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New Directive Formally Acknowledges Adoption of IRS-Wide Position on Multiple RAB Shares in CSAs

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A recent directive on the use of multiple reasonably anticipated benefit (“RAB”) shares in a cost sharing arrangement (“CSA”) withdrew a 2018 directive on the same issue, recognizing that a Chief Counsel memorandum had cemented an IRS-wide position. IRS examiners are now directed to assess the appropriateness of using single or multiple RAB shares for a CSA based on the facts at hand.

On June 5, 2019, the IRS’s Large Business and International division (“LB&I”) published a directive,¹ which formally withdrew a January 16, 2018 directive entitled “Instructions for Examiners on Transfer Pricing Selection—Reasonably Anticipated Benefits in Cost Sharing Arrangements.”² The prior directive had instructed LB&I examiners, until an IRS-wide position on the issue could be finalized, to stop making adjustments to CSAs by changing a taxpayer’s multiple RAB shares to a single RAB share when subsequent platform contribution transactions (“PCTs”) are added to an existing CSA.

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¹ Directive LB&I-04-0519-005 (dated May 21, 2019), <https://www.irs.gov/businesses/withdrawal-of-directive-lbi-04-0118-004-reasonably-anticipated-benefits-in-cost-sharing-arrangements>.

² Directive LB&I-04-0118-004 (dated Jan. 12, 2018), <https://www.irs.gov/businesses/corporations/instructions-for-examiners-on-transfer-pricing-selection-reasonably-anticipated-benefits-in-cost-sharing-arrangements>.

On July 26, 2018, the IRS Office of Chief Counsel finalized the IRS's position, releasing a memorandum that concluded that multiple RAB shares may be used in a single CSA, but only if this is the most reliable approach.³ This rendered the RAB share directive effectively moot, and the issuance of the June 2019 directive formalized its withdrawal in light of the Chief Counsel memorandum, thus ending the saga.

The initial directive and the later memorandum address situations in which a U.S. participant in an existing CSA acquires intangible property ("IP") and makes that IP available to a foreign CSA participant through a subsequent PCT. This PCT may generate profits to the participants in proportions different from the pre-existing RAB shares. When this is the case, a taxpayer has three potential RAB share ratios under the CSA: (1) the pre-existing RAB shares; (2) the RAB shares related to the IP made available by the subsequent PCT; and (3) updated RAB shares resulting from combining the newly acquired IP with the pre-existing IP covered by the CSA.

Practically, this leaves taxpayers with the options of having multiple RAB shares (i.e., one ratio for the pre-existing IP covered by the CSA and a different ratio for the newly acquired IP made available by the subsequent PCT), or of updating its pre-existing RAB shares to take into account the newly acquired IP and using this single updated RAB share ratio.

The IRS issued the initial directive because some examination teams had taken the position that the section 1.482-7 regulations require the use of a single RAB share when subsequent PCTs occur. That position was based on an example in section 1.482-7(g)(5)(v). The example addresses the use of the acquisition price method to determine the PCT, and states that each participant's pre-existing RAB share is "not reasonably anticipated to change" as a result of the acquisition. Presumably, the inference exam teams were making rests on the fact that the example specifically notes that the RAB share is not expected to change, which could imply that the pre-existing RAB share should change when the circumstances require this, and thus that multiple RAB shares are impermissible.

The Office of Chief Counsel, however, disagreed with these arguments, finding that section 1.482-7(e)(1)(ii)'s requirement that RAB shares "be determined by using the most reliable estimate" mandates use of multiple shares when this provides the best estimate and, conversely, requires use of a single blended share when this is more reliable. The Chief Counsel memorandum went beyond the scope of the RAB share directive, concluding that multiple RAB shares may be used both in the context of a subsequent PCT added to an existing CSA and in the context of separate cost pools under a single CSA.

³ AM 2018-003. The memorandum states that "[t]his advice may not be used or cited as precedent." See also section 6110(k)(3) ("Unless the Secretary otherwise establishes by regulations, a written determination may not be used or cited as precedent."). However, as a practical matter it appears that it would be difficult for the IRS to disavow the position taken in the Chief Counsel memorandum. Unless otherwise indicated, section references are to the Internal Revenue Code of 1986, as amended (the "Code") or the applicable regulations promulgated pursuant to the Code (the "regulations").

While the RAB share directive provided relative certainty that the use of multiple RAB shares would go unchallenged, at least for an interim period, this is no longer the case following the publication of the Chief Counsel memorandum and the subsequent formal revocation of the directive. Although the memorandum generally continues the approach articulated in the directive, the announcement of an IRS-wide position on the issue means that exam teams are no longer barred from changing multiple RAB shares into a single share, if they conclude the latter alternative more reliably estimates RAB. Indeed, the 2019 directive specifically instructs exam teams to “continue with the application of the most reliable method depending on the facts and circumstances of each case to determine the appropriateness of using single or multiple RAB shares with respect to a single CSA,” and to consult with the transfer pricing practice network and IRS Chief Counsel when needed.

The acceptability of a taxpayer’s use of RAB shares ultimately turns on what provides the most reliable estimate, which is an inherently factual inquiry. Under the new IRS position, taxpayers with CSAs—even if they use only a single RAB share—need to consider whether their approach provides the most reliable estimate in order to assess and address controversy risk.



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