controlled participant will have timely updated, maintained and produced the documentation required by this section for a taxable year, if the documentation is in existence at the time the return for the taxable year is filed and the documentation is provided to the Internal Revenue Service within 30 days of a request for it in connection with an examination of the taxable year to which the documentation relates.

8. Transition needed between the documentation requirements of Former Regulations and Temporary Regulations.

Former Temporary Regulation section 1.482-7(j)(2)(ii) stated that satisfaction of the Temporary Regulation section 1.482-7(j)(2)(i) documentation requirements also satisfied the principal documentation requirements under Regulation section 1.6662-6(d)(2)(iii)(B). Regulation section 1.6662-6(d)(2)(iii)(D) states that satisfaction of the Temporary Regulation section 1.482-7T(k)(2) documentation requirements satisfies most of the documentation requirements under Regulation section 1.6662-6(d)(2)(iii)(B).⁸

⁷ See Reg. § 1.6662-6(d)(2)(ii)(A)(2), which requires taxpayers to use the most current data available at the end of the year.

⁸ We note that Paragraph 17 of the regulations does not appear to have an effective date. We assume it is effective on January 5, 2009, the effective date of Temp. Reg. § 1.482-7T.

Therefore, it appears for taxable years ending after January 5, 2009 -- i.e., taxable years generally ending January 30, 2009 and thereafter -- taxpayers are required to comply with Temporary Regulation section 1.482-7T(k)(2) rather than former Temporary Regulation section 1.482-7(j)(2)(ii) if they want to be assured that they satisfy the documentation requirements under Regulation section 1.6662-6(d)(2)(iii)(B).

Given the general tenor of the transition rules, we do not believe that the new documentation requirements were intended to apply to tax years in which the documentation requirements contained in Former Regulation section 1.482-7(j)(2)(ii) were effective for most -- *i.e.*, more than six months -- of the year. Therefore, we suggest that the following transition rule be added to Regulation section 1.6662-6(d)(2)(iii)(D), “For taxable years ending prior to August 1, 2009, satisfaction of the documentation requirements contained in former Regulation section 1.482-7(j)(2)(ii) satisfies the documentation requirements listed in (d)(2)(iii)(B) of this section, except for any PCTs entered into on or after January 5, 2009.”

9. Continued acceptance of umbrella CSAs.

Temporary Regulation sections 1.482-7T(k)(1)(ii)(H) and (k)(1)(ii)(I) require that each participant enter into CSTs and PCTs covering *all* IDCs and platform contributions, respectively. However, the Transition Rule at Temporary Regulation section 1.482-7T(m)(2)(v) provides that these two contractual requirements are to be construed as applying only to qualified existing CSAs with respect to transactions entered into on or after January 5, 2009.

Although the impact of the above-referenced provisions is not entirely clear, we are concerned that together they could be construed as reflecting a change in the cost sharing regulations’ approach to umbrella CSAs. In an umbrella CSA, participants divide up an overall pool of IDCs into smaller discrete pools of IDCs based on whether all participants or only certain participants would expect to benefit from the intangibles developed from each discrete pool. Each controlled participant’s share of reasonably anticipated benefits of the intangibles developed (RAB share), relative share of IDCs, participation in PCTs and ownership of resulting intangibles is separately determined for each individual IDC pool. The results achieved are the same as would have been achieved had the participants established a separate CSA for each discrete IDC pool. However, use of a single, umbrella CSA reduces the legal complexity and administrative burden involved in establishing, maintaining and administering multiple CSAs without sacrificing the important goal of aligning each participant’s costs and risks of participation in cost sharing in proportion with its RAB share.

The use of umbrella CSAs was a matter of concern when changes to the cost sharing regulations were proposed in 1992. Under the 1992 proposed rules, a qualified CSA would have had to “[r]eflect a reasonable effort by each eligible participant to share all of the costs and risks of intangible development.”⁹ In response to concerns raised in

⁹ Prop. Reg. § 1.482-2(g)(2)(E). Notice of Proposed Rulemaking, INTL-0371-88, 57 Fed. Reg. 3571 (1992).

comments to the 1992 proposed regulations that they inappropriately restricted the use of broad, umbrella CSAs in favor of narrow CSAs requiring “that every participant be able to benefit from every intangible developed under a cost sharing arrangement,” the final regulations issued in 1995 removed this requirement.¹⁰

We believe that the use of umbrella CSAs continues to be administratively beneficial for all concerned and therefore recommend that Temporary Regulation sections 1.482-7T(k)(1)(ii)(H) and (k)(1)(ii)(I) be revised to allow specifically for their continued use. Accordingly, we suggest that these provisions be amended to state as follows (suggested changes in italics):

(H) Require the controlled participant to enter into CSTs covering all IDCs as described in paragraph (b)(1)(i) of this section *from which the controlled participant is expected to benefit*, in connection with the CSA;...

(I) Require the controlled participants to enter into PCTs covering all platform contributions, as described in paragraph (b)(1)(ii) of this section *from which the controlled participant is expected to benefit*, in connection with the CSA;

If so revised, there is no further revision necessary to the Transition Rules to accommodate umbrella CSAs. However, if Temporary Regulation sections 1.482-7T(k)(1)(ii)(H) and (k)(1)(ii)(I) are not revised and the Temporary Regulations are intended to restrict -- but not prohibit -- the use of umbrella CSAs going forward, then a further revision to the Transition Rules is necessary. The transition relief provided by Temporary Regulation section 1.482-7T(m)(2)(v) does not apply to CSTs and PCTs occurring after January 5, 2009. However, the introduction of a rule that both prohibits new pools of IDCs from being apportioned among subsets of existing participants and prohibits new participants from sharing in less than all IDCs and participating in less than all PCTs will lead to an unworkable result. For example, a new participant could join an existing umbrella CSA only if it could reasonably expect to benefit from each and every cost shared intangible developed under the CSA. Likewise, the IDA scope of an existing umbrella CSA could be expanded on or after January 5, 2009 only if the change in scope would benefit each and every existing participant. These limiting factors would force participants to terminate their existing umbrella CSAs in favor of a series of smaller CSAs with sharply delimited IDAs, IDCs and groups of controlled participants.

Accordingly, if Temporary Regulation sections 1.482-7T(k)(1)(ii)(H) and (k)(1)(ii)(I) are not revised, then it is important to allow existing umbrella CSAs to continue as such for transactions on and after January 5, 2009. We believe that Temporary Regulation section 1.482-7T(m)(2)(v) should be revised to state as follows (suggested changes in italics):

Paragraphs (k)(1)(ii)(H) and (k)(1)(ii)(I) of this section shall be construed as applying only to transactions entered into on or after January 5, 2009, *but shall not be construed to prevent the sharing of certain IDCs and participation in*

¹⁰ 60 Fed. Reg. 65,553 (1996). T.D. 8632, 1996-1 C.B. 85.

certain PCTs by less than all controlled participants if otherwise appropriate under a qualified existing CSA.

10. Application of the Transition Rules to those contractual requirements which relate to PCTs.

Currently, Temporary Regulation section 1.482-7T(m)(2)(v) indicates that two of the contractual requirements are to be construed as applying only to transactions entered into on or after January 5, 2009. In particular, paragraph (k)(1)(ii)(H) relating to CSTs, and paragraph (k)(1)(ii)(I), relating to PCTs, do not apply to transactions prior to that effective date. The Transition Rules make no reference to Temporary Regulation section 1.482-7T (k)(1)(ii)(J), relating to specifying the form of PCTs. As a result, that paragraph would apparently apply to PCTs occurring prior to the effective date, since no Transition Rule applies to that section. The lack of a Transition Rule seems inappropriate, particularly because the paragraph requires an “explanation that reasonably supports an analysis of applicable provisions of paragraph (h) of this section;” yet, under the general transition rule of Temporary Regulation section 1.482-7T(m)(2)(i), the form of payment rules in paragraph (h) do not apply to PCTs occurring prior to the transition date.

Accordingly, we suggest that a new Transition Rule be inserted after Temporary Regulation section 1.482-7T(m)(2)(v) to state, “Paragraph (k)(1)(ii)(J) of this section shall be construed as applying only to transactions entered into on or after January 5, 2009.”

11. Application of the Transition Rules to the documentation requirements.

The new documentation requirements set forth in Temporary Regulation section 1.482-7T(k)(2) (the “Documentation Requirements”) appear to be applicable on and after January 5, 2009. Under the Transition Rules of Temporary Regulation section 1.482-7T(m)(2)(vii), certain Documentation Requirements relating to PCTs are to be construed as applying only to those PCTs which are entered on or after January 5, 2009. However, the Transition Rules apply only to those Documentation Requirements relating to PCTs (*i.e.*, paragraphs (k)(2)(ii)(G) through (J)), but not to those relating to IDAs, IDCs, and similar items (*i.e.*, paragraphs (k)(2)(ii)(A) through (F)). Thus, without transition relief, the new Documentation Requirements could arguably be interpreted to apply retroactively for the full period of the CSA, which may be decades. For example, one of the requirements is that the controlled participants “Describe the functions and risks that each controlled participant has undertaken *during the term of the CSA.*”¹¹ Another example is the requirement to “Establish the amount of each controlled participant’s IDC for *each taxable year under the CSA.*...”¹²

Consistent with the general tenor of the transition rules, it would appear appropriate and reasonable to provide taxpayer with a “fresh start” with respect to the

¹¹ See Temp. Reg. § 1.482-7T(k)(2)(ii)(C).

¹² See Temp. Reg. § 1.482-7T(k)(2)(ii)(E).

Documentation Requirements. A solution would be to expand the current Transition Rule to all of the Documentation Requirements. That is, Temporary Regulation section 1.482-7T(m)(2)(vii) could be amended to state:

Paragraphs (k)(2)(ii)(A) through (F) shall be construed as applying only to the period beginning on or after January 5, 2009. Paragraphs (k)(2)(ii)(G) through (J) of this section shall be construed as applying only with reference to PCTs entered into on or after January 5, 2009.

12. Additional guidance relating to the definition of a “material change in scope” under Temporary Regulation section 1.482-7T(m)(3).

While the Transition Rules generally apply for arrangements in existence on January 5, 2009, the new periodic adjustment rules of Temporary Regulation section 1.482-7T(i)(6) will still apply to PCTs in connection with existing CSAs which occur on or after that date to the extent that there is a “material change in scope” in the existing CSA. A material change in scope would include a material expansion of the activities undertaken beyond the scope of the intangible development area. Unfortunately, there is neither further explanation of these standards nor any examples to provide any further guidance.

We believe that the standard for whether there has been a change in the scope of a CSA should be focused upon the specification of the IDA in the cost sharing agreement. Assuming that the specification is consistent with the economic substance of the underlying arrangement, subsequent research and development activities that fall within the specification of the IDA should not be treated as constituting a change in the scope of the CSA. Such factors as the specific type of intangible development costs, changes in the size of the cost pool, the nature of the current research or development activities, the size of subsequent PCTs, or other day-to-day developments undertaken pursuant to the arrangement would at most be relevant when there has been a change in the scope of the CSA – that is, in the IDA – and then only for purposes of determining whether the change in scope is material. Conversely, if specification of the IDA in the cost sharing agreement is not consistent with the economic substance of the arrangement, then the substance of the arrangement, as established by the participant’s actual course of conduct, would determine the scope of the CSA, and hence whether subsequent research and development represents a change in that scope.

For purposes of determining whether there has been a material change in the scope of the CSA, we recommend that the Temporary Regulations adopt a standard consistent with comparable positions under the transfer pricing regulations. The Temporary Regulations adopt the standard that a change of 20 percent or less in the anticipated benefits of the participants will not be considered sufficiently material to support an allocation of costs.¹³ Outside the cost sharing arena, the periodic adjustment rules generally treat divergence of less than 20 percent as insufficient to support periodic adjustments. Using these pragmatic and measured standards as a guide, we recommend

¹³ Temp. Reg. § 1.482-7T(i)(2)(ii)(A).

that the Temporary Regulations provide through clarifying text and examples that a change of 20 percent or less in the anticipated sales of the participants due to the change in the IDA will not be considered a material change in the scope of the cost sharing arrangement . By the same token, a change in anticipated sales of 60 percent or more should on all accounts be considered a material change in the scope of the cost sharing arrangement. Whether a change in the scope of the CSA that exceeds the 20 percent threshold but is less than 60 percent is material would be determined on the basis of the specific facts and circumstances of each case. We suggest that sales due to the change in the IDA is the appropriate metric to measure a material change because any other metric is likely to unduly complicate the test especially when one considers that the test must be made on a cumulative basis.

We also believe that the Temporary Regulations should recognize that in some instances, taxpayers have not recently updated their CSAs to precisely include all actual IDAs which the parties in practice have included in their arrangements. In such circumstances, taxpayers should be given an opportunity to conform the terms of their CSAs to the economic substance of their existing transactions, within the period provided by the Temporary Regulations for amending the CSA to comply with the Temporary Regulations, without such conformity itself being a material change in scope.

We believe an appropriate way to provide further guidance in this area is to provide a series of real world examples. Accordingly, we have included a series of eleven examples which we respectfully suggest to be incorporated into the Temporary Regulations. See Exhibit A, attached below.

Exhibit A

Example 1: (i) Publicly-held Foreign Parent (FP) and U.S. Subsidiary (USSub) enter into a CSA prior to January 5, 2009, for the design, manufacture, and sale of semiconductors to be used in consumer electronics. Consistent with the economic substance of the arrangement and with the participants' intentions and actual course of conduct, the CSA specifies the IDA broadly to encompass all research and development relating to any feature of any of FP's present or future semiconductor products. FP and USSub timely amend the CSA to conform to the requirements of this section. As amended, the CSA requires FP and USSub to enter into PCTs covering all platform contributions and to enter into CSTs covering all IDCs.

(ii) At the time FP and USSub formed the CSA, FP had only developed semiconductor technology to regulate the voltage in cell phones, and initial projections envisaged that research and development would relate to improvements and enhancements of the voltage-regulating technology. In 2010, FP and USSub conclude that to remain competitive they have to expand the functionality of the semiconductors they are developing and marketing. As a result, they undertake research intended to add new functionality to their voltage-regulating semiconductor. Ultimately, this research leads to a single semiconductor that can regulate the voltage, improve sound quality and enhance signal reception in cell phones.

(iii) By its terms, the CSA requires FS and USSub to share the costs of research related to the additional functionality of any of FS's semiconductor products. As a result, conducting this research is not a change in the scope of the CSA.

Example 2: (i) Publicly-held U.S. Parent (USP) and Foreign Subsidiary (FS) enter into a CSA prior to January 5, 2009, for the design, manufacture, and sale of software to be used in personal computers. Consistent with the economic substance of the arrangement and with the participants' intentions and actual course of conduct, the CSA specifies the IDA as including all design, research and development activities related to software products marketed by USP and FS for use in personal computers. USP and FS timely amend the CSA to conform to the requirements of this section. As amended, the CSA requires USP and FS to enter into PCTs covering all platform contributions and to enter into CSTs covering all IDCs.

(ii) At the time USP and FS entered into a CSA the only product that USP had developed was a word processing program ("Program"). In 2010, USP and FS conclude that to remain competitive they have to expand the functionality of Program. In 2010, USP acquires a company that has developed an advanced multi-language thesaurus feature for word processing software. USP and FS anticipate that this feature will be included in future releases of Program and will enable them to maintain market share in the highly competitive word processing market.

(iii) Under the terms of the CSA, USP and FS are required to enter into PCTs covering all platform contributions, and to enter into CSTs covering all IDCs. Consistent with these requirements, USP makes the thesaurus feature available for use within the CSA and USP and FS share the costs of the further development and integration of the thesaurus feature into Program. Inasmuch as it is consistent with the terms of the CSA,

the addition of the research and development activities relating to the thesaurus feature is not a change in the scope of the CSA.

Example 3: (i) Publicly-held U.S. Parent (USP) and Foreign Subsidiary (FS) enter into a CSA prior to January 5, 2009, for the development and exploitation of certain pharmaceutical compounds USP and FS anticipate may be useful in preventing heart disease. Consistent with the economic substance of the arrangement and with the participants' intentions and actual course of conduct, the CSA specifies the IDA as consisting in research and development activities relating to the development of these pharmaceutical compounds solely for use in prophylactics relating to heart disease. USP and FS timely amend the CSA to conform to the requirements of this section.

(ii) In 2010, USP and FS determine that one of the pharmaceutical compounds that they were developing, Compound, has no viable role in prevention of heart disease but could potentially reverse baldness in men. Under the terms of the CSA, USP and FS have no obligation to share the costs of research and development of the further development of Compound, and are not allocated any interests in any resulting intangibles. USP and FS nonetheless proceed to share the costs of research and development on Compound to develop treatments for baldness.

(iii) Inasmuch as it is not consistent with the specification of the IDA, the research and development on Compound to develop treatments for baldness is a change in the scope of the CSA.

Example 4: The facts are the same as Example 3, except that, consistent with the substance of the arrangement and the intentions and the actual course of conduct of the participants, the CSA specifies the IDA as consisting in research and development activities relating to the development and exploitation of the pharmaceutical compounds, for any and all applications or fields of use. Under the terms of the CSA, USP and FS are required to share the costs of all such research and codevelopment, and are allocated interests in each and any use of the resulting intangibles. By its terms, the CSA therefore requires USP and FS to share the costs and risks of further development of Compound, and entitles them to exploit it in their respective CSA Activities. The further development of Compound for exploitation in treatment of baldness is not a change in the scope of the CSA.

Example 5: (i) Publicly-held U.S. Parent (USP) and Foreign Subsidiary (FS) entered into a CSA prior to January 5, 2009 to develop Hepacols, a new class of pharmaceutical compounds related to the treatment of liver disease. Consistent with the economic substance of the arrangement and with the participants' intentions and actual course of conduct, the CSA specifies the IDA as consisting in research and development activities relating to the development of Products. USP and FS timely amend the CSA to conform to the requirements of this section. In 2010, USP and FS make additional contributions to the CSA in order to develop and exploit pharmaceutical compounds related to the treatment of depression. The new research and development activities employ scientific knowledge and research techniques different from those involved in the development of Products. To bring the additional research and development within the scope of the CSA, USP and FS timely amend the specification of the IDA in the CSA to include the

development and exploitation of compounds related to the treatment of depression. USP and FS reasonably determine that the sales of the compounds related to the treatment of depression will be at least 60 percent of the sales of Products.

(ii) The amendment of the CSA to add the development and exploitation of pharmaceutical compounds related to depression is a change in the scope of the CSA. Inasmuch as the additional research is expected to result in additional sales revenue of at least 60 percent of the sales revenue of the Products, the change in the scope of the CSA is a material change.

Example 6: The facts are the same as Example 5, except that USP and FS enter in to a new, separate CSA in 2010 for the development and exploitation of pharmaceutical compounds related to depression. USP and FS continue to share the costs and risks of research related to the development and exploitation of Products under the pre-January 5, 2009 CSA. The formation of the new CSA does not constitute a change in the scope of the separate, pre-January 5, 2009 CSA.

Example 7: (i) Publicly-held U.S. Parent (USP) and Foreign Subsidiary (FS) enter into a CSA prior to January 5, 2009, for the design, manufacture, and sale of computer storage devices and related products. Consistent with the economic substance of the arrangement and with the participants' intentions and actual course of conduct, the CSA specifies the IDA as consisting in all research and development activities undertaken by either USP or FS in connection with the development and commercialization of computer storage devices. USP and FS timely amend the CSA to conform to the requirements of this section. As amended, the CSA requires USP and FS to enter into PCTs covering all platform contributions and to enter into CSTs covering all IDCs.

(ii) In 2010, USP acquires a company that has developed revolutionary high-capacity secured transmission technology that will enable USP and FS to integrate physically separated storage devices into a single computer storage solution. USP and FS expect to exploit the acquired transmission technology to develop and market a multiple storage device solution as a new product.

(iii) Under the terms of the CSA, USP and FS are required to enter into PCTs covering all platform contributions, and to enter into CSTs covering all IDCs. Consistent with these requirements, USP makes the transmission technology available for use within the CSA and USP and FS share the costs of the further development and commercialization of the multiple storage device solution. Inasmuch as it is consistent with the terms of the CSA, the addition of the transmission technology to the CSA and its use in further development and commercialization of computer storage devices is not a change in the scope of the CSA.

Example 8: (i) The facts are the same as in Example 7, except that USP and FS conclude that with additional research and development the transmission technology can also be used to create a stand-alone product with applications outside the computer storage device market. USP and FS reasonably determine that additional sales of the stand-alone transmission products will at most be twenty percent of the sales of their computer storage devices. Under the terms of the CSA, USP and FS have no obligation to share the costs of research and development of the further development of the stand-

alone transmission products and are not allocated any interests in any resulting intangibles. USP and FS nonetheless proceed to share the costs of research and development of stand-alone transmission products.

(ii) Inasmuch as it is not consistent with the specification of the IDA, the research and development relating to stand-alone transmission equipment is a change in the scope of the CSA. Inasmuch as the additional revenue expected from the sale of the stand-alone transmission equipment is reasonably expected to be at most twenty percent of the sales of USP and FS's computer storage devices, the change in the scope of the CSA is not by itself a material expansion of the scope of the CSA. However, the addition of research and development relating to stand-alone transmission equipment must be taken into account in connection with any future expansions of the scope of the CSA for purposes of determining whether a material expansion has occurred.

Example 9: (i) U.S. Parent (USP) and Foreign Subsidiary (FS) entered into a CSA prior to January 5, 2009, for the design, manufacture, and sale of semiconductors to be used in consumer electronics. Consistent with the economic substance of the arrangement and with the participants' intentions and actual course of conduct, the CSA specifies the IDA as consisting of all research and development activities undertaken by either USP or FS in connection with the development and commercialization of current or future semiconductors to be used in consumer electronics. USP and FS timely amend the CSA to conform to the requirements of this section. As amended, the CSA requires USP and FS enter into PCTs covering all platform contributions and to enter into CSTs covering all IDCs. A third party U.S. entity (UST) also designs, manufactures and sells semiconductors used in consumer electronics. UST's market capitalization and revenue is approximately equal to USP's market capitalization and revenue. In 2010, UST merges into USP, which is the surviving entity. Following the merger, USP continues to develop and market the semiconductors previously developed and sold by UST.

(ii) Under the terms of the CSA, USP and FS are required to enter into PCTs covering all platform contributions, and to enter into CSTs covering all IDCs. Consistent with these requirements, USP makes UST's platform contributions available for use within the CSA and USP and FS share the costs of the further development and commercialization of UST's products. Inasmuch as it is required by the CSA, the contribution by USP of the PCTs relating to former UST's resources, capabilities, and rights related to the design, manufacture and sale of semiconductors used in consumer electronics is not a change in the scope of the CSA.

Example 10: (i) Publicly-held U.S. Parent (USP) and Foreign Subsidiary (FS) entered into a CSA prior to January 5, 2009, for the design, manufacture, and sale of mining equipment. Consistent with the economic substance of the arrangement and with the participants' intentions and actual course of conduct, the CSA specifies the IDA as consisting in all research and development activities undertaken by either USP or FS in connection with the development and commercialization of current or future mining equipment. USP and FS timely amend the CSA to conform to the requirements of this section. As amended, the CSA requires USP and FS enter into PCTs covering all platform contributions and to enter into CSTs covering all IDCs.

(ii) In 2010, USP acquires the assets of ForCo, a Country X company that develops, manufactures and sells a type of mining equipment that can primarily be used on deposits located in Country X. By its terms, the CSA requires USP and FS to engage in PCTs relating to ForCo's assets and to share the costs of further developing ForCo's mining equipment. However, USP and FS decide not to include development of ForCo's technology in the existing CSA. As a result of such decision, USP and FS amend the CSA to limit the CSA to the development of mining equipment other than the type developed and sold by ForCo. The amendment to the CSA is a contraction in the scope of the CSA, and accordingly there is no material change in scope of the CSA.

Example 11: (i) Publicly-held U.S. Parent (USP) and Foreign Subsidiary (FS) entered into a CSA prior to January 5, 2009, for the design, manufacture, and sale of semiconductors to be used in consumer electronics. The CSA specifies the IDA as consisting in all research and development activities undertaken by either USP or FS in connection with the development and commercialization of semiconductors in consumer products. Subsequent to the formation of the CSA and prior to January 5, 2009, USP and FS determined also to share the costs of research and development relating to semiconductors to be used in military applications, and each engaged in sales relating to such applications. USP and FS did not amend the CSA to reflect this change. USP and FS timely amend the CSA to conform to the requirements of this section. As amended, the CSA requires USP and FS enter into PCTs covering all platform contributions and to enter into CSTs covering all IDCs. In making the conforming amendments USP and FS also update the specification of the IDA so that it covers development of semiconductors used in either consumer electronics or military applications.

(ii) In 2010 USP acquires a company that has developed technology that will allow USP and FS to develop new features for its semiconductor products. The new features are anticipated to have military applications, but not applications in consumer electronics. By its terms, the amended CSA requires USP and FS to engage in PCTs covering all platform contributions, and to enter into CSTs covering all IDCs. Consistent with these requirements, USP makes the acquired technology available for use within the CSA and USP and FS share the costs of the further development of semiconductors with the new features for use in military applications. Inasmuch as it is required by the amended CSA, the PCT relating to the acquired technology for the design, manufacture and sale of semiconductors used in military applications is not a change in the scope of the CSA.