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Ref: OECD DISCUSSION DRAFT: BEPS ACTIONS 8, 9 AND 10, REVISIONS TO CHAPTER VIII OF THE TRANSFER PRICING GUIDELINES ON COST CONTRIBUTION ARRANGEMENTS

Dear Andrew,

BIAC thanks the OECD for the opportunity to provide comments on the revisions of Chapter VII of the Transfer Pricing Guidelines (the Discussion Draft) on Cost Contributions Arrangements (CCAs) relating to Actions 8, 9 and 10 of the Base Erosion and Profit Shifting (BEPS) Action Plan. As always, we want to acknowledge the significant amount of hard work and effort that has been put into this project.

CCAs are arrangements that allow participants to share in risks and benefits through jointly developing, producing or obtaining assets, services, or rights. More importantly, CCAs are cooperation models that allow MNEs to innovate and invest in high-risk projects, developing business opportunities and creating a positive impact for the global economy. Although abusive cases do exist, it is important that not all existing CCAs are automatically considered to create BEPS risks. CCAs, in the majority of cases, are used for genuine commercial purposes, and to streamline the application of the Arm's Length Principle (ALP) where multiple parties share costs, risks and benefits.

BIAC understands and agrees that a key objective in revising the CCAs guidance is to "*align the transfer pricing of intangibles under CCAs with the general guidance on the transfer pricing of intangibles found in the revised Chapter VI*" [i.e., the ALP], and to make the Chapter VIII guidance consistent with the broader BEPS transfer pricing (TP) work, including proposals to address the fundamental issues of risk, capital, recharacterisation and intangibles. BIAC supports the OECD's work to improve its Transfer Pricing Guidelines (TPG). To that end, we recommend that the CCA rules be as simple as possible, draw from current best practices and, thereby, reduce the likelihood of future litigation. To spell that out a little, we believe that the project should:

- Avoid introducing complexity into an area of the TPG that currently provides a relatively straightforward method of applying the ALP, that in turn facilitates efficient business models;
- Keep the OECD's CCA guidance as close as possible to other international CCA approaches; and
- Seek to avoid more TP disputes that ultimately create adversarial relationships between taxpayers and tax administrations. (This, as we have written in other comments, is particularly important if dispute resolution mechanisms are not substantially improved.)

Unfortunately, although the Discussion Draft states that simplification and consistency are at the core of the OECD's aims, we do still have certain concerns:

- The proposals create fundamental uncertainties about the purpose of the CCA concept. Such uncertainty is illustrated by the requirement for "*contributions to be measured at value rather than at cost (…) to ensure that outcomes for participants under a CCA should not differ significantly from the outcomes of transfers or development of intangibles for parties outside a CCA*." The requirement for R&D and other development services/activities contributed by participants to a CCA to be accounted for at value, where costs are not considered to provide a reliable basis for value, represents a fundamental change from the existing TPG. We deal with this at length below, but this is a critical issue.
- If the proposed requirement that all participants in a CCA must have the capability and authority to *control* the risks associated with the "risk-bearing opportunity" under the CCA, is applied too broadly by tax administrations, much of the simplification and other advantages offered by CCAs would be diminished. The Discussion Draft should clearly state that, whilst parties to a CCA should indeed have the capacity and authority to *identify and understand* the risks associated with the opportunity, a related party CCA should not create an obligation for all parties to *control* risks associated with a CCA on an ongoing basis, which would run counter to how unrelated parties operate.

In the attached comments you will find more detail on the above, as well as on a number of related issues. We very much hope that you find these comments useful, and we look forward to continuing to work with you on this important issue.

Sincerely,

Will Morris

Will Morris
Chair, BIAC Tax Committee

Introductory Comments and Executive Summary

1. As a preliminary comment, it is worth considering the purpose of CCAs. A CCA creates joint economic ownership whereby the participants share the risks of activities in return for rights to the value created by those activities. This includes the risk that a service or asset does not deliver on the expected benefit for the participants/contributors in general. CCAs enable firms to effectively and efficiently develop or acquire services, goods, tangible or intangible assets. By paying for costs in proportion to the expected benefit, entities buy an entrepreneurial interest in the outcome of the activities. CCAs are commonly applied, both internally and with third parties, in high-risk industries such as biotech, pharmaceutical, movie, and oil and gas.

2. MNEs perform their activities globally and are often organized into "hubs" – creating centres of expertise. MNEs tend not to replicate their entire operations in every country where they operate, choosing more efficient global operating structures. In particular, when MNEs perform services, technical development or research activities in different entities throughout the world, such entities may contribute to the creation of intangibles or services deriving from such activities in a number of ways (for example, in cash or in kind), with various benefits and appetites to share the ownership or use of such intangibles.

3. Such global business models can lead to very complex systems of cross charges, which are very difficult to manage. Moreover, when intangible development activities are highly complementary or integrated, it can be difficult to determine the appropriate cross-charges or value contributed by each party. In this regard, we welcome the new language in paragraph 6 stating that *"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."* And that *"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 effective ownership of the resulting intangible(s) shared in accordance with the terms of the CCA."* This language highlights some of the valuable benefits of CCAs.

4. It would be helpful to clarify the definition of "value contributed" in the Discussion Draft. Activities may create routine or non-routine (intangible) value. For example, if an entity that participates in a CCA performs R&D activities, is its contributed value equal to its R&D costs plus an arm's-length return on those activities? Or is its contributed value equal to the amount of expected intangible value created by the entity? The examples provided in the Discussion Draft suggest that the concept of value refers to the latter, since the contributed value equals the expected benefits. While the former does not significantly alter the risk-sharing nature of CCAs, the latter would change the nature of the relationship similar to that of an IP owner that charges the other participant for the use of the intangibles that it expects to create.

5. The principle of a CCA is that all participants contribute to the arrangement, and in turn, expect to share in their proportionate benefit and risks. The two fundamental criteria that are taken into account when establishing a CCA are therefore:

i. Contributions to the CCA; and

ii. Expected benefits from the CCA.

The TPG and ALP should apply to CCAs so that contributions are commensurate with the expected benefits. This should drive all other considerations under a CCA in relation to the nature and identity of the participants, the way costs and benefits are shared, the ownership of the intangibles and the way buy-in or buy-out payments are established.

6. Testing the arm's length nature of a CCA using an alternative method, where all embedded transactions are delineated to separately apply Chapter I and VI principles will create a new "Value Contribution" concept, making many existing CCAs untenable. That approach is not in line with the CCA concept, or how third parties might interact with each other under comparable circumstances. Requiring all component transactions are tested or valued as if the participants were not parties to a CCA, which would, by definition, eliminate much of the administrative benefit of entering into a CCA. BIAC believes that transactions within a CCA are not necessarily comparable to transactions under other business models, as there will be differences in risks shared, cooperation, or differences in the way that assets are owned throughout the arrangement. The differences in functional, risk profiles and the economic ownership of assets should be addressed. In other words, the risks that participants in a CCA assume are not necessarily the same as would have been agreed outside a CCA. Firms enter into agreements with third parties and share the costs of activities in accordance with their expected benefits. By sharing costs, entities share the risks associated with the activities. CCAs are valid commercial arrangements, reflected in third-party arm's-length transactions, which should be recognized in the Discussion Draft.

7. Although the Discussion Draft acknowledges the need for simplification, we are concerned that it will actually create additional complexity and disputes, substantially reducing the attractiveness of CCAs in a related party context. This result seems inappropriate given that CCAs are often utilised by independent parties to share risks and returns.

Detailed Analysis:

Participants:

8. The Discussion Draft's definition of who can participate in a CCA moves substantially away from the position in the current TPG. The new definition is greatly restricted, indicating that the 'right' functions must be performed to warrant participation (see Examples 4 and 5). When those functional requirements are not satisfied, the Discussion Draft suggests that the CCA should be disregarded, or that participants not connected to the intangible should be disregarded as participants in the CCA. This creates a new requirement to determine which parties can participate in a CCA, by proposing that they must have the capability and authority to control the risks associated with the "risk-bearing opportunity" under the CCA. In this regard, we believe that the Discussion Draft would benefit from clarification as to when and how a related party must have the capability and authority to control the risks associated with a CCA. As suggested above, the Discussion Draft should clearly state that, whilst parties to a CCA should indeed have the capacity and authority to identify and understand the risks

associated with the opportunity, a related party CCA should not create an obligation for all parties to control risks associated with a CCA on an ongoing basis, which would run counter to how unrelated parties operate. CCA participants may have the capacity to accept or decline the risk-bearing opportunity, but may choose not to be involved in managing the risk of the CCA project on an on-going basis. Such arrangements should be respected as being consistent with how unrelated parties conduct themselves. One reason third parties enter cost-sharing arrangements is that they would like to participate in a business opportunity in which their company lacks the capability to undertake on its own. Having multiple parties co-control activities and risk management on an ongoing basis increases bureaucratic costs and can create conflict and power struggles. For this reason, it is common practice to delegate day-to-day management of risk to the entity with the best capability to manage it, and grant all participants the control rights to intervene, only when necessary.

9. In addition to our comments above in relation to a party's capability and authority to control the risks associated with the "risk-bearing opportunity", we are concerned about the importance of controlling *"the development, exploitation and maintenance of intangibles, for a CCA participant to be entitled to the returns from a CCA and connected to an intangible."* Again, we note that parties to a CCA, after undertaking a full and detailed assessment of the opportunity, may choose to invest but to relinquish ongoing control over the opportunity to another party (including the development, exploitation and maintenance of assets). The Discussion Draft could be interpreted as meaning that any party not controlling those ongoing activities (for example, a provider of funding), would not be entitled to participate in a CCA. Further clarity is required to determine when and how parties can be considered to have exercised sufficient control at the outset of the CCA and on an ongoing basis to better match the Discussion Draft guidance with the behaviour of third parties operating in comparable circumstances.

10. In addition, it is common practice that CCAs replace a complex web of separate intra-group transactions, the explicit requirement on the capability and authority to control the risks associated with the 'risk-bearing opportunity' might be difficult to evidence and could result in lengthy discussions with tax administrations.

11. The following examples illustrate some CCAs between unrelated parties.

    a. Arrangements exist in the Oil & Gas sector where unrelated parties enter into large consortiums, often in joint ventures, to share benefits and risks. An operator is appointed to run operations on behalf of the joint venture (JV). The operator functions as the substitute for operations that would otherwise have to be performed by the JV members. The operator provides technical, administrative, professional and other services. It is common in the Oil & Gas industry that contributions of JV members are valued at cost and they may not earn a profit from undertaking activities for the benefit of the JV. This is set out in contractual arrangements between the unrelated parties, which often include government-owned companies. Such practices have been common since as early as the 1950s.

    b. Similarly, unrelated parties operating in the pharmaceutical and biotech industries often enter into CCAs. In this regard, we note that Biotech firms partnered with third parties to

create 63 of the 100 top-selling biotechnology drugs in 2005.[1] In 2015, five of the ten largest U.S. Biotech firms (50%) have collaboration agreements where the participants share costs. For many Biotech firms, CCAs provide funding and risk reduction, as one CCA participant may fund the development project in return for the right to commercialize the product.

c. In the movie industry, all productions require at least one co-financing studio to provide capital. It is often the case that the co-financing studios contractually relinquish control over any and all of the creative decisions involved in making and advertising the movies.

12. Evidence of such cost sharing arrangements with third parties exists in publicly available SEC filings. We have provided extracts from a number of those public filings in the Annex to this document, including some example text from an actual CCA agreement.

13. In addition to the above comments, we would like to raise the following points and questions:

a. **Example 4:** It is not clear what the activities of Company A are. If Company A is able to i) control the risk in line with current Chapter IX of the TPG, ii) has the necessary funds, iii) has the expertise to make important decisions, and iv) control the budget for development, enhancement, maintenance, protection or exploitation, then presumably the outcome is different, and Company A would be regarded as a participant and entitled to more than just a funding return?

b. **Example 5:** We would welcome further detail in example 5 to explain what impact the conclusion (*i.e. that Company A cannot be regarded as a participant in the CCA*) would have on the arm's length nature of the compensation, and how or if the outcome would differ to the funding type return suggested as the outcome under Example 4? We believe that the conclusions reached under Examples 4 and 5 do not reflect how unrelated parties approach similar CCAs.

c. **Paragraph 14 and Footnote 1:** What would be the outcome and appropriate TP method for services provided in a CCA (since such service provider should be assumed not to bear any risk or own any assets)?

d. **Paragraph 12:** This paragraph states that a participant must be assigned an interest in the intangibles, tangible assets or services that are the subject of the CCA. It should be clarified that this relates to an assignment of beneficial, rather than legal interest. Any requirement for formalised joint legal ownership will have many non-income tax ramifications.

e. What would the conclusion be if a participant contributed an existing intangible to a CCA, did not contribute to future development, but did provide financing (cash) on an ongoing basis? Should that participant be excluded from the CCA through an appropriate buy-out payment?

Contributions:

14. The Discussion Draft assumes that contributions must generally be assessed based on their value (rather than their cost). This represents a fundamental change, where it is assumed that

[1] Edwards, M. 2007. Biotechnology and Pharmaceutical Commercialization Alliances: Their Structure and Implications for University Technology Transfer Offices. Chapter 12.8 in IP Handbook of Best Practices.

cost does not provide a reliable basis for valuing the contributions of the participants to a CCA (*Paragraph 23, examples 1 to 3*). This approach reflects the general increased focus on the performance of functions and the assumption of risks in the BEPS discussion draft on risks and recharacterisation. In addition, this imports concepts from the latest OECD discussion draft on Intangibles, by placing functions relation to the "*development, enhancement, maintenance protection and exploitation*" of an intangible at the heart of any profit flow within a CCA. For example, Paragraph 13 requires all CCA participants to control risks "*in accordance with the definition of control of risks set out in Chapter I.*" Again, we believe that this risks contradicting how third parties often conduct themselves.

15. Under the proposals, all important R&D and other development activities and services contributed by the participants to a CCA will need to be accounted for/priced individually, at value rather than at cost. In practice, this would mean that arrangements that currently allow participants to share the costs of creating or enhancing intangibles or providing services in accordance with a participant's share of expected benefits would no longer qualify as a CCA. This would have a substantial impact for smaller MNEs or 'start-ups' operating on a cross-border basis, where the compliance effort associated with applying more onerous and complex TP requirements would represent a significant burden. This approach is also inconsistent with the US[2] and Japanese[3] rules applicable to Cost Sharing Arrangements (CSAs).
16. The Discussion Draft does not seem to consider the provision of capital as a real or legitimate contribution to a CCA. There are many places throughout the Discussion Draft where the guidelines have been redrafted to eliminate references to "*costs*", "*amounts*", or the term "*whether in cash or in kind*". It seems that contributions must now be something other than financial. In this regard, we note that all reference to cash contributions, other than in the context of balancing payments, have been deleted. The final example (5) also suggests that an entity providing cash without the ability to make decisions with respect to risk cannot be considered to bear or share in the risk, and, therefore, cannot be a regarded as a participant in the CCA. We note that there are real-life examples where unrelated parties contribute only financing to CCA type transactions (based on an up-front assessment of the project risk profile and expected return), where the provider of such financing will have no control over the ongoing project/risk and will be exposed to up-side and down-side potential. This is the case in the movie, pharma and biotech industries.

17. We understand that the use of "cash box" transactions (*i.e. where intangibles are owned by or financing is provided by a highly-capitalised low-function entity in a low-tax jurisdiction*) is at the heart of the BEPS project, and its objective to align the taxation of profits with substance. Although we support that broad project objective, we are concerned targeting cash box structures with substantial changes to the TPG will have a wide-ranging impact on CCAs, where

[2] The US rules appropriately separate the contribution of pre-existing rights and ongoing contributions. The former are assessed at value, the latter are assessed at cost. The US CSA appropriately reflect the economics of CCAs. Contributions of pre-existing rights are economically very different from contribution of ongoing development. The former involves sunk costs and should be contributed at value, the latter involve fixed costs that impact the cost of capital of the participants. Ongoing contributions have to be assessed at cost so that each participant faces the same proportionate increase in cost of capital as the overall investment.

[3] The concept of 'value' is fundamentally inconsistent with the Japanese CCA Guidelines which define a CCA *as 'a contract to share the cost required for the activities necessary for the achievement of a common purpose'*. The guidelines refer only to cost, there is no reference to value. (Commissioner's Directive on the Operation of Transfer Pricing, NTA, 1 June 2001).

related parties contribute funding from non-cash-box entities. Excluding all funding providers from CCAs will transform such arrangements into quasi-partnerships, requiring funding from related parties though some form of loan arrangement. Establishing such debt in accordance with the ALP would be complicated, and would require substantial TP analysis – in this regard, third party funding providers to pre-revenue and pre-profit start-ups often attach warrants and other security provisions to their transactions so that they can share in the up-side and down-side of the venture, even though they have no control over ongoing functions or risks (much like a funding provider to a current CCA might have).

18. We believe that revised Chapter VIII should continue to permit the contribution of funding to CCAs, and the consideration of other contributions at cost, rather than value. Concerns in relation to cash-box structures would be appropriately addressed through more targeted proposals. The purpose of a CCA is to allow the sharing of risks (and expected benefits), and, as a result, encourage the development of intangibles, where the risk may be too large to be borne by only one participant. We understand that the Chapter VIII guidance on CCAs has not traditionally intended to provide the same result as the application of the other chapters of the TPG – revising the guidance to prohibit the actual sharing of costs is inconsistent with the purpose of a CCA.

19. The key principle in applying the ALP to a CCA should not be to value contributions to the CCA, but to establish whether the benefits received from the CCA are commensurate with contributions. We believe it is also important to recognise that unpacking the components of a CCA arrangement to apply difficult TP principles goes against some of the very reasons that they are used by MNEs – to avoid the need to delineate complex transaction flows that are challenging to price.

20. CCAs are used as legitimate business models for developing (intangible) assets and performing services. With the proposed changes to the CCA concept, and the way in which contributions need to be determined, the complexity of operating a CCA increases substantially. This will lead to a disproportionate increase in administrative burden, which is inconsistent with the acknowledgment that CCAs should provide a mechanism to replace a web of separate intra-group transactions.

21. In addition to the above comments, the Discussion Draft raises the following questions and comments:

    a. **Paragraph 6 and 7:** CCA facilitates the pooling of resources, skills, expertise and the joint sharing of risk where compensation is provided by the expected mutual and proportionate benefit derived from the CCA. They are also different to arrangements outside a CCA for various reasons, e.g. sharing risks, cooperation and that assets are owned. As a result, such transactions are not generally comparable to activities outside a CCA, as the key differentiator is sharing the risks among the participants. Such arrangements should therefore be treated differently in order to be in line with the ALP.

    b. **Paragraph 6:** This paragraph identifies the advantages of CCAs with respect to simplification of certain transactions. We believe that simplification is largely achieved through the reliance on cost, rather than the arm's length value, to measure the contribution of low-

value service providers to CCAs. It is not clear how taxpayers should split CCAs between "low value" services and others, or how is this consistent with the discussion draft on low adding value services?

c. **Paragraph 23:** We suggest deleting the following text from the example: *"mixture of low-value and high value adding services"*. This suggests that companies utilising a CCA with a web of intra-group activities would not be able to value the low-value-added services portion at cost. The 'value at cost' option should be broadened to situations where the services received are of a similar nature to the services provided which would reflect current practices between unrelated parties, for example, as is the case in the Oil & Gas industry. Requiring all contributions to CCAs to be valued will vastly increase cost and administrative requirements, not only for taxpayers, but also for tax administrations that audit them.

d. **Paragraph 26:** We do not fully understand the rationale behind requirements for the control of the CCA *(i.e. "contributions in the form of controlling and managing the CCA, its activities and risks, are likely to be important functions in relation to the development, enhancement, maintenance, protection and exploitation"*). In line with BIAC's previous comments on risk and recharacterisation – we would welcome greater clarity over the expected impact of the proposed changes to Chapter 1 of the TPG, and how that might apply to CCAs.

e. **Paragraphs 31 and 32** seem to provide special rules for disregarding CCAs. Disregarding a CCA should be a last resort. It should be possible in virtually all cases to adjust the contributions/benefits to reflect the ALP, and how third parties would have established prices in comparable circumstances.

Benefits:

22. The Discussion Draft only focuses on direct benefits deriving from a CCA *("such intangibles, tangible assets or services are expected to create direct benefits for the businesses of each of the participants"* (Paragraph 3)) and has deleted the references from the existing guidance to the possibility of "indirectly" benefiting from the interests in a CCA (Paragraph 12). As previously stated, the notion of benefits is crucial to assess whether or not a CCA respects the ALP. We would welcome further discussion on how and when to define benefits rather than applying more complex valuation and risk concepts to all components of a CCA.

23. If an entity can only participate in a CCA if there are direct (expected or actual) benefits deriving from the arrangement, this will increase the number cases where corporate tax deductions for the cost of contributions to a CCA are challenged. This also implies that only certain benefits can be received in connection with a CCA.

24. We believe that the Discussion Draft creates confusion around the new distinction between CCAs established for the joint development, enhancement, maintenance, protection or exploitation of intangibles or tangible assets ("development CCAs"), and CCAs established for obtaining services ("services CCAs"). While we understand the intention of the Discussion Draft is not to create two separate sets of rules for these types of CCA, the revised guidance does state clearly that development CCAs typically create "ongoing, future benefits" for participants, whereas services CCAs typically result in "current benefits". We believe that this new distinction may contribute to disputes between taxpayers and tax administrations with

respect to distinguishing between development CCAs and services CCAs, and expected vs. actual benefits.

25. The current Chapter VIII of the 2010 OECD TPG mentions that a CCA should normally "allow" for balancing payments or for the allocation of contributions to be changed prospectively after a reasonable period of time to reflect changes in proportionate shares of expected benefits among the participants. The Discussion Draft states that a CCA requires that such balancing payments or changes in the allocation of contributions are made on a regular basis. This seems to reflect a presumption that the relative contributions and rights of the participants to a CCA will always evolve over time, and, should be looked at regularly and on a retrospective basis (not only at the beginning or at the end of the CCA project). A requirement for frequent review will not only add additional complexity, but does not reflect how unrelated parties would transact with each other in comparable circumstances – such requirements should reflect the behaviour of unrelated parties in comparable circumstances. In this regard, we note that the mechanics of cost sharing calculations between third parties may well not change for under-performance. Instead, on a look-forward basis, the budget calculations would be adjusted to account for changes in future expected costs or revenues.

26. The Discussion Draft also raises the following questions and comments:

a. **Paragraph 17 and 19:** The Discussion Draft suggests that if projections are different to actual results, adjustments may be required. As above, we believe that transactions between related parties should reflect how unrelated parties transact in comparable circumstances. Adjustments should therefore only be made to a transaction if unrelated parties would have done the same – although we do recognise that this can be difficult to prove either way. When considering adjustments, great care should be taken not to use hindsight, especially as regular adjustments are likely to create disagreements with tax administrations, increasing the likelihood of double taxation. Many unrelated parties accept risks based on projections, with very limited opportunities to renegotiate contracts. In this regard we note that the requirement for *'reasonably foreseeable'* projections echoes the proposed changes to Chapter 1 of the TPG, does not clearly define the concept or take account of commercial reality - often very little reliable data is available at the date a decision is made. It is not clear how a taxpayer would evidence the appropriateness of the possible adjustment identified in Paragraph 19. Further guidance is needed to explain how to evidence when independent parties would or would not have renegotiated the terms of a CCA agreement, when the expected benefits are allocated based on an allocation key, if expected and actual benefits to participants differ.

b. **Paragraph 27 and 42e:** The OECD should not rule out that a cost can still be an appropriate proxy to reflect the value of services and can be used in cases where the expected benefits have not yet materialized. Value may fluctuate over time and is therefore not always a good reflection of the expected benefits. In relation to this, we ask for further clarification on the frequency and timing that balancing payments need to be made as long as the expected benefits have not yet materialized. The issue of balancing payments has always been contentious, even now when contributions are valued at cost. Under the value concept, the likelihood of disputes (when one tax authority seeks to disallow the balancing payment) will

increase. Whilst tax authorities with significant resource and experience of dealing with valuations may be able to handle such disputes (although they will be longer and thus more expensive than before), those tax authorities that do not have access to complex valuation expertise will be at a significant disadvantage. Currently, they benefit from a more level playing field because cost is relatively easy to establish compared to value. This Discussion Draft is therefore tipping the balance in favour of larger and well-established tax authorities and against those with fewer resources and less experience.

c. **Paragraph 33:** This paragraph is inconsistent with US rules on the treatment of payments under a CSA. The US rules provide that a payment under a CSA should be treated as a reduction of deductions rather than an amount of income. We believe this treatment is the appropriate treatment under the CCA guidelines.

Documenting CCAs:

27. The new approach to CCAs represents paradigm change in terms of Transfer Pricing Documentation (TPD). Additional requirements for documentation will lead to a higher administrative burden and increased complexity. The suggested documentation is relatively specific and detailed, and would presumably be required over and above the documentation required by the OECD's recently issued guidance on transfer pricing documentation (BEPS Action 13). We, therefore, ask for greater alignment with BEPS Action 13.

Appendix: Examples of Third Party Arrangements

The following are just a few examples of paragraphs taken from publicly available SEC filings.

Aerospace Firm:

"We have established cost sharing arrangements with some suppliers for the [product program]. Our cost sharing arrangements state that the supplier contributions are for reimbursements of costs we incur for experimentation, basic design, and testing activities during the [product program] development. In each arrangement, we retain substantial rights to the [product program] part or component covered by the arrangement. The amounts received from these cost sharing arrangements are recorded as a reduction to research and development expenses since we have no obligation to refund any amounts received per the arrangements regardless of the outcome of the development efforts. Specifically, under the terms of each agreement, payments received from suppliers for their share of the costs are typically based on milestones and are recognized as earned when we achieve the milestone events and no ongoing obligation on our part exists. In the event we receive a milestone payment prior to the completion of the milestone, the amount is classified in Accrued liabilities until earned."

Entertainment Firm

"We typically attempt to mitigate the financial risk associated with film production by negotiating co-production agreements (which provide for joint efforts and cost-sharing between us and one or more third-party production companies) and pre-selling international distribution rights on a selective basis, including through international output agreements (which refers to licensing the rights to distribute a film in one or more media generally for a limited term, in one or more specific territories prior to completion of the film). We also often attempt to minimize our production exposure by structuring agreements with talent that provide for them to participate in the financial success of the motion picture in exchange for reducing guaranteed amounts to be paid, regardless of the film's success (referred to as "up-front payments"). Additionally, from time to time, we have entered into other co-financing, development and production-type arrangements with third parties. For instance, we recently entered into an agreement with [Third Party], and its wholly-owned [subsidiaries] to co-finance qualifying [company's] feature films for three years."

Pharmaceutical Firm

"We enter into alliances with third parties that transfer rights to develop, manufacture, market and/or sell pharmaceutical products that are owned by other parties. These alliances include licensing arrangements, co-development and co-marketing agreements, co-promotion arrangements and joint ventures. *When such alliances involve sharing research and development costs, the risk of incurring all research and development expenses for compounds that do not lead to revenue-generating products is reduced.* However, profitability on alliance products is generally lower because profits from alliance products are shared with our alliance partners. We actively pursue such arrangements and view alliances as an important complement to our own discovery, development and commercialization activities."

Biotech Firm

"We are party to a collaboration with [Third Party] to jointly develop and commercialize [Product] worldwide, except in Country X. The rights to develop and market [Product] in Country X are

reserved to [Third Party]. [Third Party] has no obligation to pay royalties to [Company] for sales of [Product] in Country X. Under the agreements, we fund 50% of mutually agreed R&D costs. In the United States we co-promote [Product] with [Third Party] and share equally in the profits or losses of [Product]. Outside of the United States, excluding Country X, [Third Party] manages all commercialization activities and incurs all of the sales and marketing expenditures, and we reimburse [Third Party] for half of those expenditures. In all countries outside of the United States, except Country X, we receive 50% of net profits on sales of [Product] after deducting certain [Third Party]-related costs."

More Detailed Example of Third Party Relationship

The following describes a collaboration agreement between a company, a third party, and the third-party's affiliate. The following is a description from its SEC filings. The agreements were filed with the SEC.

> "we entered into a worldwide collaboration and license agreement (the "Agreement") with [Third Party] and its affiliates ("Third Party Affiliate") for the development and commercialization of [Product], and certain compounds structurally related to [Product] in the U.S. and outside the U.S.
>
> The collaboration provides [Third Party] with an exclusive license to exploit the underlying technology outside of the U.S. (the "License Territory") and co-exclusively with [Company] in the U.S.
>
> The collaboration has no fixed duration or expiration date and provided for payments by [Third Party] to us of a [**] non-refundable upfront payment upon execution, as well as potential future milestone payments of up to [**] based upon continued development progress, regulatory progress, and approval of the product in both the U.S. and the License Territory….
>
> The agreement includes a cost sharing arrangement for associated collaboration activities. Except in certain cases, in general [Third Party] is responsible for approximately [**%] of collaboration costs and we are responsible for the remaining [**%] of collaboration costs. In general, costs associated with commercialization will be included in determining pre-tax profit or pre-tax loss, which are to be shared by the parties [%/%].
>
> The agreement also provides for [%/%] sharing of pre-tax profit or pre-tax loss from commercialization of any products resulting from the collaboration. Both parties have responsibilities for the development, manufacturing and marketing of products resulting from this agreement. [Third Party] has the sole responsibility and exclusive rights to commercialize the products in the License Territory. The parties hold joint responsibility and co-exclusive rights to commercialize the products in the U.S., and [Company] will serve as the lead party in such effort. We continue to work with [Third Party] on protocols and the design, schedules and timing of trials."

Included below is a redacted version of some of the key terms from contract relating to the third party example described above.

Third Party Contract Example of Terms (SEC Filing)

Development Costs.

Development Costs shall mean full-time employee Costs and Out-of-Pocket Costs incurred by the Parties and their Affiliates in Developing the Products in the Field, in each case to the extent incurred in accordance with this Agreement, the Development Plan and the Development Budget as follows:

- all Out-of-Pocket Costs and full-time employee Costs incurred for activities specified in the Development Plan;
- the full-time employee Costs of personnel directly engaged in performing Development activities under the Development Plan, which costs shall be determined based on time actually spent performing the applicable activities, unless another basis is otherwise agreed in advance by the Parties in writing. Notwithstanding the foregoing, if a finance professional employee of a Party or Affiliate is dedicated for more than 50% of his or her time, on a full-time equivalent basis, to supporting activities under the Development Plan (for example, performing financial planning with respect to the Development program), then the applicable portion of such employee's time shall be considered a Development full time employees (or portion thereof, as applicable), and the full-time employee Costs of such employee may be included in Development Costs;
- the Out-of-Pocket Costs and full-time employee Costs of supplies for such efforts as set forth in the Development Plan, including (i) the Supply Cost of the Product; (ii) costs and expenses incurred to purchase or package Third Party [Products]; and (iii) costs and expenses of disposal of samples;
- Out-of-Pocket Costs representing fees incurred in connection with Regulatory Filings with respect to Products in the Field;
- all Out-of-Pocket Costs and full-time employee Costs associated with pre- and post-approval commitments mandated by Governmental Authorities, to the extent incurred with respect to Products;
- Out-of -Pocket Costs and full-time employee Costs incurred in connection with (i) manufacturing process, formulation and delivery system development and validation; (ii) manufacturing scale-up and improvements; (iii) stability testing; (iv) quality assurance/quality control development; and (v) qualification and validation of Third Party contract manufacturers and subject to the terms and conditions of this Agreement, the Supply Agreement and the Supply Agreement(s), and if a Party or an Affiliate of a Party is established as a supplier, the Out-of-Pocket Costs and full-time employee Costs to do so, including the transfer of process and manufacturing technology and analytical methods, scale up, process and equipment validation, and initial manufacturing licenses, approvals and inspections;
- Out-of-Pocket Costs and full-time employee Costs identifiable to establishing, updating and maintaining a global safety database for Products;

- Out-of-Pocket Costs and full-time employee Costs associated with companion [Products], if applicable to the Development of a Product; and
- any other Out-of-Pocket Costs and full-time employee Costs incurred that are explicitly included in the Development Budget included in the Development Plan.

Development Costs shall exclude all of the payments set forth in Sections [*], all payments pursuant to Section [*] and Allowable Expenses as defined in the Financial Exhibit and capital expenditures, and any other cost not included in Development Costs, including by way of example, costs attributable to general corporate activities, executive management, investor relations, treasury services, business development, corporate government relations, external financial reporting and other overhead. For the avoidance of doubt, Development Costs do not include Out-of-Pocket Costs, full-time employee Costs or other amounts that are attributable and allocable to Post-Approval [Activities].

Cost Sharing. Subject to Section [*], Development Costs incurred during the Term by the Parties shall be borne [%] by [Third Party] and [%] by [Company], except with respect to Development Costs for [Product], which shall be borne [**] by [Third Party] and [**] by [Company]. For the avoidance of double-counting, the Parties acknowledge and agree that Development Costs shall not be included in Allowable Expenses for purposes of calculating Pre-Tax Profit or Loss in accordance with the Financial Exhibit (and, likewise, that any amounts included in Allowable Expenses shall not be included in Development Costs). Payments under Existing Third Party Agreements incurred after the Effective Date that are attributable and allocable to the Development activities for which the Parties share (or reimburse) Development Costs under this Agreement shall be included as Development Costs shared (or reimbursed, as applicable) by the Parties.

Reimbursement of Development Costs. Subject to Section [*], the Party (with its Affiliates) that incurs more than its share of the total actual Development Costs for the Products shall be paid by the other Party an amount of cash sufficient to reconcile to its agreed percentage of actual Development Costs in each Calendar Quarter. Notwithstanding the foregoing, on a Calendar Year-to-date basis, the Parties shall not share any Development Costs in excess of the amounts allocated for such Calendar Year-to-date period in the Development Budget; provided, however, that Development Costs in excess of the Development Budget shall be included in the calculation of Development Costs to be shared by the Parties if (i) the [Committee] approves such excess Development Costs (either before or after they are incurred), which approval shall not be unreasonably withheld to the extent the Development Costs in excess of the Development Budget were not within the reasonable control of the Party (or Affiliate) incurring such expense or (ii) to the extent such excess Development Costs do not exceed by more than [**] the total Development Costs allocated to be incurred by such Party and its Affiliates in the applicable Calendar Year-to-date period in accordance with the applicable Development Budget for such Calendar Year. If any excess Development Costs are excluded from sharing by the Parties for a particular Calendar Year-to-date period pursuant to the foregoing sentence, such excess Development Costs shall be carried forward to the subsequent Calendar Quarters (provided that such Calendar Quarters fall within the same Calendar Year) and, to the extent the total Development Costs incurred by such Party and its Affiliates for the Calendar Year-to-date as of the end of such subsequent Calendar Quarter are less than [**] of the aggregate Development Costs allocated to such Party under the Development Budget for such Calendar Year-

to-date period, such carried forward amounts shall be included in Development Costs to be shared by the Parties for such Calendar Year-to-date-period (*i.e.*, so that the total Development Costs incurred by such Party and its Affiliates that are shared pursuant to this Section [*] during any Calendar Year do not exceed [**] of the Development Costs allocated to such Party under the Development Budget for such Calendar Year, unless otherwise approved by the [Committee]).

Pre-Tax Profit or Loss.

Pre-Tax Profit or Loss. The Parties shall share in Pre-Tax Profit or Loss as follows: [Company] shall bear (and be entitled to) [%], and [Third Party] shall bear (and be entitled to) [%]. Procedures for quarterly reporting of actual results and review and discussion of potential discrepancies, quarterly reconciliation, reasonable forecasting, and other finance and accounting matters, to the extent not set forth in the Financial Exhibit, will be established by the Finance Working Group. Such procedures will provide the ability to comply with financial reporting requirements of each Party.

License Territory Pre-Tax Profit or Loss. The Parties shall share in Pre-Tax Profit or Loss in the License Territory as follows: [Company] shall bear (and be entitled to) [%], and [Third Party] shall bear (and be entitled to) [%]. Procedures for quarterly reporting of actual results and review and discussion of potential discrepancies, quarterly reconciliation, reasonable forecasting, and other finance and accounting matters, to the extent not set forth in the Financial Exhibit, will be established by the Finance Working Group. Such procedures will provide the ability to comply with financial reporting requirements of each Party.

Quarterly Reconciliation and Payments. The Reconciliation Procedures shall provide that within [**] days after the end of each Calendar Quarter, each Party shall submit to the Finance Working Group and the [Committee] a report, in such reasonable detail and format as is established by the Finance Working Group, of all Net Trade Sales and Allowable Expenses and other amounts necessary to calculate Pre-Tax Profit or Loss. Following receipt of such report, each Party shall reasonably cooperate to provide additional information as necessary to permit calculation and reconciliation of Pre-Tax Profit or Loss for the applicable Calendar Quarter, and to confirm that Allowable Expenses are in conformance with the approved Budget, as applicable. The Reconciliation Procedures shall provide for the Finance Working Group to develop a written report setting forth in reasonable detail the calculation of Pre-Tax Profit or Loss for the applicable Calendar Quarter, amounts owed by [Company] to [Third Party] or by [Third Party] to [Company], as the case may be, as necessary to accomplish the sharing of Pre-Tax Profit or Loss for the applicable Calendar Quarter, and to prepare such report promptly following delivery of the reports from the Parties as described above in this Section [*] and in a reasonable time (to be defined in the Reconciliation Procedures) in advance of applicable payments to accomplish the sharing of Pre-Tax Profit or Loss for the applicable Calendar Quarter. Payments to reconcile Pre-Tax Profit or Loss, and Development Costs, shall be paid within [**] days after the end of each Calendar Quarter.

Development Plan.

The global Development of the Products shall be governed by the Development Plan, and the Parties agree to conduct all their (and their Affiliates') Development activities relating to the Products in accordance with the Development Plan, except to the extent otherwise permitted pursuant to Section [*]. The initial Development Plan is attached hereto as [Exhibit *] (which also includes overall total budget figures for the initial Development Budget as described in Section [*], and budget

forecasts for subsequent periods through [**] as described in Section [*]). The Development Plan shall allocate responsibility for each Development activity set forth in the Development Plan to a Party. The Development Plan shall include general study design parameters, specific staffing requirements and the funding budget for each stage of development for each Indication in the Development Plan, and shall be consistent with the terms of this Agreement. Guidelines for additional data and/or criteria, if any, to be generated for assessment prior to commencement of any specific [Activity] are included in the Development Plan. The terms of and activities set forth in the Development Plan shall at all times be designed to be in compliance with all applicable Laws and to be conducted in accordance with professional and ethical standards customary in the industry, taking into account where applicable each Party's compliance policies. [Third Party] agrees to share its compliance policies and procedures, and updates thereof, with [Company] as [Company] may from time-to-time request.

Updating and Amending the Development Plan. The [Development Committee] shall review the Development Plan not less frequently than annually and shall develop detailed and specific Development Plan updates, which shall include the [**] Development Budget for the subsequent Calendar Year and the two succeeding Calendar Years. The [Development Committee] shall submit all such updates to the [Committee] for review and approval, such that [Committee] preliminary approval would occur no later than [Date] of each Calendar Year. Upon the [Committee]'s preliminary approval, such updates shall be submitted to each Party for its internal budgeting process with a target for final approval by the [Committee] no later than [Date] of each Calendar Year, at which time any updates shall be appended to the Development Plan. The [Development Committee] may also develop and submit to the [Committee] from time to time other proposed substantive amendments to the Development Plan. The [Development Committee] shall also review each Party's (and its Affiliates') performance under the then-current Development Plan (including the Development Budget) on a quarterly basis, and shall develop detailed and specific updates and substantive amendments to the Development Budget that reflect such performance. The [Committee] shall review proposed amendments presented by the [Development Committee] and may approve such proposed amendments or any other proposed amendments that the [Committee] may consider from time to time in its discretion and, upon such approval by the [Committee], the Development Plan shall be amended accordingly. Amendments and updates to the Development Plan, including the Development Budget, shall not be effective without the approval of the [Committee].

Commercialization Plan. In collaboration with [Third Party], [Company] shall develop, and submit to the [Commercialization Committee] for review, an updated [**] plan for Commercializing the Products for each Calendar Year (and the two succeeding Calendar Years), which shall include an updated Commercialization Budget for such three-year period. The [Commercialization Committee] shall submit each such Commercialization Plan to the [Committee] for review and approval in time to permit the [Committee]'s preliminary approval to occur no later than [Date] of the prior Calendar Year. Upon the [Committee]'s preliminary approval, such plan shall be submitted to each Party for its internal budgeting process with a target for final approval by the [Committee] no later than [Date] of the prior Calendar Year, and after final approval by the [Committee], such Commercialization Plan shall take effect on the first day of the Calendar Year to which such Commercialization Plan applies. The [Commercialization Committee] shall review each Party's (and its Affiliates')

performance under the Commercialization Plan (including the Commercialization Budget) on a quarterly basis, and shall develop detailed and specific updates and substantive amendments to the Commercialization Plan that reflect such performance. The [Commercialization Committee] shall also reasonably consider any proposed updates and amendments to the Commercialization Plan presented by either Party. The [Committee] shall review such proposed amendments presented by the [Commercialization Committee] and may approve such proposed amendments or any other proposed amendments that the [Committee] may consider from time to time in its discretion and, upon such approval by the [Committee], the Commercialization Plan shall be amended accordingly. Amendments and updates to the Commercialization Plan, including the Commercialization Budget, shall not be effective without the approval of the [Committee].