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# **EU JOINT TRANSFER PRICING FORUM**

## **Working document on Cost Contribution Arrangements**

**Meeting of 26 October 2011**

**Charlemagne building (CHAR)  
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1. The topic of Cost Contribution Arrangements (CCAs) has been of long-term interest to the JTPF. It was carried-over from the previous work programme of the Forum and under its 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.
2. CCAs are thoroughly discussed in chapter VIII of the OECD Guidelines and the OECD is currently involved in a project on the transfer pricing aspects of intangibles. Therefore, not wanting to duplicate or interfere with OECD work, the JTPF members have decided at a first stage to direct the scope of JTPF work to CCAs focused on services not creating intangibles. Although recognising that the concept of CCAs is often encountered in the context of the research and development activities, the value of this work should be seen in the context of the JTPF's earlier work on services. With respect to direct charge services the JTPF Guidelines on low value adding services conclude that the facts and circumstances will, in general, be self evident. CCAs on intra group services are not explicitly addressed. As CCAs do however play a role in the context of intra group services, this JTPF's project on services in the context of CCAs is seen as supplementing the existing guidance and completing the JTPF's work on services.
3. An exploratory discussion took place at the JTPF meeting of June 2011 addressing the questions put forward in document JTPF/016/2010/EN. It was agreed that the report on CCAs would be adopted by June 2012. The present working document takes into consideration the example provided by the private sector members and the information supplied by MS' tax administrations. This document focuses on those issues which are, for a reviewer, difficult to deal with in practice and proposes how to address them best. The term reviewer applies to the reviewer function in both the taxpayer and the tax administration.

## **1. Introduction**

4. 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 participant companies within a group. These participants made the payments/contributions and ran the economic risks. 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 countries. 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.
5. Cost Contribution Arrangements were addressed in chapter VIII of the OECD Guidelines on transfer pricing in 1997. However other chapters like VI and VII are also relevant to determine whether the arrangement is in accordance with the ALP.
6. The JTPF adopted in 2010 Guidelines on low value adding intra-group services which were endorsed by MS through Council's conclusions in May 2011. These JTPF

Guidelines aim to supplement considerations provided in Chapter VII of the OECD TP Guidelines by outlining certain principles and by providing guidance on matters that commonly cause difficulty such as a cost pool, defining shareholder costs and evaluating an arm's length charge and documentation.

7. Both OECD Guidelines and JTPF Guidelines will be taken into consideration in this document. Especially the guidance given in Chapter IV of the JTPF Guidelines on low value adding intra group services (audits) should apply equally in the context of CCA.

**Q1: Does the forum want to mention Chapter IV of the JTPF Guidelines on low value adding intra group services (audits) in the context of this document?**

**Q2: If so, does the forum consider a reference as sufficient or should certain paragraphs of the JTPF Guidelines on low value adding services be repeated (and, where appropriate, adjusted) as they address the context of service provision?**

**Q3: Has the forum any other comments to this introduction?**

## **2. Terminology**

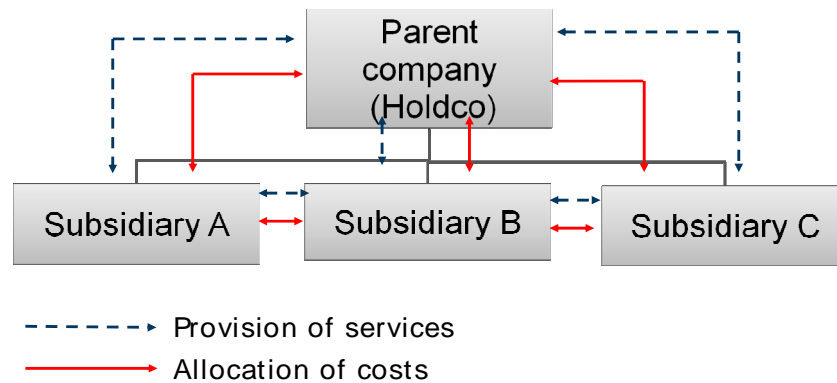
8. Given that there may be a different understanding on whether and how a CCA may be distinguished from intra group services charged directly or by way of creating a cost pool, this chapter seeks a common understanding of the terminology used. It describes the concept of a CCA and delineates it from intra-group services, recognising that in practice it might sometimes be difficult to strictly differentiate them especially from cost pools. For reasons of clarification, it also explains the OECD versus US terminology on CCAs<sup>1</sup>.
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 the aim is that each participant's proportionate share of the overall contributions to the arrangement is consistent with the proportionate share of the overall expected benefits to be received under the arrangement.
10. Based on this definition, CCAs may be divided in three different categories: CCAs to share services; CCAs to perform research and develop/produce assets or rights and CCAs combining both described aspects. This broad definition already leads to the conclusion that in practice CCAs vary and the range of different CCAs concluded intra group makes their review in some cases particularly resource intensive.

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<sup>1</sup> The terminology used by the OECD for CCAs is different from the one used under US TP regulations (US Reg. §1482-7(1)) where CCAs are divided into Cost Sharing Arrangements (CSA) and Shared Service Arrangements (SSA).

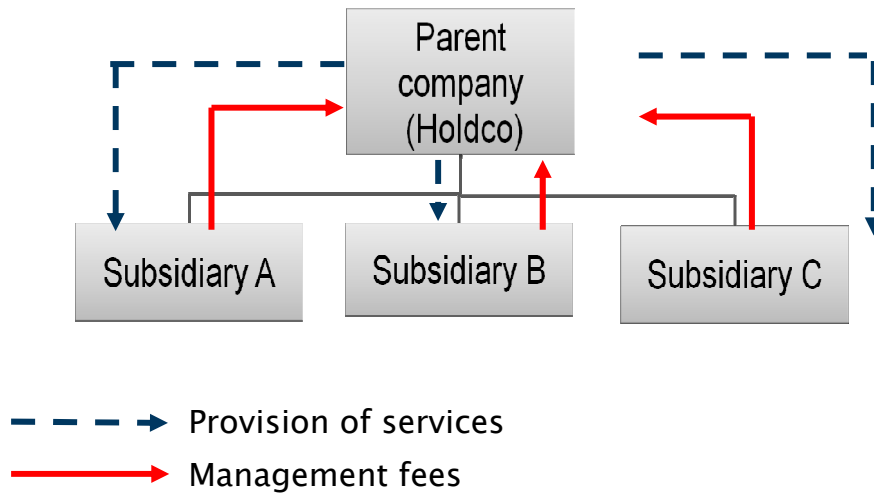
11. Illustration of a CCA:

## Cost contribution arrangement



12. The concept of Intra-group services (IGS) is described in 7.2 of the OCDE 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 costs or whether and how an arm's length charge including a mark-up may be determined.
13. It should be noted that the EU Guidelines on low value adding Intra-group services do not refer to a specific definition but provide rather some parameters to determine the type of services that are within the scope of the Guidelines.
14. Illustration of Intra-group services:

## Intra Group services



15. A further variant not explicitly mentioned in the OECD Guidelines but often encountered in practice are 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. In practice it is sometimes difficult to differentiate between (shared) Intra-group services (IGS), especially cost pools, and Cost Contribution Arrangements on services. The following table is intended to help differentiating the two concepts (but without limiting the scope to certain type of CCAs or IGS):

CCAs	IGS
Contractual agreement to share costs and risks where all participants contribute.	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.
Usually, long-term projects where the shares are calculated beforehand taking into account the expected benefits for each participant. The reference period for revision clauses is generally more than one year.	IGS are usually targeted on shorter term notwithstanding they can be provided during a long period and the service is often already available.
There are expected benefits potentially leading to buy-in and buy-out payments/fees	Generally no buy-in or buy-out issue.
A formal contract between the parties is essential, as participants will share in the future the profits of the project.	In practice, formal contracts are not always available.
The mark-up issue is usually secondary as all companies are contributing to a common project, share costs and the contribution is valued to the expected benefit rather than to a fixed mark-up.	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 company.	The allocation key is based on the way each company takes advantage of the specific service (it is a cost oriented key).

16. For the purpose of this paper the terms Cost Contribution arrangement (CCA) 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, especially with respect to cost pools.

**Q4: Does the forum agree the above analysis concerning terminology?**

**Q5: Do you see any point that should be further developed under this chapter?**

### **3. Scope**

17. As stated above, for the purpose of this working document we will limit the scope of this paper to CCAs on services and more precisely on services not creating any IP
18. An exhaustive definition of the services which may be subject of a CCA is neither possible nor desirable. Services that are covered by the scope might include the following activities: finance, tax, human resources, accounting, payroll, billing, ... (in so far as the activities performed for the joint benefit of the participants to the agreement do not result in any property being produced or developed). This list of services is only illustrative and does not automatically preclude that a service is covered or excluded of the scope of this paper.

**Q6: Does the forum agree with the scope proposed?**

**Q7: Does the forum think the list of activities covered should be further developed?**

19. 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 a cost pool or whether a CCA is considered as being more appropriate. The relevant question for a reviewer under Article 9 of the OECD Model Tax Convention and the arm's length principle is whether there are conditions made or imposed that differ from conditions that would be made between independent parties.
20. While the JTPF Guidelines focus on issues encountered in relation to services of an administrative nature auxiliary to the business of the recipient, this document addresses specific considerations in cases where all kind of intra group services without IP impact are embedded into a CCA. This paper therefore focuses on the following features in those cases where intra group services are structured in as a CCA:
- What may be considered as sufficient corroborative information to confirm that a CCA on services without IP complies with the arm's length principle?
  - What are the general features determining whether a CCA is consistent with the arm's length principle?

- Which specific aspects should be taken into account when reviewing the consistency of a CCA on services (not involving IP) with the arm's length principle?

<p><b>Q 8: Does the forum recognise and agree the previous observations?</b></p>
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### **3. Narrative related to a CCA on services not creating IP**

21. In the light of the facts and circumstances of a case, their 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. This document proposes that the contractual framework normally required for a CCA should be completed where appropriate by the provision of a narrative.
22. In preparing or reviewing a CCA one will need to understand and achieve confidence on several key issues. The main driving question is: "would independent parties have agreed in such an arrangement"? The way to answer this question will probably not vary a lot from the approach developed in the JTPF report on intra-group services where the provision of a narrative was the suggested tool.
23. The key element is of course the agreement itself. There should be a clear expectation of mutual benefit for all parties of a CCA. An independent party would not accept to enter into a sort-of CCA arrangement without a rationale expectation of benefit. Secondly, the terms of the Agreement should ensure that the allocation of the contributions encompass the relative expectations of benefits of each part of the arrangement.
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: (please see as reference in annex the IGS Guidelines paragraph relating to the narrative).
  - 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) List of participants
  - c) Budget of the project and a description of the resources at the disposal of the participant to contribute to the CCA activities
  - d) A reconciliation of the MNE's overarching transfer pricing policy to the services included in the CCA
  - e) Expected benefit to be derived by each participant and the way it was measured (including methodology and any projections used)
  - f) An account of the type of services included in the CCA.
  - 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;
  - h) The anticipated allocation of responsibilities and tasks associated with the CCA activity between participants [and other enterprises]

- i) An explanation of the structure by which contributions/costs are shared. There may be one shared service centre.
- j) Are there contributions in kind? How are they valued?
- k) Existence of government subsidies or tax incentives linked to the CCA's contributions? What is their impact?
- 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.
- 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..
- n) The annual expenditure incurred in conducting the CCA activity, the form and value of each participant's contributions made during the CCAs term 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
- o) A description of the allocation method which must reflect expected benefits.
- p) A record of how costs are accounted for to include the invoicing system, settlement dates, payment methods and any budget versus actual adjustments.
- q) A description of how any mergers or acquisitions are incorporated into the CCA.
- 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.
- s) Duration and how the CCA provisions are maintained and updated.
- t) Record of all CCAs in place or terminated with cross reference to services provided [or IP created - but outside the scope of this document]
- u) Documentation that can be provided

In addition to this list and subject to further discussions under the specific headings addressing those issues, the following points might be added:

- v. The arm's length justification of the rate of mark up applied or alternatively why no mark up is applied
  - 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 and of the calculations in case buy-in and buy-out calculations are warranted
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 provides most information. The important point is that the reviewer gets an understanding of how the CCA works in practice.

**Q9: Does the forum agree with the items included in this narrative?**

**Q10: Is there any other item/issue that should be included?**



#### **4. CCAs and the Arm's Length Principle (ALP)**

26. As a general principle, determining whether a CCA is consistent with the arm's length principle requires that a CCA is consistent with what an independent enterprise would have agreed to contribute under comparable circumstances given the benefits it reasonably expects 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.

In particular:

- i. The arrangement should make business sense
  - ii. The terms of the agreement should be consistent with its economic substance
  - iii. The terms of a CCA should be agreed prior to the beginning of the activity
  - 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. A 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 economies of scale, sharing of risks, sharing of expertise, etc
  - viii. Contributions by a participant can be in cash or in kind
  - ix. When the service is also provided to non participants in the CCA, expected benefits of non-participants must be considered and valued at arm's length.
  - x. Any transfer of a valuable interest in the results of the CCA should be on arm's length terms.
27. When the contribution provided by a participant is excessive or the benefit derived from its participation in the CCA is inadequate, this might lead to the conclusion that the arrangement is inadequate or should be revised. However when comparing the participant's expected share of benefits to participant's share of the overall contributions the reviewer should refrain from making an adjustment based on a single year and not a period of years.
28. Considering the previous paragraph, the application of the ALP might require only 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: when the facts and circumstances differ from the terms agreed in the CCA.
29. Balancing payments will be treated as an additional cost for the payer and as a reimbursement of costs for the recipients.

**Q11: Does the forum recognise and agree with these observations?**

**Q12: Any other suggestions to the list?**

**Q13: Do you consider that a written agreement should always be required to accept the CCA terms?**

**Q14: 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? ?**

**Q15: 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?**

## **5. Specific aspects**

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

### **5.1 The 'expected benefit' test**

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 in the pool and will justify the allocation key.

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. 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.

33. The reviewer might find that the actual outcomes differ from the estimates. Such differences are not uncommon. The ALP does not require per se that projections of benefits match the actual benefits. Even if there is a material difference between actual and projected benefits, this does not automatically mean that the projection was not at arm's length. If such a difference occurs, it is always necessary to analyse the reasons for this difference for concluding whether a participant's proportionate contribution has been incorrectly determined, or whether the participant's proportionate expected benefits have been incorrectly assessed. A further question is whether the difference is so essential that it requests a modification/compensation or, the difference is considered as small enough to avoid any adjustment, given that the OECD Transfer Pricing Guidelines provide that tax administrations should refrain from making minor or marginal adjustments. 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 (par 8.29 OECD TPGL) A reviewer's decision should always be based on the facts and circumstances relating to the specific arrangement for an adequate period without using hindsight.

**Q16: Does the forum recognise and agree these observations?**

**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 (e.g. a difference between 1 and 8 %)? This would become a risk assessment tool for both sides.**

**Q18: 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?**

**Q19: In your view, how and how often should the expected benefit be re-assessed? Quantitative or qualitative approach, or both?**

**Based on IGS Guidelines the Secretariat proposes the following recommendation:**

It is key that the reviewer is satisfied that from the participant's perspective the contribution provides reasonable benefits in terms of economies of scale or risk sharing or sharing of skills (etc.) and 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 to 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.

~~As mentioned above~~ 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. Given the routine nature, commonplace provision and low value adding of the services not creating IP, coupled with a supporting narrative explanation, the verification of the type of CCA service addressed by the guidelines in this paper should not be a contentious issue.

**Q20: Does the forum agree with this recommendation? Any other suggestion?**

## **5.2 Contributions of each participant**

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

**Q21: Does the forum think it 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 usually calculated on a long term basis and 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)**

**Q22: 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.)**

**Q23: 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)?**

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 the annual expenditure incurred in conducting the CCA activity, 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.

**Q24: Does the forum think that budgeted costs versus actual costs need specific recommendations?**

**Q25: 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?**

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.

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 pool should only include costs effectively spent from which tax incentives and government subsidies have been deducted.

**Q26: Does the forum want to provide specific recommendations about what are "relevant allocable costs" (including recommendations on tax incentives and government subsidies)?**

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

### **5.3 Anticipated benefit versus actual – use of hindsight**

39. As CCAs are arrangements based on expected benefits, independent parties would certainly include a clause in the contract allowing regular assessment whether anticipated

benefits are in line with actual benefits and whether contributions should not be changed prospectively.

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 the improper use of hindsight.

<p><b>Q27: Does the forum consider that the use of hindsight is a normal practice for CCAs?</b> <b>Q28: Should the forum issue recommendations in this area?</b></p>
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#### **5.4 Mark-up**

41. The value of each participant's contribution must be consistent with the value that independent parties would have agreed to in comparable situations. The essential question is therefore whether an independent party would charge an additional profit element in such circumstances. In this respect there is probably no rule that may be generally applied.

<p><b>Q29: Does the forum think that a profit element should be included in any contribution made by CCAs' participants and in which way?</b></p>
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<p><b>Q30: Does your TA have any legal or administrative position on the mark-up issue? Is there any specific case law in your country relevant for this topic?</b></p>
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<p><b>Q31: Does the forum think that some paragraphs of the JTPF IGS guidelines should be duplicated here? (See in annex relevant IGS guidelines paragraphs)</b></p>
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#### **5.5 Buy-in and buy-out**

42. The issue of entities joining or leaving a CCA is also in practice 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, the specific skills acquired from past activities are questions often leading to difficulties for any reviewer.
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 the 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?
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).

**Q32: does the forum think that this chapter in practice is relevant for services not creating IP?**

### **5.6 Documentation**

45. The OECD guidelines (Paragraph 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.
46. This theme is echoed in point 2.3.1 of the JTPF report on 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".
47. Applying this principle to the 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).
48. It should be noted that information from one source (e.g. a written agreement) may cover information required from 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.
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.

**Q33: does the forum recognise and agree these observations? Does the forum think that this chapter should be further developed?**

### **5.7 Other potential topics:**

**Q34: 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?**

**Q35: Does your TA give access to APA for CCAs?**

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

50. This section aims to summarise the current state of play as regards CCA legislation or administrative guidance within EU MS. During the JTPF meeting of 9 June 2011 members agreed that in relation to CCAs it would be useful to take stock of the situation prevailing across the EU and establish an overview. The section below is drafted by the JTPF Secretariat on the basis of contributions provided by EU tax administrations.
51. The Secretariat circulated a questionnaire for input on 1 July 2011. It was based on the questionnaire for the 2010 Fiscalis seminar on CCAs. Member States were asked to revise and update their earlier answers in order to reflect the situation prevailing on 1 July 2011.
52. As on 10 October 2011 responses to the questionnaire have been received from the following Member States: Austria, Belgium, Bulgaria, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Germany, Hungary, Ireland, Italy, Latvia, Lithuania, Malta, the Netherlands, Poland, Portugal, Romania, Slovenia, Slovakia, Spain, Sweden and the United Kingdom. Answers have not been received from 2 Member States: Greece and Luxembourg.

### **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 not planned in any MS.

### **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.