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The IRS's Cost-Sharing Proposals in the Worldwide Tax System: Why Congress Should Avoid Anti-Competitive Transfer Pricing Regulations and Embrace a Territorial Tax

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NOTE

THE IRS'S COST-SHARING PROPOSALS IN THE WORLDWIDE TAX SYSTEM: WHY CONGRESS SHOULD AVOID ANTI-COMPETITIVE TRANSFER PRICING REGULATIONS AND EMBRACE A TERRITORIAL TAX

James D. Mandolfo[*]

I. INTRODUCTION

The Internal Revenue Service's failure to adequately regulate cost-sharing arrangements highlights the need for the U.S. to adopt a territorial tax system.[1] Under the current worldwide tax system, cost-sharing arrangements and transfer pricing techniques effectively allow U.S. corporations to move profits overseas.[2] Attempting to confront

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1. *See* Chris Atkins & Scott Hodge*, The U.S. Corporate Income Tax System: Once a World Leader, Now A Millstone Around the Neck of American Business*, TAX FOUNDATION (SPECIAL REPORT), Nov. 2005, at 2-3. The U.S. has one of the highest effective tax rates for corporate taxpayers compared to other OECD countries. *Id.* Therefore, many corporations store profits abroad to avoid paying U.S. taxes (sometimes twice). *Id.* The cost-sharing proposals, discussed *infra*, were attempts to curtail deferral behavior. *Id.* The IRS, however, and Congress must resolve the cause for deferral, not the result of such strategies.

2. For international tax purposes, transfer pricing is the "division of intragroup profits or losses when members of a multinational group are jointly responsible for those profits or losses." Michelle Markham, *Tax In A Changing World: The Transfer Pricing of Intangible Assets*, 40 TAX NOTES INT'L 895, 896 (2005); *see* Martin Sullivan, *International Tax Planning: A Guide for Journalist*, 105 TAX NOTES 32, 32-33 (2004). Transfer pricing is a means to take profits from a high tax jurisdiction to a low tax

such strategic behavior, the Internal Revenue Service ("IRS") proposed rules in 2005 that would impose overzealous regulations on participants to a cost-sharing arrangement.[3] The 2005 proposals did not account for the international competition facing U.S. corporations in a global market. This Note proposes that Congress resolve the IRS's concerns pertaining to cost-sharing and other transfer pricing techniques by adopting a territorial tax system, thereby eliminating policies that encourage profit deferment.

The government's response to these arrangements is too draconian. The IRS purports that corporations strategically evade tax obligations by unevenly pricing the value of cost-sharing arrangements.[4] Specifically, the IRS is concerned that many companies sell intangible property to their foreign subsidiaries at below fair market value.[5] This allows U.S.

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jurisdiction in order to reap the tax deferral benefits. *See* Sullivan, 105 TAX NOTES at 32. For example, suppose a U.S. company with a foreign subsidiary sells a manufacturing part to its subsidiary. The subsidiary is a well-run company and is able to sell the part, which costs $2 to manufacture, at a reasonable percentage over cost at $3 per part (net gain of $1 per part). The U.S. corporation argues that the subsidiary's manufacturing parts should sell for more because of its innovative techniques, at no contribution of the parent company. As such, the subsidiary claims its product should sell for $5 per part, transferring more profit to the foreign subsidiary. The foreign subsidiary profits from an increased $3 per part compared to the $1 per part and is subject only to a low jurisdictional tax. Thus, there is a significant cost savings strategy when a company begins to produce millions of parts subject to minimal tax. *Id.* at 33; *see generally* Bob Ackerman et al., *Global Transfer Pricing Update*, 40 TAX NOTES INT'L 1139 (2005) (outlining the state of current and proposed transfer pricing rules and regulations in fourteen countries).

3. Prop. Treas. Reg. § 1.482-7, 70 Fed. Reg. 51, 116 (Aug. 29, 2005) (providing notice of proposed revisions to the existing Treas. Reg. § 1.482-7 (as amended in 2003) "regarding methods . . . to determine taxable income in connection with a cost-sharing arrangement."). *Id.* at 51, 116; *see Section 482 White Paper; Service Develops New Method For Finding Comparable Price For Intangibles*, 1988 TAX NOTES TODAY 213-74 (1988) (quoting the conference report on the Tax Reform Act of 1986 that a cost-sharing arrangement is "an agreement between two or more persons to share the costs and risks of research and development as they are incurred in exchange for a specified interest in any intangible property that is developed."); H.R. REP. NO. 99-841 at II-637-38 (1986) (Conf. Rep.), *as reprinted in* 1986 U.S.C.C.A.N. 4075, 4725-26; *IRS Issues Proposed Cost-Sharing Regs, Sets Hearing Date*, 2005 TAX NOTES TODAY 162-1 (2005) (summarizing the proposed alterations to § 1.482-7).

4. *See* Herman P. Ayayo & Lee Sheppard, *IRS Reassures Practitioners on Cost-Sharing Regs.*, 41 TAX NOTES INT'L 537 (Feb. 13, 2006).

5. *See* Keith Reams et al., *Proposed U.S. Cost Sharing Regulations: Are They A Realistic Alternative?*, 40 TAX NOTES INT'L 269, 270 (Oct. 17, 2005).

corporations to store profits abroad[6] and—according to the IRS—avoid paying U.S. taxes under its worldwide tax system.[7] The IRS attributes $2.6 to $2.8 billion average annual losses to cost-sharing arrangements.[8] Microsoft, for example, saves $500 million annually through tax strategies, which caused former Treasury Secretary John Snow to describe the current regulations as "ineffectual."[9] Facing the challenges of remaining competitive in a global market, corporate America predictably criticizes the government's response as too severe.[10]

The central policy tension confronting Congress is caused by the need to facilitate U.S. business health abroad and ensure revenue at home. The IRS voices legitimate concerns. For domestic companies to compete abroad, the U.S.'s international tax policy must confront the realities of competing against foreign corporations subject to fewer taxes under a territorial tax system. The problem of accurately taxing cost-sharing arrangements should encourage Congress to adopt a territorial tax system, rather than claustrophobic regulations.

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6. *Id.*

7. *Id.*

8. Charles H. Gustafson et al., TAXATION OF INT'L TRANSACTIONS, ¶ 8000, at 626 (2d ed. 2001) (citing I.R.S. Pub. No. 3218 (Apr. 21, 1999)), *available at* http://www.irs.gov/pub/irs-pdf/p3218.pdf. The U.S. lost tax revenue estimated at $35.6 billion in 1998 due to transfer pricing. *Id.* Analysts estimate that revenue loss due to transfer pricing has continued to grow annually. *See* Rosanne Altshuler & Harry Grubert, *Governments and Multinational Corporations in The Race To The Bottom*, 41 TAX NOTES INT'L 459, 460-61 (Feb. 6, 2006).

9. *See* Jonathan Rickman, *Current Cost-Sharing Rules Don't Stop Evasion, Treasury Snow Says*, 41 TAX NOTES INT'L 540 (Feb. 13, 2006).

10. *See* American Bar Association Section of Taxation Task Force on International Tax Reform, *U.S. International Tax Reform: Objectives and* Overview, 43 TAX NOTES INT'L 317 (July 24, 2006) (stating that "[i]n designing international tax rules, policymakers must take account of the effects of business pressures in lowering tax costs on U.S. and foreign business activity, as well as broader competitive pressures arising from global markets."). The regulations ignore the fundamental problem of deferral and the reasons for such activity. *See* Rickman, *supra* note 9, at 540 (explaining that transfer pricing strategies allow corporations to defer profits abroad despite any regulations). The IRS's mere response to deferral will not solve the cause for cost-sharing activities. *See* Cornelius C. Shields, *Proposed Regulations for U.S. Cost-Sharing Arrangements Not Enforceable*, 40 TAX NOTES INT'L 33, 34 (Oct. 3, 2005) (stating that "[t]he core of the problem is that the proposed regulations set up a game and encourage taxpayers to try for the benefits of the periodic return ratio range.").

Part II of this Note explains the financial incentives for corporations to defer profits in low tax jurisdictions under the worldwide tax system. Part III analyzes the current transfer pricing regulations and the IRS's proposals to tame cost-sharing arrangements.[11] Finally, Part IV argues that the U.S. should implement a territorial tax system and eliminate tax policies that encourage deferral. Congress should learn from the IRS's recent mistakes and instead focus on the impetus for the use of cost-sharing arrangements under the current worldwide tax system.[12] Such action will resolve the IRS's concerns regarding cost-sharing arrangements while simultaneously promoting U.S. competition and domestic investment.

II. THE WORLDWIDE TAX SYSTEM PROMOTES DEFERRAL OF PROFITS

A. U.S. Profits Rise Overseas, but Not at Home

As evidenced by the surge in U.S. profits overseas in the last five years, the U.S.'s worldwide tax system encourages companies to defer profits abroad in order to avoid paying taxes at home. U.S. companies accomplish deferral by incorporating companies in low tax jurisdictions and then holding profits in these foreign subsidiaries.[13] This explains

11. *Id.*

12. *See* Audrey Nutt, *ABA Tax Section Meeting: Tax Officials Comment on Transfer Pricing Regs.*, 113 TAX NOTES 433 (2006) (discussing IRS official comments that admitted many of its approaches in the cost-sharing proposals will be changed, including the "arm's-length ranges," which will "be introduced into the cost-sharing regulations' buy-in valuations.").

13. *See* Martin Sullivan, *Economic Analysis: Data Show Dramatic Shift of Profits to Tax Havens*, 104 TAX NOTES 1190, 1191-94 (2004); John Almond & Martin Sullivan, *Economic Analysis: While Congress Dawdles, Trapped Foreign Profits Surge*, 103 TAX NOTES 1587, 1587-90 (2004). In 2003, it was estimated that 237 of the 500 leading companies held $400 billion to $510 billion of unrepatriated foreign earnings abroad. Almond & Sullivan, 103 TAX NOTES at 1587. The companies with the largest pool of profits were Pfizer, ExxonMobil, General Electric, IBM, and Merck with $38 billion, $21 billion, $18 billion, and $18 billion respectively. *Id.* at 1588. Pursuant to the current law, if these profits were distributed as dividends to the U.S. parent, the corporations would pay a 35% tax rate (minus any foreign tax credits). *Id.* at 1587. Incorporating this strategy into tax planning, companies such as Pfizer have grown their accumulated profits from $3.9 billion in 1996 to $38 billion in 2003. *Id.* at 1591. This is a clear indication that deferral maintains an increasing role in U.S. corporations' business strategy and financial planning. *See* Martin A. Sullivan, *Economic Analysis: U.S. Drug Firms Move Profits to Save Billions*, 43 TAX NOTES INT'L 539 (Aug. 14,

the significant increase in U.S. profits in countries that lowered their corporate tax rate.[14] For instance, Ireland's effective tax rate remained constant at a low 8% from 1999 to 2002, which is well below the U.S.'s 35% corporate tax, and consequently, Ireland's pre-tax profits doubled to over $26 billion in 2002.[15] Moreover, when Denmark reduced its tax rate from 23.9% to 7.6%, U.S. profits stored in Denmark subsequently surged 200%.[16] Additionally, Belgium dropped its tax rate from 26.6% to 12.5%, and U.S. profits increased there by 84%.[17] Lastly, when Bermuda lowered its tax rate to 2% in 2002, its U.S. profits tripled compared to three years prior. This placed Bermuda ahead of the United Kingdom in pre-tax profits.[18] Due to this trend, the IRS continues to lose potential tax revenue.

Corporations defer profits overseas to avoid paying U.S. taxes. Transfer pricing is an effective and common method for a U.S. company to hold profits abroad. In short, transfer pricing is the technique by which corporations move gains realized in a high-tax jurisdiction to a foreign subsidiary in a low-tax jurisdiction.[19] For example, Parent Corp. buys widgets from International Subsidiary Ltd., which is incorporated in a low-tax jurisdiction. Parent Corp. buys these widgets for a higher price than the fair market value. Although International Subsidiary Ltd. pays taxes in the jurisdiction where it is incorporated, the IRS cannot tax International Subsidiary Ltd. until the profits are repatriated to the U.S. By using transfer pricing strategies, Parent Corp. successfully shifts profits to International Subsidiary Ltd., which is subject only to the lower foreign tax rate.[20]

The problem of cost-sharing from the IRS's standpoint is that it deprives the U.S. Treasury of revenue. The IRS claims that it is unable to effectively audit many transfer pricing strategies[21] because

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2006).

14. *See* Sullivan, *Economic Analysis: Data Show Dramatic Shift of Profits to Tax Havens*, *supra* note 13, at 1190.

15. *Id*.

16. *Id.* at 1192.

17. *Id*.

18. *Id*.

19. *Id.* at 1190.

20. *See* Myron S. Scholes et al., TAXES AND BUSINESS STRATEGY: A PLANNING APPROACH, 299-302 (3d ed. 2005).

21. *See* Gustafson, *supra* note 8, ¶ 8000, at 626-27.

arrangements like the deal between Parent Corp. and International Subsidiary Ltd. remain a highly unregulated aspect of transfer pricing under the current rules.[22] To the IRS, this connotes a failure. Consequently, the IRS proposed the 2005 regulations as an effort to revamp cost-sharing rules.[23] Congress and the IRS must therefore decide whether taxes generated under the new proposals could hinder U.S. corporate competitiveness.

B. The IRS's Authority to Regulate Transfer Pricing and Cost-Sharing Strategies

With profits rising abroad, the IRS contends that the current transfer pricing regulations fail to adequately police cost-sharing strategies. The Internal Revenue Code ("IRC") gives the IRS its authority to regulate transfer pricing and cost-sharing agreements in § 482.[24] Section 482 grants the IRS authority to transfer income, deductions, and other taxable items between "controlled"[25] taxpayers in order "to prevent

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22. *See id.*, ¶ 8096 (stating that "[t]he OECD cite[s] technological progress as one of the reasons for the rise of the multinational enterprise in the global economy over the past twenty years.").

23. *See Transfer Pricing: First Half of 1997 Adds $92 Million to Allocations Challenged in Courts*, 131 Daily Tax Rep. (BNA) G-4, at d11 (July 9, 1997) (discussing that in 1997 over 127 court cases disputed an estimated $2.7 billion).

24. Martin Przysuski et al., *Management Fees and Other Intra-Group Service Charges: The Pandora's Box of Transfer Pricing*, 34 TAX NOTES INT'L 367, 372 (Apr. 26, 2004). The Internal Revenue Code may be referenced as title 26 of the United States Code ("USC"). I.R.C. § 482 (2006) states that:

> [i]n any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such organizations, trades, or businesses. In the case of any transfer (or license) of intangible property (within the meaning of section 936(h)(3)(b)), the income with respect to such transfer or license shall be commensurate with the income attributable to the intangible.

Id.; *see* Treas. Reg. § 1.482-1(a)(1) (as amended in 2003) (stating that "[t]he purpose of Section 482 is to ensure that taxpayers clearly reflect income attributable to controlled transactions, and to prevent the avoidance of taxes with respect to such transactions").

25. *See* Treas. Reg. § 1.482-1(i)(5). It provides that a:

> [c]ontrolled taxpayer means any one of two or more taxpayers owned or controlled directly or indirectly by the same interests, and includes the taxpayer that owns or controls the other taxpayers. Uncontrolled taxpayer means any one of two or more

evasion of taxes" or "clearly to reflect income."[26] The Code of Federal Regulation ("CFR") stipulates that the purpose of § 482 is to place "a controlled taxpayer on a tax parity with an uncontrolled taxpayer by determining the true taxable income of the controlled taxpayer."[27] The IRS applies the fair market value test, more commonly termed the "arm's length method" to determine if the transfer pricing transaction satisfies the requirements of § 482.[28] The CFR, in describing "arm's length," provides that:

> A controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm's length result). However, because identical transactions can rarely be located, whether a transaction produces an arm's length result generally will be determined by reference to the *results of comparable transactions under comparable circumstances*.[29]

The IRS and U.S. corporations clash on how to value an "arm's length" transaction. Application of the "arm's length" standard to intangible property, such as intellectual property, presents particular challenges because parties must find similar transactions with identical properties under "comparable circumstances."[30] "Comparable circumstances" rarely exist[31] where corporations earn profits from research and development, licensing, patents, or other common forms of intellectual property.[32] Moreover, when "referenc[ing] comparable

taxpayers not owned or controlled directly or indirectly by the same interests.
Id.

26. I.R.C. § 482.

27. Treas. Reg. § 482(a)(1); *see* Treas. Reg. § 1.482-1(i)(1) (stating that § 482 applies even if the actor is not a taxpayer, incorporated, domestic or foreign, or a "member of an affiliated group.").

28. Treas. Reg. § 1.482-1(b)(1).

29. *Id.* (Emphasis added).

30. David Rosenbloom et al., *The U.S. Approach To Transfer Pricing: Benchmarks And Hallmarks*, 41 TAX NOTES INT'L 343, 343-45 (2005).

31. Identical intellectual property rarely exists because few research and development programs, patents, software or the like comprise the same qualities and can easily allow companies to project future profits. *See* Michelle Markham, *Tax In A Changing World: The Transfer Pricing of Intangible Assets*, 40 TAX NOTES INT'L 895, 896 (2005).

32. *See* Paulus Merks, *Categorizing Corporate Cross-Border Tax Planning*

transactions under comparable circumstances," multiple valuing analyses of the intangible property could apply.[33] To meet these regulatory requirements, U.S. parent corporations enter cost-sharing arrangements with their controlled foreign subsidiaries.

The fulcrum of conflict between corporate America and the IRS's concerns with regard to cost-sharing lies at the subsidiary's "buy-in" of the intangible property. Accordingly, the IRS focuses its attention here. U.S. corporations enjoy significant tax benefits when they enter into cost-sharing agreements with an overseas subsidiary. The deals typically involve one participant that contributes the intellectual property and the other party that pays for the use of such property.[34] The party purchasing the intangible property makes a "buy-in" for the value of the current intellectual property at the time of formation of the cost-sharing arrangement.[35] The intangible property is generally valued low at the inception of the cost-sharing arrangement because the intangible property is not yet fully developed. This allows the overseas subsidiary to make minimal "buy-in" payments for intangible property, from which it could eventually reap high profits. Cost-sharing arrangements allow the parties to allocate the costs and risks incurred in developing intangible property according to the company's expected benefit from

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Techniques, 44 TAX NOTES INT'L 55 (2006). The article finds that the:

> [t]ax authorities of industrialized countries are attaching increasing importance to compliance with the arm's length principle. In 1994 only one country had formal transfer pricing documentation and penalty rules (the U.S.). By 2005 that number grew to 32 countries and is expected to grow to over 40 in 2007. Consequently, more and more countries adopt transfer pricing rules and more importantly, learn how to enforce those rules.

Id. (citing Matheson Ormsby Prentice, *Ireland: Minister Commits to Low Taxes*, INT'L TAX REV., Feb. 2006). Allocating a value to intangible property remains a difficult process because there are very few comparable situations against which to measure. *See* Treas. Reg. § 1.482-1(b)(1); Stanley I. Langbein, *U.S. Transfer Pricing and the Outsourcing Problem*, 37 TAX NOTES INT'L 1065, 1068 (2005). The prior standard was to look at whether the transaction would have occurred between two non-related parties. *See* Langbein, 37 TAX NOTES INT'L at 1068-69. The "arm's length method" has, however, increased in popularity among other countries. *See id.* at 1090-92.

33. Gustafson, *supra* note 8, ¶ 12, 130, at 899-901.

34. Ken Wood, *Proposed U.S. Cost-Sharing Regulations—Rules in Search of Authority*, 43 TAX NOTES INT'L 893 (2006); *see* Rickman, *supra* note 9, at 540 ("Grassley cited stories in The Wall Street Journal and The New York Times, which reported that Microsoft Corp. saves as much as $500 million in taxes annually by transferring intangible assets to subsidiaries in low-tax countries.").

35. *How Cost-Sharing Arrangements Work*, Jan. 2006, http://www.rsmmcgladrey.com/RSM-Resources/Publications/Transfer-Pricing/January-2006/cost-sharing/.

the property.[36] Taxation is a cost. The minimization of the cost-sharing "buy-in" price leaves the IRS unable to tax the transaction at its actual value, lowering otherwise potential revenue. Consequently, much of the IRS's proposed cost-sharing regulations attempt to increase the initial "buy-in" payment.

The IRS regulates cost-sharing "buy-in" strategies under the umbrella of § 482.[37] To be a "qualified cost-sharing arrangement,"[38] the parties to the agreement incur costs equal to their shares of reasonably anticipated benefits.[39] Furthermore, a corporation and its subsidiary must value the intangible property so that it is "commensurate with its income."[40] The "arm's length" standard is the measure by which tax courts determine whether the parties satisfied the provisions of § 482.

The IRS argues that § 482 is too weak and acts as a windfall for cost-sharing participants.[41] By allowing corporations to make minimal "buy-in" payments, the IRS purports that corporations can easily overcome the "arm's length" standard.[42] These shortcomings provided the impetus for the IRS's 2005 proposals to amend the tax code. As the U.S. Tax Court decision in *Xilinx, Inc. and Subsidiaries v. Commissioner* will elucidate, the IRS proposed overbearing and more stringent requirements than actually imposed by the "arm's length method."[43] The next section will explain the IRS's proposed cost-sharing regulations and the issues posed by the *Xilinx* decision.

36. *See* Ackerman et al., *supra* note 2, at 1142.

37. Reams et al., *supra* note 5, at 273.

38. For purposes of this Note, a cost-sharing arrangement becomes "qualified" once it meets the requirements of Treas. Reg. § 1.482-7.

39. Gustafson, *supra* note 8, ¶ 8165, at 665.

40. *Id.*

41. *See* Rickman, *supra* note 9, at 540.

42. *Id.*

43. 125 T.C. 37 (2005); *see* Joseph DiSciullo, *NYSBA Comments on Mergers, Transferor Stock Transactions*, 113 TAX NOTES 317 (2006) (discussing the IRS's future changes that would dilute the previously proposed regulations).

III. THE IRS'S GO-GO-GADGET "ARM"[44]

The IRS's 2005 proposals to revamp cost-sharing regulations gained little traction in the tax courts.[45] At the 2002 testimony to the House Ways and Means Committee, Pamela Olson, the former Acting Assistant Secretary for Tax Policy, explained the IRS's concern regarding cost-sharing agreements.[46] She stated that many multinational corporations avoid taxes by strategically maneuvering profits overseas to subsidiaries.[47] Although technically correct, neither she nor the IRS addressed the reason corporations defer profits. In essence, the IRS's proposals treat the symptom rather than the cause of such corporate tax strategies.

Nonetheless, the IRS heeded Ms. Olson's comments and focused its regulatory efforts on ensuring that corporations do not "erode" the tax base.[48] Notwithstanding the fact that the IRS would tax more cost-sharing profits, corporations criticize the proposed guidelines because they diverge from the "arm's length method" set forth in § 482.[49] The 2005 proposals would use more analytical approaches to value cost-sharing arrangements, apply specific methods to price intellectual property that parent companies shift to subsidiaries, and transfer foreign subsidiary profits back to the U.S. if a controlled foreign corporation enjoys excessive returns.[50] Consequently, the IRS intended for these

44. Prop. Treas. Reg. § 1.482-7, 70 Fed. Reg. 51, 116 (Aug. 29, 2005). "Go-Go Gadget" refers to the children's' cartoon show, "Inspector Gadget," about a bumbling, absent-minded detective with arms and legs loaded with mechanical springs. When Inspector Gadget commanded, "Go-Go-Gadget Arms," for example, his arms would expand beyond normal human capabilities and thus hinder his ability to solve mysteries.

45. *See id.* Also, the proposals fail to address the issues that promote transfer pricing techniques, globalization, and the worldwide tax system. *Id.*

46. Reams et al., *supra* note 5, at 270.

47. *Id*. (discussing the IRS's three purposes in drafting new regulations: (1) "buy-ins" (*see infra* regarding buy-ins) are valued too low under the current regulations; (2) unrelated parties do not enter CSA's with the same "form and substance" as related parties; and (3) taxpayers advantage of weighing cost-sharing arrangements made ex ante under an ex post scheme).

48. *Id.* The American Jobs Creation Act of 2004 effectively permitted U.S. corporations to avoid paying taxes. American Jobs Creation Act of 2004, Pub. L. No. 108-357, 118 Stat. 1418 (2004). If the concern remains with "eroding" the tax base, then Congress should address such legislation. *Id.*

49. Reams et al., *supra* note 5, at 270-71.

50. Martin A. Sullivan, *Economics Analysis: Proposed IRS Rules Would Close Cost-Sharing Loophole*, 108 TAX NOTES TODAY 1098, 1099 (Sept. 5, 2005).

policies to deter corporations from forming cost-sharing arrangements.

A. Cost-Sharing Proposals Heighten Regulation and Complexity

In drafting proposals that extend beyond the "arm's length" standard, the IRS made one simple oversight: most corporations would not form such arrangements under the proposed rules. The proposed regulations would change the method by which corporations determine the value of their cost-sharing arrangements.[51] The IRS continues to term a subsidiary's initial purchase of intangible property as the "buy-in."[52] When a parent transfers an intangible property to the subsidiary, the subsidiary would have to pay the parent for (1) the value of the existing technology[53] and (2) its potential monetary development.[54] Accordingly, a party's payment would account for both its worth at the time of the purchase and the future profits from the intellectual property.[55] The IRS terms the combination of these two elements a Preliminary or Contemporaneous Transaction ("PCT").[56] The PCT is not an "arm's length" transaction. Under the proposed regulations, corporations would include future profits at the "buy-in" payment, increasing the price for subsidiaries to enter into cost-sharing arrangements.[57] Although participants may correctly value the price of intellectual property at the inception of a cost-sharing arrangement, it is unrealistic to expect corporations to predict future profits from such products at the outset. Accordingly, this is not the industry norm, and this aspect of the proposed rules restricts corporations beyond the "arm's length" standard.

The IRS's description of PCTs will affect the initial cost for corporations to enter cost-sharing arrangements. The IRS terms the "future development" of intellectual property the "external

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51. *Id.* at 1098.

52. *Id.*

53. Herman P. Ayayo, *Treasury Hicks Reviews Upcoming M&A Guidance*, 44 TAX NOTES INT'L 519 (Nov. 13, 2006). As stated above, this would be the "buy-in." *Id.*; *see also* Sheppard, *infra* note 61 and accompanying text.

54. *See* Sheppard, *supra* note 4.

55. *See* § 1.482-7. This is not required under the current regulations. *Id.*

56. *See* Sullivan, *supra* note 50, at 1099.

57. *See* Reams et al., *supra* note 5, at 270-72.

contribution."[58] The cost-sharing proposals would force corporations to include all external contributions of intellectual property.[59] This language enjoys a broader range of revenue-generating potential than the current rules for cost-sharing agreements because parties would continue to pay for the development of the intellectual property after the cost-sharing arrangement commences.[60] The IRS contends that this will deter minimal "buy-in" payments because parties would be required to continuously pay for the increase in value of the intellectual property.

In effect, the proposed rules are tantamount to the imposition of contract terms between a parent company and its subsidiary. When entering into a cost-sharing arrangement, a foreign subsidiary would pay a parent for the "exclusive, perpetual, and territorial rights" to use the intangible property.[61] Pursuant to the current cost-sharing regulations, corporations may limit their rights to the product, which drives down the "buy-in" price when entering a cost-sharing agreement. The 2005 proposed regulations attempt to deter corporations from forming arrangements that place time and geographic limitations on an intangible product, which justifies a minimal price for a "buy-in." Accordingly, the proposed regulations would increase "buy-in" prices, thereby generating more taxes from "buy-in" payments.[62] Moreover, the proposed regulations would prevent the participants from amending

58. *Id.*

59. *Id.*

60. *See* Reams et al., *supra* note 5, at 272. "An external contribution is broadly defined as a resource or capability developed, maintained, or acquired outside the CSA that is reasonably anticipated to contribute to the development of the cost-shared intangibles." *Id.* This also means that "external contributions would include the potential for value added contributions such as the future research capabilities of an assembled scientific team." *Id.*

61. *See Prop. Reg.* § 1.482-7(b)(3)(iv); *see also* Lee Sheppard, *News Analysis: Is Apportionment The Formula For Intangible Development?*, 39 TAX NOTES INT'L 987, 989 (Sept. 12, 2005). This would be included as part of the PCT during the initial "buy-in" transaction. *Id.*

62. For example, a newly developed drug will maintain large research and development expenses (including the brand value and the research and development) for that drug, which will allow for more pharmaceutical developments in the future. *See* Sheppard, *supra* note 61, at 989. Under the suggested regulations, subsidiary corporations must pay for the existing technology and the further development of the technology from the parent company (this also requires geographical constraints). *Id.* This should include projected pharmaceutical discoveries and sales produced by the research and development activities. *See id.* Accordingly, one buy-in payment for the technology will not suffice for payment of future development. *See id.*

payments for external contributions after agreeing to the qualified arrangement.[63] The only party permitted to alter payments for external contributions would be the IRS commissioner.[64] This policy restricts the freedom of parties to restructure a cost-sharing arrangement after its inception. Many critics argue that this form of financial analysis holds the participants hostage to the transaction and does not acknowledge the realities of complex corporate agreements.[65] Much like a minimum wage, the IRS constructs an artificial bargaining position. Rather than raising prices to benefit workers, it effectively raises prices to benefit the federal purse.

Additionally, the proposals suggest a new method—the "investor model"—to value a PCT.[66] The investor model proposes that both CSA participants make an aggregate investment composed of two parts: (1) what an investor would pay to invest in such an arrangement, and (2) what a parent would require given the external contributions leading to the formation of the arrangement.[67] The investor model therefore requires parties to value the intellectual property based upon the development costs and potential risks of the agreement. After corporations enter an arrangement, the proposed rules permit only one method of dividing profits between cost-sharing participants.[68] To properly value a cost-sharing arrangement under the proposed rules, the IRS would use an ex ante test to determine the amount an investor would pay at the beginning of the transaction for the perpetual rights to use the property.[69] In addition to the difficulty in valuing an initial "buy-in," the "investor model" is likely to cause more confusion and

63. *See id*.

64. *Id*.

65. *See, e.g.,* Reams et al., *supra* note 5, at 271-72. The article explains how the proposed regulations ignore corporate negotiations and amendments made to transactions, which react to the economic markets. *See id.* at 271-73, 280. Both parties bring in more than technology to the deal, such as "hard" assets. *See id*. at 273 n.23. The transaction price should reflect the value brought by each party and this may change over time. *Id.* at 280. Therefore, it is important that the arrangement can be amended at the election of the parties, not the IRS. *Id.* The proposed regulations would lock parties into transactions just to assure revenue growth. *See id.* This type of activity will likely stifle productivity for multinational corporations. *See id.* at 285.

66. Reams, *supra* note 5, at 272.

67. *Id.* at 271-72

68. *Id.*

69. *Id.* at 271.

litigation when parties assess a price for the external contribution ex ante. This is particularly true for risky technology companies that rely upon intellectual property to remain competitive.

Furthermore, the would-be regulations are inconsistent with the existing Treasury Department's standard of review. In addition to setting forth more stringent criteria for parties to satisfy the "arm's length" standard, the proposed "investor model" conflicts with Treasury Regulation § 1.482-1(f)(2)(ii).[70] The current rules state that the IRS will analyze the transaction as structured by the participants.[71] The only requirement by the IRS is that the participants' structure does not lack economic substance grounded in sound business reasons.[72] Conversely, the 2005 proposals value the price pursuant to the "investor model" or the IRS's ex ante analysis.[73] Therefore, parties that price cost-sharing arrangements using sound business principals, but ultimately failed to use the "investor model's" methods, would find no solace in the 2005 proposals. Essentially, the IRS would force corporations to use the "investor model" despite its rare application in industry practice.

B. The Tax Court Keeps the IRS at "Arm's Length"

In *Xilinx, Inc. and Subsidiaries v. Commissioner of Internal Revenue,*[74] the court addressed how stock-based compensation should be valued in the context of a cost-sharing arrangement. On April 2, 1995, Xilinx Inc., a software development company, entered into a cost-sharing agreement with its Irish subsidiary.[75] Xilinx's parent company employed more research and development employees than its Irish subsidiary during the cost-sharing agreement.[76] The employee benefits

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70. *See* Cornelius C. Shields, *Proposed Regulations for U.S. Cost-Sharing Arrangements Not Enforceable*, 40 TAX NOTES INT'L 33 (Oct. 3, 2005).

71. *Id.*

72. *Id.*

73. *See* Langbein, *supra* note 32.

74. 125 T.C. 37 (2005).

75. *See id*. at 41. The agreement stated that any technology created by either party would be jointly owned. *Id.* at 39. The parties contracted to pay for any research and development based upon projected profits. *Id.* Every year thereafter, the parties agreed to "review [the agreement], and when appropriate, adjust such percentages." *Id.* at 39-40.

76. *See generally* Ayayo & Sheppard, *supra* note 4, at 989 (explaining that the parent company maintained between 338 and 394 research and development employees. Xilinx's Irish subsidiary employed between 6 and 16 researchers.). *Id.* The stock

plan gave the researchers and developers the ability to purchase employee stock options with a five-year vesting period.[77] The employees could buy the options for 85% of the cost over a period of two years.[78] Xilinx granted the options "at-the-money."[79] The IRS and Xilinx clashed over whether these stock options should be valued when determining the price for the "buy-in" payment.[80]

The IRS claimed that Xilinx should have incorporated such shared-compensation into the arrangement. The IRS contended that Statement of Financial Accounting Standards No. 123 required reporting companies to price share-based compensation at current fair value and spread that cost over the vesting period (termed fair method value) as an expense on their income statement.[81] Additionally, the International Accounting Standards Board adopted this standard by "requir[ing] recognition of an expense for the fair value of share-based compensation."[82] During the years of the agreement, however, Accounting Principles Board Opinion No. 25 (APB 25) only requested companies to report the "intrinsic value" of share-based compensation.[83] In regards to reporting the intrinsic value, Xilinx argued they were not obliged to report the cost for these options because they were "at-the-

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options would be worth a higher value to the parent company during the "buy in" because it had more employees.

77. *See Xilinx, Inc*., 125 T.C. at 42. Employee stock options are "offers to sell stock at a stated price (i.e. exercising price)" for a designated period of time to employees. *Id.*

78. *See id*.

79. *Id*. When an option is granted, it may be "in-the-money," "at-the-money," or "out-of-the money." Richard A. Brealey & Stewart C. Myers, PRINCIPLES OF CORPORATE FINANCE (7th Edition 2003). If the exercise price is below the stock market price of the stock, then the stock option is "in-the-money." *Id.* If the option is equal to the price of the stock, then it is "at-the-money." *Id.* However, if the exercise price is above the price of the stock, then it is termed "out of the money." *Id.*

80. *See Xilinx, Inc*., 125 T.C. at 42. If a tax administrator brought this case today, Treasury Regulation Section 1.482-7(d) would apply, which dictates that corporations must account for any stock-based compensation in a cost-sharing arrangement. *See* C.F.R. § 1.482-7(d) (2006). The IRS, however, initiated their suit against Xilinx prior to the promulgation of the 2003 regulations, which speaks directly to valuing stock options for cost-sharing arrangements. *Id.*

81. *Id.* at 45.

82. *Id.*

83. *See id.* at 44. The intrinsic value is the difference between the purchase price and the market price of the shares of stock. *Id.*

money."[84]

In October 1995, the Financial Accounting Standards Board ("FASB") established that employee stock options would be valued using the "fair value method" as the "preferred method" of measuring the stock options.[85] The IRS claimed that although the fair value method was difficult to apply, it provided more realistic values to stock options than the "intrinsic value."[86] Despite sentiments from some agencies directing corporations to use the fair value method, a majority of companies in the industry elected to value the options based on their "intrinsic value," as permitted by the FASB.[87]

The IRS argued that cost-sharing arrangements require a "hypothetical market transaction" to value costs, not the "arm's length method."[88] As stated in § 1.482-1(b)(1), an "arm's length" transaction is generally "determined by reference to the results of comparable transactions."[89] The IRS purported that § 482's settled standard did not apply in the *Xilinx* case.[90] Instead, the IRS asked the tax court to develop a "hypothetical transaction," rather than analyzing the "industry practice." The IRS further contended that the "comparable transaction" should not apply because the instant case addressed a cost-sharing arrangement.[91] The IRS failed to convince the court to apply a different standard than an "arm's length."

The tax court disagreed with the IRS, stating that the section in totality requires a "comparable transaction" when no similar transactions exist.[92] The tax court dismissed the IRS's argument because it conflicted with § 482.[93] The court instead applied the "arm's length"

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84. *See id*. at 46-47. Essentially, there was no difference between the purchase price and the market price of shares. *See id.*

85. *See id*. at 45. For Xilinx's stock option purposes, there were two parts used to determine the value of a stock option: (1) the intrinsic value, and (2) the call premium, which is the fiscal gain of the stock minus the intrinsic value. The call premium is difficult to measure because "it cannot be valued daily based on market transactions" (opposed to a publicly traded company's stock because it is easily determinable on a daily basis). *Id.*

86. *Id.*

87. *Xilinx*, *Inc.*, 125 T.C. at 62.

88. Ayayo & Sheppard, *supra* note 4, at 404.

89. *See* C.F.R. § 1.482-1(b)(1).

90. *Xilinx, Inc.*, 125 T.C. at 51.

91. *Id.*

92. *Id*.

93. Ayayo & Sheppard, *supra* note 4, at 38-41. The court held that pursuant to

test, and looked to "industry practice," to determine whether unrelated parties would in fact not share the spread or grant date.[94] Xilinx's witnesses testified that the industry did not account for employee stock options when forming cost-sharing arrangements.[95] The tax court agreed, finding that employee stock options were rarely included in cost-sharing arrangements.[96] Applying "industry practice," the tax court held that corporations could continue to use the investor valuation method.[97] Hence, the taxpayers were found to have met the "arm's length" standard and to have complied with § 482.

Xilinx holds that cost-sharing arrangements will face the "arm's length" standard and be judged against "industry practices."[98] Neither the PCT nor "investor model" reflect "industry practices" when parties enter cost-sharing arrangements. Accordingly, the *Xilinx* decision is proof that the 2005 proposals over-regulate cost-sharing parties where the "arm's length" standard remains the applicable test, and that the IRS must therefore amend the proposed rules. More importantly, there is a bigger lesson learned from the conflict between the IRS's proposed regulations and the *Xilinx* holdings.

It is unlikely that complex cost-sharing proposals, which merely react to corporate tax strategies, will be successful under current international tax policies. The IRS's proposals ignore the more pertinent question of why cost-sharing participants use tax-deferral strategies. Congress and the IRS should address the reasons for strategic corporate behavior and enact legislation that will enable U.S. corporations to lead in a global market. The *Xilinx* opinion should discourage the IRS from proposing policies that only place a band-aid on a festering wound.[99]

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§ 482, cost-sharing arrangements should apply the "arm's length method." *See Xilinx, Inc.*, 125 T.C. at 51.

94. *Id.*

95. *Xilinx, Inc.*, 125 T.C. at 43-45. Xilinx pressed upon the court a most convincing argument explaining that the IRS failed to consider the actual culture of the tax market. *See id.* at 54-59. The "hypothetical market transaction" was unnecessary given there was testimony of actual industry practices. *Id.*

96. *Id.* at 46-49.

97. *Id.* at 49.

98. *See id.* at 56. *Xilinx* assures corporations that the IRS cannot dismantle the "arm's length" standard in light of "industry norms." *Id.*

99. The IRS will likely change its 2005 cost-sharing proposals after the *Xilinx* decision once the U.S. Ninth Circuit Court of Appeals rules on the U.S.'s appeal. *See* Audrey Nutt, *U.S. Government Files Appeal In Xilinx*, 45 TAX NOTES INT'L 404 (Feb. 5,

Under the worldwide tax system, the IRS's proposals do not reflect "industry norms," promote U.S. competition abroad, or give incentives to bring profits home. The "industry practice" in the international market is to play by the rules of a territorial tax system. It is time for Congress to allow U.S. corporations to compete on a level playing field with their international competitors.

IV. A TERRITORIAL TAX SYSTEM WOULD PROMOTE COMPETITION

The *Xilinx* decision illustrates that the IRS reacted incorrectly to complex cost-sharing issues, which arise under a worldwide tax system. The U.S. should instead adopt a territorial tax system,[100] which will neither promote deferral nor result in profits being transferred abroad.[101] Congress has the opportunity to embrace a territorial tax system and proactively resolve the cost-sharing and deferral issues that a worldwide tax system causes.[102]

2007). It will probably defer on the "arm's length" and exclusive territorial points. *See* Audrey Nutt, *ABA Tax Section Meeting: Tax Officials Comment on Transfer Pricing Services Regs.*, 113 TAX NOTES 433 (Oct. 30, 2006) (discussing the possible IRS strategies to change the 2005 cost-sharing proposals). The IRS has, however, stated its intention to continue drafting more regulations. Unfortunately, there will likely be more than two rounds in this bout. *Id.*

100. *See* Peter Mullins, *Moving to Territoriality? Implications for the U.S. and the Rest of the World*, 43 TAX NOTES INT'L 839 (Sept. 4, 2006). This Note does not take a stance on the specifics of the territorial tax systems recently proposed by the Presidential Panel on Tax Reform. Although, either regime in accordance with a lower corporate tax rate would evolve U.S. tax law to promote competition, and subsequent IRS regulations aimed at further enforcing transfer pricing strategies would be welcomed. Initiating restrictions under a tax system that already decreases competition leads to bad policy and over taxation of U.S. multinational corporations.

101. *But see* Samuel Thompson, *Federal Tax Reform and Reducing the Bush Deficit by $800 Billion*, Statements at Pennsylvania State University, State College, PA (Mar. 27, 2006) (adopting the view that a territorial tax system should not be implemented because "the Office of Management and Budget estimates that the tax cost of our current deferral system is $69 billion over the period 2007 through 2011."). The deferral argument provided by Mr. Thompson is actually the exact reason for adopting a territorial tax system. Corporations will not have an incentive to defer profits once Congress passes a territorial tax regime. Transfer pricing would still require regulations, but the U.S. could enjoy the investments from repatriated profits. Again, if the concern for Congress is tax revenue, then Congress would not have passed the Repatriation Act in the American Jobs Creation Act of 2004.

102. Although Congress should develop a territorial tax regime, many issues must be addressed before the passage of a new tax system. These include, but are not limited

Regulations that merely seek to redress narrow tax haven issues overlook the fundamental problems posed by a worldwide tax system. Under the current tax regime, U.S. multinationals will freely form cost-sharing arrangements that meet the "arm's length" standard and proceed to defer the profits – that is until Congress grants a repatriation holiday. Congress should implement a territorial tax system with the understanding that globalization, not tax revenue, should drive the U.S.'s international tax policies.[103]

Under a territorial tax system, corporations would not be subject to a U.S. tax on business income earned in foreign countries.[104] Critics contend that a territorial tax system will not resolve the current cost-

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to the corporate tax rate, transfer pricing regulations post implementation of a territorial tax regime, tax exemptions, passive-income, etc.

103. *Hearing on the Impact of International Tax Reform on U.S. Competitiveness Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means*, 109th Cong. (2006) (statement of Kenneth Petrini, Chairman of the Tax Council). Mr. Petrini stated that:

> [i]nternational tax policy cannot be based on misplaced concerns of those who believe that investment by U.S. firms in foreign locations substitutes for investments in the United States. The decision is not to 'invest here or there.' In today's global economy, it is increasingly a question whether U.S. companies will invest in growing markets around the world or cede that investment to foreign competition. The question is not investment in U.S. or foreign markets but rather investment and growth by U.S. or foreign companies. The U.S. economic health is not improved by foreign investment in foreign markets.

Id.

104. *See Hearing on the Impact of International Tax Reform on U.S. Competitiveness Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means*, 109th Cong. (2006) (statement of Matt McKenna, Senior Vice President of Finance for PepsiCo, Inc.) ("The global success of U.S. businesses provides real benefits in terms of economic growth and jobs in the United States. Congress must ensure that policies are in place to allow U.S. businesses to make the most of the tremendous opportunities that globalization and technological advances provide."); *see Hearing on the Impact of International Tax Reform on U.S. Competitiveness Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means*, 109th Cong. (2006) (statement of Citigroup, Inc.). As described by Citigroup, Inc., the U.S. will enhance its competitive ability in international markets by:

> [m]oving the U.S. tax system to a territorial regime [which] could improve the competitiveness of U.S.-based financial services companies operating globally. However, adoption of a territorial tax system by the United States will only enhance the competitiveness of U.S. companies if it is constructed in a fair and effective manner. Further, concurrent with any adoption of a territorial system must be a reduction of the U.S. corporate tax rate.

sharing issues because it would encourage parties to continue transfering profits overseas and evade paying a U.S. tax completely, causing the U.S. to lose even more tax revenue. This argument ignores the fact that cost-sharing participants would still be subject to the "arm's length" standard of § 482. Courts will continue to require that cost-sharing arrangements meet the industry norm. More importantly, corporations would not have an incentive to defer profits abroad because the IRS could not tax repatriated dividends that companies earned outside the U.S.[105] Under the current regime, cost-sharing arrangements and other transfer pricing strategies damage the U.S. economy because profits rarely come home. The failure of the worldwide tax system to generate its expected tax revenue from U.S. multinational corporations should not be further compounded by policies that encourage corporate profits to remain offshore.

Moreover, the lost tax revenue argument is futile in light of the American Jobs Creation Act of 2004. This legislation illustrated that Congress is more concerned with repatriating the profits than fattening the Treasury's wallet. Once critics accept that both regimes fail to adequately tax profits earned abroad, it makes sense to focus on policies that remove the deferral barrier. A territorial tax system limits deferral strategies and encourages U.S. corporations to spend foreign profits back in the U.S. since the repatriated profits would no longer be subject to U.S. taxes. This gives corporations the opportunity to invest in U.S. jobs, production plants, advertisement, marketing, human capital, and products. Conversely, under the current regime, corporations invest overseas to prevent the IRS from taxing their profits.

The IRS's attempts to heighten regulations under the current worldwide tax system hinders U.S. corporations' ability to enter and

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Id.

105. *See Hearing on the Impact of International Tax Reform on U.S. Competitiveness Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means*, 109th Cong. (2006) (statement of Paul W. Oosterhuis, Partner, Skadden Arps Slate Meagher & Flom, LLP). Explaining the dilemma posed by deferral, Mr. Oosterhuis stated that:

> [i]n large part in response to the build-up of earnings resulting from the check-the-box and other deferral planning, over the past couple of years increased the interest has been given to proposals to move to a territorial system. By permitting tax-free repatriation of earnings that benefit from deferral today, a territorial system would eliminate the distortions that result from the requirement under deferral that offshore earnings remain offshore, and invested in foreign assets, in order to avoid U.S. tax.

Id.

maintain a place in growing international markets. Accordingly, Congress should enact a tax regime that accounts for globalization and U.S. corporate competition abroad. As stated by Matt McKenna, Senior Vice-President of Finance for PepsiCo., Inc., to the House Ways and Means Committee, "Congress has an opportunity to develop a system to sustain our competitiveness and growth for the generations to come."[106] The current tax system places U.S. corporations at a disadvantage compared to foreign companies that are subject to lower tax rates.[107] U.S. tax policy should promote "competitiveness," and if nothing else, prevent tax regulations from debilitating U.S. companies that compete internationally. The worldwide tax system undermines policies that support the U.S. economy. To begin, it places U.S. companies at a competitive disadvantage (versus their foreign competition). Under a worldwide tax system, "U.S. companies are generally taxed at the higher of the source country or U.S. tax rate."[108] Moreover, these U.S. corporations often face double taxation, resulting in an incredibly high tax rate. Under a territorial tax system, corporations rightfully pay only one tax from the country where it gained the source of income. Less tax amounts to more investment, both domestic and foreign.

In addition, opponents to a territorial tax system wrongly criticize corporate tax structures that permit U.S. corporations to invest abroad. A territorial tax system will enable corporations to organize abroad, gain profits, and dividend such gains back to the U.S. Due to globalization, corporations must seek emerging markets and continue investing in foreign projects.[109] The current tax system limits corporate investment in the U.S. and forces corporations to implement unnecessary tax strategies to evade the IRS. The U.S. will ultimately reap the benefits from tax policies that promote the most competitive international business model possible. The current regime cuts against this philosophy.

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106. *See Hearing on the Impact of International Tax Reform on U.S. Competitiveness Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means*, 109th Cong. (2006) (statement of Matt McKenna, Senior Vice President of Finance for PepsiCo, Inc.).

107. *Id.*

108. *Id.*

109. *See id*. "[I]t is a plain and simple fact that in order for U.S. companies to remain healthy, and even viable, they must compete with their foreign competitors and invest in the growing and emerging markets around the world." *Id.*

In conclusion, it is time for Congress to pave a new road for U.S. companies and implement a territorial tax system that promotes competitiveness rather than deferral. The IRS's proposed cost-sharing regulations ignored the cause of the transfer pricing dilemma. Unless Congress makes a concerted effort to reform the current system and pass legislation that reflects the global market, taxpayers will continue to fund the IRS's reactionary research projects that fail to produce realistic strategies. Fortunately, the proposed regulations remain mere suggestions, and in the wake of the President's Panel on Federal Tax Reform, a territorial tax system is one-step closer to becoming a reality.