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EU JOINT TRANSFER PRICING FORUM

Secretariat discussion paper on Cost Contribution Arrangements

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1. Scope of this paper

1. The issue of Cost Contribution Arrangements (CCAs) is a current work programme item described as follows:
While noting that rules on CCAs were included in the OECD transfer pricing guidelines, and without wishing to duplicate or interfere with OECD work in this area, the JTPF intends to explore the possible scope and degree to which a common approach to CCAs could be developed within the EU.(JTPF/013/2007/EN).

2. An exploratory discussion, backed up by some Member States and BM written contributions, took place at the JTPF meeting on 8 June 2010 (JTPF/003/REV1/BACK/2010/EN). The next agreed step was that a further round of discussion, from a general perspective, takes place at the next JTPF. Attention was drawn by Member States to a recent Fiscalis training event on the subject of CCAs which could also provide some useful perspectives. The Forum is also aware of some work to be undertaken by OECD on the intangible aspects of CCAs.

2. Process

3. This discussion paper and the responses to it will form the basis of a draft report by the JTPF to provide a general perspective on the subject. The structure of the paper highlights key areas for discussion.

4. Time line: This work is anticipated to be concluded in 2011.

3. Outline of the paper and potential outcomes

5. Without pre judging the discussion but recognising the preliminary themes that are already emerging the proposed outline and outcomes could be:
   - Background.
   - Current state of play of TA legislation, administrative guidance and best practice.
   - An exploration of the issues concerning CCAs in the EU context.
   - Guidance on specific issues.
   - Guidance and best practice in identifying a CCA, and the main issues to be considered when evaluating an arrangement against the arm's length standard.

4. Background

6. The OECD guidelines (Chap VIII Para 8.3) describe a CCA 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.

7. MNEs frequently set up CCAs as they consider them to be a cost effective means of developing their businesses. Historically, CCAs have been operational since the 1950s mainly for reasons of economies of scale. This allowed a nucleus of experts to apply their expertise across the world to the companies within a group. These companies also made the payments/contributions and ran the economic risks (CCA/CSA). This type of CCA is

still seen today. Alongside this type of arrangement, we also now see a type of project for which companies conclude a CCA that involves a high cost/risk and draws on a matrix of contributions for example cash, skills and existing intellectual property from associates situated in different MS. This can lead to a seemingly complex set up that attracts attention from tax auditors who, often, may not be familiar with such arrangements. That lack of familiarity, together with the different approaches and emphasis taken by TAs in evaluating an arrangement against the arm's length principle, compounds the problem. The outcome is uncertainty of treatment and the potential for double tax, both of which are detrimental to the smooth functioning of the internal market.

8. From the TA perspective, preliminary discussions threw up something of a dichotomy. TAs, generally, did not recognise CCAs as a particularly high profile issue, whereas BM said they commonly encountered problems with Member States. The initial conclusion in reconciling these two statements was that the relative lack of experience of TAs of the subject matter gives rise to problems of identifying when a CCA is in operation. This is not made any easier by virtue of the fact that CCAs can take many forms and be variously described as CCAs, Cost Contribution Agreements, and Cost Sharing Agreements/Arrangements.

9. However, when TAs do come in to contact with a CCA they are faced with a cross border collaborative arrangement involving the creation of an asset of some value. Ownership issues, allocation of the costs and profits from the creation of that asset, and the movement of potentially large sums of money cross border are all relevant.

10. The nub of the problem seems to lie in a lack of extensive TA experience of CCAs, the variety of CCA, or hybrid versions of them, put forward by MNEs and the differing treatment of specific aspects of CCAs.

Q 1: Any comments?

<u>5. An exploration of the issues concerning CCAs in the EU context.</u>

11. Against this background it appears the issues that need to be addressed are improving understanding and consistency of treatment. It may be a useful starting point to establish the state of play of legislation, administrative guidance and best practice in each Member State.

Q 2: Can the Forum agree that it would be useful to record the current state of play of Member States CCA legislation, administrative guidance and best practice?

12. The OECD guidelines recognise *"there are many types of CCAs"(Chap VIII Para8.1).* The guidelines do not attempt a definition of CCAs as such but rather offer an insight into the concept that lies behind a CCA. The approach appears to be that if the principles that underpin the concept of a CCA are understood they can then be applied to a wide variety of arrangements. The guidelines also make it clear that CCAs must comply with the arm's length principle. The intention of a specific CCA chapter is to provide supplementary guidance in applying that principle.

13. This paper has already acknowledged that, generally, there is a knowledge gap for TAs when it comes to identifying, understanding and the evaluation of a CCA against the

arm's length standard. The table below attempts to put the many issues on which clarification requested so far into categories to guide further discussion.

Terminology	Cost contribution arrangements Cost sharing agreements IRS cost sharing arrangements	Any significant difference in the business models described by these terms?	Any significant differences in the tax treatment between each of the descriptions?		
Obtaining information	The best way to obtain information	How to deal with the provision of inadequate information	Documentation issues.	Conducting a functional analysis	Exchange of information with TAs
Understanding CCAs and applying the arm's length principle	What is the Commercial rational?	How to identify CCAs	How to applying the arm's length principle.		
Specific points	Valuation of buy in , buy out, potential benefits and cost contributions	The make up of a cost base. make up	Period of validity for a CCA	CCAs and APAs	Different types of ownership – legal beneficial economic
	When to apply a profit margin to contributions made.	Appropriate allocation keys	Treatment of tax incentives in a CCA	Treatment of government subsidies	Dealing with "informal" CCAs

14. The proposal is that each of these grouping should be discussed in arriving at a common understanding when dealing with CCAs. With that common understanding the next proposed action of producing guidance and best practice will be more easily facilitated.

Terminology

Q 3: Can the Forum make a distinction between the various arrangements and terminology used when referring to CCAs? For example: Cost Contribution

Arrangements, Cost Sharing Agreements and Cost Sharing Arrangement (IRS regs). Do they refer to the same thing and have similar tax consequences?

Q 4: The OECD guidelines state "there are many types of CCAs" (Para 8.1) and gives some examples (Para 8.6) .Can the Forum give further examples? Can the Forum identify arrangements that may have similarities to but are not in fact CCAs?

Information

Q 5: Are there any areas of documentation and or provision of information that the Forum considers to be particularly important when considering a CCA? Is it considered important to exchange the information obtained by one TA in its evaluation of a CCA to other TAs in the same arrangement as a best practice?

Understanding

Q 6: What are the key issues that lead to a good understanding of CCAs? (examples from the table, as it stands, might be functional analysis, verifying the cost base and valuation.)

Q 7: What are the key factors to be considered when evaluating an arrangement against the Arm's length principle?

Specific points

Q 8: Does the Forum wish to respond to all of these? What are its views on each subject on which it does wish to respond?

6. Guidance

15. The idea here is to prepare a ready reference document that will give guidance on how to go about identifying and understanding what CCAs is and what it is used for. Pointers will be given towards the key areas to be considered in any evaluation of a CCA and the arm's length principle. It is not intended to be a definitive guide on how to arrive at solutions to every problem. Often the guidance may be to seek specialist advice – for example in valuation but some back ground on the principles of valuation could be set down. Another example is that it is known that CCAs are being looked at as part of an OECD project on intangibles so a cross reference to that project and its findings would be appropriate.

16. The attached annex is put forward as a model on which to build.

Annex

What is a CCA

- OECD definition
- Further examples

Why CCA s

Commercial rational:

- Nature of business
- Economy of scale
- Increase efficiency
- Access to resources
- Increase potential for development

How to identify a CCA is in existence

- Common types
- Nature of business
- Knowledge of the business
- Exchange information

Understanding a CCA

- Set up to achieve what
- Who is involved
- What are their roles

Evaluating a CCA. What are the key areas?

- How to ascertain the expected benefits
- How to go about buy in buy out valuations
- How to go about valuing contributions.
- Ascertaining the cost base

Specific points subject to previous discussion but examples could be

- When to apply a profit margin
- Ownership – legal beneficial economic
- Treatment of government subsidies
- Treatment of tax incentives

Conclusions

- To be agreed