



Insights: Transfer Pricing

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Transfer pricing concepts spreading throughout the tax code

More than four years after the passage of The Tax Cuts and Jobs Act (TCJA) legislation, in December of 2017, the US Department of Treasury (US Treasury) continues to implement the law in the Internal Revenue Code (IRC) via Treasury Regulations and other guidance. While Section (§) 1.482 of the Treasury Regulations (the Transfer Pricing Regulations) remains unchanged from its pre-2017 state, several TCJA-based revisions to the tax code rely on concepts outlined in the US Transfer Pricing Regulations.¹ This article provides an overview of some transfer pricing concepts incorporated into new sections of the tax code, specifically:

- *Stewardship* expense as detailed in §1.861-8 of the Treasury Regulations; and
- the application of the Services Cost Method (SCM) to the base erosion and anti-abuse tax (BEAT) under IRC §59A.

The following sections briefly discuss these new regulations, highlighting their overlap with the transfer pricing regulations.

Stewardship expenses under §1.861-8

On September 29, 2020, US Treasury published Treasury Decision 9922 (TD 9922) which, among other things, provides guidance on the allocation and apportionment of deductions and the calculation of taxable income for purposes of IRC §904(a). One of the deductions discussed under this guidance is stewardship as defined under Treasury Regulations §1.861-8. Treasury Regulations §1.861-8 defines stewardship as follows:

*Stewardship expenses are those expenses resulting from “**duplicative activities**” (as defined in § 1.482-9(l)(3)(iii)) or “**shareholder activities**” (as defined in § 1.482-9(l)(3)(iv)) that are undertaken for a person's own benefit as an investor in a related entity, which for purposes of this paragraph (e)(4)(ii) includes a business entity as described in § 301.7701-2(a) of this chapter that is classified for Federal income tax purposes as either a corporation or a partnership, or is disregarded as an entity separate from its owner (“disregarded entity”)...*²

¹ Following the passage of TCJA, IRC Section 482 was amended to include a third sentence on the aggregation and use of realistic alternatives when valuing intangible property; and IRC Section 936(h)(B) was amended to expand the definition of intangible property.

² Treas. Reg. §1.861-8(e)(4)(ii)(A).

As emphasized in the passage above, the stewardship definition under Treasury Regulations §1.861-8 is heavily reliant on the Transfer Pricing Regulations' concepts of duplicative and shareholder activities. That said, the scope of stewardship under Treasury Regulations §1.861-8 deviates from the Transfer Pricing Regulations in that it only includes duplicative and shareholder activities "*that are undertaken for a person's own benefit as an investor in a related entity.*"³ To this end, the regulations acknowledge that while the Transfer Pricing Regulations' duplicative and shareholder activities serve as a starting place to calculate stewardship expenses under Treasury Regulations §1.861-8, stewardship expenses may differ from total expense associated with duplicative and shareholder activities.

The interpretation of Treasury Regulations §1.861-8 should be based on the facts and circumstances of an individual taxpayer. Accordingly, we have found it important to work in conjunction with our clients' tax advisors (or tax preparers) to make sure that the ultimate stewardship expense determination for Treasury Regulations §1.861-8 purposes is in line and reconcilable to the taxpayer's transfer pricing position.

SCM exemption under §59A

Under the final regulations issued under IRC §59A, on October 9, 2020, US Treasury introduced the services cost method (SCM) as an exemption for base erosion payments. Specifically, any payments to foreign-related parties for services that fall under the SCM (excluding the requirement that the services not contribute significantly to fundamental risks of business success or failure) should not be included as a base erosion payment in a taxpayer's tax filings.

The determination of which services fall under the SCM exemption for base erosion payments will depend on the facts and circumstances of the taxpayer; however, taxpayers should ensure consistency of the SCM exclusion from base eroding payments with any services charged out under the SCM for transfer pricing purposes.⁴ Since the SCM definition under IRC §59A is slightly modified from the Transfer Pricing Regulations, some differences in application may be appropriate.

Key takeaways

With the transfer pricing concepts of stewardship and the SCM now being leveraged both inside and outside of the Transfer Pricing Regulation, taxpayers should ensure that any new positions they take with regard to these concepts remain reconcilable to their existing transfer pricing positions. While differences in the application of the concepts may be appropriate, they should be fully understood and documented.

About CRA's Transfer Pricing Practice

Our consultants help clients navigate every phase of implementing and supporting international tax structures including: intellectual property (IP) and acquisition planning, documentation, and audit defense. We also provide litigation support and expert testimony services in tax and transfer pricing litigation. To follow are some highlights of projects from the past year.

³ *Ibid.*

⁴ International transfer pricing frameworks, most notably the OECD Transfer Pricing Guidelines, do not incorporate a method equivalent to the SCM. Therefore, most US taxpayers will be familiar with the SCM only on their outbound service charges. As the SCM exemption under Section 59A is being applied to inbound charges this could create an additional transfer pricing exposure to the extent the application of the SCM differs on inbound versus outbound charges.

For more information about this edition of *Insights: Transfer Pricing*, and our services, contact:

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