B.6. Cost Contribution Arrangements

Introduction

B.6.1. This chapter provides guidance on the use of cost contribution arrangements (CCAs) and the application of the arm's length principle to CCAs for transfer pricing purposes. CCAs are contractual agreements between associated enterprises in an MNE group in which the participants share certain costs and risks in return for having a proportionate interest in theassets, acquiring or

administrative and technical services, marketing and purchasing of raw materials or products.

B.6.8. On the other hand, for example in an intangible development CCA, particip

- the sharing of risks among the CCA participants; and
- exploiting the knowledge of the participants through the sharing of know-how and best practices.

B.6.11. A participant in a CCA involving intangibles is entitled to use its interest in the intangibles in accordance with its share of the intangible and cannot be required to pay a fee or royalty to use its interest in the intangible. This is the case even where legal ownership is held by one associated enterprise on behalf of the group.

B.6.12.

development of a new drug can be very significant. The facts and circumstances suggest that although there is a high risk that an individual pharmaceutical research and development CCA may fail to actually provide benefits to the participants, this may simply reflect the playing out of risks, and is not in itself indicative that the CCA does not satisfy the arm's length principle.

B.6.15.

B.6.22. In some situations budgeted costs may be used for valuing contributions. Budgeted costs may be justified on the basis that contributions to a CCA will reflect expected benefits. There are usually differences between budgeted costs and actual costs in a CCA. A key question is therefore to determine which participants bear the risk that actual costs may be greater or lower than the budgeted costs. Arm’s length parties will usually set out how to deal with the differences between budgeted costs and actual costs. [illegible]

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into account the efubtyofubt3 (e (c)4 (ou-2 (t)o)-10fubtyofu)-2 (he)4 (e)subs-2 (ntd)-10fuyntrt3 ()-2 (he addition, CCAs should provide for adjustments to be made to contributions during the course of the CCA on a prospective basis to reflect changes in the ratio of the expected benefits of the participants.

B.6.28. For some CCAs, such as for intangible development, the benefits from the CCA will be realized in the future, and the time lag between commencement and realization may be significant. Accordingly, it can be difficult to measure the expected benefits flowing from research and development CCAs. Discounted income or cash flow methods are often used (See sections B.5.6.8 to B.5.6.29 of Chapter B.5. Under the arm's length principle a participant's contributions to a CCA must be consistent with its share of the expected benefits. This requires a direct approximation of a participant's expected benefits and ensuring that its contributions reflect its expected benefits. Consequently, if a participant is expected to receive a significant direct benefit if the goals of the CCA are realized, the participant should make a significant contribution.

Example 1

Assume that Company A and Company B enter into a CCA in Year 1 to develop new technology. At the inception of the CCA it is projected that the development process will take five years and that once the new technology is commercialized development period, both Company A and Company B would have paid 50 per

comply with the arm’s length principle as an independent enterprise would not participate in such an arrangement, and thus disregard the CCA.

CCA entry, withdrawal and termination

B.6.36. At the time a CCA is established, one or more participants may be required to make a payment for

- the participants;
- any other associated enterprises who will be involved;
- any other associated enterprises that may be expected to benefit from the CCA;
- the activities of the CCA;
- the duration of the CCA;
- the measurement of the participants’ share of expected benefits;
- the contributions of each participant;
- the consequences of a participant entering the CCA, leaving the CCA or termination of the CCA; and
- balancing payments and adjustments to the terms of the CCA to reflect changes in economic circumstances of the participants.

B.6.46. In addition, the OECD Transfer Pricing Guidelines encourage participants to

Market value of Service 1: 120 per unit. That is, the arm's length price that Company A would charge Company B for the provision of Service 1 is 120.

Costs of providing Service 2 (cost incurred by Company B): 100 per unit

Market value of Service 2: 105 per unit (note: assume that this is considered a low-value service)

In year 1 and in subsequent years, Company A provides 30 units of Service 1 to the group and Company B provides 20 units of Service 2 to the group. Company A and Company B enter into a CCA to share the costs and benefits of Service 1 and Service 2. Under the CCA, the calculation of costs and benefits are as follows:

Cost to Company A of providing services:	3000 (60% of total costs)
Cost to Company B of providing services:	2000 (40% of total costs)
Total cost to group:	5000

Contribution made by Company A (market value):
3600 (63% of total contributions)

Contribution made by Company B (market value):
2100 (37% of total contributions)

Total contributions made by group: 5700

Company A consumes 15 units of Service 1 and 10 unit of Service 2.
Company B consumes 15 unit of Service 1 and 10 unit of Service 2.

Benefit to Company A:
1800 + 1050 = 2850 (50% of total value of 5700)

Benefit to Company B:

1800 + 1050 = 2850 (50% of total value of 5700)

Contributions measured atvalue: Under the CCA, Company A should bear the costs associated with 50% of the total value of contributions (5700), or 2850. The market value of Company A's in-kind contribution is 3600. Company B should bear the costs associated with 50% of the total value of contributions, or 2850. The value of Company B's in-kind contribution is 2100. Accordingly, Company B should make a balancing payment to Company A of 750.

Appendix

Differences between CCAs and service arrangements

. It is difficult to

The allocation of costs under the arm’s length principle must be based on each participant’s expected benefits under the CCA.	The allocation key is designed as a proxy measure of the expected benefits that the recipient associated enterprise will receive from the services.