A Looking Glass Tour Through a Cost Sharing Arrangement

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A LOOKING GLASS TOUR THROUGH A COST SHARING ARRANGEMENT

Sheila J. Peterson†

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INTRODUCTION

Over the years, underdeveloped countries have expressed the desire to have U.S. businesses move into their country. To entice U.S. companies to expand overseas, countries may offer a combination of tax and economic incentives, possibly including a tax holiday for a specified period;\(^1\) non-repayable loans for purchase of fixed assets, training of the work force, research activities;\(^2\) accelerated depreciation on fixed assets;\(^3\) and a variety of tax credits.\(^4\) Even small manufacturing concerns may consider these attractive reasons to risk overseas expansion.\(^5\)

Once the decision is made to expand overseas, the company must consider whether to operate the foreign activity as a separate business entity or as a division of the existing corporation. The corporation must consider which product or product line (existing or newly developed) could be efficiently manufactured overseas, and the means for setting up the manufacturing process. This process may require not only the transfer of tangible property like test equipment, computers, etc., but will also require the transfer of the invention or design that is to be manufactured. This transfer of an invention, formula, process, design, etc. is considered the transfer of an intangible\(^6\) and if transferred to a separate corporation, is a taxa-

4. Id.
5. At a minimum, the company risks losing hands-on control over all the operations. Also, an unstable political environment could certainly spell disaster to a small company even with all the tax and economic incentives.
6. I.R.C. § 936(h)(3)(B) (1986) defines an intangible to include:
   (i) patent, invention, formula, process, design, pattern or knowhow;
   (ii) copyright, literary, musical, or artistic composition;
   (iii) trademark, trade name, or brand name;
   (iv) franchise, license, or contract;
   (v) method, program, system, procedure, campaign, survey, study, forecast, estimate, customer list, or technical data; or
   (vi) any similar item,
   which has substantial value independent of the services of any individual.
There are several alternatives available for the transfer of an intangible to another corporation. Generally, the Internal Revenue Service (IRS) is not concerned about the form or the price, because unrelated parties will bargain in their own best interest, and an arm's length price will necessarily result.

However, there is a great deal of concern over a transfer of property between related parties, as intercompany transactions may not be sufficiently arm's length. The parties' common goal may be to pay the least amount of combined tax on the transaction, specifically contrary to the IRS' determination of U.S. tax liability.

Internal Revenue Code § 482 provides the IRS with a mechanism for income reallocation on the transfer of property between related parties. A transfer to the foreign subsidiary in the form of a sale or license is subject to reallocation under § 482, if in the form of a taxable capital contribution to the related party, the transfer will be subject to reallocation under the special rules of § 367(d)(2).

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8. The discussion here involves solely the income tax consequences of such a transfer. There may be, *inter alia*, sales tax, customs tax and property tax consequences which will not be discussed here.
9. BLACK'S LAW DICTIONARY 100 (5th ed. 1979) defines as follows: Arm's length transaction: "Said of a transaction negotiated by unrelated parties, each acting in his or her own self interest; the basis for a fair market value determination."
10. Hereinafter referred to as I.R.C. § or merely §. Unless otherwise stated, all references are to the Internal Revenue Code of 1986, and the regulations promulgated thereunder.
11. I.R.C. § 482 (1986) reads as follows:
   
   In any case of 2 or more...businesses...by the same interests, the Secretary may...allocate gross income,[or] deductions...if he determines that such...allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income...or such...businesses. In the case of any transfer (or license) of intangible property (within the meaning of § 936(h)(3)(B)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible. (emphasis added).
12. I.R.C. § 367(d) (1986) reads as follows:
   
   Special rules Relating to Transfers of Intangibles -
   
   (I) General Rule: Except as provided in Regulations, if a US person transfers any intangible property (within the meaning of § 936(h)(3)(b)) to a foreign corporation in an exchange described in § 351, (a) subsection (a) shall not apply to the transfer...[and](b) the provisions of this subsection shall apply...
   
   (2) In general, if paragraph (1) applies, the US person transferring such property shall be treated as (i) having sold such property in exchange for payments which are contingent upon the productivity, (or) use...of such property and (ii) receiving amounts which reasonably reflect the amounts which would have been received
      
      (I) Annually over the useful life, or
      
      (II) at the time of the disposition.
These reallocation provisions have become even more significant with the introduction of the "super-royalty" provisions of the Tax Reform Act of 1986. Substantially similar amendments to three code sections (§§ 482, 367(d) and 936) introduced an almost revolutionary concept into the tax law. These super-royalty provisions are based on an eight-word phrase which requires that the income recognized on the transfer of an intangible be "commensurate with the income attributable to the intangible." That is, the income relating to the intangible developed by the party (or parties) will be recognized by the parties. This wording appears to alter the historic arm's length standard of prospectively assessing the value of the property on the transfer of intangibles between related parties, and introduces an additional "hindsight" or "look-back" approach. The essence of this change is that the IRS can, on audit, review the profitability of the intangible and reset the sales price or royalty rate (hence, the super-royalty) to reflect actual experience, something the parties could not have known at the time of entering into the agreement. This may be a rather frightening uncertainty for a company that participates in sophisticated tax planning, and one they would certainly want to avoid.

One way to avoid the super-royalty provisions is to make no transfer, while still allowing the related party access to the intangible. While the sharing of one's managerial expertise and experience...
ence has been held to be a transfer of technology, it is not a transfer if both parties jointly own the intangible. Joint ownership from inception can be achieved through the use of a Bona Fide Cost Sharing Arrangement (hereinafter, a BFCSA). Much like a joint venture between unrelated parties, a BFCSA is a written agreement between related parties to share the costs and risks of the research and development (R & D) in return for a specified interest in the future intangible. The conference report on the super-royalty provisions indicates that BFCSAs are still an appropriate method of allocating income as long as "consistent with the purposes of this provision."

The following example will illustrate the effects of the super-royalty provisions. The IRS conducts an audit three years after a U.S. company transfers its technology and sets up a royalty agreement with its foreign subsidiary. The agreement provides for a royalty of twenty dollars per unit to be paid to the U.S. company, with a declining rate for sales over a particular quantity per period (say fifteen dollars for sales over 1,000 for the quarter). The IRS reviews the worldwide profits generated by the new technology and adjusts the royalty rate payable to the U.S. developer to thirty dollars per unit. This amount may be far in excess of the amount the parties contemplated in their original negotiations.

This comment reviews the historical development of BFCSAs and the Congressional concerns in allowing for their continued use. The comment develops the issues and mechanics one need consider in setting up a BFCSA from the idea stage through completion of the product. Further, the comment analyzes four sets of materials on cost sharing: the proposed regulations which were never enacted, but serve to enlighten the reader as to qualifying requirements; the final regulations which were enacted, but which are so vague as to provide little guidance to the taxpayer; the § 482 White Paper "Discussion Draft" issued by the IRS in October, 1988.

20. Hospital Corp. of America and Subsidiaries v. Comm'r of Internal Revenue, 81 T.C. 520 (1983).
21. Treas. Reg. § 1.482-2(d)(4) (1968). It is unclear what "risks" are being shared other than costs. Risks may conceivably indicate factors such as lost time, loss of market position, and labor which could be diverted to other ideas. Risks may also include uncertainty as to the product's ultimate performance, market acceptance and efficiency of the manufacturing process.
23. § 482 adjustments are tools of the Secretary of the Treasury (i.e., the IRS), not the taxpayer. Presumably, no adjustments will be made if the profitability is less than was originally anticipated in the arm's length negotiation.
with a view toward collecting information and eventually proposing new regulations; and a draft of comments by the American Bar Association (ABA) suggesting revisions prior to proposing new regulations.

HISTORICAL PERSPECTIVE

The § 482 reallocation provisions have been around for many years. BFCSAs were a noted exception to these provisions under proposed regulations issued in 1966 which provided detailed rules with respect to BFCSAs. The proposed regulations gave the district director the right to reallocate the costs of the R & D; discussed the required method for sharing the costs and risks of development; provided rules for measurement of a participating member's full share of the costs and risks of development; and covered some of the agreement terms.

In 1968, cost sharing regulations were adopted in a truncated version from that discussed above. About one-eighth the size of the proposed regulations, the final regulations were short, simple, and rather vague. They included a definition of BFCSAs, a definition of good faith, a transitional rule, and a statement of the district director's power to reallocate to an arm's length share of the costs and risks. None of the includible costs, full shares, required methods, or agreement terms and conditions within the proposed regulations were mentioned.

Information on foreign treatment of cost sharing arrangements is sparse. Cost sharing arrangements are discussed favorably in a report prepared by the Organisation for Economic Co-Operation and Development (OECD). The report entitled *Transfer Pricing and Multinational Enterprises* indicates that "experience with such intra-group cost sharing arrangements is said to be positive and they do not appear to have opened up avenues for tax avoidance."

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53 (Oct. 20, 1988) [hereinafter White Paper]. This is a study prepared by the Treasury Department regarding intercompany pricing in conjunction with the Tax Reform Act of 1986.

25. Pursuant to comments by D. Lilly, Professor of Law, Santa Clara University, no proposed regulations are expected any time soon, but it is expected that "lines will be drawn" in the proposed regulations.

26. The origins of § 482 can be traced to Articles 77 and 78 of Rep. 41 (1921) with respect to the filing of consolidated returns. 230-3rd (US) Tax Mgmt. (BNA) A-1.


28. Id.


31. Organisation for Economic Cooperation and Development Report of the Commit-
The OECD report details the U.S. treatment of cost sharing arrangements, but indicates that “[o]ther countries contributing to the preparation of this report had little experience [with]... cost sharing arrangements on the lines of those approved by the United States regulations” and indicate that the other countries “have not felt the need to draft special rules regarding the deductibility of such [cost sharing] payments. . . .”

Although the German tax agents “Handbook” does not take a position as to whether contributions to a “research pool” may be made by German subsidiaries to foreign parent companies “[t]here have been at least a few cases in which the tax authorities allowed sizeable German subsidiaries to participate in research and development pools. . . .” In France, although “[t]he French tax administration does not have special rules applicable to cost sharing arrangements,” the arrangement may be subject to value added tax (V.A.T.) and a source withholding tax may apply to the payments.

The § 482 White Paper also reflects the lack of information available to the IRS and requests information from the taxpayer. “In view of the limited information currently available on both related and unrelated cost sharing agreements, the Service and Treasury would appreciate receiving information from taxpayers regarding their contractual arrangements and experience with cost sharing.”

CONGRESSIONAL CONCERNS ON COST SHARING

BFCSAs appear well-received in the Committee Reports under § 482 of the 1986 Tax Reform Act, and the conferees seem amenable to their continuation. The conferees stated, “[i]n revising § 482, the conferees do not intend to preclude the use of certain bona fide research and development cost-sharing arrangements as an appropriate method of allocating income attributable to intangibles among related parties. . . .”

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32. OECD, Transfer Pricing and Multinational Enterprises, at 58.
However, the Conferees added a limitation to the use of BFCSAs by continuing the above sentence as follows: "...[i]f and to the extent such agreements are consistent with the purposes of this provision that the income allocated among the parties reasonably reflect the actual economic activity undertaken by each." This limitation appears to reflect an intent that the super-royalty provisions apply to cost sharing arrangements in some form.

The White Paper breaks out the text of the committee report into three specific areas of Congressional concern. These areas are significant issues in the cost sharing arena and include selective inclusion of high profit intangibles, the basis for contributions to the BFCSA and the buy-in of currently existing intangibles. Although these topics may fall within a subheading of a larger category in the accompanying text, the issue itself could make or break the corporation's ability to use cost sharing effectively. Each of these three items will be discussed separately below.

**SETTING UP YOUR BONA FIDE COST SHARING ARRANGEMENT**

*Product Coverage*

In setting up a BFCSA, the first consideration should be the products or projects that will be covered by the arrangement. A specific category of Congressional concern, the White Paper cautions the taxpayer on "selective inclusion", also known as "cherry-picking." It is inappropriate for a taxpayer to share costs with their foreign manufacturer only on what is expected to be a highly profitable product. Cost sharing on a highly profitable product would reduce expenses of a U.S. developer by an amount equal to the participants' share of the costs. This is presumably much less than the amount that would have been recognized as royalty income on the licensing of that same product. The White Paper concern is derived from the following wording in the committee reports:

"Under such a bona fide cost-sharing arrangement, the cost sharer would be expected to bear its portion of all research and develop-

37. Id.
38. The White Paper deals exclusively with manufacturing intangibles like patents, trade secrets and know-how, and makes it clear that marketing intangibles are not the proper subject of a cost sharing arrangement as they would be covered by the service regulations of Regs. 1.482-2(b)(2). Pursuant to comments by D. Lilly, Professor of Law at Santa Clara University, an in-depth worldwide market research study may be the appropriate subject of a BFCSA.
ment costs, on unsuccessful as well as successful products within an appropriate product area, and the costs of research and development at all relevant development stages would be included. (emphasis added).

The § 482 White Paper finds the "appropriate product area" discussed in the Conference report would be the three-digit Standard Industrial Classification (SIC) codes. These codes generally define products across rather broad product lines. For example, a manufacturer of chemicals and allied products would fall under Code 2830 for all its manufactured drug products, and under Code 2850 for its painting products. Likewise, an electronics manufacturer, would fall under Code 3670 for the manufacture of its electronic components and accessories (e.g. integrated circuits, power supplies, and transformers) and under Code 3698 for all other electrical equipment (presumably, all its computers and test equipment).

This approach seems to include a broad spectrum of R & D products within a cost sharing arrangement. The White Paper specifically notes that this approach is at odds with the 1966 proposed regulations: "The approach in ... the ... legislative history [of the 1986 Act] contrasts to the proposed 1966 regulations. Cost sharing arrangements described in the 1966 proposed regulations could cover a single project, although multi-project or product area cost sharing agreements were not prohibited."

Even though this seems to be a strict requirement of product grouping, the IRS states that "[b]oth the Service or the taxpayer should be permitted to demonstrate... that a narrower or broader agreement is more appropriate." The White Paper then proceeds with a discussion of the proof requirements:

Taxpayers choosing a narrower agreement would need to show that the agreement is not merely an attempt to shift profits from successful research areas while leaving expenses of unsuccessful or less successful areas to be absorbed by the U.S. or higher tax affiliate... [T]axpayers choosing a broader agreement would need to

41. These codes are used by the IRS in various places (see instructions for Form 5471 at 12). They are designed to facilitate the administration of the Internal Revenue Code by classifying enterprises by the type of activity in which they are engaged. Though similar in format and structure to the Standard Industrial Classification codes, they should not be used as SIC codes.
42. This is the same classification used under § 936(h) for cost sharing with possessions corporations.
44. Id. at 116.
show that the agreement is *not being used to charge U.S. affiliates* or other participants for research and development without reasonable prospect of benefit. (emphasis added)\(^45\)

Therefore, a "narrower agreement" requires the U.S. taxpayer to meet a higher standard of proof. It would likely be invoked where the U.S. taxpayer has one highly profitable intangible developed under a BFCSA with their foreign subsidiary, and several other low profit intangibles which are not covered by a BFCSA. This higher standard of proof requirement results in a corresponding lower standard of proof to the IRS with respect to technology developed in the U.S. Likewise the "broader agreement" proof will require a higher standard where a foreign developer shares costs on all, or substantially all, of its products and the U.S. partner participates in all costs.\(^46\)

The American Bar Association (ABA) has prepared a draft of proposed revisions for the Service on the substance of the White Paper. The ABA comment suggests a need for more flexibility than strict SIC product code coverage for cost sharing arrangements:

We believe the focus should be on benefit or reasonably expected benefit, and that more flexibility needs to be introduced into the rules governing product coverage. This could be along the lines of the 1966 proposed regulations approach to product or project coverage, but in any event, it should be without the special burdens of proof discussed in the White Paper. If the taxpayer can establish a reasonably anticipated commensurate benefit, that alone should satisfy the taxpayer's burden of proof without the need for additional product coverage restrictions. (emphasis added).\(^47\)

*Participating Parties*

Even though the § 482 White Paper appears to require equal treatment for all R & D projects under a specific SIC product code, exclusion of a participant from a BFCSA on particular product may still be appropriate depending on the functions of the participants. The White Paper's discussion of "Overly Broad Agreements" suggests that inclusion is required only if the participants plan to manufacture the product. The White Paper describes a manufacturer of

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46. The committee reports of the 1986 Tax Reform Act indicate that both outbound transfers and inbound transfers are specifically covered by the super-royalty provisions. H.R. CONF. REP. No. 841, *supra* note 34.

widgets and gadgets who enters into a BFCSA with its affiliate A that manufactures only gadgets, and suggests that cost sharing between the manufacturer and affiliate A is only appropriate for the gadget research. "It may be necessary . . . either to have separate cost sharing agreements for widget and gadget research, to adjust affiliate A's cost share to reflect the costs related to gadget research, or to exclude affiliate A from the cost sharing arrangement."48

This example runs contrary to the previously discussed standard of product code cost sharing. The ABA comment agrees with the use of a benefit test "[i]f the affiliate does not stand to benefit from the overall or widget research, then clearly under a benefit test it should not be included in the cost sharing applicable to widgets."49 However, the ABA comment states that "[i]n a given set of facts, the affiliate which manufactures only gadgets may nonetheless benefit from widget research,"50 and again finds the White Paper standard to be lacking in the necessary flexibility required from a set of cost sharing rules.

In addition to having plans that the participant manufacture, the participant must have the capability of manufacture. This requirement is described within the White Paper section entitled "Direct exploitation of intangibles by participants". The IRS finds, generally, that the benefit being derived by a participant in a BFCSA is the right to manufacture the intangible. Though the capability to manufacture need not necessarily be present at the time the costs are actually incurred, the White Paper indicates that the parties must anticipate that the participants "will be capable of manufacture once the intangibles are developed and will use the intangibles developed . . . in the manufacture of products."51

It is unclear why the IRS is setting the general rule that the participant must be able to manufacture to participate in a BFCSA. Aside from manufacture, it seems that a participant might benefit from new products in many other ways. As the ABA comment indicates, the manufacturing requirement will eliminate cost sharing for engineering and other service businesses.52

A threshold consideration before entering into a BFCSA involves a preliminary decision regarding where the product will be manufactured and an evaluation of the risk that the parties will

50. Id.
eventually decide NOT to manufacture or sell out of the participant’s facility. Presumably, as long as the participating corporation has the plans and the capability of manufacture on completion of the intangible, the BFCSA will still be valid. However, corporate plans to manufacture at a designated site several years into the future may be relatively unstable. From a tax planning standpoint, cost sharing with a manufacturing subsidiary in a low tax or tax haven country may provide a deduction to the foreign manufacturer without tax benefit (i.e., no tax is paid on manufacturing income). A subsequent transfer from the BFCSA to the “new” manufacturing site will require an arm’s length payment at fair market value and there will be taxable royalties (generally taxable even in a tax haven country) on the transfer.

**Includible Costs**

BFCSA stands for Bona Fide Cost Sharing Arrangement, and bona fide is defined to be “made in good faith.” The final regulations state that the arrangement “must reflect an effort in good faith by the participating members to bear their respective shares of all costs and risks of development on an arm’s length basis.”

Preliminarily, the participants should consider which costs will be shared through inclusion in the R & D pool. The 1966 proposed regulations required that shared costs include “all the direct and indirect costs actually incurred by the parties to the agreement;” an amount allocable for services rendered by a non-participant member of the controlled group; and an arm’s length consideration for the use of other intangible property made available to the BFCSA. Each of these three items will be addressed separately below.

**Direct & Indirect Costs**

Direct costs would include expenses for salaries, research

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53. **WEBSTER’S NEW COLLEGIATE DICTIONARY** 125 (5th ed. 1977).
56. Id. § 1.482-2(d)(4)(iii)(a)(2).
57. Id. § 1.482-2(d)(4)(iii)(a)(3).
58. Presumably, this could mean all salaries paid the employees working directly on the R & D for whatever purpose. It is unclear whether additional wages based on the “stock spread” (FMV of the non-qualified stock options at the date of exercise less the option price) should be included in the allowable costs. The parties may wish to specifically exclude the income spread within the agreement. Arguments for exclusion: 1) The stock option exercise spread in NOT an expense for Generally Accepted Accounting Principles (GAAP), rather it is treated as an equity offset; 2) Costs contingent on widely fluctuating stock prices would not
materials, supplies, and rent on the facilities. Direct costs should also include an allowance for depreciation limited to the amount allowed for U.S. purposes.\textsuperscript{59} Indirect costs would generally include general and administrative overhead and a charge for support staff. The White Paper specifically requires indirect costs to include an allocation for "corporate management expense and overall interest expense."\textsuperscript{60} The ABA comment suggests that this allocation requirement is "far more broad that the 1966 proposed regulations requirement"\textsuperscript{61} and finds it "inappropriate to include overall interest expense"\textsuperscript{62} in the R & D pool.

Services of a Non-Participant

Under the proposed regulations, costs shared by the group should include an amount for services rendered by a non-participant member of the controlled group. This was not discussed in the White Paper or in the ABA comments. Presumably, it would be considered to be a direct cost attributed to the BFCSA in an amount based on arms-length consideration.

Buy-Ins

The final cost item discussed in the proposed regulations has come to be known as the buy-in, and is a significant issue surrounding cost sharing after the 1986 Tax Reform Act. Buy-ins are a specific category of Congressional concern discussed in the cost sharing provisions of the \textsection 482 White Paper. Since BFCSAs are designed to allow for participation in the development stage, any product that is already partially or fully developed when the agreement is entered into cannot be covered by the cost sharing agreement. Frequently, however, an existing product is the necessary impetus for a technological advancement, the necessary first step. If the existing product cannot be cost shared, it must be sold or licensed to the group at an arm's length consideration. The Committee Report states:

To the extent...that one party is actually contributing funds to-

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\textsuperscript{59} White Paper, supra note 25, at 120.
\textsuperscript{60} Id.
\textsuperscript{61} J. Fuller & R. Shea, supra note 46, at 16.
\textsuperscript{62} Id.
ward research and development at a significantly earlier point in time... or is otherwise effectively putting its funds at risk to a greater extent than the other, it would be expected that an appropriate return would be required to such party to reflect its investment. (emphasis added).63

This is the buy-in situation. Under the 1966 proposed regulations, it was stated in simpler terminology requiring sharing of costs which included:

...an amount equal to the arm's length value of the use of any intangible property of a party to the agreement which is made available by it for use in connection with the activities undertaken pursuant to the arrangement and which is likely to contribute to a substantial extent in the production of intangible property.64

A simple example may make the buy-in issue easier to follow. If Corporation A had made a technological breakthrough on E-wid-gets, and had now decided to enter into a BFCSA with its affiliate Corporation F (a wholly-owned foreign corporation) to make super-E-wid-gets, the only costs which could be shared would be those incurred after the commencement of the BFCSA. Corporation A would sell or license the E-widget design to the BFCSA at its fair market value, the BFCSA would “buy-in” to the E-widget technology.

The § 482 White Paper goes beyond the discussion in the proposed regulations and specifically defines three situations requiring a buy-in:

A participant may own preexisting intangibles at various stages of development that will become subject to the arrangement. A company may also conduct basic research not associated with any product. Finally, there may be a going concern value associated with a participant's research facilities and capabilities that will be utilized. (emphasis added).65

The E-widget design discussed above is an example of the pre-existing intangible situation in the first sentence. If the cost sharing arrangement were moved back in time prior to the E-Widget breakthrough, the terminology above could presumably require a buy-in of the original idea for the E-widget design. At this level, it may be difficult to ascertain any fair market value for the idea, but it would be required from a theoretical standpoint.

63. H.R. CONF. REP. No. 841, supra note 23, at II-638.
65. White Paper, supra note 25, at 121.
The White Paper's requirement of a buy-in of the going concern value could open a Pandora's box. It might be a reasonable requirement if the multinational group has a relatively small R & D operation. However, it would essentially prohibit cost sharing for a multinational with a very large R & D facility, because even a small percentage of the "going concern" value would equate to a substantial deduction for the participant, either the U.S. participant or the foreign participant. The ABA comment makes this problem abundantly clear:

There is no way that a foreign country will permit the subsidiary of a U.S. parent company to deduct what is a potentially enormous tax-sheltering charge in such a situation. It is also highly likely that the U.S. subsidiary of a foreign parent company would be the subject of a serious and substantial challenge by its IRS examining agent if it attempted to shelter its U.S. taxable income for a period of years with such a charge. (emphasis added). 66

The final buy-in discussion in the White Paper, basic research not associated with any product, seems to fall neatly under the discussion of going concern with like arguments, and will not be discussed separately.

Character of the Cost Sharing Payment

The White Paper discusses the character of the cost sharing payment. Since cost sharing is considered to be participation in the ownership of the product, the payments are not treated as income to a U.S. developer. 67 The original payment of 100% of the expenses incurred by the developer is considered a "loan" to the extent of the participant's share. The participant's cost sharing payment is the "repayment of the loan," 68 i.e. the participant's share of the expense. This payment will reduce the gross expenses of the developer to reflect only his share of the total costs incurred. Even though only the net R & D expense is allowable as a deduction, and the cost sharing payment is a non-income item to the developer, the cost sharing payment may have other significant tax effects.

Where U.S. taxpayers are required to withhold tax at the source of the payment, the White Paper indicates "no U.S. withholding tax would be imposed on outbound cost sharing payments

67. Since these payments are not income to the U.S. developer, they are obviously not considered foreign source income. White Paper, supra note 22, at 124.
68. White Paper, supra note 25, at 123.
made by a U.S. person to a foreign person."

Where the taxpayer's foreign source income is important in determining applicable foreign tax credits, only the net R & D expense will be allocated between foreign source and U.S. source income. This will generally result in a higher foreign tax credit to the U.S. taxpayer.

The White Paper indicates that the R & D tax credit based on 100% of the R & D costs is properly attributed to the U.S. taxpayer/developer, even if participating in a cost sharing arrangement. It indicates that "[M]embers of a commonly controlled group of corporations may disregard the intercompany reimbursements for research expenditures." Even though the cost sharing payment reduces the developer's expenses, § 41 allows the R & D credit to the U.S. developer for the full amount of costs incurred in the U.S.

The White Paper contains no discussion of the deductibility of the buy-in. Since the buy-in is the purchase or license of an existing product, an arm's length consideration which is "commensurate with the income attributable to the intangible" would be required. This arm's length payment will conceivably retain the same character as any other purchase or license of an asset.

SHARES IN THE BFCSA

A specific Congressional concern discussed in the § 482 White Paper deals with the contributions each party will make to the BFCSA and their derived benefit. Under the White Paper, the shares in the venture should be based on several factors. The two most important factors include the expected profit from the intangible and the geographic rights to be received on completion of the project. These will be discussed below.

**Expected Profit from the Intangible**

The Committee Report states:

In order for cost-sharing arrangements to produce results consistent with the changes made by the Act to royalty arrangements,

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69. White Paper, supra note 25, at 123.
73. White Paper, supra note 25, at 123.
it is envisioned that the allocation of R & D cost-sharing arrangements generally should be proportionate to profit as determined before deduction for research and development. (emphasis added).\(^7^5\)

Although the Committee Report specifically states that the cost allocation should be proportionate to profit, profits may be difficult to estimate. The 1966 proposed regulations were much more flexible and indicated that "shares of the participating members...[of a BFCSA] must be based upon a standard (such as comparative current sales or profits) which reflects changing conditions."\(^7^6\) The proposed regulations also provided examples of the shares computation using prior sales and estimated sales.\(^7^7\) The § 482 White Paper requires that the sharing of costs be proportionate to profit, but does not preclude other methods where profits may not be easy to estimate. "[I]n many cases, estimated units of production may be an appropriate measure of benefit assuming that there is a uniform unit of production... If there is no uniform unit of production, then sales value may be an appropriate measure..."\(^7^8\) However, the White Paper makes it clear that neither units of production, nor sales value is appropriate if it is "apparent...that profitability differed substantially with respect to various participants' rights."\(^7^9\)

It is unclear how participants in a BFCSA will know at the outset whether profitability will differ substantially from estimates. The IRS, however, can easily compare these figures on audit. The ABA comment indicates a concern over this language in the White Paper as it "would offer examining agents the opportunity to disqualify many cost sharing agreements."\(^8^0\)

The White Paper should not prohibit cost sharing arrangements simply because an examining agent is able to show that gross or net profit margins turned out to be different from what was expected and that therefore the cost sharing arrangement, which may have been based on units of production or sales, is no longer a valid cost sharing arrangement. (emphasis added).\(^8^1\)

This should be a very real concern to companies currently participating in, or expecting to participate in a BFCSA. When a cost

\(^7^5\) H.R. CONF. REP. NO. 841, supra note 23, at II-638.
\(^7^7\) Id.
\(^7^8\) Id. at 119.
\(^7^9\) Id. at 120.
\(^8^0\) J. Fuller & R. Shea, supra note 46, at 14.
\(^8^1\) Id.
sharing agreement is disqualified, everything developed to the date of disqualification (i.e., the audit period) must be sold or licensed to the "new" BFCSA at the then current fair market value. This fair market value may be more or less than the R & D costs incurred to date. A product that appears highly successful could have a fair market value significantly higher than the incurred costs. The extent of this difference may make it prohibitive to buy it back into the BFCSA.

Periodic evaluation (perhaps, an annual review) of the BFCSA's methods for splitting up the shares and a review of the underlying numbers should indicate a good faith effort at an appropriate reflection of income. The new regulations should be clear that this is all that is required of the taxpayer to maintain the "bona fides" of the arrangement and to stave off disqualification.

Assignment of Exclusive Geographic Rights

In determining each party's contribution to the costs of the BFCSA, the § 482 White Paper requires the "[a]ssignment of exclusive geographic rights." Within that titled section, the IRS states "[w]hile it is difficult under the best of circumstances to predict what benefits each of the participants will derive, it is virtually impossible to do so unless the participants are assigned specific exclusive geographic rights to intangibles developed under the arrangement."82 Unlimited exploitation rights (undivided rights) to each member could cause numerous problems on a disposition of the asset in that it may be difficult to determine the benefits derived on the sale by the participating member. Exclusive geographic rights would certainly make for a simpler audit. The ABA comment suggests that this requirement may be contrary to current business practice and will unnecessarily restrict business flexibility.83

Assignment of U.S. Geographic Rights

As to U.S. geographic rights in the intangible produced, the White Paper states that:

U.S. geographic rights should never be permitted to be assigned under a cost sharing arrangement to a foreign person if either:
(1) the participants are part of a U.S. owned multinational group;
(2) a significant portion of the research is performed in the

82. White Paper, supra note 25, at 117.
United States; or (3) any U.S. person participates in the arrangement.\textsuperscript{84}

The White Paper goes on to describe the only kind of foreign person who could hold U.S. rights would be "a foreign-owned multinational group that conducts the research overseas and does not include any U.S. affiliates as a participant in the arrangement."\textsuperscript{85}

The White Paper says that this prohibition is consistent with long-standing § 367(a) policy.\textsuperscript{86} The ABA comment indicates the belief that this is incorrect, and it goes on to state:

The issue under § 367(a) involves separating the research deduction from the income producing intangible developed by that research effort. Cost sharing is completely different. The cost and risk of developing an intangible under a cost sharing arrangement are borne in direct proportion to the expected benefit.\textsuperscript{87}

The ABA comment also gives examples which make the White Paper prohibition on assignment of U.S. geographic rights to a foreign person somewhat illogical.

The fact that significant research is performed at a U.S. university pursuant to funding provided by a foreign parent company...should not subject the foreign parent company to a requirement that U.S. geographic rights must be owned by its U.S. subsidiary, or that it must incorporate a U.S. subsidiary to own those rights. Further, the fact that "any U.S. person" participates in the arrangement, such as a U.S. citizen in a foreign country, should not serve as a prohibition against having the foreign parent company own the developments of the research which it has funded.\textsuperscript{88}

There are obviously some significant glitches in the White Paper if a literal reading of its terms produce examples so unfair to a foreign parent company with U.S. subsidiaries.

\textit{No Safe Harbors}

The previous discussion on apportionment of the BFCSA shares based on estimated profits and geographical rights may leave the taxpayer uncertain as to the practicality of cost sharing in their particular situation. In fact, tax practitioners have indicated that it is unrealistic to expect taxpayers to estimate gross or net profit mar-
gins from estimated sales.\textsuperscript{89} Allowing the taxpayer a safe harbor would provide limited certainty for the future. The White Paper bluntly rejects safe harbors and states that “[o]ne of the most consistent criticisms of the section 482 regulations is that they do not provide taxpayers with enough certainty to establish intercompany prices that will satisfy the Service without overpaying taxes.”\textsuperscript{90} The White Paper then goes through a lengthy explanation of their objections to safe harbor provisions and concludes that “[h]istorical experience with safe harbors indicates that they generally result in unwarranted windfalls for taxpayers without significant benefits for the government.”\textsuperscript{91}

\textit{Periodic Adjustments}

In order to reflect income which is “commensurate with the income attributable to the intangible,”\textsuperscript{92} the parties must have some mechanism to periodically review the actual income generated by the intangible. The House report details the necessary adjustments:

[T]he committee intends to require that the payments made for the intangible be adjusted over time to reflect changes in the income attributable to the intangible. The bill is not intended to require annual adjustments when there are only minor variations in revenues. However, it will not be sufficient to consider only the evidence of value at the time of the transfer. Adjustments will be required when there are \textit{major variations in the annual amounts of revenue} attributable to the intangible. (emphasis added).\textsuperscript{93}

On first glance, this seems like a reasonable approach. But, in order to assess whether an adjustment is required, the company must make an annual review of the profitability of the intangible. The White Paper discusses periodic adjustments in the context of transfer prices, but since the “commensurate with income” standard apples to BFCSAs, the discussion should also apply to cost sharing:

\textit{[T]axpayers should review} transfer pricing arrangements relating to intangibles (especially high profit intangibles) \textit{as often as necessary to assure that their transfer prices are consistent with substantial changes in intangible income} that may have occurred since

\textsuperscript{90} White Paper, supra note 25, at 73.
\textsuperscript{91} Id. at 78.
\textsuperscript{92} I.R.C. § 482 (1986). For the complete text of § 482, see supra note 11.
the inception of the...arrangements. For industries that undergo rapid technological change...this standard may dictate annual review. (emphasis added). 94

Both the House Report and the White Paper seem to indicate that adjustments may be necessary annually, but certainly not more frequently. Thus, an annual review may assure that corporation that there are no substantial changes in intangible income from the amounts originally estimated, or as previously revised.

AGREEMENT TERMS AND CONDITIONS

It is crucial that the cost sharing agreement be in writing95 and complete as to conditions, terms, and general provisions. A poorly written cost sharing agreement may be the instrument by which the court finds the entire arrangement a sham and ignores its existence.96 A well-written agreement which is not followed by the corporation could also negate the BFCSA. This would allow the IRS to invalidate the BFCSA and require a buy-in of the existing technology at then current fair market value.

Although a BFCSA may be an arrangement between related parties, the transaction should be set up to “look” arm’s length. In setting up the agreement, the parties may wish to document significant factors which would alter the terms of an arm’s length dealing.

The agreement, among other things, should include a statement of the parties’ good faith effort to bear their respective shares of all the costs and risks of development on an arm’s length basis.97 It should include each member’s understanding of the risk that no intangible property may be produced98 or that any intangible property produced will be of insufficient value to recover cost.

The agreement should specifically describe, inter alia, the parties’ intent to enter into a cost sharing arrangement, the R & D project(s) undertaken, the nature and extent of the interest of each participating member (e.g., exclusive rights to a particular geographic territory), the method for determining each participant’s cost allocation (i.e., the percentage of costs to be allocated to that party) and the risks and benefits to be shared in the event that cir-

95. The BFCSA must be in writing pursuant to Treas. Reg. § 1.482-2(d)(4) (1968).
96. A cost sharing arrangement which is determined to be a sham (i.e., NOT bona fide) could be invalidated on audit. This may require the parties to buy-in to the existing developments.
cumstances change. Rights granted under the agreement should be perpetual except for specific unanticipated events like bankruptcy, expropriation, or departure from the controlled group.

Further, to establish the arm's length nature of the arrangement and the good faith of the participating parties, the agreement may provide for the creation of a review committee comprised of one or more representatives of each participating member of the BFCSA. The committee's duties should be clearly prescribed in the agreement and should include provisions for an annual review. At a minimum, the periodic review should encompass a review of the costs included in the R & D pool, the computation of costs allocated to each member, the progress of the R & D venture, and the plans for completion. It should also compute adjustments for major variations in the profitability of the intangible.

**Duration of the Arrangement**

The written agreement should contain a provision regarding the duration of the arrangement. In some instances, the parties may wish to maintain the BFCSA indefinitely to cover the costs of technological improvements.

**Grandfathering Provisions**

The § 482 White Paper suggests that some sort of grandfathering provision would be appropriate:

One possibility would be to permit any cost sharing agreement that conforms to the existing regulations, and that has been in existence for more than 5 years prior to 1987, to be recognized fully if conformed within a certain period after the promulgation of the new rules. . . . If the cost sharing agreement has been in effect for less than 5 years and the agreement does not conform substantially to the new rules, the old agreement would not be recognized.

What is the possible motive for placing the five-year requirement on the grandfathering provisions? If the agreement conforms

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100. Comments by the Committee on Foreign Activities of U.S. Taxpayers of the Tax Section of the American Bar Association, Section IV [hereinafter “Comments”].


to the existing regulations and is fully conformed to any new rules within a certain period, then it should be allowed. Obviously, the five-year requirement would serve to invalidate numerous cost sharing arrangements, and require the buy-in of the existing technology. This buy-in could have a drastic tax effect on the U.S. developer. The ABA comment, also, urges deletion of the five-year requirement.\textsuperscript{103}

\textit{Administrative Requirements}

The § 482 White Paper suggests that taxpayers participating in a BFCSA be required to make a formal election, document the specifics of the agreement, and file a copy of the agreement with the first tax return filed subsequent to the effective date of the agreement.\textsuperscript{104} The IRS would also require the taxpayer to agree to produce "in English and in the United States, the records of foreign participants necessary to verify the computation and appropriateness of the respective cost shares within sixty days of a request by the Service."\textsuperscript{105}

\textbf{BFCSA ILLUSTRATIONS}

The following will illustrate the mechanics of several BFCSAs. Since the future of the regulations is still mere speculation, these illustrations may or may not meet the necessary requirements for a BFCSA in regulations as adopted.\textsuperscript{106}

The illustrations will involve a U.S. developer performing the R & D in the U.S. and its foreign wholly-owned subsidiary participating in the R & D through a BFCSA.\textsuperscript{107} Each participant plans to manufacture a product using the intangible, and subsequently sell such product. Each participant will become the owner of exclusive rights to market in a specified geographic territory.\textsuperscript{108}

In order to have a successful BFCSA, the arrangement must be

\begin{footnotesize}
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\item\footnotesize{103. J. Fuller & R. Shea, \textit{supra} note 46, at 22. For tax purposes, a change in accounting method requires the prior approval of the Commissioner of Internal Revenue. The ABA comment recommends that the regulations indicate that a conforming modification to an existing BFCSA does not constitute a change in method of accounting.}
\item\footnotesize{104. \textit{White Paper}, \textit{supra} note 25, at 125.}
\item\footnotesize{105. \textit{Id.} at 105-106.}
\item\footnotesize{106. The \textit{White Paper} is merely a study and discussion of the possibilities for future regulations.}
\item\footnotesize{107. As discussed above, the super-royalty provisions apply equally to inbound technology and outbound technology. If the R & D is being carried on in the foreign country and the U.S. participant is making the payments, the concerns will generally be reversed.}
\item\footnotesize{108. Cost contributions must be commensurate with the benefits to be received from the BFCSA. Thus the benefits must be measurable rights. Unlimited exploitation rights (undi-}
\end{enumerate}
\end{footnotesize}
workable from a corporate standpoint. The corporation must be able to provide books and records which contain the required information. This will include records like the general ledger, management reports, and cost center breakdown with the R & D group accounted for separately. The corporation must also have the ability to break down the R & D further into specific projects.

THEORETICAL BFCSA POSSIBILITIES

There may be several mechanical methods that would conceivably meet the requirements of a BFCSA. The following discussion will provide some basic illustrations on how to estimate each party's share of the costs and rights to the developed product. The first three examples allocate profits based on a prediction of the future. Each one uses a different measuring stick, i.e. profits, units of production or gross sales. The fourth example provides an estimate of future profits, units of production or gross sales based on past experience for a three-year moving average. The fifth and sixth examples illustrate non-traditional BFCSAs and the final example illustrates the buy-in situation discussed previously.

Future Actual Profits

A cost sharing method based on future actual profits will utilize an ever-changing prediction of future profits attributable to the intangible. The estimated future profits by location are used to determine the applicable percentage of costs to be borne by each participant. This allocation percentage is used to allocate the R & D pool between the parties.

Mechanically, start with an estimate of profits from the intangible, split between the U.S. parent and the foreign subsidiary. Divide foreign profits by worldwide profits. The resulting percentage is multiplied by the R & D pool (all includible costs) for Year One and the result is the cost sharing payment of the foreign participant in Year One. An example of the computation may provide clearer understanding:

vided rights) to each member could cause numerous problems on a disposition, or sale of the asset. It could also be a vehicle for avoiding recognition of the profits in the U.S. developer.
In Year Two, the profit percentage is re-computed based on more accurate figures (hopefully) and the resulting percentage is multiplied by the R & D pool for Year Two. Year Two's cost sharing payment PLUS the adjustment for Year One (using the more accurate percentage) will be the total cost sharing payment of the foreign participant.\textsuperscript{109} This will alter the allocation percentage both prospectively and retrospectively for the number of years covered in the agreement.

This method falls neatly within the "commensurate with income" language of the Committee reports.\textsuperscript{110} It utilizes the best information available at the time the agreement is negotiated, and is adjusted annually to reflect actual profit experience. This alternative is obviously more work for the corporation than a one-time arm's length approach as it requires yearly evaluation and, possibly, adjustment. However, it seems far from impracticable. If the company gathered good estimates up front, then they should be able to gather the information based on actuals.

Determining the profits attributable to the intangible, however, may not be that clear-cut. The actual profits may vary due to manufacturing efficiencies, marketing tactics, translation rates, local competition, etc., rather than as a direct result of the intangible. Breaking out only those profits directly related to the intangible...
may be very difficult, and could be the source of much litigation over the bona fides of the BFCSA.\textsuperscript{111}

From the taxpayer standpoint, a moving estimate seems to take the pressure off a single year’s estimate. The information is analyzed and appropriate entries and payments are made taking a “best shot” approach. If the cost allocation is high, it can be adjusted down in the following year, if low it can be adjusted up in the following year. It appears neutral from an IRS standpoint as they still have the capacity to make future audit adjustments if they disagree with the allocation method and have lost nothing in the outcome, and it puts the burden on the taxpayer to perform an annual evaluation.

\textit{Units of Production}

Another alternative is to base the cost sharing payment on estimated units of production to be allocated to the parties. This method may provide a clearer reflection of income attributable to the intangible. “Presumably, the value of technology is best measured by the proportionate usage of such technology and not by the relative profitability of each party which would be influenced by other factors. . .”\textsuperscript{112}

Mechanically, start with an estimate of total units of production split between the foreign subsidiary and the U.S. parent. Divide foreign units by worldwide units. The resulting percentage is multiplied by the R & D pool for Year One, the result is the cost sharing payment of the foreign participant in Year One. In Year Two, the profit percentage is re-computed. This continues as discussed above under \textit{Future Actual Profits} to retroactively alter the percentage over the number of years provided in the BFCSA.

Although the conferees “[e]nvisioned that the allocation of R & D cost sharing arrangements generally should be proportionate to profit as determined before deduction for research and development,”\textsuperscript{113} the wording appears suggestive rather than proscriptive. It would appear that an allocation \textit{not} proportionate to profits would be allowed as long as they are “consistent with the changes made by the Act to royalty arrangements.”\textsuperscript{114}

As discussed above, this approach also requires yearly evalua-

\begin{footnotesize}
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\item \textsuperscript{111.} Regarding the effect of disqualification based on the bona fides of the plan, see \textit{supra} text accompanying notes 63-66 regarding \textit{Buy-ins}.
\item \textsuperscript{112.} Comments, \textit{supra} note 98.
\item \textsuperscript{113.} H.R. CONF. REP. No. 841, \textit{supra} note 23, at II-638.
\item \textsuperscript{114.} \textit{Id}.\
\end{itemize}
\end{footnotesize}
tion and, possibly, adjustment. It requires up-front source information for production estimates and an R & D cost summary.

This alternative measures usage of the technology in the manufacturing process which reflects real use of the intangible, and ignores profits which may be influenced by factors such as translation rates, or manufacturing and marketing efficiencies. The White Paper makes it clear that units of production will be inappropriate if it is “apparent . . .that profitability differed substantially with respect to various participants’ rights.”  

Thus, although units of production may be an excellent gauge of the use of the intangible, unless it can be converted to a profitability number, the IRS may attempt to disqualify the cost sharing arrangement.

**Gross Sales**

The gross sales method was suggested as an example of cost sharing in the 1966 proposed regulations. Mechanically, it is the same as the previous two examples, using a different measuring stick. As with Units of Production, it will be inappropriate to use sales if it is “apparent . . .that profitability differed substantially with respect to various participants’ rights.”

**Moving Average Using Prior Profits, Units or Sales**

Using the three examples discussed above, the taxpayer may have some difficulty determining its first year estimate for a new product. It may be feasible to use prior experience in ventures involving the same participants in like arrangements. As some years may be better than others, or some products better than others, one year may not provide a very good basis for estimation. A three-year or five-year average of profits, units or sales may be more appropriate and could be adjusted annually for that year’s experience.

This moving average could eliminate the gamble based on sales or profit projections for a particular year’s cost sharing computation. However, these estimates may be no better in actuality than the one-time profit projections discussed above.

**Reciprocal BFCSAs**

Similar to a cross-licensing agreement, the parties may set up mutual BFCSA’s evaluated annually to determine the net costs of

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116. *Id.*
The excess value multiplied by the percentage of ownership should be paid by the party developing the product with the lesser value. The best way to demonstrate the mechanics of this type of BFCSA is by example.

Example 1: Party X has accrued $5 million in R & D cost at the end of Year One on Product A, Party Y has accrued $7 million in cost on Product B. Assuming each party will own a 50% share of each product on completion, party X is required to pay $1 million ($2 million difference in R & D pools, multiplied by X's 50% share) to Party Y.

Example 2: Same as in Example 1 except that Party X will own a 10% share in each technology on completion. Costs accrued to date on both projects equal $12 million. X is responsible for $1.2 million ($12 million multiplied by 10%), but has accrued $5 million of cost. Therefore, Y's cost sharing payment to X in Year One is $3.8 million ($5.0 million less $1.2 million).

Example 3: Same as in Example 2 except that in Year Two, the allocation percentage is changed and it is determined that Party X will own a 15% share in each technology on completion. Costs accrued to date on both projects equal $20 million. X's total share over the two years is $3 million ($20 million multiplied by 15%). X will be responsible for $1.8 million for Year Two ($3 million less $1.2 million-amount paid in year One).

Reciprocal BFCSAs have the same requirements as the previous three illustrations of BFCSAs, except that the information is required for both parties. This may appear to be double the administrative work. Eventually, though, each of these developers would have to account for the transfer of the technology at a conceivably higher price.

**Advance Payment Adjusted by Profits**

Similar to an advance royalty on the sale of a book, the foreign participant makes a lump-sum payment to the developer up front with an annual adjustment for the actual allocation percentage as discussed in the above illustrations. Each party contributes to the economic activity from inception. As opposed to the other pos-

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117. A cross-licensing agreement (or a reciprocal license) may be used where corporations own valuable technology that they want to make available to each other. Essentially it is a swap in that there is no net transfer of technology between the parties, or a net transfer for the difference in value of the technology. This type of license can be useful in developing product enhancements by both members, or in viewing the other part's manufacturing line. See Treas. Reg. § 1.482-2(d)(2) (1968).
sibilities, the foreign participant puts his cash\textsuperscript{118} at risk up front rather than at year-end when the cost-sharing payment is calculated. This method, therefore, equalizes the respective economic risk at the front end. Otherwise, it is identical to other possibilities discussed earlier.

\textit{Buy-in to Base Technology; Cost Share the Enhancements}

For a BFCSA utilizing the existing technology of one of the participants, a buy-in will likely be required.\textsuperscript{119} The buy-in could be either a direct purchase of the intangible for a lump sum amount or a licensing of the existing technology, both of which are subject to the § 482 regulations under the 1986 Tax Reform Act. For a high-technology product that becomes quickly obsolete, it may be appropriate to set a declining royalty payment over the remaining life of the asset. The BFCSA on the enhancements will necessarily include the illustrations previously discussed.

\textbf{GENERAL CONSIDERATIONS}

It is important to assess the future R \& D “product” before entering blindly into a BFCSA. Although it may be difficult to predict up front, the BFCSA will probably work to corporate advantage where the technology is expected to be very sophisticated, highly proprietary, and highly profitable, that is, where the royalties would keep increasing over its useful life.

A licensing arrangement, on the other hand, may be less expensive in the long run under circumstances in which the technology is easily duplicated, much of the value is derived from components purchased from outside vendors, the foreign country has limited protection against piracy, or differences in the manufacturing line or selling strengths of the foreign subsidiary contribute to foreign profits.

\textbf{CONCLUSION}

In the realm of the super-royalty provisions, cost-sharing remains an impressive exception. Taxpayers are looking for relief from the uncertainty behind the new and frightening super-royalty provisions and their possible detrimental future effects. BFCSAs

\textsuperscript{118} There appears to be no requirement that an actual cash transfer take place. The parties will probably reflect the payments by appropriate intercompany accounting entries.

\textsuperscript{119} See supra text accompanying notes 64-67 regarding Buy-ins.
are here to stay, but may be significantly curtailed by future § 482 regulations.

It is imperative that the corporate developer assess its intended product, its manufacturing and marketing plans, and the product's estimated profitability before deciding on the form of "transfer." Management should be informed of the various tax alternatives for the intended transfer or co-ownership of technology and the consequences of each.

It is only in this enlightened state that corporate management can make the decision on whether to set up a BFCSA or some alternative method of transfer with some certainty as to future tax effect.