USCIB

UNITED STATES COUNCIL FOR INTERNATIONAL BUSINESS

Guidance on Profit Splits

Risk Sharing: Shared Assumption of Risks, Shared Control of Risks

Bill Sample, Chair, Tax Committee, USCIB

- Risk sharing should be a necessary precondition to the use of the transactional profit split method, but sharing of risk alone is insufficient to justify its application.
- We agree, therefore, with paragraph 10 that "It would be contrary to the guidance of Section D of Chapter 1 to apply a transactional profit split of actual profits where the functional analysis demonstrates that one party does not exercise any degree of control over those risks, since to do so would assign to that party the impact of risks it does not control."
- This standard should also apply to profit splits of anticipated profits because if one party does not exercise any degree of control over any risks then a profit split would not be the most appropriate method. The discussion draft should make clear that control of risk by both parties to the transaction is also necessary to the proper application of an anticipatory profit split.

- The existence of risk does not, however, mean that comparables are not available. Many risks taken on by related parties are similar to risks that exist between unrelated parties and can be priced appropriately using other methods.
- It is USCIB's view, therefore, that in most cases risk can be priced accurately without resorting to the transactional profit split method unless both parties make unique and valuable contributions. The existence of unique and valuable contributions, in virtually all cases implies the use of non-routine intangibles.

Transactional Profit Split Of Actual Profit: Most Appropriate Method

Company A in Country A
- Develops movie
- Estimated Costs: $100 Million

LICENSE MOVIE

LICENSE P&A

Company B in Country B
- Develops all P&A materials
- Estimated Costs: $100M

Development, Enhancement, Maintenance and Protection of Intangible Assets

Exploitation of Intangible Assets

Company A in Country A
- Worldwide Theater exploitation
- Uses Movie and P&A Intangibles

AGREE TO SHARE COMBINED NET PROFITS 50%-50%

Company B in Country B
- Worldwide VOD, DVD, Other Media exploitation
- Uses Movie and P&A intangibles

Transactional Profit Split: Not Most Appropriate Method

Company A in Country A
- DEMP Intangible X
- Licenses Intangible X to Company B
- No further interest in Company B

LICENSE X

Company B in Country B
- DEMP Intangible Y
- Combines Intangibles X and Y in Product W

Development, Enhancement, Maintenance and Protection of Intangible Assets

Exploitation of Intangible Assets

Company B in Country B
- Controls all exploitation functions
- Make and sell product W
- All exploitation in Country B