Chapter VIII

Cost contribution arrangements

A. Introduction

8.1. This chapter discusses cost contribution arrangements (CCAs) between two or more associated enterprises. The purpose of the chapter is to provide some general guidance for determining whether the conditions established by associated enterprises for transactions covered by a CCA are consistent with the arm's length principle. The analysis of the structure of such arrangements should be informed by the provisions of this chapter and other provisions of these Guidelines and should be based on an adequate documentation of the arrangement.

8.2. Section B provides a general definition and overview of the concept of CCAs, and Section C gives guidance as to the application of the arm's length principle to CCAs. Section C includes guidance on how to measure contributions to a CCA, whether balancing payments are needed (i.e. payments between participants to adjust their proportionate shares of contributions), and guidance on how contributions and balancing payments should be treated for tax purposes. It also addresses the determination of participants in the CCA and issues related to the entry or withdrawal of participants, and the termination of CCAs. Finally, Section D discusses suggestions for structuring and documenting CCAs.

B. Concept of a CCA

B.1. In general

8.3. A CCA is 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 benefits for the individual businesses of each of the participants. A CCA is a contractual arrangement rather than necessarily a distinct juridical entity or fixed place of business of all the participants. A CCA does not require the participants to combine their operations in order, for example, to exploit any resulting intangibles jointly or to share the revenues or profits. Rather, CCA participants may exploit their interest in the outcomes of a CCA through their individual businesses. The transfer pricing issues focus on the commercial or financial relations between the participants and the contributions made by the participants that create the opportunities to achieve those outcomes.

8.4. As indicated in Section D.1 of Chapter I, the delineation of the actual transaction undertaken forms the first phase in any transfer pricing analysis. The contractual agreement provides the starting point for delineating the actual transaction. In this respect, no difference exists for a transfer pricing analysis between a CCA and any other kind of contractual arrangement where the division of responsibilities, risks, and anticipated outcomes as determined by the functional analysis of the transaction is the same. The guidance on identifying the other economically relevant characteristics is equally applicable to CCAs as to any other type of contractual arrangement, including an assessment as to whether the parties contractually assuming risks are actually assuming these risks based on the framework for analysing risk set out in paragraph 1.60 of these Guidelines. As a consequence, parties performing activities under arrangements with similar economic characteristics should receive similar expected returns, irrespective of whether the contractual arrangement in a particular case is termed a CCA. However, there are specific characteristics of CCAs that warrant special consideration.

8.5. A key feature of a CCA is the sharing of contributions. In accordance with the arm's length principle, at the time of entering into a CCA, each participant's proportionate share of the overall contributions to a CCA must be consistent with its proportionate share of the overall expected benefits to be received under the arrangement. Further, in the case of CCAs involving the development, production or obtaining of intangibles or tangible assets, an ownership interest in any intangibles or tangible assets resulting from the activity of the CCA, or rights to use or exploit those intangibles or tangible assets, is contractually provided for each participant. For CCAs for services, each participant is contractually entitled to receive services resulting from the activity of the CCA. In either case, participants may exploit the interest, rights or entitlement without paying additional consideration (other than the contributions and balancing payments described in Sections C.4 and C.5, respectively) to any party for such interest, rights or entitlement.

8.6. Some benefits of the CCA activity can be determined in advance, whereas others will be uncertain. Some types of CCA activities will produce current benefits, while others have a longer time frame or may not be successful. Nevertheless, in a CCA there is always an expected benefit that each participant seeks from its contribution, including the attendant rights to have the CCA properly administered. Each participant's interest in the results of the CCA activity should be established from the outset, even where the interest is inter-linked with that of other participants, e.g. because legal ownership of developed intangibles or tangible assets may be vested in only one of them but all of them have certain rights to use or exploit the intangibles or tangible assets as provided in the contractual arrangements (for example, perpetual, royalty-free licences for the territory in which the individual participant operates).

8.7. In some cases CCAs can provide helpful simplification of multiple transactions (bearing in mind that the tax consequences of transactions are determined in accordance with applicable local laws). In a situation where associated enterprises both perform activities for other group members and simultaneously benefit from activities performed by other group members, a CCA can provide a mechanism for replacing a web of separate intra-group arm's length payments with a more streamlined system of netted payments, based on aggregated benefits and aggregated contributions associated with all the covered activities (see also paragraphs 3.9 to 3.17 of these Guidelines). A CCA for the sharing in the development of intangibles can eliminate the need for complex cross-licensing arrangements and associated allocation of risk, and replace them with a more streamlined sharing of contributions and risks, with ownership interests of the resulting intangible(s) shared in accordance with the terms of the CCA. However, the streamlining of flows that may result from the adoption of a CCA does not affect the appropriate valuation of the separate contributions of the parties.

8.8. As an illustration of a CCA, take the example of an MNE group which manufactures products through three enterprises which each operate a production site and have their own R&D teams engaged in various projects to improve production processes. Those three enterprises enter into a CCA aimed at generating production process improvements, and as a result pool their expertise and share the risks. Since the CCA grants each participant rights to the outcomes of the projects, the CCA replaces the cross-licensing arrangements that may have resulted in the absence of a CCA and if the enterprises had individually developed certain intangibles and granted rights to one another.

B.2. Relationship to other chapters

8.9. As indicated in paragraph 8.4, there is no difference in the analytical framework for analysing transfer prices for CCAs compared to analysing other forms of contractual relations. The guidance in Section D of Chapter I is relevant to the analysis of all transactions between associated enterprises, and applies to identify the economically relevant characteristics of the commercial or financial relations between the parties as expressed in a

CCA. The contractual terms of the CCA provide the starting point for delineating the transaction between the parties and how the responsibilities, risks, and anticipated outcomes were intended to be allocated at the time of entering into the arrangements. However, as set out in that guidance, the evidence of the conduct of the parties may clarify or supplement aspects of the agreement. The framework for analysing risk in Section D.1.2.1 of Chapter I is relevant to determining whether parties assume risks under the CCA, as discussed in Section C.2 of this chapter, and the consequences for providing funding without assuming risk or performing other functions. Chapter VI provides guidance regarding the determination of arm's length conditions for transactions that involve the use or transfer of intangibles. Paragraphs 6.60 to 6.64 give relevant guidance on exercising control over the financial risk if the funding is used for investment in R&D projects. The guidance in Sections D.3 and D.4 of Chapter VI on hard-to-value intangibles is equally applicable to CCAs. Chapter VII provides guidance on issues that arise in determining for transfer pricing purposes whether services have been provided by a member of an MNE group to other members of that group and, if so, in establishing arm's length prices for those intra-group services. This chapter's objective is to provide supplementary guidance on situations where resources and skills are pooled and the consideration received is, in part or whole, the reasonable expectation of mutual benefits. Thus, the provisions of Chapters VI and VII, and indeed all the other chapters of these Guidelines, will continue to apply to the extent relevant, for instance in measuring the value of a contribution to a CCA as part of the process of determining the proportionate shares of contributions. MNEs are encouraged to observe the guidance of this chapter in order to ensure that their CCAs operate in accordance with the arm's length principle.

B.3. Types of CCAs

8.10. Two types of CCAs are commonly encountered: those established for the joint development, production or the obtaining of intangibles or tangible assets ("development CCAs"); and those for obtaining services ("services CCAs"). Although each particular CCA should be considered on its own facts and circumstances, key differences between these two types of CCAs will generally be that development CCAs are expected to create ongoing, future benefits for participants, while services CCAs will create current benefits only. Development CCAs, in particular with respect to intangibles, often involve significant risks associated with what may be uncertain and distant benefits, while services CCAs often offer more certain and less risky benefits. These distinctions are useful because the greater complexity of development CCAs may require more refined guidance, particularly on the valuation of contributions, than may be required for services CCAs, as discussed below. However, the analysis of a CCA should not be based on superficial distinctions: in some cases, a CCA for obtaining current services may also create or enhance an intangible which provides ongoing and uncertain benefits, and some intangibles developed under a CCA may provide short-term and relatively certain benefits.

8.11. Under a development CCA, each participant has an entitlement to rights in the developed intangible(s) or tangible asset(s). In relation to intangibles, such rights often take the form of separate rights to exploit the intangible in a specific geographic location or for a particular application. The separate rights obtained may constitute actual legal ownership; alternatively, it may be that only one of the participants is the legal owner of the property but the other participants have certain rights to use or exploit the property. In cases where a participant has such rights in any property developed by the CCA, there is no need for a royalty payment or other further consideration for the use of the developed property consistent with the interest to which the participant is entitled under the CCA (however, the contributions of a participant may need to be adjusted if they are not proportionate to their expected benefits; see Section C.5).

C. Applying the arm's length principle

C.1. In general

8.12. For the conditions of a CCA to satisfy the arm's length principle, the value of participants' contributions must be consistent with what independent enterprises would have agreed to contribute under comparable circumstances given their proportionate share of the total anticipated benefits they reasonably expect to derive from the arrangement. What distinguishes contributions to a CCA from any other intra-group transfer of property or services is that part or all of the compensation intended by the participants is the expected mutual and proportionate benefit from the pooling of resources and skills. In addition, particularly for development CCAs, the participants agree to share the upside and downside consequences of risks associated with achieving the anticipated CCA outcomes. As a result, there is a distinction between, say, the intra-group licensing of an intangible where the licensor has borne the development risk on its own and expects compensation through the licensing fees it will receive once the intangible has been fully developed, and a development CCA in which all parties make contributions and share in the consequences of risks materialising in relation to the development of the intangible and decide that each of them, through those contributions, acquires a right in the intangible.

8.13. The expectation of mutual and proportionate benefit is fundamental to the acceptance by independent enterprises of an arrangement for sharing the consequences of risks materialising and pooling resources and skills. Independent enterprises would require that the value of each participant's proportionate share of the actual overall contributions to the arrangement is consistent with the participant's proportionate share of the overall expected benefits to be received under the arrangement. To apply the arm's length principle to a CCA, it is therefore a necessary precondition that all the parties to the arrangement have a reasonable expectation of benefit. The next step is to calculate the value of each participant's contribution to the joint activity, and finally to determine whether the allocation of CCA contributions (as adjusted for any balancing payments made among participants) accords with their respective share of expected benefits. It should be recognised that these determinations are likely to bear a degree of uncertainty, particularly in relation to development CCAs. The potential exists for contributions to be allocated among CCA participants so as to result in an overstatement of taxable profits in some jurisdictions and the understatement of taxable profits in others, measured against the arm's length principle. For that reason, taxpayers should be prepared to substantiate the basis of their claim with respect to the CCA (see Section E).

C.2. Determining participants

8.14. Because the concept of mutual benefit is fundamental to a CCA, it follows that a party may not be considered a participant if the party does not have a reasonable expectation that it will benefit from the objectives of the CCA activity itself (and not just from performing part or all of the subject activity), for example, from exploiting its interest or rights in the intangibles or tangible assets, or from the use of the services produced through the CCA. A participant therefore must be assigned an interest or rights in the intangibles, tangible assets or services that are the subject of the CCA, and have a reasonable expectation of being able to benefit from that interest or those rights. An enterprise that solely performs the subject activity, for example performing research functions, but does not receive an interest in the output of the CCA, would not be considered a participant in the CCA but rather a service provider to the CCA. As such, it should be compensated for the services it provides on an arm's length basis external to the CCA. See paragraph 8.18. Similarly, a party would not be a participant in a CCA if it is not capable of exploiting the output of the CCA in its own business in any manner.

8.15. A party would also not be a participant in a CCA if it does not exercise control over the specific risks it assumes under the CCA and does not have the financial capacity to assume these risks, as this party would not be entitled to a share in the output that is the objective of the CCA based on the functions it actually performs. The general principles set out in Chapter I of these guidelines on the assumption of risks apply to situations involving CCAs. Each participant makes particular contributions to the

CCA objectives, and contractually assumes certain risks. Guidance under Section D.1 of Chapter I on delineating the actual transaction will apply to the transfer pricing analysis in relation to these risks. This also means that a party assuming risks under a CCA based on an analysis under step 4(i) of the framework for analysing risks in paragraph 1.60 (“assumes the risk under the CCA”) must control the specific risks it assumes under the CCA and must have the financial capacity to assume these risks. In particular, this implies that a CCA participant must have (i) the capability to make decisions to take on, lay off, or decline the risk-bearing opportunity presented by participating in the CCA, and must actually perform that decision-making function and (ii) the capability to make decisions on whether and how to respond to the risks associated with the opportunity, and must actually perform that decision-making function. While it is not necessary for the party to perform day-to-day risk mitigation activities in relation to activities of the CCA, in such cases, it must have the capability to determine the objectives of those risk mitigation activities to be performed by another party, to decide to entrust that other party to provide the risk mitigation functions, to assess whether the objectives are being adequately met, and, where necessary, to decide to adapt or terminate the arrangement, and must actually perform such assessment and decision-making. In accordance with the principles of prudent business management, the extent of the risks involved in the arrangement will determine the extent of capability and control required. The guidance in paragraphs 6.60 to 6.64 is relevant for assessing whether a party providing funding has the functional capability to exercise control over the financial risk attached to its contributions to the CCA and whether it actually performs these functions. See Examples 4 and 5 in the Annex to this chapter for an illustration of this principle.

8.16. To the extent that specific contributions made by participants to a CCA are different in nature, e.g. the participants perform very different types of R&D activities or one of the parties contributes property and another contributes R&D activities, the guidance in paragraph 6.64 is equally applicable. This means that the higher the development risk attached to the development activities performed by the other party and the closer the risk assumed by the first party is related to this development risk, the more the first party will need to have the capability to assess the progress of the development of the intangible and the consequences of this progress for achieving its expected benefits, and the more closely this party may need to link its actual decision-making required in relation to its continued contributions to the CCA to key operational developments that may impact the specific risks it assumes under the CCA. A development CCA in which benefits are uncertain and distant is likely to give rise to greater risks than does a services CCA in which benefits are current.

8.17. As described in the previous paragraphs, it is not necessary for the CCA participants to perform all of the CCA activities through their own personnel. In some cases, the participants in a CCA may decide to outsource certain functions related to the subject activity to a separate entity that is not a participant under the standard of paragraph 8.14 above. In such situations, the participants to the CCA should individually meet the requirements on exercising control over the specific risks they assume under the CCA. Such requirements include exercising control over the outsourced functions by at least one of the participants to the CCA. In circumstances in which the objective of the CCA is to develop an intangible, at least one of the participants to the CCA should also exercise control over the important development, enhancement, maintenance, protection and exploitation functions that are outsourced. When the contribution of a participant to the CCA consists of activities other than controlling the outsourced functions, the guidance in paragraph 8.15 is relevant for assessing whether this party has the functional capability to exercise control over the specific risks it assumes under the CCA, in particular if these risks are closely linked to the outsourced functions.

8.18. In cases where CCA activities are outsourced, an arm's length charge would be appropriate to compensate the entity for services or other contributions being rendered to the CCA participants. Where the entity is an associated enterprise of one or more of the CCA participants, the arm's length charge would be determined under the general principles of Chapters I-III, including *inter alia* consideration of functions performed, assets used, and risks assumed, as well as the special considerations affecting an arm's length charge for services and/or in relation to any intangibles, as described in Chapter VII and Chapter VI (including the guidance on hard-to-value intangibles).

C.3. Expected benefits from the CCA

8.19. The relative shares of expected benefits might be estimated based on the anticipated additional income generated or costs saved or other benefits received by each participant as a result of the arrangement. An approach that is frequently used in practice, most typically for services CCAs, would be to reflect the participants' proportionate shares of expected benefits using a relevant allocation key. The possibilities for allocation keys include sales (turnover), profits, units used, produced, or sold; number of employees, and so forth.

8.20. To the extent that a material part or all of the benefits of a CCA activity are expected to be realised in the future and not solely in the year the costs are incurred, most typically for development CCAs, the allocation of contributions will take account of projections about the participants' shares of those benefits. The use of projections may raise problems for tax administrations in verifying the assumptions based on which projections have been made and in dealing with cases where the projections vary markedly from the actual results. These problems may be exacerbated where the CCA activity ends several years before the expected benefits actually materialise. It may be appropriate, particularly where benefits are expected to be realised in the future, for a CCA to provide for possible adjustments of proportionate shares of contributions over the term of the CCA on a prospective basis to reflect changes in relevant circumstances resulting in changes in relative shares of benefits. In situations where the actual shares of benefits 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. When the expected benefits of a CCA consist of a right in an intangible that is hard to value at the start of the development project or if pre-existing intangibles that are hard to value are part of the contributions to the CCA project, the guidance in Sections D.3 and D.4 of Chapter VI on hard-to-value intangibles is applicable to value the contributions of each of the participants to the CCA.

8.21. If an arrangement covers multiple activities, it will be important to take this into account in choosing an allocation method, so that the value of contributions made by each participant is properly related to the relative benefits expected by the participants. One approach (though not the only one) is to use more than one allocation key. For example, if there are five participants in a CCA, one of which cannot benefit from certain services activities undertaken within the CCA, then in the absence of some form of set-off or reduction in contribution, the contributions associated with those activities might be allocated only to the other four participants. In this case, two allocation keys might be used to allocate the contributions. Whether any particular allocation key or keys are appropriate depends on the exact nature of the CCA activity and the relationship between the allocation key(s) and the expected benefits. The guidance in Chapter VII on the use of indirect methods of determining an arm's length charge for services (paragraphs 7.23-7.26) may be helpful in this regard. In contrast, the three enterprises operating production sites in the illustration of a CCA in paragraph 8.8 are all anticipated to benefit from the multiple projects to improve production processes, and may adopt an allocation key based on, for example, relative size of production capacity. If one of the enterprises chooses not to implement the outcome of a particular project, this should not affect the relative share of benefits or the allocation key used. However, in such circumstances careful consideration should be given to the reason the enterprise chose not to implement the outcome, whether it ever had any reasonable intention of so doing, whether the expected benefits should have been adapted as the CCA arrangement developed and when its intention changed.

8.22. Whatever the method used to evaluate participants' relative shares of expected benefits, adjustments to the measure used may be necessary to account for differences between the respective shares of expected and actual benefits received by the participants. The CCA should require periodic reassessment of contributions *vis-à-vis* the revised share of benefits to determine whether the future contributions of participants should be adjusted accordingly. Thus, the allocation key(s) most relevant to any particular CCA may change over time leading to prospective adjustments. Such adjustments may reflect either the fact that the parties will have more reliable information about foreseeable (but uncertain) events as time passes, or the occurrence of unforeseeable events.

C.4. The value of each participant's contribution

8.23. For the purpose of determining whether a CCA satisfies the arm's length principle – i.e. whether each participant's proportionate share of the overall contributions to the CCA is consistent with the participant's proportionate share of the overall expected benefits – it is necessary to measure the value of each participant's contributions to the arrangement.

8.24. Contributions to a CCA may take many forms. For services CCAs, contributions primarily consist of the performance of the services. For development CCAs, contributions typically include the performance of development activities (e.g. R&D, marketing), and often include additional contributions relevant to the development CCA such as pre-existing tangible assets or intangibles. Irrespective of the type of CCA, all contributions of current or pre-existing value must be identified and accounted for appropriately in accordance with the arm's length principle. Since the value of each participant's relative share of contributions should accord with its share of expected benefits, balancing payments may be required to ensure this consistency. The term "contributions" as used in this Chapter includes contributions of both pre-existing and current value made by participants to a CCA.

8.25. Under the arm's length principle, the value of each participant's contribution should be consistent with the value that independent enterprises in comparable circumstances would have assigned to that contribution. That is, contributions must generally be assessed based on their value at the time they are contributed, bearing in mind the mutual sharing of risks, as well as the nature and extent of the associated expected benefits to participants in the CCA, in order to be consistent with the arm's length principle. In determining the value of contributions to a CCA the guidance elsewhere in these Guidelines should be followed.

8.26. In valuing contributions, distinctions should be drawn between contributions of pre-existing value and current contributions. For example, in a CCA for the development of an intangible, the contribution of patented technology by one of the participants reflects a contribution of pre-existing value which is useful towards the development of the intangible that is the objective of the CCA. The value of that technology should be determined under the arm's length principle using the guidance in Chapter I-III and Chapter VI, including, where appropriate, the use of valuation techniques as set out in that Chapter. The current R&D activity under the development CCA performed by one or more associated enterprises would constitute a current contribution. The value of current functional contributions is not based on the potential value of the resulting further application of the technology, but on the value of the functions performed. The potential value of the resulting further application of the technology is taken into account through the value of pre-existing contributions and through the sharing of the development risk in proportion to the expected share of benefits by the CCA participants. The value of the current contributions should be determined under the guidance in Chapters I-III, VI and VII. As noted in paragraph 6.79, compensation based on a reimbursement of cost plus a modest mark-up will not reflect that anticipated value of, or the arm's length price for, the contribution of the research team in all cases.

8.27. While all contributions should be measured at value (but see paragraph 8.28 below), it may be more administrable for taxpayers to pay current contributions at cost. This may be particularly relevant for development CCAs. If this approach is adopted, the pre-existing contributions should recover the opportunity cost of the *ex ante* commitment to contribute resources to the CCA. For example, a contractual arrangement (i.e. the CCA) that commits an existing R&D workforce to undertake work for the benefit of the CCA should reflect the opportunity cost of alternative R&D endeavours (e.g. the present value of the arm's length mark-up over R&D costs) in the pre-existing contributions, while contributing current activities at cost (see Example 1A in the Annex to this chapter).

8.28. Whereas it cannot be assumed that the value of pre-existing contributions corresponds to costs, it is sometimes the case that cost could be used as a practical means to measure relative value of current contributions. Where the difference between the value and costs is relatively insignificant, for practical reasons, current contributions of a similar nature may be measured at cost in such cases for services CCAs. However, in other circumstances (for example where contributions provided by the participants vary in nature and include a mixture of service types and/or intangibles or other assets) measuring current contributions at cost is unlikely to provide a reliable basis for determining the value of the relative contributions of participants, and may lead to non-arm's length results. For development CCAs, the measurement of current contributions at cost (apart from the administrative guidance in paragraph 8.27) will generally not provide a reliable basis for the application of the arm's length principle. See Examples 1-3 in the Annex to this chapter for illustration of this guidance. Where uncontrolled arrangements are claimed to be comparable to the arrangements between the associated enterprises in the CCA, and those uncontrolled arrangements provide for contributions to be made at cost, it is important to consider the comparability of all of the economically relevant characteristics of the transactions in the broader context of the arrangement, including the impact of any broader arrangement of economically related transactions which may exist between the parties to the uncontrolled transaction, and the sharing of risks. Particular attention should be paid to whether other payments are made in the uncontrolled arrangements; for example, stage payments or compensating contributions may be made in addition to the reimbursement of costs.

8.29. Since contributions are based on expected benefits, this generally implies that where a cost reimbursement basis for valuing current contributions is permitted, the analysis should initially be based on budgeted costs. This does not necessarily mean fixing the costs, since the budget framework may accommodate variability arising from factors such as varying demand levels (for instance budgeted costs may be expressed as a fixed percentage of actual sales). Additionally, there are likely to be differences between budgeted costs and actual costs during the term of the CCA. In an arm's length situation, the terms agreed between the parties are likely to set out how such differences should be treated since, as stated in paragraph 2.96, independent parties are not likely to use budgeted costs without agreeing what factors are taken into account in setting the budget and how unforeseen circumstances are to be treated. Attention should be paid to the reason for any significant differences between budgeted costs and actual costs, since the difference may point to changes in the scope of activities which may not benefit all the participants in the same way as the activities originally scoped. In general terms, however, where cost is found to be an appropriate basis for measuring current contributions, it is likely to be sufficient to use actual costs as the basis for so doing.

8.30. It is important that the evaluation process recognises all contributions made by participants to the arrangement. This includes contributions made by one or more parties at the inception of the CCA (such as contributions of pre-existing intangibles) as well as contributions made on an ongoing basis during the term of the CCA. Contributions to be considered include property or services that are used solely in the CCA activity, but also property or services (i.e. shared property or services) that are used partly in the CCA activity and also partly in the participant's separate business activities. It can be difficult to measure contributions that involve shared property or services, for example where a participant contributes the partial use of assets such as office buildings and IT systems or performs supervisory, clerical, and administrative functions for the CCA and for its own business. It will be necessary to determine the proportion of the assets used or services that relate to the CCA activity in a commercially justifiable way with regard to recognised accounting principles and the actual facts, and adjustments, if material, may be necessary to achieve consistency when different jurisdictions are involved. Once the proportion is determined, the contribution can be measured in accordance with the principles in the rest of this chapter.

8.31. For development CCAs, contributions in the form of controlling and managing the CCA, its activities and risks, are likely to be important functions, as described in paragraph 6.56, in relation to the development, production, or obtaining of the intangibles or tangible assets and should be valued in accordance with the principles set out in Chapter VI.

8.32. The following scenario illustrates the guidance on determining participants, the share of benefits, and the value of contributions.

8.33. Company A based in Country A and Company B based in Country B are members of an MNE group and have concluded a CCA to develop intangibles. Company B has entitlement under the CCA to exploit the intangibles in Country B, and Company A has entitlement under the CCA to exploit the intangibles in the rest of the world. The parties anticipate that Company A will have 75% of total sales and Company B 25% of total sales, and that their share of expected benefits from the CCA is 75:25. Both A and B have experience of developing intangibles and have their own research and development personnel. They each control their development risk under the CCA within the terms set out in paragraphs 8.14 to 8.16. Company A contributes pre-existing intangibles to the CCA that it has recently acquired from a third-party. Company B contributes proprietary analytical techniques that it has developed to improve efficiency and speed to market. Both of these pre-existing contributions should be valued under the guidance provided in Chapters I-III and VI. Current contributions in the form of day-to-day research will be performed 80% by Company B and 20% by Company A under the guidance of a leadership team made up of personnel from both companies in the ratio 90:10 in favour of Company A. These two kinds of current contributions should separately be analysed and valued under the guidance provided in Chapters I-III and VI. When the expected benefits of a CCA consist of a right in an intangible that is hard to value at the start of the development project or if pre-existing intangibles that are hard to value are part of the contributions to the CCA project, the guidance in Sections D.3 and D.4 of Chapter VI on hard-to-value intangibles is applicable to value the contributions of each of the participants to the CCA.

C.5. Balancing payments

8.34. A CCA will be considered consistent with the arm's length principle where the value of each participant's proportionate share of the overall contributions to the arrangement (taking into account any balancing payments already made) is consistent with the participant's share of the overall expected benefits to be received under the arrangement. Where the value of a participant's share of overall contributions under a CCA at the time the contributions are made is not consistent with that participant's share of expected benefits under the CCA, the contributions made by at least one of the participants will be inadequate, and the contributions made by at least one other participant will be excessive. In such a case, the arm's length principle would generally require that an adjustment be made. This will generally take the form of an adjustment to the contribution through making or imputing a (further) balancing payment. Such balancing payments increase the value of the contributions of the payor and decrease that of the payee.

8.35. Balancing payments may be made by participants to "top up" the value of the contributions when their proportionate contributions are lower than their proportionate expected benefits. Such adjustments may be anticipated by the participants upon entering into the CCA, or may be the result of periodic re-evaluation of their share of the expected benefits and/or the value of their contributions (see paragraph 8.22).

8.36. Balancing payments may also be required by tax administrations where the value of a participant's proportionate contributions of property or services at the time the contribution was made has been incorrectly determined, or where the participants' proportionate expected benefits have been incorrectly assessed, e.g. where the allocation key when fixed or adjusted for changed circumstances was not adequately reflective of proportionate expected benefits. Normally the adjustment would be made by a balancing payment from one or more participants to another being made or imputed for the period in question.

8.37. In the case of development CCAs, variations between a participant's proportionate share of the overall contributions and that participant's proportionate share of the overall expected benefits may occur in a particular year. If that CCA is otherwise acceptable and carried out faithfully, having regard to the recommendations of Section E, tax administrations should generally refrain from making an adjustment based on the results of a single fiscal year. Consideration should be given to whether each participant's proportionate share of the overall contributions is consistent with the participant's proportionate share of the overall expected benefits from the arrangement over a period of years (see paragraphs 3.75-3.79). Separate balancing payments might be made for pre-existing contributions and for current contributions, respectively. Alternatively, it might be more reliable or administrable to make an overall balancing payment relating to pre-existing contributions and current contributions collectively. See Example 4 in the Annex to this chapter.

8.38. In the example in paragraph 8.33, the participants, Companies A and B, expect to benefit from the CCA in the ratio 75:25. In the first year the value of their pre-existing contributions is 10 million for Company A and 6 million for Company B. As a result, a net balancing payment is required to be made to Company B by Company A of 2 million (i.e. 4.5 million from Company A to Company B less 2.5 million from Company B to Company A) in order to increase Company A's contribution to 12 million (75% of the total contributions) and reducing Company B's contribution to 4 million (25% of the total).

C.6. Accurately delineating the actual transaction

8.39. As indicated in paragraph 8.9, the economically relevant characteristics of the arrangement identified under the guidance in Section D of Chapter I may indicate that the actual transaction differs from the terms of the CCA purportedly agreed by the participants. For example, one or more of the claimed participants may not have any reasonable expectation of benefit from the CCA activity. Although in principle the smallness of a participant's share of expected benefits is no bar to eligibility, if a participant that is performing all of the subject activity is expected to have only a small fraction of the overall expected benefits, it may be questioned whether the reality of the arrangements for that party is to pool resources and share risks or whether the appearance of sharing in mutual benefits has been constructed to obtain more favourable tax results. The existence of significant balancing payments arising from a material difference between the parties' proportionate shares of contributions and benefits may also give rise to questions about whether mutual benefits exist or whether the arrangements should be accurately delineated, taking into account all the economically relevant characteristics, as a funding transaction.

8.40. As indicated in paragraph 8.33, the guidance in Chapter VI on hard-to-value intangibles may equally apply in situations involving CCAs. This will be the case if the objective of the CCA is to develop a new intangible that is hard to value at the start of the development project, but also in valuing contributions involving pre-existing intangibles. Where the arrangements viewed in their totality lack commercial rationality in accordance with the criteria in Section D.2 of Chapter I, the CCA may be disregarded.

C.7. The tax treatment of contributions and balancing payments

8.41. Contributions, including any balancing payments, by a participant to a CCA should be treated for tax purposes in the same manner as would apply under the general rules of the tax system(s) applicable to that participant if the contributions were made outside a CCA, to carry on the activity that is the subject of the CCA. The character of the contribution will depend on the nature of the activity being undertaken by the CCA, and will determine how it is recognised for tax purposes.

8.42. In services CCAs, a participant's contribution to the CCA will often give rise to benefits in the form of cost savings (in which case there may not be any income generated directly by the CCA activity). In development CCAs, the expected benefits to participants may not accrue until some time after contributions are made, and therefore there will be no immediate recognition of income to the participants on their contributions at the time they are made.

8.43. Any balancing payment should be treated as an addition to the contribution of the payor and as a reduction in the contribution of the recipient. As with contributions generally, the character and tax treatment of any balancing payments will be determined in accordance with domestic laws, including applicable tax treaties.

D. CCA entry, withdrawal or termination

8.44. Changes in the membership of a CCA will generally trigger a reassessment of the proportionate shares of participants' contributions and expected benefits. An entity that becomes a participant in an already active CCA might obtain an interest in any results of prior CCA activity, such as completed or work-in-progress intangibles or tangible assets. In such cases, the previous participants effectively transfer part of their respective interests in the results of the prior CCA activity to the new entrant. Under the arm's length principle, any such transfer of intangibles or tangible assets must be compensated based on an arm's length value for the transferred interest. Such compensation is referred to in this chapter as a "buy-in payment".

8.45. The amount of a buy-in payment should be determined based upon the value (i.e. the arm's length price) of the interest in the intangibles and/or tangible assets the new entrant obtains, taking into account the new entrant's proportionate share of the overall expected benefits to be received under the CCA. There may also be cases where a new participant brings existing intangibles or tangible assets to the CCA, and that balancing payments may be appropriate from the other participants in recognition of this contribution. Any balancing payments to the new entrant could be netted against any buy-in payments required, although appropriate records must be kept of the full amounts of the separate payments for tax administration purposes.

8.46. Similar issues could arise when a participant leaves a CCA. In particular, a participant that leaves a CCA may dispose of its interest in the results, if any, of past CCA activity (including work in progress) to the other participants. Any such transfer should be compensated according to the arm's length principle. Such compensation is referred to in this chapter as a "buy-out payment".

8.47. The guidance in Chapters I-III and Chapter VI is fully applicable to determining the arm's length amount of any buy-in, buy-out or balancing payments required. There may be instances where no such payments are required under the arm's length principle. For example, a CCA for the sharing of administrative services would generally only produce benefits to participants on a current basis, rather than any valuable on-going results.

8.48. Buy-in and buy-out payments should be treated for tax purposes in the same manner as would apply under the general rules of the tax system(s) (including conventions for the avoidance of double taxation) applicable to the respective participants as if the payment were made outside a CCA as consideration for the acquisition or disposal of the interest in the results of the prior CCA activity.

8.49. When a CCA terminates, the arm's length principle requires that each participant retains an interest in the results, if any, of the CCA activity consistent with their proportionate share of contributions to the CCA throughout its term (adjusted by any balancing payments actually made, including those made as a result of the termination), or is appropriately compensated for any transfer of that interest to other participants.

E. Recommendations for structuring and documenting CCAs

8.50. Generally, a CCA between controlled parties should meet the following conditions:

a) The participants would include only enterprises expected to derive mutual and proportionate benefits from the CCA activity itself (and not just from performing part or all of that activity). See paragraph 8.14.

b) The arrangement would specify the nature and extent of each participant's interest in the results of the CCA activity, as well its expected respective share of benefits.

c) No payment other than the CCA contributions, appropriate balancing payments and buy-in payments would be made for the particular interest or rights in intangibles, tangible assets or services obtained through the CCA.

d) The value of participants' contributions would be determined in accordance with these Guidelines and, where necessary, balancing payments should be made to ensure the proportionate shares of contributions align with the proportionate shares of expected benefits from the arrangement.

e) The arrangement may specify provision for balancing payments and/or changes in the allocation of contributions prospectively after a reasonable period of time to reflect material changes in proportionate shares of expected benefits among the participants.

f) Adjustments would be made as necessary (including the possibility of buy-in and buy-out payments) upon the entrance or withdrawal of a participant and upon termination of the CCA.

8.51. The transfer pricing documentation standard set out in Chapter V requires reporting under the master file of important service arrangements and important agreements related to intangibles, including CCAs. The local file requires transactional information including a description of the transactions, the amounts of payments and receipts, identification of the associated enterprises involved, copies of material intercompany agreements, and pricing information including a description of reasons for concluding that the transactions were priced on an arm's length basis. It would be expected that in order to comply with these documentation requirements, the participants in a CCA will prepare or obtain materials about the nature of the subject activity, the terms of the arrangement, and its consistency with the arm's length principle. Implicit in this is that each participant should have full access to the details of the activities to be conducted under the CCA, the identity and location of the other parties involved in the CCA, the projections on which the contributions are to be made and expected benefits determined, and budgeted and actual expenditures for the CCA activity, at a level of detail commensurate with the complexity and importance of the CCA to the taxpayer. All this information could be relevant and useful to tax administrations in the context of a CCA and, if not included in the master file or local file, taxpayers should be prepared to provide it upon request. The information relevant to any particular CCA will depend on the facts and circumstances. It should be emphasised that the information described in this list is neither a minimum compliance standard nor an exhaustive list of the information that a tax administration may be entitled to request.

8.52. The following information would be relevant and useful concerning the initial terms of the CCA:

a) a list of participants

b) a list of any other associated enterprises that will be involved with the CCA activity or that are expected to exploit or use the results of the subject activity

c) the scope of the activities and specific projects covered by the CCA, and how the CCA activities are managed and controlled

d) the duration of the arrangement

e) the manner in which participants' proportionate shares of expected benefits are measured, and any projections used in this determination

f) the manner in which any future benefits (such as intangibles) are expected to be exploited

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 (including any budgeted *vs* actual adjustments) 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, and the mechanisms for managing and controlling those responsibilities and tasks, in particular, those relating to the development, enhancement, maintenance, protection or exploitation of intangibles or tangible assets used in the CCA activity

i) the procedures for and consequences of a participant entering or withdrawing from the CCA and the termination of the CCA

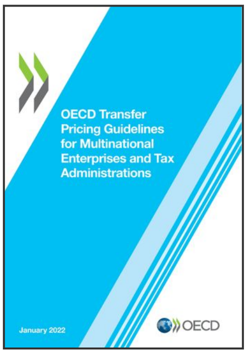
j) any provisions for balancing payments or for adjusting the terms of the arrangement to reflect changes in economic circumstances.

8.53. Over the duration of the CCA term, the following information could be useful:

a) any change to the arrangement (e.g. in terms, participants, subject activity), and the consequences of such change

b) a comparison between projections used to determine the share of expected benefits from the CCA activity with the actual share of benefits (however, regard should be had to paragraph 3.74)

c) the annual expenditure incurred in conducting the CCA activity, the form and value of each participant's contributions made during the CCA's term, and a detailed description of how the value of contributions is determined.



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