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"INTERNATIONAL TAX TREATMENT OF COST-CONTRIBUTION ARRANGEMENTS"

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Abstract:

The production of an intangible is expensive and sometimes the cost is unaffordable for just one entity. This aspect motivates the fact that business organizations decide to finance jointly a research project to obtain an intangible asset. In general terms, the cooperation takes place through a cost-contribution agreement (CCA), a provision of services or a license of technology development agreement. On the other hand, the agreements can take place between related or non-related companies. Each of these three figures has a different tax treatment, so is necessary to distinguish between one and the others.

Keywords: Intangible assets, royalties, cost-contribution agreements, right to use, beneficial interest.

Conceptual aspects:

-**Cost-contribution arrangement (CCA):** "A framework agreed among business enterprises to share the costs and risks of developing, producing or obtaining assets, services or rights, and to determine the nature and extent of the interest of each participant in those assets, services, or rights" (OECD Guidelines definition).

-**Cost-sharing agreement (CSA):** expresion used in some countries, most notably the United States. CSAs are defined by the US Regulations as: "an agreement under which the parties agree to share the costs of development of one or more intangibles in proportion to their shares of reasonably anticipated benefits from their individual exploitation of the interests in the intangibles assigned to them unther the arrangement".

-**Differences between CCAs and CSAs:**

•A CCA is broader than a CSA (and can encompass other services, such as administrative services).

•In a CCA, the contributing business enterprises share the risks of failure of the activity. In a CSA it is not clear because the Regulations does not mention who shares the risks. But it should be accepted that the risks are likely to be commensurate with the costs, and thus a member contributing to costs under a CSA shares the risks as well.

•The differences are theoretical because from a practical taxation point of view, the divergences in this respect may not be significant.

General features of a CCA:

▪It is an agreed framework.

▪The contributing business enterprises share risks of failure of the activity. Each participant's proportionate share of the contributions must be commensurate with that participant's proportionate share of the expected benefits.

▪Each participant is a direct, but separate, owner of the benefit arising from the CCA. The benefits are determined at the commencement of the CCA.

▪The participant is not a licensee. He is an owner of the benefits, so he has an inmediate right to access its share of the intangible property which results from the research program.

▪A CCA is similar to a joint development project or a partnership. In a joint venture two or more parties set up to pursue a common business goal. In a joint development the R&D project is carried our jointly. And it involves sharing the costs of inputs and risks, and ownership of outputs. The CCA is more restricted than a joint venture or partnership arrangement. In a CCA, the parties develop the property of an intangible jointly; a joint venture or partnership arrangement usually involves exploiting the intangible jointly or a joint management of the business activities.

	OECD Transfer Pricing Guidelines:
If the agreement states that one entity provides R&D&i services to another entity, and the other one assumes all risk, being the only owner of the intangible resulting on the research:	-It is not a CCA according to the OECD Guidelines. -It is a provision of services. So the payments made to the entity that provides the R&D&i services should be qualified as **business profits (art. 7 OECD MC).**
If the agreement states that one entity assumes all risk of failure of the activity and the other obtains some rights on the intangible that results from the research project:	-It is not a CCA according to the OECD Guidelines. -It is rather a licence of the resulting intangible agreement. The payments made by the entity which acquires the right to use the technology (when it is ready/developed) should be qualified as **royalties (art. 12 OECD MC).**
If the agreement grants the right to use the result of the research to one of the participants:	If it relates to the right to use one of the categories mentioned in art. 12 OECD MC, the contributions paid by the participant should be qualified as **royalties (art. 12 OECD MC).**
Entry of new participants on the CCA (buy-in payments):	- New entrants contribute to the existing ones to compensate the possible benefits on the results of the research. If the new participant becomes an effective owner in any property developed under the CCA, the but-in payments should be qualified as **business profits (art. 7 OECD MC).** If the new participant acquires just the right to use the resulting technology (protected by Intelectual Property rights), the buy-in payments should be qualified as **royalties (art. 12 OECD MC).** -Sometimes the existing participants make payments to the new entrant in consideration of the contribution of an intangible asset to the research project. If the new entrant maintains the property of the intangible asset, the payments made by the others to him should be qualified as **royalties (art. 12 OECD MC).**
Withdrawal from the CCA by one participant (by-out payment):	-If the payment made by the other participants to the one who withdraws from a CCA entitles the payer to obtain only a right to use intangible property belonging to a participant and the payer does not obtain a beneficial interest in such intangible property itself, it should be qualified as **royalties (art. 12 OECD MC).** -If the buy-out payment entitles the payer to obtain the property (a beneficial interest) of the intangible which is being developed, that payment should be qualified as **business profits (art. 7 OECD MC).**
Termination of the CCA:	-If the result of the research is positive: the participants receive a beneficial interest in the results of the activity consistent with the participant's proportionate share of contributions. No royalties involved in this case. But if a participant receives the right to use the intangible property rights of the others, the consideration for that should be qualified as **royalties (art. 12 OECD MC).** -If the research does not succeed: art. 12 OECD MC and the Interest and Royalties Directive state that royalties are the payments made for the "use" or the "right to use" any of the intangibles mentioned. This makes posible the qualification as **royalties** of the contributions made for a participant who obtains the right to use an intangible which is being developed even if the research does not have positive results.

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