SwissHoldings
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Via E-Mail
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OECD Discussion Draft: BEPS Actions 8 - Revisions to Chapter VIII of the Transfer Pricing Guidelines on Cost Contribution Arrangements

Dear Mr. Hickman

The business federation SwissHoldings represents the interests of 61 Swiss based multinational enterprises from the manufacturing and service sectors (excluding the financial sector). SwissHoldings is pleased to provide comments on the OECD Discussion Draft of the Proposed Modifications to Chapter VIII of the Transfer Pricing Guidelines on Cost Contribution Arrangements (CCAs) (hereafter referred to as "the Draft").

SwissHoldings supports the objective to ensure that transfer pricing outcomes are in line with value creation as well as the Chapter VIII update and alignment with the most recent changes to the Guidelines.

Our comments to the Draft are as follows:

General

1. For both Services CCAs and Development CCAs, the contributions need to be determined based upon reasonable expected or actual benefits. The proposed purely value based approach is not in line with the principles of a CCA and the reason why companies (related or unrelated) enter a CCA. It is not in line with the arm's length principle as it ignores the majority of the CCA cases for which the cost based approach results in arm's length prices.

2. We want to highlight that CCAs are often not accepted (especially by non-OECD countries) and would appreciate any support for a wider acceptance to ensure that MNEs can globally implement CCAs without non-deduction and double taxation.

3. We would also appreciate any clarification that CCA payments are not subject to withholding tax.

Concept of a CCA

4. Par. 6 states that "*CCAs can provide helpful simplification of multiple transactions…..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"*. This is indeed an advantage of CCAs and reduces the already enormous compliance burden for taxpayers.

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5. However, given mutual expected benefits, the main reason and purpose of entering into a CCA is sharing/pooling of resources and - in particular risks - between the parties on a contractual basis. Hence, we do not understand the introduction of the new "comparability principle" in the last sentence of par. 6 (i.e., that the transfer pricing outcome for the parties in CCAs should be the same as if they had made individual transactions outside of CCAs). For CCAs, this principle (covered also in par. 22) is not in line with the arm's length principle as defined in Chapter 1 and the existing par. 8.14 of the TP Guidelines. This new principle disregards the contract concluded between the parties and and the chosen function and risk profile of the parties.

6. Assuming that other factual and economic conditions (e.g., substance, actual conduct, etc.) are met, tax authorities need to respect the risk allocation of the parties according to the CCA (i.e., comparing CCAs with a non-comparable service agreement or another transaction is not in line with the arm's length principle). CCAs are special business models where risk sharing is the key element. The closest comparable transactions or business models are joint venture situations. Also unrelated parties may enter into agreements to pool resources to combine the different individual strengths. In arm's length joint ventures contributions are often calculated at costs while determining the value is arbitrary and parties are interested in the expected benefit of the joint efforts.

7. Hence, the last sentence in par. 6 needs to be deleted. As a consequence, corresponding adjustments in the other sections of the Draft are required.

The value of each participant's contribution

8. For both Services CCAs and Development CCAs the contributions need to be determined upon reasonable expected or actual benefits.

9. According to par. 6 and par. 22, the Draft has introduced a new "value based approach" which is based upon a wrong comparability assumption. In the case of CCAs, there is no need to "value" or benchmark CCA activities. Instead, the purpose is to ensure that the budgeted or actual costs (subject to the terms of the CCA) are shared between the participants in line with the expected/actual benefits.

10. As mentioned in the second sentence of par. 15 and section C.3, the key transfer pricing challenge was (and remains) the determination of a comparable/arm's length *allocation key* for the costs to be shared. There is no need to value the cost/activities/services as such in isolation (and enter indirectly into benchmarking services and/or applying the correct profit mark-up).

11. For Services CCAs the determination of the allocation key should in practice be easier (i.e., the expected benefit should be in line with the expected or actual *(relative) consumption* of the services).

12. As a consequence, respecting the function and risk profile of the parties and applying the correct comparability principles, all 3 services examples should lead to the same results. In line with the expected benefits (i.e., the relative budgeted or actual consumption of the services (here 50%)) both parties should contribute 2500, respectively, the net result would be a payment of 500 from company B to Company A.

13. Moreover, the correct application of CCAs does not require a differentiation between low-value-adding services and other services as all types of CCA contributions should be assessed in line with the expected benefit. A clarification would be welcome.

14. As described in section C3. – *prospective - adjustment clauses* can be added in CCAs to manage material changes of expected benefits over time. Assuming that the arm's length standard is met, the actual terms of the CCAs need to be respected by the tax authorities.

Participants of CCAs

15. In terms of eligibility to qualify as a participant, the Draft seems to focus almost entirely on "*capability and authority to control the risks*". Consequently, the Draft seems to virtually ignore other "important functions" related to the joint development, enhancement, maintenance, protection, and exploitation of intangibles or services. This interpretation limits the application of CCAs and is not in line with the arm's length principle. This extreme interpretation and limitation is also not observed in joint venture situations.

16. From our perspective, it should be sufficient to demonstrate the mutual interests, expected proportionate benefits and active participation (substance) of the participants in the important functions mentioned above. In such a case, the actual control exercised by the leadership teams (e.g., BOD) of the parties should be sufficient to meet the "risk-control" requirement described in par. 13 and par. 26. A clarification would be welcome.

Documentation and Compliance

17. The proposed CCA documentation principles seem to go beyond the existing extensive documentation requirement as defined in BEPS Action 13. A clarification and reduction of requirements would be welcome.

18. In particular, the implementation of a value based approach for CCAs would significantly increase the compliance burden for MNEs (i.e., requiring more sophisticated documentation and costly expert guidance). The complex valuation principle would also increase the potential for controversy and double taxation for the MNE. Extensive documentation is (already) required to ensure tax deductibility of CCA payments, balancing payments or buy-in/buy-out payments.

19. CCAs covering low value-added activities should benefit from the reduced compliance requirements applicable to low value-added services. Accordingly, the Draft should include a clarifying statement in par. 42.

Hard to Value Intangibles

20. Par. 32.: We appreciate the reference to the guidance in Chapter VI on Hard to Value Intangibles but want to repeat the related comments to Chapter VI previously made by SwissHoldings:

    – The term Hard-to-value Intangibles is not clearly defined. Without a clear definition, the implementation will fail and result in controversy and double taxation.
    – With unrelated parties, the proposed price adjustment mechanism is the exception and not the rule, especially for the long term. Hence, making the exception to the rule for MNEs is not arm's length and must therefore be dropped. However, as an alternative, if taxpayers choose this option and properly document the chosen set-up, then this must be respected by the tax administrations.

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We kindly ask you to take our comments and proposals into due consideration.

Yours sincerely

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