OECD's Proposed Changes to Cost Contribution Arrangements Generate Controversy

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In a webcast update by the Organization for Economic Co-operation and Development ("OECD") on its Base Erosion and Profit Shifting ("BEPS") initiative on June 8, 2015, Andrew Hickman, Head of the Transfer Pricing Unit, acknowledged the numerous taxpayer comments received on the OECD's *Discussion Draft on Revisions to Chapter VIII of the Transfer Pricing Guidelines on Cost Contribution Arrangements* ("Discussion Draft"). The Discussion Draft proposes text for an updated Chapter VIII on cost contribution arrangements ("CCAs") in the OECD's *Transfer Pricing Guidelines*. The proposed text would require contributions to be measured at value rather than at cost so that the outcomes for participants in a CCA do not differ significantly from those for parties outside a CCA. While agreeing that any pre-existing intangible property should be transferred at value, a number of taxpayers raised concern about requiring ongoing payments to be made at value instead of cost, citing third-party examples of CCAs done at cost to support their case.

The Discussion Draft defines a CCA as "a contractual arrangement among business enterprises to share the contributions and risks involved in the joint development, production or the obtaining of intangibles, tangible assets or services with the understanding that such intangibles, tangible assets or services are expected to create direct benefits for the businesses of each of the participants."[1] The draft also distinguishes between the two common types of CCAs:

- Development CCAs and
- Services CCAs.

A development CCA is for the "the joint development, enhancement, maintenance, protection or exploitation of intangibles or tangible assets."[2] It tends to create ongoing, future benefits for its participants. A services CCA is for obtaining services. It often creates current benefits only. As such, allocations of contributions under a development CCA will generally consider future expected benefits while allocations under a services CCA will likely be based on current measures of benefit.

The 2010 edition of the *Transfer Pricing Guidelines* does not require contributions to be measured based on value but indicates that further guidance might be necessary on when cost or "market prices" are appropriate. The guidance in the Discussion Draft comes out clearly on the side of value. The authors of the draft consider contributions measured at value more likely to be consistent with the arm's length principle. Indeed, a stated purpose of the Discussion Draft is to help ensure that "the outcomes for transfer pricing purposes for CCA participants should be consistent with those which would have arisen had the parties made similar contributions on similar terms outside of a

[1] OECD, *Discussion Draft on Revisions to Chapter VIII of the Transfer Pricing Guidelines on Cost Contribution Arrangements* (2015), 5.
[2] *Ibid.*, 6.

CCA mechanism."[3] Yet, commentators pointed to evidence of third-party arrangements done at cost so CCAs among related parties may very well be wholly consistent with the arm's-length principle.

As a practical matter, CCAs are generally based on costs (as the term "cost" contribution arrangement would suggest) so the proposed text would mark a significant departure from current practice. Some commentators appealed to the OECD for at least some type of grandfathering for existing CCAs. One exception made by the OECD is permitting contributions of low value-adding services under a CCA at cost.

Tax administrations and taxpayers should be able to reach a compromise that preserves the commercial effectiveness of CCAs while addressing the OECD's greatest concerns about BEPS. One of the most important objectives of the BEPS initiative is to prevent the transfer of intangible property within a multinational enterprise at less than value. Taxpayers concur that any pre-existing intangible property should only be contributed to a CCA at value, even though there may be some disagreement on the methods for valuing such intangible property. Requiring ongoing contributions to be made at value instead of cost, though, removes the commercial efficiencies of a CCA without furthering one of the principal objectives of the BEPS initiative. Greater emphasis should be placed on how to value the pre-existing intangible property instead of the ongoing development contributions.

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[3] *Ibid.*, 6.