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EU JOINT TRANSFER PRICING FORUM

Working document on Cost Contribution Arrangements on Services not creating Intangible Property (IP)

Meeting of 8 March 2012

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Secretariat's note

General:

This document, doc: JTPF/020/REV2/2011/EN, includes the comments/suggestions received until Friday 10 February 2012 to the previous doc JTPF/020/REV1/2011/EN from Austria, The Netherlands, Ireland, Sweden and the Private Sector Members (PSM).

The document contains several mere drafting suggestions from Ireland that are shown in track changes within the text. The Bureau considers those mere drafting changes as adoptable.

Comments on substance are shown in boxes at the end of the respective paragraphs.

Summary of the main points addressed in the contributions received:

1. **Austria** regards contracts/written agreements as a prerequisite for a CCA (see par. 11).
2. **The Netherlands** have concerns about the need that participants should be involved in the strategic decisions (see par. 16).

In addition, the Netherlands provided 3 examples illustrating their conclusion that only in some cases it is appropriate to measure contributions in kind at costs (see section B of background document JTPF 006/BACK/2012/EN).

3. **Private sector members (PSM)** raised several issues on the paragraphs discussed at the last meeting and provided comments on the paragraphs not yet discussed.

Their main concerns are that in the absence of formal contracts, the document cannot suggest using "revision clauses" and that sharing of skills and knowledge should not be an essential criterion for this kind of CCA. - Further and alike the Netherlands, they have concerns regarding the requirement for CCA participants to be involved in strategic decisions.

Further they submitted examples illustrating areas where CCAs on services may occur in practice and also allocation keys that may be considered (see section A of background document JTPF 006/BACK/2012/EN).

4. **Ireland** made drafting suggestions for improving the language of the document. Their comments on substance can be found under paragraphs 11, 16, 17, 25 and 50.
5. **Sweden** suggested drafting the conclusion with respect to the mark-up (par 11) in accordance with the OECD Guidelines, i.e. that contributions **normally** do not include a mark up. Further they think a written agreement is important as it would normally be found between third parties.

Bureau's comments:

The comments received show that there are still the following open issues with respect to the paragraphs already discussed at the last meeting:

A. The need for/reference to "contracts" (main discussion in par. 11):

During its last meeting, JTPF members agreed that the existence of a written agreement was not a pre-requisite for a CCA. Based on this agreement PSM have suggested deleting all reference to "revision clauses" in the document as this term is seen as implying a contract. On the other hand Austria suggests that at least a written agreement should be regarded as an

essential prerequisite for a CCA. Sweden also underlines the importance of having a written agreement. The Bureau considers that for this discussion the following points should be taken into consideration:

1. In 8.3 of the OECD Guidelines a CCAs is defined as a contractual arrangement.
2. It may be asked, whether independent parties would agree to something equivalent to a CCA (e.g. a joint venture) without signing a contract or a written agreement?
3. What would be the behaviour of a prudent manager, i.e. would at least something in writing be required by independent parties?

Based on this, clarification is needed on what should be required for recognising a CCA on services:

- a) a formal contract and the information described in the narrative or
- b) a written agreement supplemented with the narrative or
- c) only the provision of the narrative .

A drafting suggestion based on the comment made by Austria is made in the box below paragraph 11. Further the following paragraphs may be affected by this discussion:

- Paragraph 7 "contractual arrangement",
- Paragraph 11 last sentence and box 3,
- Paragraph 16 points ii) and iii) and x) "revision clause",
- Paragraphs 21 Q1, 33 and 40 "revision clause",
- Paragraphs 24 and 49 "terms of the agreement"

B. Measuring contributions in kind at cost or at market value (main discussion in paragraphs 11 and 42)

Some MS raised concerns regarding the conclusion taken at the last meeting saying that contributions to the kind of CCA at stake do not include a mark up. The Netherlands provided 3 examples illustrating their conclusion that only in some cases it is appropriate to measure contributions in kind at cost (see section B of background document JTPF 006/BACK/2012/EN). In order to cover situations where a valuation at market prices might be needed, Sweden also suggested softening the language.

C. Sharing of skills and knowledge (see paragraph 11, first box)

For PSM sharing skills and knowledge should not be mentioned as a characteristic of a CCA. The Bureau agrees to this suggestion as not in all CCAs participants share skills and knowledge but some may e.g. only contribute in cash.

D. The kind and degree of active participation: (see paragraph 16 viii))

PSM and The Netherlands do not see an involvement in the decision making process as a general feature for determining whether a CCA is consistent with the arm's length principle. They prefer a limitation to the more flexible approach of determining the level of influence in accordance with the kind of CCA, expertise and costs allocated as outlined in the last sentence

of this box. This results in a kind of facts and circumstances approach leaving open, whether there may be CCAs without active involvement of all members of the CCA

E. Timing issues (paragraphs 16 iii) and iv) and 39)

The comment by Ireland on paragraph 16 shows that different points in time may be relevant when assessing a CCA, i.e. the time when the agreement is entered into and the point in time when the agreement enters into force. The term "entering into force" may have different meaning to readers, i.e. a pure legal meaning or a meaning as the point in time when the activity which is subject to the CCA actually starts.

For the Bureau the point in time when parties enter into the agreement is decisive for determining the arm's length nature of the CCA. For avoiding misunderstandings and in case the JTPF does not consider a formal contract as a prerequisite for recognising a CCA the Bureau suggests the drafting outlined in the boxes below paragraphs 16 and 39.

1. Introduction

1. [new] Cost Contribution Arrangements (CCAs) are commonly used as a cost-effective means for MNEs to carry out the group's activities. The business decision to have recourse to a CCA can be justified by various reasons, e.g. reasons of economies of scale, sharing of risks, or skills or resources.
2. [1] The topic of CCAs has been of long-term interest to the JTPF. It was carried-over from its previous work programme and under the new mandate the JTPF confirmed its former decision to explore the possible scope and degree to which a common approach to CCAs could be developed within the EU.
3. [2] CCAs are thoroughly discussed in chapter VIII of the OECD Transfer Pricing Guidelines (OECD Guidelines) and the OECD is currently involved in a project on the transfer pricing aspects of intangibles. To avoid duplicating OECD work, JTPF work will focus on services not creating intangibles. This work should be seen as supplementing the existing guidance and completing the JTPF's work on low value adding intra group services (JTPF IGS Guidelines).
4. [3] This document focuses on those issues which are for a reviewer difficult to deal with in practice and proposes how best to address them. The term reviewer covers both the taxpayer and the tax administration.

Note:

PSM suggested adding the word "in" to the original drafting. If **Ireland's** suggestions are adopted this word is superfluous.

Sweden suggests clarifying that this document does not include guidance in the VAT area. In case the JTPF sees a need for this clarification, the following drafting may be adopted:

"This document focuses on those issues which are for a reviewer difficult to deal with in practice when applying Article 9 of the OECD Model Tax Convention and proposestax administration. Other issues, e.g. those in the area of VAT are outside the scope of this document."

5. [7] Both OECD Guidelines (mainly chapter VIII but also VI and VII in relation to the ALP determination) and JTPF IGS Guidelines are taken into consideration in this document.

2. Terminology

6. [8] Given that there may be a different understanding on whether and how a CCA on services may be distinguished from intra group services charged directly or by way of creating a cost pool, this chapter seeks a common understanding of the terminology used. It describes the concept of a CCA on services and distinguishes it from intra-group services.

7. [9] A CCA is defined under 8.3 of the OECD Guidelines as a framework agreed among business enterprises to share the costs and risks of developing, producing or obtaining assets, services or rights, and to determine the nature and extent of the interests of each participant in those assets, services or rights. A CCA is a **contractual** arrangement rather than necessarily a distinct juridical entity or PE of all the participants. In a CCA each participant's proportionate share of the overall contributions to the arrangement will be consistent with the participant's proportionate share of the overall expected benefits to be received under the arrangement.

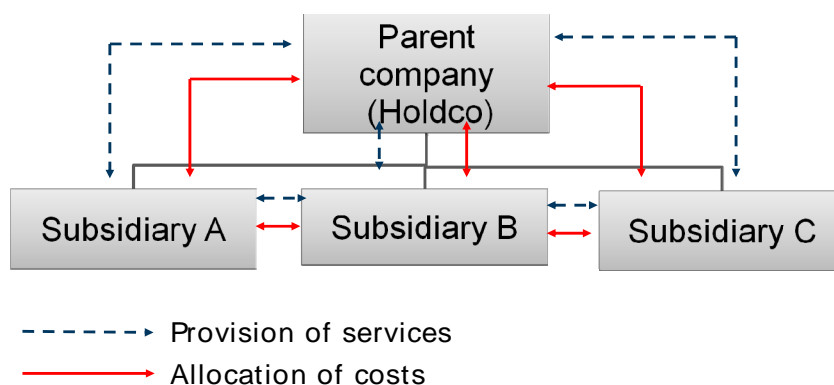
Note:

PSM suggest deleting "contractual" in the fourth row. Their suggestion should generally be seen in the context of the general discussion on the need for contracts or written agreements (see par 11 and the Secretariats note at the beginning of this document).

It should, however, be noted that the text is a quotation of the OECD Guidelines. Therefore the **Bureau suggests** leaving the text unchanged but to flag this part as a quotation from the OECD TPG

8. [11] Illustration of a CCA on services:

Cost contribution arrangement

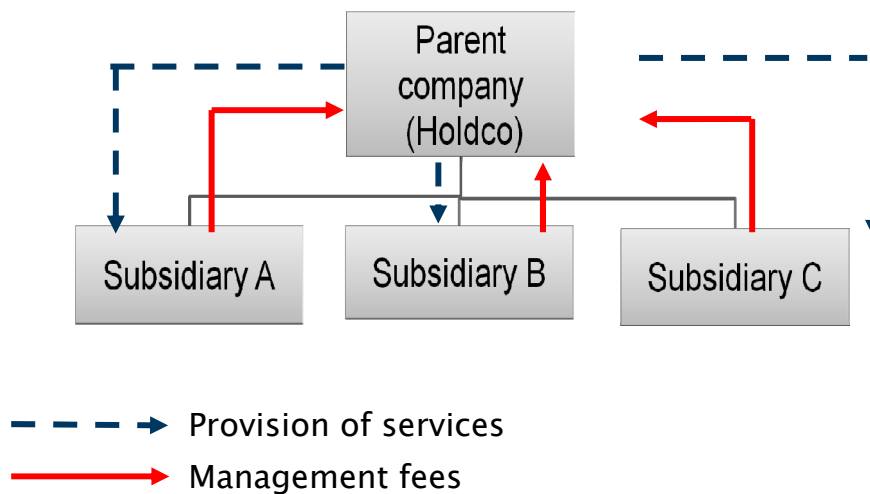


9. [12] The concept of intra-group services is described in 7.2 of the OECD Guidelines: nearly every MNE group must arrange for a wide scope of services to be available to its members, in particular administrative, technical, financial and commercial services. The cost of providing such services may be borne initially by the parent, by a specially designated group member ("a group service centre") or by another group member. Chapter VII of the OECD Guidelines provides guidance for

determining whether intra group services have been rendered, on direct or indirect charging mechanisms and for determining under which circumstances services may be charged at cost or whether and how an arm's length charge including a mark-up may be determined.

10. [14] Illustration of Intra-group services:

Intra Group services



11. [15] A further variant not explicitly mentioned in the OECD Guidelines but often encountered in practice is arrangements where several members of a multinational group pool the costs of certain services and charge them (directly or indirectly) to members of the group benefiting from those services. Further it is also possible that some members of the multinational group agree on a CCA on services and other members of the group that do not participate in the CCA provide services to the members of the CCA. In practice it is sometimes difficult to differentiate between (shared) intra-group services - including cost pools - and CCAs on services not creating intangible property (IP). The following table is intended to help reviewers to differentiate between the two concepts, notably when no written convention (agreement or contract) is available.

Note:

PSM raise a question whether the first highlighted sentence helps to differentiate between CCA and IGS

Sweden suggests deleting the last part of the last sentence for reasons of not underestimating the importance of written agreements. The last sentence may also need to be redrafted in accordance with the decision on the need for contracts/written agreements.

CCAs on services not creating IP	Intra-group services
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Agreement to share costs, risks and benefits where all participants contribute in cash or in kind and share skills and knowledge. Contributions do not include a mark up.	Intra-group services are limited to the provision or acquisition of a service by members of the MNE Group and the risk is generally borne by the service provider. A mark-up is generally charged.
If participants join or leave a CCA, shares should be adjusted/rebalanced in accordance with the arm's length principle.	Terminating or extending the service agreement to other participants has generally no implication on other service recipients.
A formal contract between the participants is often found but is not a prerequisite for recognising a CCA. A written agreement and/or sufficient documentation is important for the reviewer when examining the implementation/performance of the CCA.	In practice, formal contracts are not always available. The agreement often is limited to the direct relationship between the provider and the recipient of the service but demonstrated by the "benefit test".
As all participants are contributing to a common project and share costs and the contributions reflect the expected benefits there is no mark up charged between the participants.	The mark-up charged by the provider of the service is usually a key element as the provider will not share profits with the recipients.
The repartition of the costs is based on the expected benefits for each participant.	The allocation key is based on the extent each company has requested/received or is entitled to the service.

Note on CCAs (left column)

First box:

PSM and **Ireland** suggest deleting "*and share skills and knowledge*" in the first box of the left column" Ireland proposes this deletion because it is already covered by the concept of "*in kind*".

Third box:

PSM suggest replacing "sufficient" with "relevant"

Sweden highlights the importance of agreements in writing. For **Austria** a written agreement should be a general prerequisite for a CCA. With respect to this, they suggest going either back to the original language, saying that a formal contract is essential or as an alternative, leaving out the second part of the first sentence, i.e. "*but not a prerequisite for recognising a CCA*".

The Bureau suggests drafting the text in the box along the line suggested by Austria and by concretely highlighting that documentation as elaborated below are required instead of using terms like "*sufficient*" or "*relevant*".

"A formal contract between the participants is often found. A written agreement and documentation along the lines outlined in section 5 below is important for the reviewer when examining the implementation/performance of the CCA."

Paragraphs 7, 16, 21, 24, 33, 40 and 49 will have to be drafted in accordance with the agreement reached here.

Fourth box:

Ireland suggests deleting in the first box "*Contributions do not include a mark up*" as it is already stated in box 4.

Sweden suggests aligning the text in the first and the fourth box with the language used in par 8.15 of the OECD TPGL, i.e. that normally no mark up is charged. If Irelands suggestion above is adopted a change would only concern the fourth box.

For **The Netherlands** the general statement that contributions do not include a mark up does not apply to all cases. Only comparable contributions can be valued at cost. If contributions to a CCA are not comparable they need to be measured at market value in order to get an arm's length outcome. Considering the kind of CCA at stake it may be appropriate for practical reasons to value the contributions at cost considering the often small difference between the pricing at cost value and at market value. NL has submitted three examples illustrating this (see also box below paragraph 42)

The Bureau suggests the following drafting to the first and fourth box of the table:

First box: *Contributions often do not include a mark up and*

Fourth box: *.... benefits there is often no mark up charged between the participants.*

Note on IGS (right column):

Ireland suggests deleting the reference to the mark up in the first box as already mentioned in box 4.

12. [16] For the purpose of this document the terms CCA on services and Intra Group Service (IGS) should have the meaning as elaborated in the table above, taking into account that there may be overlaps in practice.

3. Scope

13. [20 - first sentences] While the JTPF IGS Guidelines focus on issues encountered in relation to services of an administrative nature ancillary to the business of the recipient, this document addresses specific considerations in cases where all kinds of intra group services without IP impact are embedded into a CCA.
14. [18] An exhaustive definition of the services which may be subject of a CCA is neither possible nor desirable. Services that are within the scope of this document might include the following activities: IT, logistics, purchasing, real estate, finance, tax, human resources services, accounting, payroll, billing, ...(in so far as the activities performed for the joint benefit of the participants to the CCA do not result in any material IP being produced or developed). This list of services is only illustrative and does not automatically imply that a service is covered by or excluded from the scope of this document

Note:

PSM suggest adding the examples in the third row and "material" before IP in the sixth row. Other drafting suggestions have been suggested by Ireland.

For the **Bureau** the drafting suggestions seem to be uncontroversial. However, JTPF Members may want to discuss the implications and usefulness of adding "material" before IP.

4. General Features: is the CCA consistent with the arm's length principle

15. [19 first part] The OECD Guidelines state that MNEs are free to organise their business operations as they see fit. A MNE is free to decide whether services performed intra group will be charged directly or indirectly, by way of IGS (including cost pools) or whether a CCA is considered as being more appropriate.
16. [26 and 19 second part] As a general principle, determining whether a CCA is consistent with the arm's length principle requires that a CCA is consistent with what independent enterprises would have agreed to contribute under comparable circumstances given the benefits they reasonably expect to derive from the arrangement (from the pooling of resources and skills) and which includes the sharing of costs and risks to satisfy a common need. The relevant question for a reviewer under Article 9 of the OECD Model Tax Convention is whether a CCA is implemented/ performed in accordance with the arm's length principle. This should not lead the reviewer to challenge the business choice or the reasons behind the choice or to request from the taxpayer an analysis of what was the best choice, i.e. a reviewer should not request a comparison between a CCA and an IGS if one of these has been used.

Note:

Sweden suggests redrafting the first sentence as shown in the text.

PSM suggest deleting "specific" before comparison.

Although the original drafting could theoretically be understood as allowing a reviewer to request not a specific but a general comparison, the **Bureau suggests** adopting this proposal to avoid any misunderstanding.

In particular:

- i. The arrangement should make business sense.
- ii. The economic substance should be consistent with the terms of the CCA.
- iii. The terms of a CCA should be agreed before the agreement enters into force (no retroactive effect).
- iv. The terms of a CCA should be at arm's length taking into account the circumstances known or reasonably foreseeable at the time of entry into the arrangement.
- v. Each participant should have a reasonable expectation of benefit.
- vi. The participant's share of the costs should be consistent with its share of the expected benefits.
- vii. Reasonable expected benefits can be assessed in terms of efficiency or effectiveness in quantitative or qualitative terms.

- viii. Contributions by a participant can be in cash or in kind and therefore active participation is not a requisite. **However, each participant is involved in strategic decision-making but not necessarily in the day to day decision making.** The level of influence on decision making will vary depending on the type of CCA, the expertise and the amount of costs being allocated to the respective participant.
- ix. When a service subject to a CCA is also provided to or received from non participants in the CCA it has to be valued at arm's length.
- x. If participants join or leave the CCA, shares should be adjusted/re-balanced in accordance with the arm's length principle (this implies the existence of a revision clause).

Note:

Ireland suggests drafting sub item ii) iii) iv) v) and viii) as outlined above.

For the **Bureau** the point in time when parties enter into the agreement is the relevant point in time for determining the arm's length nature of the CCA. For avoiding misunderstandings and in case the JTPF does not consider a formal contract as a prerequisite for recognising a CCA the Bureau suggests the following drafting:

"iii) The terms of a CCA should be in advance (no retroactive effect).

iv) The terms of a CCA should be at arm's length taking into account the circumstances known or reasonably foreseeable at the time of entry into the arrangement."

If this drafting is adopted, par. 39 may remain as suggested. Otherwise a redraft would be necessary

The Netherlands and **PSM** suggest deleting the second sentence in sub item viii) as not relevant considering the type of activities covered.

PSM further suggest deleting the text in brackets in the last sentence of sub item x because a contract is not required. This issue is linked to the overall discussion on the "contract" issue.

17. [first part of 33, partly moved to new paragraph 19] The actual outcome may differ from the projected outcome, e.g. the contribution provided by a participant is excessive or the benefit derived from its participation in the CCA is inadequate. Such differences are not uncommon. When such a difference occurs, the reviewer should analyse the reasons for this difference before concluding whether a participant's proportionate contribution has been correctly or incorrectly determined, or whether the participant's proportionate expected benefits have been correctly or incorrectly assessed.
18. [second part of 33] A further question for the reviewer is whether the difference is so essential that it requires modification/compensation or the difference is considered as small enough to avoid any adjustment, given that the OECD Guidelines provide that tax administrations should refrain from making minor or marginal adjustments.

19. [third part of 33 with additions from first part of 33] In some cases the facts and circumstances may also indicate that the reality of the arrangement differs from the terms purportedly agreed by the participants (8.29 OECD Guidelines). A reviewer's decision should always be based on the facts and circumstances relating to the specific arrangement for an adequate period but the reviewer should refrain from making an adjustment based on a single year. □ A reviewer should also take into consideration that the ALP does not require per se that projections of benefits match the actual benefits and even a material difference between actual and projected benefits does not automatically mean that the projection was not at arm's length. In addition, the use of hindsight is never appropriate.

Note:

PSM suggest adding the following sentence after the second sentence:

"A reviewer should acknowledge that the CCA may contain a suite of activities and may not therefore require evidence of benefit for every participant from every activity, as long as the overall expected benefit of the arrangement is in line with the participant's contribution."

20. [28] Considering the previous paragraph, the application of the ALP might require an adjustment of the participant's contribution through a balancing payment when the situation arose for example from an incorrect evaluation of the expected benefits. In some other cases part or all of the provisions of the CCA will be disregarded e.g. when the facts and circumstances differ from the terms agreed in the CCA¹.

Note:

For **Sweden** a contribution in cash, either as a pure cash contribution or in the form of a not insignificant balancing payment, has to be looked at closer in order to conclude whether or not it should be characterized as a payment for a service provided by the CCA to that specific contributor instead of a contribution to the CCA. (*A comparison to a CCA licensing the rights to use IP against a royalty payment can be made.*) This should be highlighted in the document. According to the TPGL all transactions shall be evaluated according to their substance, not their form.

JTPF may discuss whether this suggestion should be adopted or whether the message is not already covered by the last sentence of paragraph 20. Further a reference to the new Chapter IX part IV "Recognition of the actual transactions undertaken" may be considered.

21. [29] Balancing payments will be treated as an additional cost for the payer and as a reimbursement of costs for the recipients.

Q1: [14] One should ask whether independent parties would not review on a regular basis agreements that can be compared to CCAs. Does the forum consider that CCAs should include a revision clause in order to be at arm's length and would it be appropriate to elaborate the document with respect to revision clauses?

¹ In this respect see par 8.26 to 8.30 of the OECD TPGL

PSM comment: As there is no need for an agreement, there is presumably no need for a revision clause and we see no need to elaborate on revision clauses.

Sweden: OECD working area

Q2: [Former Q17] Should the JTPF prepare recommendations about specific considerations indicating that adjustments could be considered as minor or marginal and justifying that no adjustment is made to the contributions? Should the forum agree on a threshold under which the difference would be considered as minimal? This would become a risk assessment tool for both sides.

PSM comment: It would be helpful to establish the principle that minor relative differences should not trigger automatic adjustments (in line with the range concept in the TPG)

Sweden: This does not fall within the JTPF mandate. Each member state must have the right to decide what limits and thresholds should be applied. However, we find it acceptable to give descriptions of what can be done and applied, but not to be prescriptive.

Q3: [15] Does the forum consider that a participant to a CCA can engage a separate entity to perform part or all of the activities? What impact could it have on a reviewer's assessment of the CCA?

PSM comment: Yes. In principle, no impact as long as the arrangement is arm's length

Sweden: OECD working area

5. Corroborative Information: Narrative related to a CCA on services not creating IP

22. [21] In the light of the facts and circumstances of a case, the level of experience and knowledge of the particular MNE concerned, a reviewer may take different approaches in requesting what is considered sufficient corroborative information to confirm that a CCA on services complies with the arm's length principle. In making an informed decision, access to sufficient, good quality information is crucial.
23. [22] In preparing or reviewing a CCA, a reviewer will need to understand and achieve confidence on several key issues. The main driving question is: "would independent parties have agreed to such an arrangement"? The way to answer this question will probably not vary a lot from the approach developed in the JTPF IGS Guidelines, where the provision of a narrative was the suggested tool.
24. [23] The key element is of course the agreement itself. There should be a clear expectation of mutual benefit for all parties to a CCA. An independent party would enter into a CCA-type arrangement without a reasonable expectation of benefit (see 6.1 below). Secondly, the terms of the agreement should ensure that the allocation of the contributions reflect each participant's expected benefits (see 6.2 below).

Note:

Drafting suggested by **Ireland**

25. [24] As each CCA will be different, the exact content and extent of the narrative may vary but the following list of items should address the requirements of most reviewers.

i) General information about the CCA

- a) [a)] Explaining the CCA within the overall context of the MNE's business in order to understand the rationale: participant's mutual economic interest, required knowledge and skills, expected benefits, what risks are shared, etc.
- b) [f)] An account of the type of services that are the subject of the CCA.
- c) [b)] List of participants.
- d) [h)] The allocation of responsibilities and tasks associated with the CCA activity between participants and other enterprises.

<p>Note: Drafting suggested by Ireland</p>
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- e) [c)] Budget of the project and a description of the resources at the disposal of the participants to contribute to the CCA activities.
- f) [d)] A reconciliation of the MNE's overarching transfer pricing policy to the services included in the CCA.
- g) [u)] Documentation that can be provided.
- h) [new, taken from former s)] Duration of the CCA.

<p>Note: PSM suggest deletion of points e, f, g</p>
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ii) Benefit from the CCA

- i) [e)] Expected benefit to be derived by each participant and the way it was measured (including methodology and any projections used).
- j) [o)] A description of the allocation method which must reflect expected benefits.

iii) Contribution to the CCA

- k) [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 and how accounting principles are applied consistently to all participants in determining expenditures and the value of contributions.

<p>Note: PSM suggest deletion of the last part of point k after the word "and". Sweden suggests deleting this sub item completely as covered by p)</p>
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- l) [i)] An explanation of the structure by which contributions/costs are shared. There may be one shared service centre.
- m) [p)] A record of how costs are accounted for to include the invoicing system, settlement dates, payment methods and any budget versus actual adjustments.

n) [j)] Are there contributions in kind? How are they valued?

Note:

PSM suggest deletion of point n)

o) [k)] Existence of government subsidies or tax incentives linked to the participants' contributions? What is their impact?

Note:

PSM suggest deletion of point o).

Ireland's suggestion is to replace the word "CCA's" by "participants".

p) {n)] The annual expenditure incurred in conducting the CCA activity, the form and value of each participant's contributions made during the term of the CCA and a detailed description of how the value of contributions is determined and how accounting principles are applied consistently to all participants in determining expenditures and the value of the contributions.

iv) Monitoring/Adjusting the CCA

q) [m)] A description of how any contribution pool is constructed. Information about balancing payments, i.e. under which conditions they arise, how they are calculated and when they are due.

r) [l)] A description of the Group standard as it relates to its audit approach and as applied to CCAs. For example defining direct and indirect costs for inclusion in the contribution pool; safeguards in place to ensure the consistent application of an allocation key for a particular service; ensuring costs/services are not duplicated.

s) [s)] How the CCA provisions are maintained and updated.

t) [w)] An understanding of how new participants are integrated into the CCA and how a participation is terminated. Provision of the method to be applied when shares in the CCA need to be adjusted/rebalanced.

v) Relationship to other entities

u) [q)] A description of how any mergers or acquisitions are incorporated into the CCA.

v) [r)] A list of other members of the Group or independent enterprises who benefit from services included in the CCA. Description of the fees to be charged and allocation key(s) for the repartition between the participants.

26. [25] The above information may be made available and provided in different ways such as a dedicated written narrative or it may also be the case that the written agreement already provides most information. The important point is that the reviewer gets an understanding of how the CCA works in practice.

Q4 [9]: Does the forum agree with the items included in this narrative?

PSM comment: yes subject to amendments proposed

Q5 [10]: Is there any other item/issue that should be included?

PSM comment: No

6. Specific aspects

27. [30] This chapter addresses some specific issues for which the reviewers might need additional guidance.

6.1 The 'expected benefit' test

28. [31] The 'expected benefit' test is an essential element in the setting-up and review of a CCA. It will be the basis for assessing the arm's length nature of each participant's contribution to the CCA and will justify the allocation key.
29. [32] Based on the arm's length principle, the participant's contribution must be consistent with the expected benefits it will derive from its participation in the CCA. Benefit in this context means an increase in economic or commercial value such as the savings of expenses or an increase in income. It should be noted that what distinguishes IGS from CCA as regards the benefit test is that for CCAs a reviewer should check - in addition to the verification whether the services covered were actually provided (IGS requirement) - whether contributions are in accordance with the expected benefits that each participant might derive from the pooling of skills and resources.
30. [box below former paragraph 33-now § 17 to 19: suggested re-drafting of IGS Guidelines] It is key that the reviewer is satisfied that from the participant's ~~the~~ perspective ~~of the provider~~ the contribution provides reasonable benefits in terms of economies of scale or risk sharing or sharing of skills and that service has been rendered and from the perspective of the recipient the service provides economic or commercial value to enhance its commercial position and the participant recipient would have paid for the service activity or else performed the service itself. The allocation key of the costs is commensurate with the expected benefit of the participant, the participant takes advantage of the outcome of the CCA in a consistent way with the arrangement and, if applicable, arm's length fees/indemnities are expected for late comers and early leavers.
31. [box below former paragraph 33-now § 17 to 19: suggested re-drafting of IGS Guidelines] The degree of certainty a reviewer requires in accepting that the provision of a service under a CCA meets the arm's length standard will vary from case to case on a risk assessment basis.

Q6 [16]: Does the forum recognise and agree to these observations and more specifically is the concept of benefit described sufficiently?

PSM comment: Yes, subject to comments made (included under para 19 above):

"A reviewer should acknowledge that the CCA may contain a suite of activities and may not therefore require evidence of benefit for every participant from every activity, as long as the overall expected benefit of the arrangement is in line with the participant's contribution."

Q7 [18]: In your view, how should the expected benefit be assessed? Quantitative or qualitative approach, or both? For services, which elements do you consider as most relevant for the quantitative analysis?

PSM comment: both assessments required

Q8 [19]: In your view, how and how often should the expected benefit be re-assessed? Quantitative or qualitative approach or both?

PSM comment: as appropriate

6.2 Contributions of each participant

32. [34] Each participant's contribution must be consistent with what independent parties would have contributed in comparable circumstances. Valuation of the shares in the reasonably expected benefits is one of the major difficulties in CCAs. However this will form the basis for the calculation of the contributions.

Note:

Drafting suggested by **Ireland**

33. [35] In practice the allocation method might be based on estimated costs that will be saved by each participant in the arrangement but more often allocation keys are used to determine each participant's contribution.

Q9 [21]: Does the forum think it is appropriate to refer to JTPF IGS guidelines as regards allocation keys, or rather that some specific work on the issue should be necessary, taking into account that the expected benefits for CCAs are based on a projection whereas the allocation key for shared services is usually based on an annual ex-post calculation? (Please see IGS extract in annex) Should we include language along the lines of paragraphs 47 – 53 of the IGS Guidelines?

PSM comment: helpful

Q10 [22]: Does the forum consider that only a direct method of evaluation of expected benefit (i.e. estimation of the additional income to be generated or costs to be saved) or indirect methods would also be acceptable (i.e. using indirect indicators of the expected profit like turnover, number of employees, gross profits, etc.)?

PSM comment: Both

Sweden: OECD working area, but ok with examples

Q11 [23]: Does the forum think that the arrangement should mention different steps in the activities covered by the CCA which would be linked to revision clauses as regards the allocation keys (methods)?

PSM comment: No

34. [36] As contributions are based on expectations this generally implies that contributions are based on budgeted figures which are compensated at a later stage based on actual figures. In order to address this issue, the OECD Guidelines recommend preparing an annual account of expenditure incurred in conducting the CCA activity, which would include a detailed description of how the value of the contributions is determined and how accounting principles are applied consistently to all participants in determining expenditures and the value of the contributions.

Note:

Drafting suggested by **Ireland**

Q12 [24]: Does the forum think that budgeted costs versus actual costs need specific recommendations?

Q13 [new]: Would the forum agree on not relying on its own (national) accounting principles for determining the contribution of a certain participant but would rather accept a calculation based on international accounting standards or a calculation based on the accounting standards of one of the participant's home states?

PSM comment: Rephrasing:

"Would the forum agree that the contribution of a certain participant is based on international accounting standards rather than a calculation based on the accounting standards of one of the participant's home states?"

Answer: Yes.

Sweden: Each MS must have the right to decide this

Q14 [25]: Does the forum think that MNEs should be encouraged to ask external auditors to issue an annual report or a letter stating the costs supported for the CCA and the consistency or accuracy of the allocation key which might include reconciliation with the expected benefits?

PSM comment: No

35. [37] Contributions should include all relevant costs for the acquisition, maintenance or for securing the benefits derived from the arrangement. A reviewer will need to understand which costs have been considered relevant (allocable). Sometimes this will be self-evident from the type of services covered by the CCA. Sometimes, in more complex situations, the arrangement should clearly explain what costs are excluded or how potential duplication of costs has been avoided.
36. [38] Related issues are the treatment of tax incentives and government subsidies which have not been addressed by the OECD Guidelines. Those issues are probably

less relevant for the type of CCAs this document is addressing but the key question is whether costs passed to the CCA should only include costs effectively spent from which tax incentives and government subsidies have been deducted

Note:

PSM comment: deletion of paragraph 36 (not relevant)

Q15 [26]: Does the forum want to provide specific recommendations about what are "relevant allocable costs" (including recommendations on tax incentives and government subsidies)?

PSM comment: yes

Note:

If the Forum wants to make specific recommendations, Austrian's contribution on the treatment of tax incentives may be reflected here

Sweden: OECD working area

It should be noted that Germany in its guidelines requires deduction of any tax incentive or subsidies.

6.3 Anticipated benefit versus actual

37. [39] As CCAs are arrangements based on expected benefits, independent parties might in consideration of the often long duration of the CCA include a clause in the contract allowing regular assessment of whether expected benefits are in line with actual benefits and whether contributions should not be changed prospectively.
38. [40] Addressing those two concerns opens the issues of whether contributions can be adapted to the actual situation and whether this is to be considered as arm's length or as the improper use of hindsight.
39. [new] The CCA must be examined by reference to the assumptions of future benefits based on the economic and commercial circumstances prevailing or reasonably foreseeable at the time the arrangement is entered into. Therefore if a reviewer considers the benefit projections as correct, future events affecting the initial projections should not lead to retrospective adjustment of the contributions.
40. [new] As unexpected or unforeseeable events or circumstances may affect the initial benefit assumptions a reviewer should consider whether independent parties would have included a revision clause to provide for such a situation. Reviewers might address this by including a revision clause in the agreement.

Note:

PSM comment: deletion of last sentence of the paragraph.

Drafting suggested by **Ireland** are included in paragraph 39 and 40 but will depend on the final outcome of the discussion in paragraph 11

Q16 [27]: Does the forum agree to those paragraphs?

PSM comment: Yes with proposed amendments

Q17 [28]: Should the forum try to develop further recommendations in this area?

PSM comment: No.

6.4 Participation in a CCA

41. [new] The key feature of a CCA is that the contributions of the participants are in accordance with the expected benefits of the respective participants from the participation in the CCA. An enterprise taking its expected benefit solely or mainly from the performance of the CCA activity itself would not be considered as being a member of the CCA but rather as a service provider (company) that would add a profit element in its calculation, i.e. should be considered as a company providing services covered by the IGS Guidelines.
42. [new] Based on the considerations above, a company actively contributing to a CCA would therefore make a comparison of the alternatives reasonably available to it, i.e. whether the expected benefit of participating in the CCA (without getting a mark-up) is more or at least equally beneficially to it as not participating in the CCA and charging the activity with a mark up/paying an arm's length charge for services that will be received from the participants of the CCA.

Q18 [31]: Does the forum agree with these observations?

PSM comment: No, suggestion to omit paragraphs 41 and 42 (seem redundant)

Ireland raises the question whether those two paragraphs are totally correct considering the "mutual benefit" criterion?

Bureau suggestion:

Considering the comment by **The Netherlands** on whether a contribution should be measured at costs or at market prices (see box below paragraph 11 above) the Bureau suggests changing the headline to "6.4 Participation in the CCA/Mark up" and replacing paragraph 42 as follows:

42. The value of each participant's contribution must be consistent with the value that independent parties would have agreed to in comparable situations. No specific result can be provided for determining participant's contributions in all situations, but rather the question must be resolved on a case by case basis consistent with the general operation of the arm's length principle. One essential question is whether an independent party would charge an additional profit element in such circumstances. Countries have experience both with the use of costs and with the use of market prices for the purposes of measuring value of contributions to arm's length CCAs. A straightforward matter to determine the relative value of each participant's contribution may be in a situation, where all contributions are made wholly in cash, for example, where the activity is being carried out by an external service provider and the costs are jointly funded by all participants. In cases where all contributions are comparable, a valuation at costs may be appropriate. If contributions to a CCA are not comparable they need to be measured at market value in order to get an arm's length

outcome. Considering the kind of CCA at stake it may be appropriate for practical reasons to value the contributions at cost considering the often small difference between the pricing at cost value and at market value.

6.5 Joining/Leaving a CCA

43. [42] The general issue of entities joining or leaving a CCA is in practice often a very difficult topic even if mergers and restructuring are part of the day-to-day business of MNEs. How to assess the value of work in progress and/or the specific skills acquired from past activities are questions often leading to difficulties for any reviewer.
44. [43] However, as the present scope is limited to CCAs on services not creating IP, the examination of buy-in / buy-out issues should be very limited (or non existent). Answering the following questions should help reviewers: what additional costs will be paid by former participants when an entity joins or leaves? Is the arrangement still sustainable after the departure of this company? Should those new elements (different cost structure, or expertise, or skills, or risks, etc.) be compensated in money or do they only lead to a revision of the expected benefits that will lead to the adoption of new allocation keys or does the new participant bring specific knowledge?
45. [44] Clearly, if the outcomes of prior activities developed under the CCA have no value, no compensation should take place. However, entry or departure of a company will generally lead to an adjustment of the proportionate shares (allocation keys).

Q19 [32]: does the forum agree with these conclusions?

PSM comment: Yes

6.6 Documentation

46. [new, reflects former t)] Reviewers should be aware that CCAs are already governed by the Code of conduct on EU Transfer Pricing Documentation (EU TPD) wherein it is stated that MNEs should include in the masterfile a list of CCAs as far as group members in the EU are affected.
47. [45] The OECD Guidelines (5.4) refer to prudent management principles that would govern the process of considering if transfer pricing is appropriate for tax purposes and the extent of any required level of supporting transfer pricing documentation.
48. [46] This theme is echoed in point 2.3.1 of the EUTPD which says: "The "prudent business management principle", based on economic principles, implies that the sort of evidence that would be appropriate in relation to a transaction of large value might be very different from the sort of evidence that would be appropriate in relation to a transaction where the overall value is significantly smaller".

49. [47] Applying this principle to CCAs would lead participants to prepare or to obtain materials about the nature of services covered and the terms of the arrangement as well as its consistency with the ALP (including projections used to establish the expected benefits and budgeted versus actual expenditures).
50. [48] It should be noted that information from one source (e.g. a written agreement) may cover information already covered by another source (e.g. a narrative). The extensive use of computerized systems also provides the opportunity to see summary level detail which may then prevent the need for more extensive primary documentation.

Note:

For **Ireland** the first sentence seem not clear

51. [49] CCA agreements supplemented where necessary by information listed in the narrative relating to CCAs are considered by the JTPF as relevant information as regards EUTPD requirements.

Q20 [33]: does the forum recognise and agree these observations? Does the forum think that this chapter should be further developed?

PSM comment: Yes, with a view to practical guidance

Q21 [new]: should terminated CCAs be included in the masterfile list mentioned in § 46?

PSM comment: generally not

6.7 Post review considerations:

52. [new] CCAs will often involve more than two entities and therefore any adjustment affecting one entity will impact the other entities. Inin case of dispute the mutual agreement procedure may involve more than two Competent Authorities. Therefore it will be useful to apply the multilateral approaches recommended in the Code of Conduct on the Arbitration Convention for triangular cases.

Q20 [new]: A change of the contribution, e.g. the cash paid by one participant, automatically influences the shares of the other participants. Does the forum agree that a reference to multilateral approaches or the JTPF paper on triangular cases is useful?

PSM comment: Yes

Q21 [34]: Based on the former analysis, does the forum consider that the JTPF should develop specific recommendations on Dispute resolution/MAPs and APAs related to CCAs on services not creating IP?

PSM comment: Maybe for later consideration

Q 22 [35]: Does your TA give access to APA for CCAs?

7. Current state of play as regards Member States' CCA legislation, administrative guidance and best practices

53. [50] This section aims to summarise the current state of play as regards CCA legislation or administrative guidance within EU MS.
54. [51] The section below is drafted on the basis of contributions provided by EU tax administrations to reflect the situation prevailing on 1 July 2011.

Question 1: Do you have specific legislation relating to CCAs? If not, is it under consideration and when might it be introduced?

Few MS have specific legislation on CCAs.

Estonia, Spain, the Netherlands, Portugal and Slovenia apply specific legal provisions concerning CCAs for obtaining assets, rights or services, whereas Poland's legislation refers to CCAs only in the context of intangibles. Germany has specific provisions only as regards CCA documentation. Other MS use the OECD Transfer Pricing Guidelines or their own general TP guidelines to evaluate CCAs.

Introducing new specific provisions on CCAs is only under examination in Greece.

Question 2. Has your administration issued internal audit guidelines providing guidance on CCAs and if yes, which key points do they address (e.g. how to recognise an arrangement, how to audit the arrangement, how to facilitate exchange of information with other countries, etc.)?

Few MS have issued internal guidelines on auditing CCAs.

Italy, Lithuania, Slovenia and the United Kingdom have guidelines on transfer pricing which also cover the audit of CCAs. In particular, the UK guidelines stress the importance of identifying a clear expectation of mutual, overall benefit to distinguish a CCA from a more normal situation with straightforward transfer of goods or services.

In Hungary, a government decree on documentation requirements regarding transfer pricing agreements in general is applied.

Latvia has internal general guidelines regarding CCAs, which are based on the OECD guidelines.

Portugal is in the process of approving a Transfer Pricing Audit Manual that also includes internal audit guidelines in areas such as CCAs.

Question 3. Has your administration published domestic administrative guidance on CCAs (Guidelines, Regulations, Circular Letters, etc.) explaining the procedure to be followed by the taxpayer when preparing a CCA, with particular reference to the structure and documentation requirements (where existing, could you provide details of the electronic link to the documents)?

Few MS have issued domestic administrative guidance on CCAs.

In Denmark, CCAs are addressed in the Danish Transfer Pricing Documentation Guidelines.

Estonia has issued guidelines containing a short overview of the OECD TP guidelines and examples.

In Hungary, a government decree on documentation requirements regarding transfer pricing agreements in general is applied.

Germany has issued administrative guidance which is binding for the tax administration, but not for the courts.

The Italian audit guidelines are public, addressed to tax inspectors but also followed by taxpayers.

Portuguese regulations envisage including relevant information on a CCA in the TP file.

Question 4. What is the most common type of CCA used by enterprises in your MS?

CCAs dealt with by MS Tax Administrations most often relate to services, development of intellectual property, research and development and acquisition of assets.

Questions 5-7. What particular practical problems have you encountered in dealing with CCAs and how have you addressed those problems? What are your particular concerns as regards CCAs on services? Based on your experience, how frequent are disputes linked to CCAs?

The most common practical problems encountered in the context of CCAs relate to the availability/timely provision by taxpayers of sufficient information/TP documentation, the suitability of allocation keys, the calculation of entry and exit fees, valuation of buy-in/buy-out payments, distribution of costs, identification of comparables, applicability of profit margins, as well as the actual identification of a CCA.

Specific concerns for TAs in this context include the criteria for identification of a CCA, measuring the value of participants' contributions to a CCA and evaluating the associated benefits (expected and actual) and risks for the purpose of allocating costs, the applicability of mark-ups, as well as access to relevant documentation.

Disputes related to CCAs in EU MS are reported to be rare.

ANNEX: Table with MS' answers on CCAs legislation and administrative guidance

To be included in the final report.

Annex on IGS Guidelines:

Please note that the annexes relating to the IGS Guidelines are only provided to facilitate the analysis of the actual working document.

The IGS Guidelines' narrative:

- As part of a sanity check exercise to put the provision of services in context some indicative ratios may be requested (e.g. costs incurred for intra group services compared to overall operating expenses or the level that intra group service provision turnover bears to total turnover). Any such ratios will need to be interpreted within the context of the associate's nature of trade.
- Explaining a service provision within the overall context of the MNE's business in order to understand the rationale both for the provider and the recipient. For example economies of scale may make it more efficient for a subsidiary to have payroll services or HR services centrally provided. Again, it may make more economic sense to have "on demand" access to IT services.
- A reconciliation of the MNE's overarching transfer pricing policy to the services actually centrally provided.
- An account of the type of services provided and to whom.
- Details of the benefit or expected benefit to the recipients. The benefit derived from certain services will be self evident (e.g. payroll). Other services, where the benefit is not so immediately apparent, may require further explanatory comment. For instance if worldwide promotional activity services are present how does that service benefit an individual subsidiary?
- An explanation of the structure by which services are delivered. There may be one central service providing entity or alternatively different subsidiaries provide specific services intra group. Again a mix of two systems may be used and the interaction of those systems will need to be understood.
- A description of the group standard as it relates to its audit approach and as applied to services. For example defining direct and indirect cost for inclusion in the cost pool; safeguards in place to ensure the consistent application of an allocation key for a particular service; ensuring services are not duplicated.
- A description of how any cost pool is constructed.
- A description of the allocation key (s).
- The arm's length justification of the rate of mark up applied or alternatively why no mark up is applied.
- A record of how services are accounted for to include the invoicing system, settlement dates, payment methods and any budget versus actual adjustments.
- A description of how any mergers or acquisitions are incorporated into the service provision system.
- An understanding of how new services are integrated into the system and how a service is terminated.
- How on demand services are handled.
- How the service provision system is maintained and updated.
- Documentation that can be provided.

The IGS Guidelines on allocation keys:

Two particularly relevant commentaries from the OECD guidelines about allocation keys are:

"Any indirect charge method should be sensitive to the commercial features of the individual case (e.g. the allocation key makes sense under the circumstances), contain safeguards against manipulation and follow sound accounting principles and be capable of producing charges or allocations of costs that are commensurate with the actual or reasonably expected benefits to the recipient of the service" (OECD 7.23).

"To satisfy the arm's length principle the allocation method chosen must lead to a result that is consistent with what comparable independent enterprises would have been prepared to accept." (OECD 7.24)

The application of a self evident allocation key for a single service provision should not present the reviewer with any undue problems e.g. payroll service allocated by headcount.

The provision of more than one service under a single contract may require the deployment of several different allocation keys. Different rationales will be applied in deciding upon an allocation key depending on the specific circumstances. It would, however, be inconsistent to apply a different allocation key to different recipients of the same services.

The touchstone is that any allocation key can be justified and is consistently applied (and is reviewed on a regular basis). A balance is needed between the precision of the key and the burden that would be created if a complex key is insisted upon that only gives a marginal improvement over a key that is operationally more easily applied.

The pragmatic approach outlined above is that whatever allocation key is decided upon it must be capable of being justified and applied consistently.

Whilst the application of any particular allocation key will depend on the facts and circumstances of a particular case the following keys are in common usage:

IT: number of PCs

Business management software (e.g. SAP): number of licences

Human Resources: headcount

Health and safety: headcount

Management development: headcount

Tax, Accounting, etc: turnover or size of balance sheet

Marketing services: turnover

Vehicle fleet management: number of cars

It should be noted that more complex allocation keys might also be used.

It may be the case that historically an allocation key has been agreed that reflects arm's length conditions and the consequent price. It is not intended these guidelines require an automatic review of what may already be in place.

The IGS Guidelines relating to the mark up issue:

1. As the low value adding services we are concerned with in this document will typically only attract a modest mark up, establishing an appropriate cost base is relatively more important.
2. Once the cost base of a particular service is determined it is then appropriate to consider what mark up, if any, on those costs should be applied. OECD guidelines recognize that it is not always the case that a mark up should be applied (OECD 7.33 and 7.36). Indeed the guidelines go further in suggesting that although as a matter of principle a mark up may be appropriate a cost benefit analysis may be such that a tax administration may not pursue the matter beyond allocating costs. (OECD 7.37).
3. In cases where it is appropriate to use a mark up, this will normally be modest and experience shows that typically agreed mark ups fall within a range of 3-10%, often around 5%. However that statement is subject to the facts and circumstances that may support a different mark up.
4. The character of the services that these guidelines address would suggest the in-depth analysis of the five comparability factors, including the functional analysis, together with a qualifying benchmarking exercise covering a quantitative and qualitative screening of the potential comparables to establish a suitable mark up may be a too resource intensive approach. It may be envisaged, therefore, that a reviewer will consider a less prominent search for information to evaluate the mark up put forward. However, the less prominent search should of course pass the arm's length test. To a greater or lesser degree the following non exhaustive list may be taken into account by a reviewer in arriving at a final position:
 - (a) The underlying rationale and evidence the service provider relied on in setting the mark up.
 - (b) The experience and knowledge of the reviewer in what they have typically encountered as agreed mark ups for the type of services these guidelines envisage.
 - (c) The wider body of evidence that is available from statistical research.
 - (d) Published practice /experience e.g. by some tax administrations.
5. It is sometimes the case that the same mark up is applied to a range of services provided under a single contract. That may well be an acceptable proposition if it can be judged that the particular services would attract a similar mark up and any variance is anticipated to be minimal.