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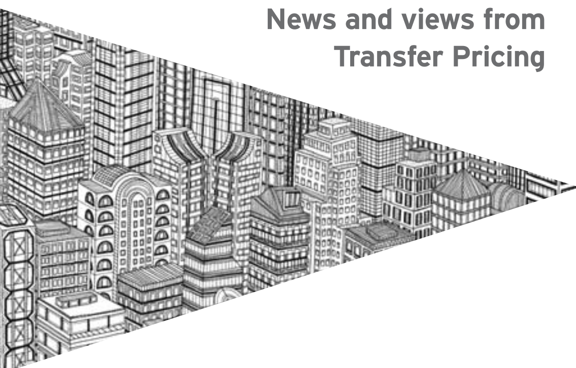

IRS will withdraw 2007 coordinated issue paper on cost sharing buy-in transactions

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Speaking at a Pacific Rim Tax Institute conference on 19 January, IRS Transfer Pricing Director Samuel Maruca has announced that the IRS will withdraw its 2007 coordinated issue paper, LMSB-04-090762, (the CIP) addressing buy-in payments for intangible property made available to cost-sharing arrangements (CSAs).

Background

The IRS released the CIP in September 2007, following its identification of cost sharing as a Tier I issue, for the purpose of providing internal guidance to IRS personnel on the methods that may be used to evaluate the buy-in payment for pre-existing and subsequently acquired intangible property made available to a qualified CSA. The CIP was a comprehensive statement of the IRS's position on the issues that exist with respect to positions for IRS agents and economists to use in evaluating the adequacy of cost sharing buy-in payments. The CIP was directed at what IRS perceived as potential abuses in the valuation of the intangible property contributed to a CSA.

The CIP used a simplified fact pattern to demonstrate methods used for evaluating buy-in payments. The CIP also contained a critique of many positions used by taxpayers to support buy-in valuations. The CIP generally advocated that IRS agents and economists choose, as the best method to evaluate a buy-in, certain transfer pricing methods first described in the 2005 proposed cost sharing regulations: the income method (foregone profits), the market capitalization method, the acquisition price method,

and a revised version of the residual profit split method (RPSM). The CIP rejected taxpayer use of the comparable uncontrolled transaction method (CUT) and RPSM as the best methods to value a cost sharing buy-in. These methods were subsequently specified in temporary regulations effective on 5 January 2009 and final regulations effective on 16 December 2011. See International Tax Alerts: *Treasury and IRS release temporary cost sharing regulations*, dated 7 January 2009 and *IRS adopts final cost sharing regulations*, dated 22 December 2011. The temporary and final regulations were largely consistent with the CIP but dealt with the new specified methods and other issues in greater detail. For further discussion of the 2007 CIP, see International Tax Alert, *IRS issues coordinated Issue paper addressing "buy-in" payments for intangible property made available to cost-sharing arrangements*, dated 8 October 2007.

CIP withdrawal

Mr. Maruca stated that the CIP was mistakenly being used, in many cases as a "blueprint" and applied as blanket advice for transfer pricing cases. Instead, he signaled that transfer pricing must be handled on a fact-specific, case-by-case basis. Maruca noted that while the 2007 CIP required consideration of certain circumstances of a case, it "acquired a "life of its own" and was routinely applied by IRS International Examiners without adequate consideration of the facts.

Acknowledging taxpayer complaints that the 2007 CIP was more of a club than a scalpel, Maruca explained that in withdrawing the guidance the IRS plans to return its focus to the specific facts of the individual cases. However, he also stated that the IRS is not renouncing income-based valuation, which he noted may remain the best method in certain circumstances.

Maruca stated that an IRS team is looking at the pending buy-in dispute cases under the pre-2009 regulations and it will work with the teams on each case to analyze the cases based on their specific facts.

Implications

From a technical perspective, the implications of the CIP withdrawal are limited. With the adoption of the final regulations (as was the case with the CSA temporary regulations), there is little need for the CIP to provide internal technical guidance to IRS personnel on these issues. Similarly, the CIP provides no support for IRS litigating positions additional to that provided by the position's own persuasiveness. Although courts will show deference to IRS interpretative regulations, they are under no such obligation with respect to sub-regulatory guidance such as the CIP.

From a practical perspective, however, since the final and temporary regulations are more nuanced in their approach than is the CIP, the withdrawal of the CIP could lead IRS International Examiners to become more attuned to the particular facts of taxpayers' CSAs. They will then be less likely to apply the "cookie cutter checklist" or blueprint type of approach that was applied under the CIP and has led to very large adjustments. Notwithstanding Mr. Maruca's denials and the limited advantage provided to the IRS by the CIP, it is also possible the withdrawal of the CIP evidences an intention to focus more on CSA transactions that occur after the effective date of the temporary regulations.

For taxpayers with IRS disputes involving tax years prior to the temporary regulations, the revocation of the CIP provides an opportunity to approach the IRS examination team to seek a resolution process and avoid a potentially lengthy Appeals process. Resolution at the field level through the use of fast track settlement could be an option, in addition to working with their teams to resolve the issue based on facts and circumstances without the need for Appeals hazards authority. Taxpayers should consider how the various IRS resolution processes can be used to achieve certainty sooner. Taxpayers currently in Appeals should evaluate their positions in light of the recent announcement to determine the best approach in working to resolve the case administratively in Appeals. Some cases may be returned to the field for further development and evaluation.

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