

among the three controlled taxpayers. A, B, and C have the exclusive rights to manufacture and sell products based on the new technology in North America, South America, and Europe, respectively. When the new technology is developed, C expects to use it to manufacture and sell products in most of Europe. However, for sound business reasons, C expects to license to an unrelated manufacturer the right to use the new technology to manufacture and sell products within a particular European country owing to its relative remoteness and small size. In these circumstances, C has not entered into the arrangement with a principal purpose of obtaining covered intangibles for transfer or license to controlled or uncontrolled taxpayers, because the purpose of licensing the technology to the unrelated manufacturer is relatively insignificant in comparison to the overall purpose of exploiting the European market.

(4) *Treatment of a controlled taxpayer that is not a controlled participant—(i)*

*In general.* If a controlled taxpayer that is not a controlled participant (within the meaning of this paragraph (c)) provides assistance in relation to the research and development undertaken in the intangible development area, it must receive consideration from the controlled participants under the rules of § 1.482-4(f)(3)(iii) (Allocations with respect to assistance provided to the owner). For purposes of paragraph (d) of this section, such consideration is treated as an operating expense and each controlled participant must be treated as incurring a share of such consideration equal to its share of reasonably anticipated benefits (as defined in paragraph (f)(3) of this section).

(ii) *Example.* The following example illustrates this paragraph (c)(4):

*Example.* (i) U.S. Parent (USP), one foreign subsidiary (FS), and a second foreign subsidiary constituting the group's research arm (R+D) enter into a cost sharing agreement to develop manufacturing intangibles for a new product line A. USP and FS are assigned the exclusive rights to exploit the intangibles respectively in the United States and Europe, where each presently manufactures and sells various existing product lines. R+D, whose activity consists solely in carrying out research for the group, is assigned the rights to exploit the new technology in Asia, where no group member presently operates, but which is reliably projected to be a major market for product A. R+D will license the Asian rights to an unrelated third party. It is reliably projected that the shares of reasonably anticipated benefits of USP and FS (i.e., not taking R+D into account) will be 66 2/3% and 33 1/3%, respectively. The parties' agreement provides that USP and FS will reimburse 40% and 20%, respectively, of the intangible development costs incurred by R+D with respect to the new intangible.

(ii) R+D does not qualify as a controlled participant within the meaning of paragraph (c) of this section. Therefore, R+D is treated

as a service provider for purposes of this section and must receive arm's length consideration for the assistance it is deemed to provide to USP and FS, under the rules of § 1.482-4(f)(3)(iii). Such consideration must be treated as intangible development costs incurred by USP and FS in proportion to their shares of reasonably anticipated benefits (i.e., 66 2/3% and 33 1/3%, respectively). R+D will not be considered to bear any share of the intangible development costs under the arrangement.

(iii) The Asian rights nominally assigned to R+D under the agreement must be treated as being held by USP and FS in accordance with their shares of the intangible development costs (i.e., 66 2/3% and 33 1/3%, respectively). See paragraph (g)(6) of this section. Thus, since under the cost sharing agreement the Asian rights are owned by R+D, the district director may make allocations to reflect an arm's length consideration owed by R+D to USP and FS for these rights under the rules of §§ 1.482-1 and 1.482-4 through 1.482-6.

(5) *Treatment of consolidated group.*

For purposes of this section, all members of the same affiliated group (within the meaning of section 1504(a)) that join in the filing of a consolidated return for the taxable year under section 1501 shall be treated as one taxpayer.

(d) *Costs—(1) Intangible development costs.* For purposes of this section, a controlled participant's costs of developing intangibles for a taxable year mean all of the costs incurred by that participant related to the intangible development area, plus all of the cost sharing payments it makes to other controlled and uncontrolled participants, minus all of the cost sharing payments it receives from other controlled and uncontrolled participants. Costs incurred related to the intangible development area consist of the following items: operating expenses as defined in § 1.482-5(d)(3), other than depreciation or amortization expense, plus (to the extent not included in such operating expenses, as defined in § 1.482-5(d)(3)) the charge for the use of any tangible property made available to the qualified cost sharing arrangement. If tangible property is made available to the qualified cost sharing arrangement by a controlled participant, the determination of the appropriate charge will be governed by the rules of § 1.482-2(c) (Use of tangible property). Intangible development costs do not include the consideration for the use of any intangible property made available to the qualified cost sharing arrangement. See paragraph (g)(2) of this section. If a particular cost contributes to the intangible development area and other areas or other business activities, the cost must be allocated between the intangible development area and the

other areas or business activities on a reasonable basis. In such a case, it is necessary to estimate the total benefits attributable to the cost incurred. The share of such cost allocated to the intangible development area must correspond to covered intangibles' share of the total benefits. Costs that do not contribute to the intangible development area are not taken into account.

(2) *Examples.* The following examples illustrate this paragraph (d):

*Example 1.* Foreign Parent (FP) and U.S. Subsidiary (USS) enter into a qualified cost sharing arrangement to develop a better mousetrap. USS and FP share the costs of FP's research and development facility that will be exclusively dedicated to this research, the salaries of the researchers, and reasonable overhead costs attributable to the project. They also share the cost of a conference facility that is at the disposal of the senior executive management of each company but does not contribute to the research and development activities in any measurable way. In this case, the cost of the conference facility must be excluded from the amount of intangible development costs.

*Example 2.* U.S. Parent (USP) and Foreign Subsidiary (FS) enter into a qualified cost sharing arrangement to develop a new device. USP and FS share the costs of a research and development facility, the salaries of researchers, and reasonable overhead costs attributable to the project. USP also incurs costs related to field testing of the device, but does not include them in the amount of intangible development costs of the cost sharing arrangement. The district director may determine that the field testing costs are intangible development costs that must be shared.

(e) *Anticipated benefits—(1) Benefits.* Benefits are additional income generated or costs saved by the use of covered intangibles.

(2) *Reasonably anticipated benefits.* For purposes of this section, a controlled participant's reasonably anticipated benefits are the aggregate benefits that it reasonably anticipates that it will derive from covered intangibles.

(f) *Cost allocations—(1) In general.* For purposes of determining whether a cost allocation authorized by paragraph (a)(2) of this section is appropriate for a taxable year, a controlled participant's share of intangible development costs for the taxable year under a qualified cost sharing arrangement must be compared to its share of reasonably anticipated benefits under the arrangement. A controlled participant's share of intangible development costs is determined under paragraph (f)(2) of this section. A controlled participant's share of reasonably anticipated benefits under the arrangement is determined under paragraph (f)(3) of this section. In