

European Business Initiative on Taxation (EBIT)

**Comments on the OECD Discussion Draft on BEPS Action 8:
Revisions to Chapter VIII of the TP Guidelines on Cost
Contribution Arrangements**

EBIT's Members at the time of writing this submission: AIRBUS, BP, CATERPILLAR, DEUTSCHE LUFTHANSA, DIAGEO, GSK, INFORMA, JTI, LDC, MTU, NUTRECO, RELX GROUP, ROBEKO, ROLLS-ROYCE, SAMSUNG ELECTRONICS, SCHRODERS and TUPPERWARE.

EBIT comments on the OECD's Public Discussion Draft on BEPS Action 8: Revisions to Chapter VIII of the TP Guidelines on Cost Contribution Arrangements

Andrew Hickman
Head of the Transfer Pricing Unit
OECD/CTPA
2, rue André Pascal
75016 Paris
FRANCE

Submitted by email to: TransferPricing@oecd.org

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Dear Andrew,

EBIT is grateful for this opportunity to comment on the OECD's BEPS Action 8 Discussion Draft: Revisions to Chapter VIII of the Transfer Pricing Guidelines on Cost Contribution Arrangements (hereinafter: "Discussion Draft").

EBIT generally welcomes the further guidance by the OECD on the development and use of intangibles under Cost Contribution Arrangements (CCAs) and welcomes efforts to align the revised Chapter VIII to other Chapters of the OECD Transfer Pricing (TP) Guidelines. This is a very complex issue. EBIT therefore welcomes the OECD's acknowledgement in the Discussion Draft of the need to achieve simplification. At the same time, we believe that some of the recommendations, if adopted in their current form, are bound to significantly and unnecessarily increase complexity further as well as the number of future disputes between tax administrations and commercial parties with regard to CCAs. This surely cannot be the aim of the OECD, however. We note in this respect that there is no consensus view among the CFA or BEPS-44 on the present Discussion Draft at this late stage of the BEPS project.

EBIT has a number of concerns with the Discussion Draft which are set out below, together with a number of recommendations.

GENERAL COMMENTS

EBIT Members first of all wish to reiterate that CCAs are a valid, practical commercial arrangement. CCAs are essentially being used for the pooling of certain control and risk management functions by parties in order to achieve significant cost reductions, including the costs of joint development of intangible assets or services and risks, often for longer periods, whereby the return on investment is sometimes uncertain.

EBIT welcomes the additional clarifications in the Discussion Draft to measure CCA contributions at value. We note that the proposed changes are in line with the increased focus by the OECD on substance and less focus on contractual arrangements, as we have seen in other BEPS Discussion Drafts. For CCAs this guidance will mean that contributions should be measured based more on value rather than costs. We strongly recommend that there should still be a possibility to measure contributions at cost where cost is the appropriate basis for determining the value of a contribution.

The Discussion Draft clearly focuses strongly on discouraging the setting up of controlled entities solely to benefit from CCAs without performing any meaningful function in the CCA.

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The Discussion Draft introduces the fundamental new requirement that any participant in a CCA shall have the “capability and authority to control the risks associated with the risk-bearing opportunity” under the CCA. EBIT believes that it is not feasible or desirable to require all participants in a CCA to perform similar functions in order to share on a perfectly equitable basis in the benefits of a CCA, as proposed by the OECD. We note that the OECD makes a distinction between development CCAs and services CCAs. Particularly in the case of development CCAs costs may not be a good measurement for value. EBIT welcomes the OECD's rather nuanced wording in paragraph 23:

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

At the same time, independent parties will in our view also accept risks which they do not manage and control for the full 100%, as long as they deem the return on the capital invested to be commensurate with the risk they undertake. The OECD should in our view recommend in its final Discussion Draft on Chapter VIII that any entity participating in a CCA shall conduct an analysis which takes into account the effect of performing important functions itself or as a contractor to another party, prior to joining a CCA to demonstrate that it represents its best realistic alternative.

EBIT is also concerned with regard to the Discussion Draft's proposals for “disregarding” part or all of the terms of a CCA by tax authorities on a discretionary basis, which was also proposed in the OECD's Discussion Drafts regarding BEPS Actions 8-10. To limit the number of future disputes between tax administrations and commercial parties, EBIT Members recommend that the OECD insert a reference into its final Discussion Draft which states that an analysis should be performed of the costs shared between the CCA participants and whether potential adjustments to the sharing of those costs might result in an appropriate arm's length result, before disregarding the CCA.

EBIT notes that the Discussion Draft does not deal with the mechanics of the practical application of the CCA rules, for example, how to deal with income resulting from a joint ownership of IP developed under a development CCA? Where one participant in the CCA receives income from a user of the IP outside the CCA, how the income sharing transactions between the CCA participants should be handled from other tax perspectives is unclear to us. EBIT requests the OECD to provide further clarification with regard to the mechanics of the practical application of the proposed CCA rules.

Another issue including potential for increased disputes in our view is the issue of balancing payments. EBIT urges the OECD to clarify in the TP Guidelines that whilst there might be a need for balancing payments between the CCA participants due to incorrect income allocation among them, this does not include that countries outside the CCA can challenge IP payments made towards any CCA participant for the use of the IP created by the CCA.

SPECIFIC COMMENTS

In paragraph 3, the Discussion Draft considers that “intangibles, tangible assets or services are expected to create direct benefits for the businesses of each of the participants”, however, EBIT Members believe that when independent parties enter into transactions they may also

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obtain “indirect” benefits, In our view, the Discussion Draft should include both ‘indirect’ and “direct” benefits, as per the existing Chapter VIII of the TP Guidelines on CCAs. EBIT is concerned how this ties in with the notions of “overall expected benefits” in paragraph 4 and the “aggregated benefits” in paragraph 6 of the Discussion Draft. We urge the OECD therefore to clarify a) the difference between “direct” and “indirect” benefits, and b) what benefits are acceptable direct benefits under a CCA and what benefits are not. EBIT is concerned that the strong focus on “direct” benefits from the interest in a CCA may lead tax administrations to have higher expectations regarding the income earned as a consequence of being a participant to a CCA.

The Discussion Draft states in paragraph 6 that one advantage of CCAs is that “a web of separate intra-group arm’s length payments” can be replaced with “netted payments” and that “complex cross-licensing arrangements” can be eliminated. In paragraph 33, the Discussion Draft states that contributions to CCAs need to be treated under general local tax rules (respectively for each participant). We note that the existing TP Guidelines recommend, when possible, to segment transactions to avoid the aggregation of transactions because it would make it more difficult to identify the remuneration of each transaction. For clarity’s sake, EBIT suggests to link the guidance on “netted payments” to the existing guidance on segmented and aggregated transactions.

EBIT Members welcome the statement made in paragraph 17 of the Discussion Draft that: “In situations where actual results differ markedly from projections, tax administrations might be prompted to enquire whether the projections made would have been considered acceptable by independent enterprises in comparable circumstances, taking into account all the developments that were reasonably foreseeable by the participants, without using hindsight”, as this will help reduce the risk of disputes in our view.

Paragraph 23 of the Discussion Draft proposes to accept measuring contributions to “low value-added services” by costs, a suggestion which is welcomed by EBIT, provided a link is made to the definition of low value-added services in the revised Chapter VII of the TP Guidelines. EBIT is concerned that in this same paragraph, it is concluded that costs will generally not provide a reliable basis on which to value contributions for development CCAs, as opposed to service CCAs, because in our view, this is not always the case where one or more components of the contributions to any CCA consist of low value-added services.

Paragraph 26 of the Discussion Draft states that “For development CCAs, contributions in the form of controlling and managing the CCA, its activities and risks, are likely to be important functions in relation to the development, enhancement, maintenance, protection and exploitation of the intangibles or tangible assets and should be valued in accordance with the principles set out in Chapter VI.” However in Example 4 of the Discussion Draft Company A should receive a risk-adjusted rate of anticipated return on its funding commitment even where Company A has performed a diligent analysis and risk assessment, not only for itself but for Company B’s risk handling capacity as well.

At first sight, it seems that the functions performed by Company A under the CCA include “important functions”. However, Example 4 could also be read to mean that Company A performed the functions described in paragraph 58 of the Discussion Draft exclusively for its own development activities before it joined the CCA, but once in the CCA, it only provides the funding without performing the functions listed. EBIT Members believe that further clarification and guidance from the OECD on the interpretation of the fact pattern of Example 4 and the concept of “important functions” is needed. We recommend applying the same definition as provided in the revised Chapter VI of the TP Guidelines for consistency’s sake. The determining factors of an appropriate risk-adjusted return should also be explained to help mitigate disputes.

EBIT is concerned with paragraph 29 of the Discussion Draft which states that: “Balancing payments may also be required by tax administrations where the value of a participant’s

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proportionate contributions of property or services has been incorrectly determined, or where the participants' proportionate expected benefits have been incorrectly assessed", as this is likely to open the door to many disputes because in our experience, tax authorities can be expected to react to such a statement by requiring balancing payments. A reference to the existing methods for evaluating contributions would be helpful.

The Discussion Draft in paragraph 42 on the general conditions that must be met for entering into a CCA between controlled parties states under paragraph (e) that: "The arrangement would require balancing payments and/or changes in the allocation of contributions prospectively after a reasonable period of time to reflect changes in proportionate shares of expected benefits among the participants". We read this to mean that balancing payments should be made on a regular basis and for an undefined period during the life span of the CCA and in the light of the OECD's apparent assumption that the proportionate shares of expected benefits among the participants necessarily varies with time. EBIT is concerned that, based on this assumption, tax administrations could much more easily challenge the extent or the lack of balancing payments without any time limitation, and that this would essentially become a totally subjective matter. Therefore, in order to avoid a surge in unreasonable claims from tax administrations (and a subsequent surge in disputes by businesses), we strongly recommend the OECD to rephrase paragraph 42(e) and align it wording with paragraphs 27-30 of the present Discussion Draft:

"The arrangement may require balancing payments and/ or possible changes in the allocation of contributions prospectively after a reasonable period of time to reflect changes in proportionate shares of expected benefits among the participants".

EBIT trusts that the above comments are helpful and will be taken into account by the OECD in finalising its work in this area. We are committed to a constructive dialogue with the OECD and are always happy to discuss.

Yours sincerely,

European Business Initiative on Taxation – May 2015

For further information on EBIT, please contact its Secretariat via Bob van der Made, Telephone: + 31 6 130 96 296; Email: bob.van.der.made@nl.pwc.com).

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