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EU JOINT TRANSFER PRICING FORUM

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

Additional examples submitted by Private Sector Members and by The Netherlands

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Secretariat's Note

At the JTPF October meeting, the Forum decided to provide additional examples on CCAs in order to facilitate the discussions on several issues. This document includes examples on CCAs on services not creating intangible property submitted both by Private Sector Members and by The Netherlands.

PSM's examples illustrate the business reasons for entering into a CCA and areas where CCAs on services may arise as well as allocation keys that may be used.

The examples submitted by The Netherlands address the issue on whether the contributions from participant's contributing in kind should be measured at cost or at market value.

The examples will be considered under Agenda item 4. (ii) of the 8 March 2012 JTPF meeting

The Secretariat's recommendation to the Members is to consider these examples only as a way to support the discussions on several issues. At a later stage the members should decide whether it is relevant to include one or several examples in the final report.

A. Draft Examples Submitted by Private Sector Members

Introductory remarks

Below are some examples of typical areas that could be the subject of cost contribution agreements between related parties. They address the nature of the activities, expected benefits to cost contribution participants, the risk to the participants, the contributions involved and finally a possible determination of contributions in line with expected benefits for the participants. These are only examples of functions provided under a CCA; many other functions can form the subject of a CCA and the risks, contributions and benefits will vary based on the activities involved. The examples chosen are considered for these purposes as not giving rise to the creation of intangible property. The question of whether such functions could create intangible property in an actual situation is a question of fact which may be influenced by the enterprise(s) and industry in question.

A common factor in the examples is that through the cost contribution arrangement, individual participants have access to a higher quality resource at competitive cost than they might otherwise have been able to achieve on an individual company basis, and the participating companies, through sharing of activity and experiences, will contribute to increasing the level of expertise of the participants. For the purposes of the examples, it is assumed that the functions are provided by one or more of the participants in the CCA, with responsibility for the consolidation and allocation of the costs to the participants similarly undertaken by one of the participating enterprises.

Example 1: Accounting and Administrative functions

The nature of the services includes amongst others the creation and sharing of guidelines regarding accounting policies, guidance and assistance in preparation of periodic financial statements and meeting local statutory requirements. The expected benefits to the cost contribution participants include receiving a reliable quality service to support local operations and meet local requirements. Additionally, due to specialisation and economies of scale the service may be received at a lower cost than compared to each participant performing the services themselves. The risks for the participants include any financial consequences as a result of relying on the services provided, including penalties, as well as the financial risk of inefficient service provision resulting in actual costs higher than budgeted. The contribution of each participant will be a proportionate share of the total actual costs incurred of the accounting and administrative services in line with the expected benefits. The proportionate expected benefit is determined by using the allocation key *total expenditures per individual participant*. The rationale for the allocation key is that the larger the participant's operations, the more the participant is expected to benefit from the services.

Example 2: Procurement functions

The nature of the services includes amongst others provision of sourcing strategies, tender process management, vendor selection and contract management. The actual contract and sourcing of goods or services is directly by the participating company and the respective vendor. The expected benefits to the cost contribution participants include

receiving a reliable quality service to support local operations and local requirements regarding the sourcing of goods or services. Additionally, due to specialisation and economies of scale the goods or services may be procured by the participant at a lower cost than compared to each participant performing procurement independently. The risks for the participants include any financial consequences as a result of relying on the services provided, as well as the financial risk of inefficient service provision resulting in actual costs higher than budgeted. The contribution of each participant will be a proportionate share of the total actual costs incurred of the procurement services in line with the expected benefits. The proportionate expected benefit is determined by using the allocation key *total expenditures per individual participant*. The rationale for the allocation key is that the larger the participant's operations, the more the participant is expected to benefit from the services.

Example 3: Human resource functions

The nature of the services includes amongst others guidelines regarding human resource policies, selection and hiring of personnel, training of personnel, development programmes and assistance in meeting local labour law requirements. The expected benefits to the cost contribution participants include receiving a reliable and qualitative service to support local operations and meet local requirements. Additionally, due to specialisation and economies of scale the service may be received at a lower cost than compared to each participant performing the services themselves. The risks for the participants include any financial consequences as a result of relying on the services provided, as well as the financial risk of non-efficient service provision resulting in actual costs higher than budgeted. The contribution of each participant will be a proportionate share of the total actual costs incurred of the human resource services in line with the expected benefits. The proportionate expected benefit is determined by using the allocation key *headcount per individual participant*. The rationale for the allocation key is that the larger the participant's headcount, the more the participant is expected to benefit from the services.

Example 4: Marketing functions

The nature of the services includes amongst others the conceptualisation and development of marketing campaigns in support of the participants' products. The expected benefits include the reliable and customised provision of the marketing services and potentially lower costs due to economies of scale realised by the participants. The risks for the participants include the financial risk of inefficient service provision resulting in actual costs being higher than budgeted, or inefficient service provision leading to less product sales. The contribution of the different cost contribution participants is a proportionate share of the total cost incurred for the marketing services, including staff costs, costs incurred for marketing materials, TV slots etc. The proportionate expected benefit is determined by using the allocation key *turnover per individual participant*. The rationale for the allocation key is that the larger the participant's turnover, the more the participant is expected to benefit from the services.

<u>Other functions suitable for CCA</u>

Based on the rational above, costs related to other functions such as logistics, real estate and warehousing could also typically be shared within a group of companies by way of a CCA. With respect to logistics the expected benefit could be determined by *total expenditures per individual participant* whereas real estate could be based on *square metres per individual participant*.

B. Examples of a service CCA submitted by The Netherlands

Introduction

After a merger of a number of enterprises, it is decided that it is more efficient for the new group and its individual members to develop one centralized IT system. The intention is to have the new centralized IT system in place after 3 years.

Example 1: all participants to the CCA contribute in cash

1 group company acts as service provider. Providing the centralized IT system is the core business of this group company. Assume that no IP is created (if IP would be created this IP stays with the service provider as the service provider has all the knowledge). This group company is not a participant to the CCA and receives an AL reward (i.e. including a mark-up).

6 group companies sign up to a CCA. In this CCA they agree to contribute in cash to cover the (budgeted) expenses. All companies have a reasonable expectation of benefit. The allocation key for the contributions per CCA participants is line with the expected benefit per CCA participant (what allocation key?). The participants to the CCA merely buying over time a new IT system and specialized IT service.

Expected benefits are cost savings through advantages of scale and better service through specialization. The participants of the CCA share the risk of failure of the project. This example seems similar to cost pool (IGS document).

Example 2: all participants to the CCA contribute in kind

6 group companies sign up to a CCA. In this CCA they all agree to contribute in kind. They all provide one IT person that will spend half of his time to the IT project. The value of their contribution is comparable. This means the value can be measured at cost. All companies have a reasonable expectation of benefit. The allocation key for the contributions per CCA participants is line with the expected benefit per CCA participant (what allocation key?). Assume that no IP is created (if IP would be created this IP all participants are entitled to the benefits of this IP, however this outside the scope of the JTPF project).

Expected benefits are cost savings through advantages of scale and better service through specialization. The participants of the CCA share the risk of failure of the project.

<u>Example 3: 3 participants contribute in cash and 3 participants contribute in kind</u>

6 group companies sign up to a CCA. In this CCA it is agreed that 3 participants contribute in cash and 3 participants contribute in kind. The latter 3 participants provide one IT person that will spend half of his time to the IT project. The value of the contribution of these 3 participants is comparable. However, the value of their contribution in kind is not comparable to the contribution in cash by the other 3 participants. Therefore, it seems that the contributions in kind need to be measured at market value. Assume that no IP is created (if IP would be created the question arises whether all participants are entitled to the benefits of this IP, however this outside the scope of the JTPF project). The fact that no IP is created seems to indicate that the services provided are of relatively low value. In that case the market value of the contributions in kind is in fact not much higher than if these contributions were valued at cost. For practical reasons countries may in that case consider to value the contribution in kind at cost.

All companies have a reasonable expectation of benefit. The allocation key for the contributions per CCA participants is line with the expected benefit per CCA participant (what allocation key?). Expected benefits are cost savings through advantages of scale and better service through specialization. The participants of the CCA share the risk of failure of the project.