

Public Discussion Draft

BEPS ACTION 8:

REVISIONS TO CHAPTER VIII OF THE TRANSFER PRICING GUIDELINES ON COST CONTRIBUTION ARRANGEMENTS (CCAs)

29 April 2015 - 29 May 2015



DISCUSSION DRAFT ON REVISIONS TO CHAPTER VIII OF THE TRANSFER PRICING GUIDELINES ON COST CONTRIBUTION ARRANGEMENTS

29 April 2015

Public comments are invited on this discussion draft which deals with work in relation to Action 8 of the BEPS Action Plan (“Assure that transfer pricing outcomes are in line with value creation”).

The Action Plan on Base Erosion and Profit Shifting, published in July 2013, identifies 15 actions to address BEPS in a comprehensive manner, and sets deadlines to implement these actions.

Action 8 of the BEPS Action Plan covers the transfer pricing of intangibles and requires the development of rules to prevent BEPS by moving intangibles among group members. A first instalment of work in response to this Action is found in the report, Guidance on Transfer Pricing Aspects of Intangibles (2014), which provides modifications to, mainly, Chapter VI of the Transfer Pricing Guidelines. This discussion draft responds to the requirement under Action 8 to update the guidance on cost contribution arrangements (“CCAs”) found in Chapter VIII of the Transfer Pricing Guidelines, and provides proposed text for an updated chapter.

CCAs can often be used for the joint development, enhancement, maintenance, protection or exploitation of intangibles and a key objective in revising the guidance is to align the transfer pricing of intangibles under CCAs with the general guidance on the transfer pricing of intangibles found in the revised Chapter VI. In particular, the clarification in the guidance to require contributions to be measured at value rather than at cost helps to ensure that outcomes for participants under a CCA should not differ significantly from the outcomes of transfers or development of intangibles for parties outside a CCA.

The guidance in this discussion draft also takes into account draft guidance on Chapter I of the Transfer Pricing Guidelines released for public comments on 19th December 2014. In particular, the draft guidance on risk in Chapter I is relevant to a CCA which depends on the bearing of risks by all participants. The concept of control over risks developed in the draft revisions to Chapter I is relevant in determining participants in a CCA. Finalising the guidance contained in this discussion draft will therefore also take into account any conforming amendments required arising from changes to other parts of the Transfer Pricing Guidelines.

The views and proposals included in this discussion draft do not represent consensus views of the Committee on Fiscal Affairs or its subsidiary bodies but are intended to provide stakeholders with substantive proposals for analysis and comment.

Public comments are invited on this discussion draft, including on whether the goal of consistency with other parts of the Guidelines is appropriate, and if so, whether the draft achieves such consistency. The discussion draft is submitted for comment by interested parties. Comments should be submitted by **29th May 2015 (no extension will be granted)** and should be sent by email to TransferPricing@oecd.org in PDF and Word format. They should be addressed to Andrew Hickman, Head of Transfer Pricing Unit, Centre for Tax Policy and Administration.

Please note that all comments received regarding this consultation draft will be made publicly available. Comments submitted in the name of a collective “grouping” or “coalition” or by any person submitting comments on behalf of another person or group of persons, should identify all enterprises or individuals who are members of that collective, or the person(s) on whose behalf the commentator(s) are acting.

A public consultation on the discussion draft and other topics will be held on 6/7 July 2015 at the OECD Conference Centre in Paris. Registration details for the public consultation will be published on the OECD website in due course. Speakers and other participants at the public consultation will be selected from among those providing timely written comments on the discussion draft.

CHAPTER VIII

COST CONTRIBUTION ARRANGEMENTS

A. Introduction

1. This chapter discusses cost contribution arrangements (CCAs) between two or more associated enterprises. The purpose of the chapter is to provide some general guidance for determining whether the conditions established by associated enterprises for transactions covered by a CCA are consistent with the arm's length principle. The analysis of the structure of such arrangements should be informed by the provisions of this chapter and other provisions of these Guidelines and should be based on an adequate documentation of the arrangement.

2. Section B provides a general definition and overview of the concept of CCAs, and Section C gives guidance as to the application of the arm's length principle to CCAs. Section C includes guidance on how to measure contributions to a CCA, whether balancing payments are needed (*i.e.* payments between participants to adjust their proportionate shares of contributions), and guidance on how contributions and balancing payments should be treated for tax purposes. It also addresses the determination of participants in the CCA and issues related to the entry or withdrawal of participants, and the termination of CCAs. Finally, Section D discusses suggestions for structuring and documenting CCAs.

B. Concept of a CCA

B.1 In general

3. A CCA is a contractual arrangement among business enterprises to share the contributions and risks involved in the joint development, production or the obtaining of intangibles, tangible assets or services with the understanding that such intangibles, tangible assets or services are expected to create direct benefits for the businesses of each of the participants. A CCA is a contractual arrangement rather than necessarily a distinct juridical entity or fixed place of business of all the participants.

4. In accordance with the arm's length principle, each participant's proportionate share of the overall contributions to a CCA must be consistent with the participant's proportionate share of the overall expected benefits to be received under the arrangement. Further, each participant becomes an effective owner of an interest in any intangibles or tangible assets resulting from the activity of the CCA, or is entitled to receive services resulting from the activity of the CCA, and may exploit such interest or entitlement without paying additional consideration to any party for that interest or entitlement.

5. Some benefits of the CCA activity can be determined in advance, whereas others will be uncertain. Some types of CCA activities will produce current benefits, while others have a longer time frame or may not be successful. Nevertheless, in a CCA there is always an expected benefit that each participant seeks from its contribution, including the attendant rights to have the CCA properly administered. Each participant's interest in the results of the CCA activity should be established from the outset, even where the interest is inter-linked with that of other participants, *e.g.* because legal ownership of developed intangibles or tangible assets may be vested in only one of them but all of them have effective ownership interests.

6. In some cases CCAs can provide helpful simplification of multiple transactions (bearing in mind that the tax consequences of transactions are determined in accordance with applicable local laws). In a situation where associated enterprises both perform activities for other group members and simultaneously

benefit from activities performed by other group members, a CCA can provide a mechanism for replacing a web of separate intra-group arm's length payments with a more streamlined system of netted payments, based on aggregated benefits and aggregated contributions associated with all the covered activities. A CCA for the sharing in the development of intangibles can eliminate the need for complex cross-licensing arrangements and associated allocation of risk, and replace them with a more streamlined sharing of contributions and risks, with effective ownership of the resulting intangible(s) shared in accordance with the terms of the CCA. However, the streamlining of flows that may result from the adoption of a CCA does not affect the appropriate valuation of the separate contributions of the parties. It follows, therefore, that the outcomes for transfer pricing purposes for CCA participants should be consistent with those which would have arisen had the parties made similar contributions on similar terms outside of a CCA mechanism.

B.2 Relationship to other chapters

7. Chapter VI provides guidance regarding the determination of arm's length conditions for transactions that involve the use or transfer of intangibles. Similarly, Chapter VII provides guidance on issues that arise in determining for transfer pricing purposes whether services have been provided by a member of an MNE group to other members of that group and if so, in establishing arm's length prices for those intra-group services. This chapter's goal is to provide supplementary guidance where resources and skills are pooled and the consideration received is, in part or whole, the reasonable expectation of mutual benefits. Thus, the provisions of Chapters VI and VII, and indeed all the other chapters of these Guidelines, will continue to apply to the extent relevant, for instance in measuring the value of a contribution to a CCA as part of the process of determining the proportionate shares of contributions. MNEs are encouraged to observe the guidance of this chapter in order to ensure that their CCAs operate in accordance with the arm's length principle.

B.3 Types of CCAs

8. Two types of CCAs are commonly encountered: those established for the joint development, enhancement, maintenance, protection or exploitation of intangibles or tangible assets ("development CCAs"); and those for obtaining services ("services CCAs"). While each particular CCA should be considered on its own facts and circumstances, a key difference between these two types of CCAs will often be that the former are expected to create ongoing, future benefits for participants, while the latter will often create current benefits only. In some cases, a CCA for obtaining current services may also create or enhance an intangible which provides ongoing benefits.

9. Under a development CCA, each participant receives a share of rights in the developed intangible(s) or tangible asset(s). In relation to intangibles, such rights often take the form of separate rights to exploit the intangible in a specific geographic location or for a particular application. The separate rights obtained may constitute actual legal ownership; alternatively, it may be that only one of the participants is the legal owner of the property but the other participants have an effective ownership interest in the property. In cases where a participant has an effective ownership interest in any property developed by the CCA, there is no need for a royalty payment or other further consideration for the use of the developed property consistent with the interest that the participant has acquired (however the contributions of a participant may need to be adjusted if they are not proportionate to their expected benefits; see Section C.5).

C Applying the arm's length principle

C.1 In general

10. For the conditions of a CCA to satisfy the arm's length principle, the value of participants' contributions must be consistent with what independent enterprises would have agreed to contribute under comparable circumstances given their proportionate share of the total anticipated benefits they reasonably expect to derive from the arrangement. What distinguishes contributions to a CCA from an ordinary intra-group transfer of property or services is that part or all of the compensation intended by the participants is the expected mutual and proportionate benefit from the pooling of resources and skills. Independent enterprises do enter into such joint arrangements when there is a common need from which the enterprises can mutually benefit. For instance, independent parties at arm's length might engage in a pooling of resources and skills in order to achieve savings, perhaps from economies of scale, or to improve efficiency and productivity, perhaps from the combination of different individual strengths and spheres of expertise. More generally, such arrangements are found when a group of companies with a common need for particular activities decides to centralise or undertake jointly the activities in a way that minimises costs and risks to the mutual benefit of all of the participants.

11. The expectation of mutual and proportionate benefit is fundamental to the acceptance by independent enterprises of an arrangement for pooling resources and skills. Independent enterprises would require that the value of each participant's proportionate share of the actual overall contributions to the arrangement is consistent with the participant's proportionate share of the overall expected benefits to be received under the arrangement. To apply the arm's length principle to a CCA, it is therefore a necessary precondition that all the parties to the arrangement have a reasonable expectation of benefit. The next step is to calculate the value of each participant's relative contribution to the joint activity, and finally to determine whether the allocation of CCA contributions (as adjusted for any balancing payments made among participants) accords with their respective share of expected benefits. It should be recognised that these determinations may bear a degree of uncertainty. The potential exists for contributions to be allocated among CCA participants so as to result in an overstatement of taxable profits in some countries and the understatement of taxable profits in others, measured against the arm's length principle. For that reason, taxpayers should be prepared to substantiate the basis of their claim with respect to the CCA (see Section D).

C.2 Determining participants

12. Because the concept of mutual benefit is fundamental to a CCA, it follows that a party may not be considered a participant if the party does not have a reasonable expectation that it will benefit from the CCA activity itself (and not just from performing part or all of that activity).¹ A participant therefore must be assigned an interest in the intangibles, tangible assets or services that are the subject of the CCA, and have a reasonable expectation of being able to benefit from that interest.

13. The general principles set out in Chapter I of these guidelines on the allocation of risks when delineating transactions apply to situations involving CCAs. Since a CCA is premised on all participants sharing not only contributions but also risks of the CCA activities, to qualify as a participant in a CCA an entity must have the capability and authority to control the risks associated with the risk-bearing opportunity under the CCA in accordance with the definition of control of risks set out in Chapter I. In particular, this means that a CCA participant should have the capability to make decisions to take on the

¹ An enterprise whose benefit consists solely in the performance of the CCA activity itself would not be considered a participant in the CCA but rather a service provider to the CCA. As such, it should be compensated for the services it provides on an arm's length basis external to the CCA. See paragraph 14.

risk-bearing opportunity, to make decisions on how to respond to the risks, and to assess, monitor, and direct any outsourced measures affecting risk outcomes under the CCA. See examples 4 and 5 at the end of this chapter for an illustration of this principle.

14. In some cases, the participants in a CCA may decide that all or part of the subject activity will be carried out by a separate entity that is not a participant under the standard of paragraph 12 above. In such a case, an arm's length charge would be appropriate to compensate the entity for services or other contributions being rendered to the CCA participants. Where the entity is an associated enterprise of one or more of the CCA participants, the arm's length charge would be determined under the general principles of Chapters I – III, including *inter alia* consideration of functions performed, assets used, and risks assumed, as well as the special considerations affecting an arm's length charge for services and/or in relation to any intangibles, as described in Chapter VII and Chapter VI (including the guidance on hard to value intangibles).

15. There is no rule that could be universally applied to determine whether each participant's proportionate share of the overall contributions to a CCA activity is consistent with the participant's proportionate share of the overall benefits expected to be received under the arrangement. The goal is to estimate the shares of benefits expected to be obtained by each participant and to ensure that their contributions are in the same proportions. This may require that participants' contributions are adjusted using balancing payments.

C.3 *Expected benefits from the CCA*

16. The shares of expected benefits might be estimated based on the anticipated additional income generated or costs saved or other benefits received by each participant as a result of the arrangement. An approach that is frequently used in practice would be to reflect the participants' proportionate shares of expected benefits using a relevant allocation key. The possibilities for allocation keys include sales (turnover); units used, produced, or sold; number of employees, and so forth.

17. To the extent that a material part or all of the benefits of a CCA activity are expected to be realised in the future and not solely in the year the costs are incurred, the allocation of contributions will take account of projections about the participants' shares of those benefits. This will often be the case for development CCAs. The use of projections may raise problems for tax administrations in verifying the assumptions based on which projections have been made and in dealing with cases where the projections vary markedly from the actual results. These problems may be exacerbated where the CCA activity ends several years before the expected benefits actually materialise. It may be appropriate, particularly where benefits are expected to be realised in the future, for a CCA to provide for possible adjustments of proportionate shares of contributions over the term of the CCA on a prospective basis to reflect changes in relevant circumstances resulting in changes in shares of benefits. In situations where actual results differ markedly from projections, tax administrations might be prompted to enquire whether the projections made would have been considered acceptable by independent enterprises in comparable circumstances, taking into account all the developments that were reasonably foreseeable by the participants, without using hindsight.

18. If an arrangement covers multiple activities, it will be important to take this into account in choosing an allocation method, so that the value of contributions made by each participant is properly related to the benefits expected by the participants. One approach (though not the only one) is to use more than one allocation key. For example, if there are five participants in a CCA, one of which cannot benefit from certain services activities undertaken within the CCA, then in the absence of some form of set-off or reduction in contribution, the contributions associated with those activities might be allocated only to the other four participants. In this case, two allocation keys might be used to allocate the contributions.

Whether any particular allocation key or keys are appropriate depends on the exact nature of the CCA activity and the relationship between the allocation key(s) and the expected benefits. The guidance in Chapter VII on the use of indirect methods of determining an arm's length charge for services (section B.2.2.2) may be helpful in this regard.

19. Whatever the method used to evaluate participants' relative shares of expected benefits, adjustments to the measure used may be necessary to account for differences between the expected and actual benefits received by the participants. Independent enterprises might include a clause in the agreement (particularly where the CCA is of long duration) allowing for periodic reassessment of contributions *vis-à-vis* actual benefits to determine whether the future contributions of participants should be adjusted accordingly. In particular, the allocation key(s) most relevant to any particular CCA may change over time. Furthermore, if unexpected or unforeseeable events materially affect the initial benefit assumptions, consideration should be given as to whether independent enterprises would have provided for an adjustment or renegotiation of the CCA agreement.

C.4 The value of each participant's contribution

20. For the purpose of determining whether a CCA satisfies the arm's length principle – *i.e.* whether each participant's proportionate share of the overall contributions to the CCA is consistent with the participant's proportionate share of the overall expected benefits – it is necessary to measure the value of each participant's contributions to the arrangement.

21. Contributions to a CCA may take many forms. For services CCAs, contributions primarily consist of the performance of the services. For development CCAs, contributions typically include the performance of development activities (*e.g.* R&D, marketing), and often include additional contributions relevant to the development CCA such as tangible assets or intangibles. Irrespective of the type of CCA, all contributions of current or pre-existing value must be identified and accounted for appropriately in accordance with the arm's length principle. Since the value of each participant's relative share of contributions accords with its share of expected benefits, balancing payments may be required to ensure this consistency. The term 'contributions' as used in this Chapter includes both initial or ongoing contributions made by participants to a CCA as well as any balancing payments that may be required. See section C.5.

22. Under the arm's length principle, the value of each participant's contribution should be consistent with the value that independent enterprises would have assigned to that contribution. That is, contributions must generally be assessed based on their value (rather than their cost) in order to be consistent with the arm's length principle. In determining the value of contributions to a CCA the guidance elsewhere in these Guidelines should be followed.

23. It is sometimes the case that the value (*i.e.* the arm's length price) of services contributed to a CCA corresponds to the costs associated with providing those services. It may also be the case that the difference between the value and costs is relatively modest, such as for low value-added services described in Chapter VII. In this case it is recommended for practical reasons to value contributions at cost. However, in all other circumstances (for example where contributions include a mixture of low and high value-adding services and/or intangibles or other assets) costs are unlikely to provide a reliable basis for determining the value of the relative contributions of participants, and the use of costs may lead to non-arm's length results. For development CCAs costs will generally not provide a reliable basis on which to value contributions. See examples 1-3.

24. Since contributions are based on expected benefits, this generally implies that where a cost reimbursement basis for valuing contributions is permitted, the analysis should initially be based on

budgeted costs. This does not necessarily mean fixing the costs, since the budget framework may accommodate variability arising from factors such as varying demand levels (for instance budgeted costs may be expressed as a fixed percentage of actual sales). Additionally, there are likely to be differences between budgeted costs and actual costs during the term of the CCA. In an arm's length situation, the terms agreed between the parties are likely to set out how such differences should be treated since, as stated in paragraph 2.96, independent parties are not likely to use budgeted costs without agreeing what factors are taken into account in setting the budget and how unforeseen circumstances are to be treated. Attention should be paid to the reason for any significant differences between budgeted costs and actual costs, since the difference may point to changes in the scope of activities which may not benefit all the participants in the same way as the activities originally scoped. In general terms, however, where cost is found to be an appropriate basis for measuring contributions, it is likely to be sufficient to use actual costs as the basis for so doing.

25. It is important that the evaluation process recognises all contributions made by participants to the arrangement. This includes contributions made by one or more parties at the inception of the CCA (such as contributions of pre-existing intangibles) as well as contributions made on an ongoing basis during the term of the CCA. Contributions to be considered include property or services that are used solely in the CCA activity, but also property or services (*i.e.* shared property or services) that are used partly in the CCA activity and also partly in the participant's separate business activities. It can be difficult to measure contributions that involve shared property or services, for example where a participant contributes the partial use of assets such as office buildings and IT systems or performs supervisory, clerical, and administrative functions for the CCA and for its own business. It will be necessary to determine the proportion of the assets used or services that relate to the CCA activity in a commercially justifiable way with regard to recognised accounting principles and the actual facts, and adjustments, if material, may be necessary to achieve consistency when different jurisdictions are involved. Once the proportion is determined, the contribution can be measured in accordance with the principles in the rest of this chapter.

26. For development CCAs, contributions in the form of controlling and managing the CCA, its activities and risks, are likely to be important functions in relation to the development, enhancement, maintenance, protection and exploitation of the intangibles or tangible assets and should be valued in accordance with the principles set out in Chapter VI.

C.5 *Balancing payments*

27. A CCA will be considered consistent with the arm's length principle where the value of each participant's proportionate share of the overall contributions to the arrangement (taking into account any balancing payments already made) is consistent with the participant's share of the overall expected benefits to be received under the arrangement. Where the value of a participant's contributions under a CCA is not consistent with that participant's share of expected benefits under the CCA, the contributions made by at least one of the participants will be inadequate, and the contributions made by at least one other participant will be excessive. In such a case, the arm's length principle would require that an adjustment be made. This will generally take the form of an adjustment to the contribution through making or imputing a (further) balancing payment. Such balancing payments increase the value of the contributions of the payer and decrease that of the payee.

28. Balancing payments may be made by participants to 'top up' the value of the contributions when their proportionate contributions are lower than their proportionate expected benefits. Such adjustments may be anticipated by the participants upon entering into the CCA, or may be the result of periodic re-evaluation of their share of the expected benefits and/or the value of their contributions (see paragraph 19).

29. Balancing payments may also be required by tax administrations where the value of a participant's proportionate contributions of property or services has been incorrectly determined, or where the participants' proportionate expected benefits have been incorrectly assessed, *e.g.* where the allocation key when fixed or adjusted for changed circumstances was not adequately reflective of proportionate expected benefits. Normally the adjustment would be made by a balancing payment from one or more participants to another being made or imputed for the period in question.

30. In the case of development CCAs, variations between a participant's proportionate share of the overall contributions and that participant's proportionate share of the overall expected benefits may occur in a particular year. If that CCA is otherwise acceptable and carried out faithfully, having regard to the recommendations of Section E, tax administrations should generally refrain from making an adjustment based on the results of a single fiscal year. Consideration should be given to whether each participant's proportionate share of the overall contributions is consistent with the participant's proportionate share of the overall expected benefits from the arrangement over a period of years (see paragraphs 3.75-3.79).

C.6 Disregarding part or all of the terms of a CCA

31. In some cases, the facts and circumstances may indicate that the reality of an arrangement differs from the terms purportedly agreed by the participants. For example, one or more of the claimed participants may not have any reasonable expectation of benefit from the CCA activity. Although in principle the smallness of a participant's share of expected benefits is no bar to eligibility, if a participant that is performing all of the subject activity is expected to have only a small fraction of the overall expected benefits, it may be questioned whether the reality of the arrangements for that party is to share in mutual benefits or whether the appearance of sharing in mutual benefits has been constructed to obtain more favourable tax results.

32. A tax administration may also disregard part or all of the purported terms of a CCA where over time there has been a substantial discrepancy between a participant's proportionate share of contributions (adjusted for any balancing payments) and its proportionate share of expected benefits, and the commercial reality is that the participant bearing a disproportionately high share of the contributions should be entitled to a greater interest in the subject of the CCA. In such a case, that participant might be entitled to an arm's length compensation for the use of that interest by the other participants. The guidance in Chapter VI on Hard to Value Intangibles may equally apply in situations involving CCAs. In relevant circumstances it may be appropriate for a tax administration to disregard the CCA in its entirety in accordance with the principles for non-recognition of the delineated transaction set out in Chapter I.

C.7 The tax treatment of contributions and balancing payments

33. Contributions, including any balancing payments, by a participant to a CCA should be treated for tax purposes in the same manner as would apply under the general rules of the tax system(s) applicable to that participant if the contributions were made outside a CCA, to carry on the activity that is the subject of the CCA. The character of the contribution will depend on the nature of the activity being undertaken by the CCA, and will determine how it is recognised for tax purposes.

34. In services CCAs, a participant's contribution to the CCA will often give rise to benefits in the form of cost savings (in which case there may not be any income generated directly by the CCA activity). In development CCAs, the expected benefits to participants may not accrue until some time after contributions are made, and therefore there will be no immediate recognition of income to the participants on their contributions at the time they are made.

35. Any balancing payment should be treated as an addition to the contribution of the payer and as a reduction in the contribution of the recipient. As with contributions generally, the character and tax treatment of any balancing payments will be determined in accordance with domestic laws, including applicable tax treaties.

D CCA entry, withdrawal or termination

36. Changes in the membership of a CCA will generally trigger a reassessment of the proportionate shares of participants' contributions and expected benefits. An entity that becomes a participant in an already active CCA might obtain an interest in any results of prior CCA activity, such as completed or work in-progress intangibles or tangible assets. In such cases, the previous participants effectively transfer part of their respective interests in the results of the prior CCA activity to the new entrant. Under the arm's length principle, any such transfer of intangibles or tangible assets must be compensated based on an arm's length value for the transferred interest. Such compensation is referred to in this chapter as a "buy-in payment".

37. The amount of a buy-in payment should be determined based upon the value (*i.e.* the arm's length price) of the interest in the intangibles and/or tangible assets the new entrant obtains, taking into account the new entrant's proportionate share of the overall expected benefits to be received under the CCA. There may also be cases where a new participant brings existing intangibles or tangible assets to the CCA, and that balancing payments may be appropriate from the other participants in recognition of this contribution. Any balancing payments to the new entrant could be netted against any buy-in payments required, although appropriate records must be kept of the full amounts of the separate payments for tax administration purposes.

38. Similar issues could arise when a participant leaves a CCA. In particular, a participant that leaves a CCA may dispose of its interest in the results, if any, of past CCA activity (including work in progress) to the other participants. Any such transfer should be compensated according to the arm's length principle. Such compensation is referred to in this chapter as a "buy-out payment".

39. The guidance in Chapters I-III and VI is fully applicable to determining the arm's length amount of any buy-in, buy-out or balancing payments required. There may be instances where no such payments are required under the arm's length principle. For example, a CCA for the sharing of routine administrative services would generally only produce benefits to participants on a current basis, rather than any valuable on-going results.

40. Buy-in and buy-out payments should be treated for tax purposes in the same manner as would apply under the general rules of the tax system(s) (including conventions for the avoidance of double taxation) applicable to the respective participants as if the payment were made outside a CCA as consideration for the acquisition or disposal of the interest in the results of the prior CCA activity.

41. When a CCA terminates, the arm's length principle requires that each participant retains an interest in the results, if any, of the CCA activity consistent with their proportionate share of contributions to the CCA throughout its term (adjusted by any balancing payments actually made, including those made as a result of the termination).

E. Recommendations for structuring and documenting CCAs

42. Generally, a CCA between controlled parties should meet the following conditions:

- a) The participants would include only enterprises expected to derive mutual and proportionate benefits from the CCA activity itself, (and not just from performing part or all of that activity);
- b) The arrangement would specify the nature and extent of each participant's interest in the results of the CCA activity, as well its expected respective share of benefits;
- c) No payment other than the CCA contributions, appropriate balancing payments and buy-in payments would be made for the interest in intangibles, tangible assets or services obtained through the CCA;
- d) The value of participants' contributions would be determined in accordance with these Guidelines and, where necessary, balancing payments should be made to ensure the proportionate shares of contributions align with the proportionate shares of expected benefits from the arrangement;
- e) The arrangement would require balancing payments and/ or changes in the allocation of contributions prospectively after a reasonable period of time to reflect changes in proportionate shares of expected benefits among the participants; and
- f) Adjustments would be made as necessary (including the possibility of buy-in and buy-out payments) upon the entrance or withdrawal of a participant and upon termination of the CCA.

43. It would be expected that application of prudent business management principles would lead the participants in a CCA to prepare or to obtain materials about the nature of the subject activity, the terms of the arrangement, and its consistency with the arm's length principle. Implicit in this is that each participant should have full access to the details of the activities to be conducted under the CCA, the identity and location of the other parties involved in the CCA, the projections on which the contributions are to be made and expected benefits determined, and budgeted and actual expenditures for the CCA activity. All this information could be relevant and useful to tax administrations in the context of a CCA and taxpayers should be prepared to provide it upon request. The information relevant to any particular CCA will depend on the facts and circumstances. It should be emphasised that the information described in this list is neither a minimum compliance standard nor an exhaustive list of the information that a tax administration may be entitled to request.

44. The following information would be relevant and useful concerning the initial terms of the CCA:

- a) A list of participants;
- b) A list of any other associated enterprises that will be involved with the CCA activity or that are expected to exploit or use the results of the subject activity;
- c) The scope of the activities and specific projects covered by the CCA, and how the CCA activities are managed and controlled;
- d) The duration of the arrangement;
- e) The manner in which participants' proportionate shares of expected benefits are measured, and any projections used in this determination;
- f) The manner in which any future benefits (such as intangibles) are expected to be exploited;

- g) The form and value of each participant's initial contributions, and a detailed description of how the value of initial and ongoing contributions is determined (including any budgeted vs actual adjustments) and how accounting principles are applied consistently to all participants in determining expenditures and the value of contributions;
- h) The anticipated allocation of responsibilities and tasks, and the mechanisms for managing and controlling those responsibilities and tasks, in particular, those relating to the development, enhancement, maintenance, protection or exploitation of intangibles or tangible assets used in the CCA activity;
- i) The procedures for and consequences of a participant entering or withdrawing from the CCA and the termination of the CCA; and
- j) Any provisions for balancing payments or for adjusting the terms of the arrangement to reflect changes in economic circumstances.

45. Over the duration of the CCA term, the following information could be useful:

- a) Any change to the arrangement (*e.g.* in terms, participants, subject activity), and the consequences of such change;
- b) A comparison between projections used to determine expected benefits from the CCA activity with the actual results (however, regard should be had to paragraph 3.74); and
- c) The annual expenditure incurred in conducting the CCA activity, the form and value of each participant's contributions made during the CCA's term, and a detailed description of how the value of contributions is determined.

ANNEX TO CHAPTER VIII – EXAMPLES TO ILLUSTRATE THE GUIDANCE ON COST CONTRIBUTION ARRANGEMENTS

Example 1

46. Example 1 illustrates the general principle that contributions should be assessed at value (*i.e.* based on arm’s length prices) rather than at cost in order to produce results that are consistent with the arm’s length principle.

47. Company A and Company B are members of a multinational group and decide to enter into a CCA. Company A performs Service 1 and Company B performs Service 2. Company A and Company B each “consume” both services (that is, Company A receives a benefit from Service 2 performed by Company B, and Company B receives a benefit from Service 1 performed by Company A).

48. Assume that the costs and value of the services are as follows:

Costs of providing Service 1 (cost incurred by Company A)	100 per unit
Value of Service 1 (<i>i.e.</i> the arm’s length price that Company A would charge Company B for the provision of Service 1)	120 per unit
Costs of providing Service 2 (cost incurred by Company B)	100 per unit
Value of Service 2 (<i>i.e.</i> the arm’s length price that Company B would charge Company A for the provision of Service 2)	105 per unit

49. In year 1 and in subsequent years, Company A provides 30 units of Service 1 to the group and Company B provides 20 units of Service 2 to the group. Under the CCA, the calculation of costs and benefits are as follows:

Cost to Company A of providing services (30 units * 100 per unit)	3000	(60% of total costs)
Cost to Company B of providing services (20 units * 100 per unit)	<u>2000</u>	(40% of total costs)
Total cost to group	5000	
Value of contribution made by Company A (30 units * 120 per unit)	3600	(63% of total contributions)
Value of contribution made by Company B (20 units * 105 per unit)	<u>2100</u>	(37% of total contributions)
Total value of contributions made under the CCA	5700	

Company A and Company B each consume 15 units of Service 1 and 10 units of Service 2:		
Benefit to Company A:		
Service 1: 15 units * 120 per unit	1800	
Service 2: 10 units * 105 per unit	<u>1050</u>	
Total	2850	(50% of total value of 5700)
Benefit to Company B		
Service 1: 15 units * 120 per unit	1800	
Service 2: 10 units * 105 per unit	<u>1050</u>	
Total	2850	(50% of total value of 5700)

50. Under the CCA, the value of Company A and Company B's contributions should each correspond to their respective proportionate shares of expected benefits, *i.e.* 50%. Since the total value of contributions under the CCA is 5700, this means each party must contribute 2850. The value of Company A's in-kind contribution is 3600 and the value of Company B's in-kind contribution is 2100. Accordingly, Company B should make a balancing payment to Company A of 750. This has the effect of 'topping up' Company B's contribution to 2850; and offsets Company A's contribution to the same amount.

51. If contributions were measured at cost instead of at value, since Companies A and B each receive 50% of the total benefits, they would have been required contribute 50% of the total costs, or 2500 each, *i.e.*, Company B would have been required to make a 500 (instead of 750) balancing payment to A.

52. In the absence of the CCA, Company A would purchase 10 units of Service 2 for the arm's length price of 1050 and Company B would purchase 15 units of Service 1 for the arm's length price of 1800. The net result would be a payment of 750 from Company B to Company A. As can be shown from the above, this arm's length result is only achieved in respect of the CCA when contributions are measured at value.²

² Some countries consider that an alternative way to achieve an arm's length result in this example is through the use of a two-step process:

Step 1 (contributions measured at cost): Company A should bear 50% of the total cost of 5000, or 2500. The cost of Company A's in-kind contribution is 3000. Company B should bear 50% of the total cost or 2500. The cost of Company B's in-kind contribution is 2000. Company B should thus make an additional payment to Company A of 500.

Step 2 (accounting for additional contributions of value to the CCA): Company A produces 20 of value above costs per unit. Company B produces 5 of value above costs per unit. Company A consumes 10 units of Service 2 (50 of value over cost), and Company B consumes 15 units of Service 1 (300 of value over cost). Accordingly, Company A should be compensated 250 for the additional 250 of value that it contributes to the CCA.

The two-step method provides for a sharing of costs plus a separate and additional payment to the participant that makes an additional contribution of value to the arrangement. The additional contribution of value might reflect the contribution of property, such as intangibles, owned by one of the participants that is relevant to the purpose of the CCA. Thus, the two-step method might be most usefully applied to development CCAs.

Example 2

53. The facts are the same as example 1, except that both Service 1 and Service 2 are low-value services. The per-unit value of Service 1 is 103 and the per-unit value of Service 2 is 105. Assume, therefore, that the calculation of the costs and value of the services is as follows:

Cost to Company A of providing services (30 units * 100 per unit)	3000	(60% of total costs)
Cost to Company B of providing services (20 units * 100 per unit)	<u>2000</u>	(40% of total costs)
Total cost to group	5000	
Value of contribution made by Company A (30 units * 103 per unit)	3090	(59.5% of total contributions)
Value of contribution made by Company B (20 units * 105 per unit)	<u>2100</u>	(40.5% of total contributions)
Total value of contributions made under the CCA	5190	

Company A and Company B each consume 15 units of Service 1 and 10 units of Service 2:		
Benefit to Company A:		
Service 1: 15 units * 103 per unit	1545	
Service 2: 10 units * 105 per unit	<u>1050</u>	
Total	2595	(50% of total value of 5190)
Benefit to Company B		
Service 1: 15 units * 103 per unit	1545	
Service 2: 10 units * 105 per unit	<u>1050</u>	
Total	2595	(50% of total value of 5190)

54. Under the CCA, the value of Company A and Company B's contributions should each correspond to their respective proportionate shares of expected benefits, *i.e.* 50%. Since the total value of contributions under the CCA is 5190, this means each party must contribute 2595. The value of Company A's in-kind contribution is 3090. The value of Company B's in-kind contribution is 2100. Accordingly, Company B should make a balancing payment to Company A of 495. This has the effect of 'topping up' Company B's contribution to 2595; and offsets Company A's contribution to the same amount.

55. In this example, since all contributions to the CCA are low value added services, for practical reasons, contributions may be valued at cost since this will achieve results which are broadly consistent with the arm's length principle. Under this practical approach, the cost of Company A's in-kind contribution is 3000; the cost of Company B's in-kind contribution is 2000; and each participant should

bear the costs associated with 50% of the total cost of contributions (2500). Accordingly, Company B should make a balancing payment to Company A of 500.

Example 3

56. The facts are the same as example 1, except that Service 1 and Service 2 are equally valuable, and neither is a low-value service. The per-unit value of each service is 120.

Cost to Company A of providing services (30 units * 100 per unit)	3000	(60% of total costs)
Cost to Company B of providing services (20 units * 100 per unit)	<u>2000</u>	(40% of total costs)
Total cost to group	5000	
Value of contribution made by Company A (30 units * 120 per unit)	3600	(60% of total contributions)
Value of contribution made by Company B (20 units * 120 per unit)	<u>2400</u>	(40% of total contributions)
Total value of contributions made under the CCA	6000	

Company A and Company B each consume 15 units of Service 1 and 10 units of Service 2:		
Benefit to Company A:		
Service 1: 15 units * 120 per unit	1800	
Service 2: 10 units * 120 per unit	<u>1200</u>	
Total	3000	(50% of total value of 6000)
Benefit to Company B		
Service 1: 15 units * 120 per unit	1800	
Service 2: 10 units * 120 per unit	<u>1200</u>	
Total	3000	(50% of total value of 6000)

57. Under the CCA, the value of Company A and Company B's contributions should each correspond to their respective proportionate shares of expected benefits *i.e.* 50%. Since the total value of contributions under the CCA is 6000, this means each party must contribute 3000. The value of Company A's in-kind contribution is 3600. The value of Company B's in-kind contribution is 2400. Accordingly, Company B should make a balancing payment to Company A of 600. This has the effect of 'topping up' Company B's contribution to 3000; and offsets Company A's contribution to the same amount. Example 3 illustrates that, in general, assessing contributions at cost will not result in an arm's length outcome even in those situations in which the arm's length mark-up on the cost of contributions is identical.

Example 4³

58. In Year 1, a multinational group comprised of Company A (a country A corporation) and Company B (a country B corporation) decides to develop an intangible, which is anticipated to be highly profitable based on Company B's existing intangibles, its track record and its experienced research and development staff. Company A performs, through its own personnel, all the functions expected from an independent entity providing funding for a research and development project, including the analysis of the intangible at stake and the anticipated profits that can be derived from the investment, the evaluation of the funding risk, including the risk that further investment may be required to complete the project, and of the capacity of Company A to take that risk, and the making of decisions to bear, cover, or mitigate that risk. The particular intangible in this example is expected to take five years to develop before possible commercial exploitation and if successful, is anticipated to have value for 10 years after initial exploitation.

59. Company A and Company B decide to undertake the development through a CCA. Under the CCA, Company A will provide all funding associated with the development of the intangible (the development costs are anticipated to be \$100 million per year for 5 years). Company B will contribute the use of its existing intangibles and will perform and control all activities related to the development, maintenance, and exploitation of the intangible. The value of Company B's contributions (encompassing the performance of activities as well as the use of the pre-existing intangibles) would need to be determined in accordance with the guidance in Chapter VI and would likely be based on the anticipated value of the intangibles expected to be produced under the CCA, less the value of the funding contribution by Company A.

60. Once developed, the intangible is anticipated to result in global profits of \$550 million per year (years 6 to 15). The CCA provides that Company B will have exclusive rights to exploit the resulting intangible in country B (anticipated to result in profits of \$220 million per year in years 6 to 15) and Company A will have exclusive rights to exploit the intangible in the rest of the world (anticipated to result in profits of \$330 million per year).

61. A functional analysis by the country B tax administration of the arrangement assesses the functions performed, assets used and contributed, and risks assumed by Company A and by Company B. The analysis concludes that Company A's contribution to the CCA is solely R&D funding, including assuming the inherent risk associated with that funding. Taking into account the realistic alternatives of Company A and Company B it is determined that Company A should receive a risk-adjusted rate of anticipated return on its funding commitment. Assume that this is determined to be \$110 million per year (for years 6 to 15).⁴ However, since the CCA provides for Company A to reap benefits amounting to \$330 million of profits per year in years 6 to 15 (rather than \$110 million), balancing payments from Company A to Company B to account for the difference are required. In effect, Company A would need to 'top up' its contribution during the development phase by making a balancing payment to Company B equal in present value to \$220 million per year anticipated in years 6 to 15.

³ This example is based on Example 7 of the Guidance on Transfer Pricing Aspects of Intangibles, OECD/G20 Base Erosion and Profit Shifting Project, <http://dx.doi.org/10.1787/9789264219212-en>. Example 7 was bracketed and shaded in the 2014 report, indicating it should be viewed as interim guidance, not yet fully agreed by delegates. To the extent that changes are made to Example 7 in Chapter VI with respect to the language, the treatment of unanticipated profits, the rate of return to the funder or other figures applied, conforming changes are also likely to be required to Example 4 of Chapter VIII.

⁴ For purposes of this example, it is not necessary to derive these results. The example assumes that making a funding 'investment' of \$100 million per year for 5 years in a project with this level of risk should earn at arm's length anticipated profits of \$110 million per year for the following 10 years.

Example 5

62. The facts are the same as in Example 4 except that the functional analysis indicates Company A has no capacity to make decisions to take on or decline the risk-bearing opportunity represented by its participation in the CCA, or to make decisions on whether and how to respond to the risks associated with the opportunity. It also has no capability to mitigate the risks or to assess, monitor and direct the risk mitigation activities of another party conducted on its behalf.

63. In accurately delineating the transactions associated with the CCA, the functional analysis therefore indicates that Company A does not control the risks associated with the CCA and consequently should not be regarded as bearing them. Since a CCA requires all participants to share the contributions and risks associated with the CCA activities, Company A cannot be regarded as a participant in the CCA.