Report on the proceedings of Seminar C

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Seminar C: Transfer pricing and cost sharing arrangements

This seminar dealt with a wide array of issues related to the structuring intercompany service activities with special focus on research and development activities.

Globally operating groups perform research activities for legal entities throughout the world. The same applies to other categories of services. If intellectual property and the know-how created is made available to a wider group of companies, payment structures and service fee charges will need to be made between all entities owning IP or providing services and the ones using the IP or using the services. This leads to a highly complex system of cross charges, which is difficult to manage from a transfer pricing point of view.

In particular, with respect to research there are basically three models according to which a company can organize and finance the research. The first is that each legal entity that performs the research finances the research and consequently the intellectual property eventually generated by the research will be owned by this legal entity. If sharing of know-how is required, this model leads to many transactions between multiple companies, which requires establishing arm's length prices. This model is therefore highly complex.

The second model for financing research is to contract R&D activities: one company in the group finances all the research that is performed in the group. Under this model the IP is owned by the entity that contracts the related entity(ies) for the R&D. Under this model sharing of know-how between the different entities may be much simpler because IP is centralized.

Finally, the third model is represented by cost-sharing. Under a cost-sharing model the entities engaged in R&D conclude an agreement and pay for the research "in a pool", which also implies that they become joint owner of the IP

The Chair then clarified that the topic of the seminar is the notion of cost-sharing arrangements or according the OECD terminology: cost contribution agreements. The topic is discussed through the illustration of a case study.

The case study dealt with a hypothetical multinational enterprise (D-group) engaged in the R&D, manufacturing and sales of pharmaceutical products. The manufacturing entities, A and B, each manufacturing a specific product are based in A country and B country, respectively. While A and B have developed their own intangible assets, company C is located in country C and manufactures yet another product under license granted by a third party. Company D is the holding company. The group is not well integrated.

D-group wants to enter into a new field for medicine, the Y product, because it regards it as a profitable field. The group decides to have all members of the group join forces to develop Y. Of course, A, B, and C will want to sell the Y product in the respective countries and D has decided

that it would sell the Y product in the rest of the world. In addition, the D-group would like to take this opportunity to improve their efficiency by centralizing certain services, such as the IT maintenance and support which will be provided by A and B for the whole group. The whole group would include the distribution companies based in the rest of the world as well as some contract manufacturers. The group therefore considers entering into cost-sharing agreements, one for sharing the R&D effort and the other for the IT services.

The Chair questioned whether the cost-sharing arrangement constitutes a suitable instrument to organize the IT maintenance for support activities. One panelist clarified that, as far as terminology is concerned, the OECD cost contribution agreement (CCA) concept has a very broad scope, as opposed to – for instance – the notion of cost sharing arrangement (CSA) under US transfer pricing regulations. Under the OECD terminology, a cost contribution agreement may be used for both generic services as well as for research and development activities. So according to the OECD, a CCA is a framework agreed among enterprises to share the costs of developing, producing or obtaining assets, services or rights and to determine the nature and extent of interest of each participant in those assets, services or rights.

The US regulations on the other hand state that a CSA is an agreement under which the parties agree to share the costs of development for one or more intangibles in proportion to their shares in the reasonably anticipated benefits from their individual exploitation of interest and intangible assigned to their entity under the arrangement.

One of the fundamental ideas behind CCA's and CSA's is the proportion or share of the expected anticipated benefit for each participant: the efforts or contributions of each party should be proportionate to the anticipated benefits for each one. The arm's-length must also apply when (future) members decide to enter into a cost-sharing agreement.

In the D-group there are only two members (A and B) that will be providing services to the rest of the group while the other participants will basically provide cash, no services. It may be questioned whether it would make sense for A and B to receive cash on a cost basis or rather as service providers they should charge their costs with a mark-up. In an extreme situation, where there is just one service provider, then the notion of CCA would not apply and the service provider should charge at arm's length (i.e. with a mark-up).

The US panelist explained that the ability to charge an affiliate at cost only has been part of IRS regulations for a long time, since the late 60's. Until very recently there was no explicit recognition of a multi-party agreement pursuant to which a US company and its foreign affiliates could share services in that context. There is now an explicit recognition of what is sometimes referred to as a 'shared services arrangement'. In any case the ability to charge out at cost has been there for a long time. Only beginning in 2003 the IRS undertook a new regulation project to significantly constrain the circumstances in which cost only could be used within the group and in particular – and this is important for the case study – the provision of R&D services could no longer be charged at cost only. This is stipulated in a new set of regulations.

The Chair argued that one of the questions to be asked in the case at hand is whether in fact a CCA/CSA should be used for routine services.

One panelist commented that in practical terms it is quite appropriate a cost sharing arrangement or cost contribution arrangement for services where there are multiple centers providing those services. However, as a practical matter there are significant areas of discussion to be had with the various tax authorities around the appropriate measure of costs in these circumstances and in

particular one of the things that is starting to appear as a point of controversy is to whether to regard costs as being equal in unit terms wherever incurred in the world. So for instance, if there are three IT service providers located in different jurisdictions which inherently have different cost bases, then looking at the proportionality test one of the difficulties in service cost sharing is whether it is appropriate to regard the equivalent of a dollar spent in each of these countries contributing equally to the profitability or efficiency savings in the overall group.

Another panelist clarified that under both the OECD Guidelines and the IRS regulations, there are formalities to be respected to constitute a valid CCA/CSA. It is in fact required to have formal agreements in place with a clear identification of scope, parts and nature of the CCA or CSA and also the extent of each participant's beneficial interest as a result of the agreement. It is also key to regulate contributions, buy-ins and buy-outs and – if the case – allocation keys including the possibilities for revision to change the economic conditions.

The Chair then posed the question on whether in fact CCA/CSA are appropriate/convenient for research and development activities.

A panelist commented that this is a contentious area in the US (and perhaps in other jurisdictions as well). As an alternative to cost-sharing the parties may consider engaging in cross-licensing or structuring things so that there is centralized ownership: this is sometimes called cost-bearing with other members that have R&D activities and R&D services for compensation. Further, it's theoretically possible to have combinations of these three arrangements as well. He argues that in the fact pattern of the case study it is important to recognize that there's more than one R&D centre and presumably there will be an interest in information of a technical / know-how nature with this R&D centers and this is an important fact to take into account on how to structure the arrangement. One could look at the history and background of the group and conclude that there is a fair amount of decentralization in terms of the development of intellectual property and this is compatible with R&D cost-sharing. One could argue that it might be more customary in such decentralization to see cross-licensing but that does raise a fair number of issues of R&D cost-sharing. That allows for the acquisition of any pre-existing IP for cost only rather than value. And this is a key factor in many planning decisions. In addition, cost-sharing in the context of R&D avoids administrative difficulties associated with cross-licensing and possible withholding tax issues will at least in most jurisdictions be avoided in terms of the payments that are made back and forth between the entities.

In the US in presence of a qualified CSA the regulations will also provide two additional benefits. One is that there will be no partnership formed for US tax purposes by reason of this arrangement, and secondly which is really a corollary to the first one, there will not be a US trader business or permanent establishment created by reason of this qualified or appropriate CSA. In conclusion, there certainly are some benefits that seem applicable to the fact pattern of the case study.

Another panelist explained that, for instance, for the pharmaceutical industry the cost-bearing approach described before where the ownership is centralized could be very efficient when the time comes to dealing with tax optimization. In France there is a very favorable regime applicable to royalty income deriving from patented technology which is taxed at 15%. So with a 15% deduction in France and standard rates in other countries, for the pharmaceutical industry the cost-bearing approach could be more beneficial. It is interesting to note that France is going to improve that benefit with the future Finance Act and not only royalty income will be taxed at 15% but also capital gains on the disposal of technology will be taxed at that reduced rate.

As to whether the arm's length principle should apply in the context of cost sharing arrangement, the previous panelist clarified that the current movement in the IRS approach is reflected in the proposed regulations on R&D cost-sharing and in the temporary service regulations. The IRS nominally accepts the tax payer's transactions as structured, but it reserves a very important right by looking at the other forms in which the transactions could have realistically taken place and by using these other benchmarks for determining the answer to how much. In addition under this definition, the IRS regulations purport to require that certain normative or prescriptive standards will apply regardless of what third parties actually do.

From a OECD perspective it is acceptable and it is clearly described in the guidelines that other parties, non-related parties do enter into CCA and therefore there should exist comparability even if conditions are not obviously simple to define, a panelist argued. So this is a fundamental differentiation from the US and the OECD.

According to the US panelist the regulations today don't answer that question. The implication of the regulations is that it is highly likely that the IRS will take the position, perhaps to be rebutted by a court, that what you have is a form of licensing. The IRS says it will clarify its views on this. They're also struggling with the notion of explicitly recognizing in the regulation that in addition to following its very narrow view one could have an acceptable CSA among related parties, if in fact it mimics, copies or borrows from a transaction that third parties have entered into. So the IRS has put itself in a difficult position by insisting that this narrow definition is the arm's-length standard as opposed to saying it is a safe harbor. Two sorts of problems have been created: what one should do with third party arrangements and what happens if one does not fall within this narrow definition. Practitioners in the US are looking forward to the IRS extract itself from its corner.

The Chair then asked how define eligible participants to a cost sharing agreement.

A panelist argued that the answer may be give on two different levels: first of all a theoretical level based on largely on what OECD says about CSA's and CCA's but then secondly also on a practical level based on the experience of the acceptance or not of CSA's by various governments around the world. As to the attributes of the companies the test, at least in the view expressed by tax authorities, is to see whether parties would at arm's length enter into a CSA and specifically whether the participants have the skills to do so. So if one looks at the companies in the example there's no doubt that A and B do and can carry on R&D, have the necessary skills. C, and D by contrast, do not carry on R&D but it is proposed to introduce C and D as a member participants in the cost-sharing. As a consequence if one believes that the test of the participation in a CCA situation is limited to those with the requisite skills, the starting point would be that A and B are legitimate participants, C less so and D even less so.

But by looking at the letter of OECD one may certain language, which implies that that CCA's need to be considered within the context of the broader set of guidelines and specifically the general arm's length principle in Chapter 1. However, one may also find some very narrow language. For example, paragraph 8.26: '[a] CCA will be considered consistent with the arm's-length principle where each participant's proportionate share of the overall contributions to the arrangements adjusted for any balancing payments is consistent with the participant's proportionate share of the overall expected benefits to be received under the agreement.' It is rare when one reads through OECD guidelines to find words like 'will'; often the OECD, because it is a consensus-driven organization will fall short of such prescription. It may be argued that taxpayers can take some comfort from that. At paragraph 8.8 of the OECD guidelines it is

necessary to determine that all the parties to the arrangement have the expectation of benefit. Then, it is necessary to calculate each participant's relevant contribution for the joint activity whether in cash or in kind and finally to determine whether the allocation of the contributions is proper. As a consequence it may be argued that participants to a CCA can contribute in cash or in kind: hence both D and C have an expectation of benefit through the margins and the profits they will realize on their individual routes to different markets through the exploitation of the R&D of product Y. Finally, from the OECD language one can learn that despite the utterance of some tax administrations the test is passed in the case of all 4 companies for entering into a CCA.

The US panelist explained how the IRS is not in favor of "cash box" companies participating to CSAs. It is worth noting that in 1995 the IRS updated the regulations introducing a rule that said that each participant had to actively conduct or trade in business and must carry out substantial managerial and operational activities. That rule was taken out of the regulations within 6 months by the IRS; there was an outcry about its validity and the effects that it had. In the proposed cost-sharing regulations there is no trace of that rule; so nominally, all 4 of our participants – even D which might be at one end of the spectrum – can participate. However, the proposed regulations introduce the infamous investor model. This is a device used by the IRS to make it effectively so unattractive for D to participate in terms of its returns, that one wonders why D would participate. In effect, what the investor model does is allocating an entity that does not contribute IP only a return on its functions: it does not share in the value of intellectual property. In other words the IRS does not want cash-box type entities to benefit from R&D cost-sharing, even though nominally they can participate. These regulations were criticized by many tax payers, advisors and associations. In fact, the volume of comments on this far exceeds the number of companies that actually use R&D cost-sharing. But there are some very important principles at stake here; for example, some people are concerned that the investor model will creep over into the area of licensing, and not remain limited to the IRS' view of what is appropriate R&D cost-sharing. The IRS recently said that the investor model is here to stay but that there will be some changes in how it is applied and perhaps how it is defined. So, not only those interested in cost-sharing but also those engaged in licensing and other types of transfers of intangibles are very interested to see what the next view is of the IRS on this particular subject.

Additional facts to the case study were introduced. Group D finally decides to move on. So companies A, B, C and D enter into an R&D CSA/CCA. From now on the focus will be on the R&D modeling, although one could imagine that the D group could have another CCA/CSA for routine services and in this regard one could also imagine that the affiliates could also participate in the service CCA. In this structure, it is found that 2 members, A and B, perform R&D and the pool has access to some of the pool members (A's and B's) pre-existing know-how and other intangible property.

A panelist explained that there has to be a factual connection, a relevancy of the costs to the efforts that are being undertaken, in order to regard costs as legitimately deductible. A question was raised earlier whether the relevant costs would only include the types of costs that 3rd parties actually charge each other and here again at least on the issue of stock-option related compensation the IRS has taken the position that it is not what 3rd parties actually charge but it's what in the view of the IRS, 3rd parties *should* charge each other. The IRS lost that issue under earlier regulations in the *Xilinx* decision that is currently being re-heard in the court of appeals.

Another panelist added that in his opinion stock options are nothing but a way to provide an incentive to employees and they could be compared to straightforward bonuses. Stock options are used in general for publicly traded companies and there is very little interest for a smaller business, which is not traded to enter into a stock option plan. This issue brings about more

general comparability issues, though. For instance, if one looks at benchmarking a distributor in Europe under a TNMM (or CPM) approach, the tested party would be compared to independent distributors which under the OECD guidelines should not be member of a group and thus may not have entered into a stock option plan. But then again, it could be fair to compare stock option costs to other incentives made to employees in those companies.

A panelist argued that this is a somewhat dangerous way of thinking, because whenever a country looks at a normative view of what should happen in the market place as opposed to what actually happens in the market place, everybody (taxpayers and tax authorities) will face substantial difficulties. For instance, some countries think that because a distributor no longer distributes all the products it used to or because a company no longer manufactures all the products that it used to, somehow that is a taxable event: something has left the country that is of commercial value. Having looked at actual decided court cases, non-tax related, there is a great deal of evidence to say that 3rd party do not compensate each other when there are certain changes. There may be some circumstances where a contract is specifically written to cover those eventualities but what is currently being discussed on the restructuring, stock option and the investor model and other aspects, is a growing view that people should behave not as 3rd parties actually behave but how they should have behaved in the eyes of the beholder, in this case, the beholder being the tax administration such as the IRS.

The next issue deals with the allocation of costs to the individual members. This issue should be addressed via a two-step test, a panelist commented. First of all, what is the benefit that the parties can reasonably expect to receive? It is that question that drives the answer to the 2nd question: how then does one allocate costs in proportion to those benefits? In terms of benefit received, the OECD quite carefully includes several possibilities as measures of benefit. As a practical matter, experience tells that most tax administrations – perhaps most tax administrations in the world – will want to have as a measure of expected benefit anticipated profit, and probably, very crudely, taxable profit in the jurisdiction. However, that is certainly not the only available option. Various other keys, various other measures can be used provided of course that they represent a good proxy for the benefit that the parties will receive. The list that OECD lays out at paragraph 8.19 includes units of sale, units produced used or sold, gross profit, operating profit, number of employees, capital invested and indeed some mix of those various allocation keys. So the first thing is to determine the measure of benefit based on the facts of the case.

Step two then is to go to the cost pool and to determine how the costs should be allocated. It is questionable whether a simple quantification of actual costs borne in different jurisdictions is the correct thing to be using or whether one should be considering if calibrating the bearing of these costs is necessary, so that the parties end up with a proportionate share to the benefits they will receive. If, for instance in this case study, two of the providers of services are in radically different cost-based jurisdictions, then it could be argued that one should not be looking at the actual costs but in fact, should be taking account of the value that each if them is being asked to deliver. So in summary: what is the benefit that the parties will be expected to reasonably receive and then two, how does one determine an allocation between the parties of costs or of value to those benefits.

The IRS does emphasize the relevance if not great importance of the resulting profitability of the participants, one panelist argued. And if R&D cost-sharing is meant to align benefits with costs, then that is not an unreasonable position. There are other jurisdictions that may – in principle – state otherwise but that is going to be the rare situation around the world where a tax administration will continue to use units sold or net sales revenue when it appears that their participant is consistently losing money when the participants in the other jurisdictions are not.

There is a serious question about whether one should look at any one of those measures of benefit on a year by year basis or on a multi-year basis, having in mind that ideally governments should not opportunistically take positions on the appropriate allocation method depending what happens in a particular year. Certainly if the companies are in an industry that has a long business cycle it would be necessary to test the functioning of the CCA/CSA over at least one business cycle.

The Chair interjected by stating that question is of course whether some of the other measures could also adequately reflect the profitability and that what is then in the end is practically applicable. In the case study, A and B bring pre-existing know-how and other IP to the pool: the next issue to be discussed is then how to deal with the question of ownership of intangibles and the use of the pre-existing IP.

A panelist explained that the very first question is whether the pre-existing IP is relevant to the future works of the R&D cost-sharing because a new product, Y, is going to be developed which is different from product A and B. One would consider that there is actually no relevant technology which is provided by A and B because they are going to start research in an entirely new field. One could take that position, but in the opinion of the panelist in the pharmaceutical/chemical business one does use not only former experience but more importantly all the developments that have made are based on a common ground which has been developed over years of research. So, even if Y is not similar to A and B as products, one can argue that the intangibles that are brought on the table by A and B do have relevance to the new project and thus represent valuable intangibles for the other members which are C and D. So, it would not be fair that C and D just enter into the pool and start incurring costs as well as A and B and indirectly take some kind of an ownership on that passed developed intangible. What the OECD and the US regulations provide here is for a balancing payment to be made by C and D to the pool so they acknowledge the fact that A and B are providing value to their project. The question here is the whether such balancing payments should be taxed at the time the CCA/CSA is created. The OECD believes that there is no transfer of ownership from A and B to the pool and that the contribution that is made by C and D is to be considered as a reduction of costs for A and B. On the other hand, depending on how it is constructed, the US could consider that as royalty income. If qualified as royalties the payments may be subject to withholding taxes, however.

Another panelist submitted that the question if there is some base technology that could be relevant is a fair question and the follow-up question has to be: even if it is relevant does it still have value in the market place? Another specific, separate question is the question of what to do with the workforce in place. If one assumes for a moment that there is no patent that is being conveyed with the workforce in place. Furthermore if one assumes that if one looks at the people individually, there is no apparent value beyond their activities as service providers. Nonetheless, it is possible that the aggregation of the individuals, the collection of individuals, if made available in a cost-sharing context is itself making available intellectual property or an intangible asset. And the next question should be: how much is it worth? Is it worth a great deal more than the compensation that is being paid to the individuals? How much would it cost to replace some of these scientists? Is there a high turnover of individuals? Is training costs relatively quantifiable and not very significant?

As to ownership of intangibles under a CSA, one would consider that all the intangibles that are developed in common by the members of the cost-sharing agreement are also co-owned. There can be a split arranged under the CSA on a territorial basis, on a product-by-product basis. In the case at hand it would not be applicable because there is only one product developed. As a consequence there would be a co-ownership of the rights with specific rights attributed to the members based on their territorial competency, a panelist submitted. As to the issue of economic

versus legal ownership, typically the CCA/CSA would provide that one of the members would be the one who will appear to be owner for legal protection purposes, but still 'tax ownership' will be with all the members.

Additional facts were discussed in the case study: after a few years company C wants to leave the pool, while the group recently acquired company E, which wants to join CSA/CCA.

The starting assumption is that C on leaving the pool might be entitled to some compensation. Prima face it would be: it's been involved in bearing some costs over time of the development of IP and intangibles that are being used to generate profits. And so if it's going to cede those rights back to the pool or possibly cede them to the new entrant E then it should receive fair market value as compensation for what it is ceding. That is a concept specifically endorsed by OECD and regularly applied by tax administrations. Then the question arises what mechanism is appropriate for C to receive that value and for E to pay? Options include a straight buy-out by the pool members of C's value, and indeed, a straight payment by E to the group members to access that value. Or a royalty-type arrangement, be that a flat rate based on sales in the future, or perhaps even a declining royalty to recognize the relative diminishing value of that IP as a new generation of IP is brought into play by the new cost-share participant. However it might also be argued that it is not necessarily the case that compensation is due, if the facts would support the contention that either, e.g. C is retaining some of those rights and will exploit them for the foreseeable future. Its withdrawal from the cost-sharing pool or participation doesn't necessarily mean that it is immediately giving up all its rights to exploitation. Another example of where E might not have to pay for access to CCA becoming a participant in it, is if it itself brought valuable IP which it was essentially contributing to the pool of IP that the participants would jointly exploit. So, in some cases it is conceivable that no payment, buy-in, buy-out would be needed. The IP may have no value, its usage may be continued by C for the foreseeable future and/or E might bring something equally valuable and contribute it to the pool.

A panelist commented on the tax treatment of buy-in and buy-out payments under a CSA/CCA. Depending on the perspective and the country's local jurisdiction, there might be two different situations. It may be treated as income or treated as capital. So it should be remembered that not all countries treat R&D expense as immediate deduction; some countries require that R&D expenses should be capitalized for future amortization. So a possible capital gain issue may arise in this circumstance. According to OECD, buy-in and buy-out should be treated in the same manner as normal contributions, so not as royalty and no withholding tax would apply in this situation. For US purposes it could be treated as taxable royalty income and expenses, depending on the situation.

In terms of additional functions/contributions brought in by E, if the market situation hasn't changed one would think that the allocation key that was established should be maintained. There might, however, be circumstances where there are characteristics that differ between the new participant and the old participants. Perhaps the arriving participant is much more efficient and therefore it will be much more profitable as compared with its predecessor. It is fair to say that it is useful to review periodically the allocation keys to see if something is changing and whether or not an adjustment or change should be made keeping in mind the earlier observation that when there is a business cycle of let's say 10 or 12 years, it is to be expected that there will be changes from year to year but the perspective will be to look at the full business cycle and not to adjust the allocation keys on an annual basis.

A panelist asked the question as to whether it would be possible to do retrospective adjustments to the allocation keys.

The US panelist replied that from a US perspective there are certain circumstances in which the taxpayer can make an adjustment in a prior year, for example, before the tax return is filed, and one could even, after that, make adjustments if US income is adjusted upwards. There is not a blanket permission to go back indefinitely or under all circumstances, however.

Further facts were added to the case: after so many years and uncertain results of the CCA, tax authorities successfully established that the CCA/CSA did not meet the arm's length standard. The Chair questioned what the consequence of this would be.

A panelist explained that at the end of 2003, one of the major accounting firms surveyed their tax professionals in 25 countries about the attitude of tax administrations to CSAs and their tax professionals went in many cases to talk to the enforcement agencies in those 25 countries. A number of common themes emerged, purely on a practical level. First of all, the world really divided itself into two sets of countries: the Anglo-Saxon countries and some western European countries in one camp where CSAs and CCAs are common and the other camp composed of countries where simply CCAs and CSAs were not used, because of mistrust, lack of understanding of the concepts and the need for a great degree of discussion and education of the parties as to what was really intended by the cost-sharing. On a practical basis, the points of principle and some of the technical points that have been touched on in this presentation, he argued, are on the front of discussion with the Western European and Anglo-Saxon countries far more than they are elsewhere. And the themes that emerge there are really quite few: around whether the so-called proportionality test has been correctly applied, the cost contribution share has been pre-determined based on reasonably anticipated benefit and the allocation of that benefit between the participants in the arrangement; around the valuation, quantification and structure of buy-in and buy-out payments, etc. Very importantly, the ability to disregard the CSA or CCA is very limited in those countries. Typical adjustments are either the disallowance of a payment or some form of buy-out or a balancing payment: a disallowance in the country of the payer, because the test of proportionality has been failed or in some cases, an imputation of additional income from the pool of participants because it is felt that a country has been under-rewarded as a result of the cost contribution agreement. However, there are already various examples of governments introducing legislation which attempts to second guess a tax payer's intent and the tax payer's good faith efforts to structure matters in accordance with tax law. Tax administrators are starting to apply a test that essentially looks at the characteristics of the participants in a CSA and attempts to challenge whether, based on skills, based on the ability to pay for R&D for example, that entity would have been a participant in some form of joint-venture between third parties. In the example at hand, A-country (distributing product Y in country A) is being supplied by company D: if company D is not in the eyes of the distributor's tax authority equipped to make R&D decisions, the tax authority of the distributor's country may argue that the price that is being paid to company D is excessive because when carrying out a functional analysis or contribution analysis of country D and its activities, it emerges that company D doesn't have the people who would command the kind of price that is actually being paid by A. in the opinion of the panelist, this conclusion is far-fetched. However, in chapter 8 of the OECD Guidelines, there is really only one case where a tax administration is allowed to fully disregard a CCA: that is where reality differs from the purported terms of the cost-sharing. In the opinion of the panelist that threshold should not be expected to have been met too often. He concludes that, despite the more aggressive behavior of some taxing authorities, still CCAs and CSAs – if well constructed and implemented – are to be respected.

Another panelist argued that in some circumstances, the tax authorities may conclude that a specific arrangement should be characterized as a CCA/CSA although not agreed as such by the

parties. In its regulations, for instance, the IRS has taken a very strong position whereby it believes it has the authority to do that.

The panel answered some questions from the floor.

One question dealt with the interaction of a CCA/CSA, which is multilateral, and the mutual agreement procedure, which is bilateral, under the relevant provision of tax treaties. As a technical matter, to the extent that a tax administration is asserting an adjustment on one particular participant in a CSA then a government will have to make clear against which co-participant(s) that adjustment is being asserted, a panelist submitted. Sometimes this does not occur, however. Assuming, for instance, that the adjustment is being made in respect of 2 or 3 co-participants in the CSA, then lamentably, under today's arrangements one would have to lodge mutual agreement procedures claims or where appropriate claims under super-national conventions like the European Arbitration Convention, on bilateral bases.

Another question pointed at the main drivers to enter into a CSA or CCA as opposed to setting up a centralized R&D future licensor. Certainly the history and the culture of the group can be very important as a driver here, a panelist argued. In Silicon Valley although R&D might have been primarily conducted in one place companies found R&D cost-sharing to be attractive from the perspective of expanding the use of the intellectual property. Certainly tax considerations played a very major role in their planning. Other drivers may be the location of cash, the time to market for the new product, the duration of the R&D process etc. One thing that needs to be considered is if the amount of the tax cost when entering into a CSA: if a group does have a lot of pre-CSA intangibles, balancing payments need to be made and this might cause some tax costs. Furthermore, other benefits that one can get from cost-sharing are reduced or limited exposure to withholding tax and no exposure, at least from a US perspective to partnership issues.