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Grant Thornton discussion draft response

BEPS Action 8: Revisions to Chapter VIII of the Transfer Pricing Guidelines on Cost Contribution Arrangements (CCAs)

Grant Thornton International Ltd welcomes the opportunity to comment on the OECD public discussion draft entitled BEPS Action 8: Revisions to Chapter VIII of the Transfer Pricing Guidelines on Cost Contribution Arrangements (CCAs), issued on 29 April 2015.

We appreciate the work that the OECD has undertaken on the revised chapter VIII and would like to make the following comments on the public discussion draft.

We welcome the OECD's proposal to maintain the central role of the transfer pricing guidelines, within the BEPS project, in the international tax framework for the appropriate allocation of profit and avoidance of double taxation. CCAs are an important area and while we acknowledge that the OECD recognises the need for simplification, the revised chapter VIII may in fact lead to increased complexity and the risk of double taxation. Our reasoning stems from the proposed fundamental shift to measuring contributions at 'value' over 'cost'. Further guidance on how to apply this method under different scenarios would help to explain the practical implications of the proposed changes, and using real life examples would be welcomed.

Measuring the contribution – 'value' and 'cost'

The updated guidelines as per the discussion draft emphasise that contributions should be assessed based on their 'value' in most cases, as opposed to their 'cost'. Indeed cost is only to be permitted for services CCAs and even then only in cases where the only services contributed are low value-added services.

Comment: While we understand the BEPS focus on 'substance' and 'value creation', more guidance is needed on how companies will measure their contributions at value. This presumption against cost will likely increase the management and administrative cost of implementing and managing CCAs, while the added complexity will likely only serve to exacerbate the number of transfer pricing disputes.

The purpose of a CCA should be to reduce complex webs of cross charges and continually revisiting the value of 'in process' developments, whilst ensuring that contributions are commensurate with expected benefits. Many third party arrangements for example between joint venture partners, or in crowd funding, follow this concept.

Currently there is no guidance on whether any retrospective alterations will be required for existing multi-year arrangements based on the new value based contributions. There is also no guidance on whether existing CCAs will either remain effective or have to re-evaluate their contribution measurements. If the final guidance follows the draft, our recommendation is for the new rules to apply prospectively only to new CCAs entered into after the date that the new rules come into effect. This will minimise the administrative impact of the new rules on companies and tax administrators because established CCAs will not need to be revisited. Otherwise transitional provisions will be required, including a timeframe outlining when a company must become compliant with the proposed changes, to clarify the potential impact of the revised chapter. Further guidance is also important in ensuring that companies do not suffer unnecessary or excessive administrative costs in managing this transition.

If the guidance remains as drafted, a principles-based definition of the low value added services that can be valued at cost (at some, but not all, points the discussion draft cross refers to the revised Chapter VII, which reflects the BEPS Action 10 draft on low value added services) should help to provide further consistency and reduce the potential for disputes. We advocate principles because a definitive list often has the effect of introducing grey areas, particularly as a result of translation into different languages and application to different business sectors in a complex global business environment.

We suggest that the wording in paragraph 23 could be softened. For example, it is not necessarily a problem if some services valued at cost are not low value added.

Types of CCAs – the distinction

There is now a definite distinction between two types of CCAs commonly encountered – being 'development CCAs' and 'services CCAs'. The key difference is that the former are expected to create on-going future benefits for participants, while the latter will often create current benefits only.

- **Development CCAs** - for the joint development, enhancement, maintenance, protection or exploitation of intangible or tangible assets.
- **Services CCAs** - for obtaining services.

Comment: When asked to think of an example of 'cost sharing', most people would think of sharing development costs (and thereby sharing the inherent risks) in conducting research and development (R&D) over a period of time where the benefits are uncertain and indeed a loss may result. Examples exist in business sectors such as pharmaceuticals or defence where investment is often long term, costly and risky because of uncertain timing and amount of returns. The draft guidance seems to move a long way from that concept of sharing risks, and almost takes us to the point where there is no sense in having a separate chapter for these types of arrangements.

The use of 'services' CCAs should in effect allow management charges to be recharged at cost, unless the entity providing the service is solely a service provider and not also a beneficiary. This will benefit all parties if it results in fewer challenges from recipient tax authorities which currently assume that management fees are 'base eroding' payments.

Experience benefits vs actual benefits received – accounting for the arrangement's arm's length nature

The draft guidance addresses the importance of differentiating between an expected flow of benefits and the actual benefits received, in an attempt to better account for future developments when determining the arm's length nature of the arrangement. The aim is also to limit enquiries from tax administrators as to whether projections by independent parties would be acceptable in comparable circumstances.

Comment: The element of hindsight should be removed. It is inequitable on companies and inefficient for tax administrators because uncertainty remains for both parties. Unfortunately, there remains an element of hindsight and suggestion of continual revisiting and review in some of the wording (for example paragraph 42 d). Revisiting budgets and judgments with the benefit of hindsight introduces further potential for debate and inefficiency, and possible cherry-picking by tax authorities.

Determining the participants of a CCA – control of risk

In addition to the likelihood of an expected flow of benefit, a participant to a CCA must have the capability and authority to control the risks in relation to CCA activities. This is consistent with draft revisions made to Chapter I of the transfer pricing guidelines.

Comment: Consistent with our earlier comment on transitional provisions, companies will need to know whether the proposed changes will be applied to existing or only to new CCAs entered into after the effective date of the revised transfer pricing guidelines.

It is not immediately clear to us why there is a requirement that all participants must have the capability and authority to control risks. It is possible that one participant will contribute in part to the CCA by mitigating a particular risk, perhaps by virtue of their particular expertise. There are also numerous examples whereby third parties contribute cash but do not control any risks (for example in crowd funding), yet still accept the possibility of loss in return for the chance of superior returns from an early stage investment.

As an aside, we recommend considering replacing the word 'control' with 'manage' and/or 'mitigate'. Often, risks may have been identified but may still be outside the control of the participants. For example, foreign exchange movement is beyond the control of a company, but a company may mitigate the risk of foreign exchange movement by entering into foreign exchange hedging arrangements.

Further comments

The draft explains that a participant that only provides funding cannot be a cost sharer and must always receive a limited return (see comment above in relation to crowd funding). We appreciate the concern relating to so-called cash box entities but we consider that disregarding a CCA, or deeming an entity cannot be a participant to the CCA, should be considered only in extreme cases.

There is an extensive list of expected documentation and support in section E which seems disproportionate, and inconsistent with the BEPS Action 13 recommendations, and we respectfully suggest that these be re-aligned.

The revised Chapter VIII is obviously intended to be consistent with the BEPS amendments to risk, capital, recharacterisation and intangible assets. The revised Chapter VIII should be revisited together with the aforementioned areas once they are nearly finalised.

If you would like to discuss any of these points in more detail then please contact:

Wendy Nicholls
Partner
Grant Thornton UK LLP
E wendy.nicholls@uk.gt.com
M: +44(0)7714 069862

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