

United States v. Microsoft Corporation (2020)

Limits of Cost Contribution Arrangements in the Transfer Pricing of Intangibles

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1. Facts

Microsoft Puerto Rico (MSPR) was established in 1989 as Microsoft's primary CD-ROM¹ (Compact Disc Read-Only Memory) manufacturing facility for North and Latin America. The factory produced a large share of Microsoft Windows and Microsoft Office CDs and employed 85 full-time employees, in addition to contingent staff. To manufacture those CDs, MSPR licensed the software from Microsoft U.S. in exchange for royalty payments. The CDs were then sold in the Americas not directly by MSPR, but through an affiliated Microsoft U.S. trading company, with the U.S. market accounting for the largest share of sales.

Beyond operational manufacturing efficiency, the available record suggests that MSPR had further importance for the Microsoft group. The subsidiary generated roughly \$25 million per year in net tax savings, leading to a cumulative balance of \$192 million by 2002². Such tax savings were derived from Internal Revenue Code Section 936 provisions (IRC §936), a U.S. federal tax regime designed to encourage investment by U.S. companies in Puerto Rico and other U.S. territorial possessions. Concisely, the provision allowed qualifying corporations to claim tax credits against U.S. federal income tax on certain income generated from active business in Puerto Rico. Similar to the foreign tax credit mechanism, the IRC §936 credit equaled the income tax attributable to Puerto Rico for active conduct of a trade or business, provided that the corporation satisfied certain income tests.

Considering that IRC §936 was expected to terminate at the end of 2006, Microsoft engaged external consultants and carried out a comprehensive analysis

¹ CD-ROM is an optical data storage medium popular in the 1990s, and largely used until the 2010s to store text, audio, video, software, etc.

² A methodological caveat is required: because the litigation surrounding *United States v. Microsoft Corporation* includes privilege disputes, not all relevant documents are publicly available. Accordingly, the factual reconstruction presented herein relies exclusively on publicly accessible materials from the case record and related public sources. See: MICROSOFT CORPORATION. *Microsoft 2003 Memo on Puerto Rico Factory*: Exhibit 146-7. In: *United States v. Microsoft Corporation*, No. 2:15-cv-00102-RSM, W.D. Washington, 12 October, 2016. Available at: <<https://s3.documentcloud.org/documents/6556274/Microsoft-2003-Memo-on-Puerto-Rico-Factory.pdf>>. Access: March 30, 2026.

to define the next steps for its Puerto Rican subsidiary. Preliminary conclusions available in internal documentation disclosed in the course of the legal dispute assumed that shutting down MSPR and outsourcing the CD production was the best option from an economic standpoint, as the IRC §936 credit was the “main reason for manufacturing” there³. Although this does not prove that later restructurings lacked business purpose, it strongly suggests that tax planning was central to this arrangement.

In this sense, Microsoft considered several alternatives to keep MSPR active and preserve a low effective tax rate after 2006, including a Puerto Rico CFC, an IP company with a Puerto Rico branch, or a variation of this last configuration with a Dutch sales branch⁴. Each of these alternatives sought to reduce future U.S. tax exposure while requiring only limited changes to the underlying business operations, whether by relying on U.S. tax deferral mechanisms or on treaty-based planning.

Ultimately, the chosen structure centered on a cost contribution arrangement under which Microsoft U.S. and MSPR agreed to share research and development (R&D) costs in exchange for an ownership interest in the intellectual property (IP) created through that joint investment. At the time, Microsoft already maintained other CCAs for EMEA and APAC, effective in 1999 and 2004, respectively, which were also challenged by the U.S. Internal Revenue Service (IRS). Under the new arrangement, effective in July 2005, MSPR would co-fund the development of intellectual property and thereby acquire an interest in that IP. Because part of the relevant IP had already been developed, MSPR was also required to make a buy-in payment to compensate for the pre-existing intangible value⁵.

After that, the Puerto Rico affiliate could manufacture CDs with the relevant software for later distribution in the Americas. Considering the dispute is *in camera*, the public sources do not disclose the full valuation report, financial model, discount rate, economic projections, or other working papers used by Microsoft to determine the amount of the buy-in payments, but they estimate the contribution at USD 17 billion⁶. At this point, it is worth highlighting that MSPR was

³ MICROSOFT CORPORATION. *Microsoft 2003 Memo on Puerto Rico Factory*, p. 8.

⁴ MICROSOFT CORPORATION. *Planning alternatives in Puerto Rico*. Available at: <<https://s3.documentcloud.org/documents/6556275/KPMG-2004-Pitch-to-Microsoft.pdf>>. Access: April 6, 2026.

⁵ UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON. *Microsoft's Brief Regarding Privileged Documents Still in Dispute*. Available at: <<https://www.uschamber.com/assets/documents/Microsoft20Brief20Re20Privileged20Documents20In20Dispute20-20United20States20v.20Microsoft20Corporation2028USDC20-20Western20District20of20Washington29.pdf>>. Access: April 6, 2026, p. 11-14.

⁶ See the testimony of Bill Sample, Corporate Vice President for Worldwide Tax at Microsoft Cor-

originally funded by Microsoft Ireland and that its business was deeply dependent on intercompany transactions, including licensing the IP from the United States, CD manufacturing, and then selling CDs back to the U.S. distribution chain. Taken together, these features reinforce that tax-efficiency considerations were deeply embedded in the structure.

While the buy-in payments compensated for pre-existing intangibles, the cost-sharing arrangement also provided for recurring payments to share ongoing costs of developing and maintaining such IP between the contracting parties. The payments should contribute to funding the development of new software, bug fixing, new releases, and overall maintenance of Microsoft Windows and Microsoft Office IPs. In this sense, available evidence suggests that Microsoft Puerto Rico had agreed to bear approximately 25% of Microsoft's worldwide R&D costs each year in return for 47% of the Americas' retail sales revenue. Such payments amounted to roughly USD 8 billion per year, totaling accumulated payments of USD 30 billion by 2012⁷.

Other CCAs that Microsoft entered into for EMEA and APAC, with Ireland and Singapore serving as regional hubs, appear to have followed the same basic architecture: the U.S. headquarters and the regional participant shared R&D costs in return for rights over intellectual property and the resulting income streams. Publicly available materials indicate that these structures also involved very substantial intercompany payments. In the EMEA arrangement, for example, Microsoft made annual cost-sharing contributions of approximately USD 2.8 billion and intercompany relicensing rights of USD 9 billion. More broadly, Microsoft appears to have regionalized intangible ownership and the allocation of related profits through successive CCAs, rather than developing offshore markets through simpler licensing arrangements from the United States.

Ultimately, the IRS opened an audit in 2007 to examine Microsoft's operations for tax years 2004 to 2006, later expanding the audit through 2013. During that examination, the IRS sought documents that Microsoft resisted producing, leading to litigation to enforce IRS summonses. Microsoft withheld certain documents on grounds of IRC §7525 work-product protection, attorney-client privilege, and tax-practitioner privilege⁸. In its 2020 order, however, the Court largely

poration, in: UNITED STATES SENATE. Committee on Homeland Security and Governmental Affairs, Permanent Subcommittee on Investigations. *Offshore Profit Shifting and the U.S. Tax Code: Part 1* (Microsoft and Hewlett-Packard). Hearing held on Sept. 20, 2012. Washington, DC: U.S. Government Publishing Office, 2012. Available at: <<https://www.govinfo.gov/content/pkg/CHRG-112shrg76071/html/CHRG-112shrg76071.htm>>. Access: April 6, 2026.

⁷ UNITED STATES SENATE. Committee on Homeland Security and Governmental Affairs, Permanent Subcommittee on Investigations. *Offshore Profit Shifting and the U.S. Tax Code: Part 1* (Microsoft and Hewlett-Packard).

⁸ U.S. IRC § 7525 grants a limited confidentiality privilege for tax advice furnished by federally

rejected those claims, holding that many of the disputed documents were not protected because they served both litigation and business purposes, and that others fell within the tax-shelter exception. Although this was not a merit ruling on the transfer-pricing validity of the arrangement, the Court's reasoning exposed the extent to which the Puerto Rico structure was associated with tax-sensitive planning.

The audit ultimately resulted in Notices of Proposed Adjustment (NOPAs) issued in September 2023, through which the IRS sought USD 28.9 billion, in addition to penalties and interest⁹. The judicial decisions rendered so far are procedural rather than substantive as they do not determine the appropriate transfer-pricing method, the validity of the buy-in valuation, or the correct allocation of intangible-related profits. They do, however, provide a valuable window into the structure under review and into the core questions this paper addresses, namely, whether a CCA is an appropriate structure for producing intangibles, whether buy-in payments can validly price pre-existing IP, and how intangible-related profits should be allocated under such arrangement.

2. Legal rationale and structural limits of cost contribution arrangements and the production of intangibles

Cost-sharing arrangements (CSAs), or cost contribution arrangements (CCAs), as defined in Chapter VIII of the OECD Transfer Pricing Guidelines, are contractual frameworks through which two or more group entities share the costs and risks of developing, producing, or obtaining assets, services, or rights in light of the benefits they reasonably expect to derive from the arrangement. In this model, each participant is not treated as a mere licensee of the resulting intangible, but as a participant entitled to exploit its share of the outcome as an effective owner.

From a structural perspective, the CCA model diverges from the legal and economic logic of a traditional royalty or service chain, because it differs from both the classic royalty model and the principal model for producing intangibles. Briefly, under a royalty structure, one entity owns or controls the intangible, and grants use rights to operational affiliates in exchange for a royalty fee. Under the principal structure, a centralized entity assumes the key risks and functions associated with the development of the intangible, while other group entities operate

authorized tax practitioners, functioning as a partial statutory analogue to attorney-client privilege. Its scope, however, is narrower than ordinary attorney-client privilege, since it is confined to noncriminal tax matters and excludes communications connected to the promotion of tax shelters.

⁹ MICROSOFT CORPORATION. *Annual Report 2024*: Quarterly financial statements (Note on Income Taxes and Uncertain Tax Positions). Available at: <<https://www.microsoft.com/investor/reports/ar24/index.html>>. Access: April 7, 2026.

as limited-risk service providers. By contrast, under a cost contribution structure, the intangible is jointly developed or obtained by multiple participants, each contributing to the arrangement in anticipation of exploiting the resulting asset¹⁰.

The rationale of a CCA lies in the shared development of future value. If multiple associated enterprises genuinely expect to benefit from the future exploitation of an intangible, it is reasonable that they should also bear the corresponding development costs and risks. In that sense, the OECD states that each participant's share of the overall expected benefits should be proportionate to its share of the overall contributions. This rationale is stronger when the arrangement concerns the development of a genuinely new intangible. In Microsoft's case, however, the arrangement was entered into in 2005, when the company's core products were already among the most commercially successful in the world¹¹. As a result, the case does not fit neatly within the paradigm of uncertain early-stage development that most naturally justifies a CCA¹².

This helps explain why CCAs became attractive in international tax planning. They allowed multinational groups to characterize offshore entities not as mere recipients of passive royalty income, but as co-developers of future intangibles. In addition, the structure could reduce cross-border royalty flows and, depending on the circumstances, also reduce withholding tax exposure and simplify the internal allocation of development costs.

For that very reason, cost contribution arrangements remain highly controversial in transfer pricing practice. Their central difficulty is that the contractual sharing of costs does not necessarily correspond to the actual creation of value. A party may formally contribute to funding the arrangement and yet contribute little or nothing to the economically significant functions that drive the development, enhancement, maintenance, protection, and exploitation (DEMPE) of the resulting intangible. This is precisely one of the central issues raised by Microsoft's case: MSPR primarily contributed capital, contractual participation, and formal entitlement, while the decisive development functions, strategic decisions,

¹⁰ See more detailed analysis of these arrangements in VLASCEANU, Ruxandra. Chapter 8: Intellectual Property Structuring in the Context of the OECD BEPS Action Plan. In: COTRUT, Madalina (ed.). *International tax structures in the BEPS era: an analysis of anti-abuse measures*. IBFD, 2015.

¹¹ Microsoft's FY2005 financial statements do not permit a precise calculation of Windows and Office revenue specifically in the Americas, but the company disclosed global revenue of USD 39 billion, whereas the US accounts for USD 27 billion, a figure that included exports of finished goods primarily to Latin America and Canada. See more in MICROSOFT CORPORATION. *Annual Report 2005*. Available at: <<https://www.sec.gov/Archives/edgar/data/789019/000119312-505174825/d10k.htm>>. Access: June 2, 2026.

¹² A similar issue arose in *Amazon.com v. Commissioner*, No. 17-72922, before the U.S. Court of Appeals for the Ninth Circuit. On the valuation of the buy-in payment in that case, see: COT-TANI, Giammarco; LUDOVICI, Paolo; STRIATO, Marco. *Transfer pricing and intangibles*, p. 461.

and control over economically significant risks appear to have remained in the U.S.

The post-BEPS debate shifted the analysis away from mere legal ownership and contractual participation toward DEMPE-related substance, and this shift applies equally in the context of CCAs. More recent literature stresses that the contractual owner of an intangible, or the entity funding its development, is not automatically entitled to the full economic return associated with it¹³. Transfer pricing outcomes must instead reflect the functions performed, assets used, and risks assumed by each party. In particular, funding alone does not justify entitlement to the full intangible return where the funder neither controls the relevant risks nor performs the key value-creating functions. In this sense, the “cash box entity” critique captures this point well: a lightly staffed financing entity may, at most, justify a risk-adjusted or even a risk-free return, but not the full residual profit associated with the intangible¹⁴.

2.1. Validity and valuation challenges of buy-in payments in cost contribution arrangements

Buy-in payments arise when a new participant enters a cost contribution arrangement after valuable intangible property, or an economically relevant knowledge base, already exists. In arrangements such as Microsoft's, the newcomer is not contributing only to the future development of intangible assets; it is also obtaining access to pre-existing IP created by related parties before its entry. For that reason, the OECD Guidelines require such compensation to be determined at arm's length, based on the value of the interest in the intangible and the participant's proportional share of the overall expected benefits under the arrangement.

The same rationale applies in more complex situations. Where, for example, an entering participant contributes pre-existing intangibles of its own, balancing payments may be appropriate from the other participants or netted against any required buy-in. Likewise, when a participant exits a CCA and disposes of its interest in the results of the arrangement to the remaining participants, it may also be entitled to arm's-length compensation, commonly described as a buy-out payment¹⁵.

¹³ Paragraph 8.15 of the OECD TP guidelines defines that a party can not be a participant in a CCA if it does not exercise control over the specific risks it assumes under the CCA and does not have the financial capacity to assume these risks, as this party would not be entitled to a share in the output that is the objective of the CCA based on the functions it actually performs.

¹⁴ COTTANI, Giammarco; LUDOVICI, Paolo; STRIATO, Marco. Transfer pricing and intangibles. In: LANG, Michael; PETRUZZI, Raffaele; COTTANI, Giammarco (ed.). *Fundamentals of transfer pricing: general topics and specific transactions*. [S.l.]: Wolters Kluwer, 2024, p. 452-454.

¹⁵ OECD. *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.

Although the conceptual justification for a buy-in payment is relatively clear, the practical central problem remains difficult: how should it be priced? The first difficulty is the absence of reliable comparables. Buy-ins often concern unique and valuable intangibles for which no reliable comparable uncontrolled transactions exist. In such circumstances, the classic Comparable Uncontrolled Price (CUP) logic becomes difficult to apply with confidence, and valuation therefore tends to depend on financial techniques based on projections rather than on direct market evidence.

In Microsoft's case, MSPR reportedly made a USD 17 billion buy-in payment to enter the CCA and co-fund pre-existing Microsoft Windows and Microsoft Office IP. While other operating systems and productivity applications were available in the market, they were not directly comparable to Microsoft's software, given differences in market position, scale of adoption, interoperability, and other economically relevant features that can affect valuation. In this sense, Yariv Brauner has long argued that the valuation of intangibles is the central weakness of the arm's-length regime, because the unique characteristics of intangibles make reliable valuation exceptionally difficult and generate undesirable incentives within transfer-pricing practice¹⁶.

To overcome this difficulty, and in the absence of reliable comparables, an income-based valuation method may be considered. This approach, including discounted cash flow and relief-from-royalty methods¹⁷, estimates the value of the intangible by calculating the present value of the future income expected to arise from its economic exploitation over its remaining useful life. While this approach seems to address the lack of comparability, it immediately gives rise to a second challenge: future income projections are highly sensitive to assumptions concerning revenue streams, arm's-length royalty rates, growth, taxation, and discount rates.

Thus, a further challenge in income-based valuation lies in estimating the useful life of the intangible. In this sense, although highly valuable intangibles such as Microsoft's IP could support a very long, or close to indefinite, useful life, courts in similar disputes have rejected perpetual-life assumptions for pre-existing intangibles and instead adopted a more limited useful-life estimate¹⁸. Such

Available at: <https://www.oecd.org/content/dam/oecd/en/publications/reports/2022/01/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2022_57104b3a/0e655865-en.pdf>. Access: April 8, 2026, p. 352-353.

¹⁶ BRAUNER, Yariv. *Value in the eye of the beholder: the valuation of intangibles for transfer pricing purposes*, 28 Va. Tax Rev. 79 (2008). Available at: <<http://scholarship.law.ufl.edu/facultypub/18>>. Access: June 9, 2026, p. 87-89.

¹⁷ The relief-from-royalty method uses arm's-length royalty rates as a proxy for the future income expected to be generated by the intangible.

¹⁸ On the rejection of perpetual-life assumptions in comparable disputes, see Veritas Software Corp.

decisions can have a dramatic impact on the final tax assessment, as different assumptions on useful life produce different results. In buy-in cases, this problem is particularly acute because the value of the pre-existing intangible is typically inferred from anticipated future exploitation, which is uncertain by nature. A possible solution, as observed in Brazil under Article 28 of IN RFB No. 2.161/2023, should formally adopt an *ex ante* approach and require the taxpayer to establish the terms of the controlled transaction on the basis of the information available at the time the arrangement is executed. In buy-in cases, this means that later developments cannot automatically invalidate the original valuation, although they may still intensify disputes over whether the assumptions adopted at the outset were commercially and economically reasonable¹⁹.

The Microsoft case, hence, captures the essential fragility of buy-in payments in highly integrated software businesses. On the one hand, a buy-in payment is conceptually required because the offshore participant was entering a structure built on valuable pre-existing software intangibles. On the other hand, the scale of the disclosed amounts, the integration of Microsoft's product development, and the heavy concentration of R&D activity in the United States make it difficult to isolate the value of the pre-existing platform from future development and future market exploitation. The case thus demonstrates that, where the pre-existing intangible is exceptionally valuable, integrated, and dynamic, any valuation exercise is likely to remain contestable.

2.2. Methodological and substantive challenges of allocating intangible-related profits under cost contribution arrangements

Once the CCA is in place and any required buy-in payment has been made, the central transfer-pricing issue becomes how the future profits associated with the intangible should be allocated among the participants. At this stage, the question is no longer limited to compensating pre-existing value. Instead, the analysis must determine which participants are entitled to profits generated by the subsequent development, enhancement, maintenance, protection, and exploitation of the intangible, and in what proportion.

Even though the specific contributions of the participants to a CCA may

v. Commissioner, 133 T.C. No. 14, and Amazon.com v. Commissioner, No. 17-72922.

¹⁹ A related caution appears in recent work published by Ruth Mason on the Apple state aid litigation, where the authors criticize the reliance on retroactively applied OECD standards and an ambiguous conception of the arm's-length principle. Although arising in the EU state aid context, that critique is relevant here because it highlights the danger of judging complex intangible allocations through *ex post* or conceptually unstable standards. See MASON, Ruth; DALY, Stephen. What went wrong in the Apple State Aid Case. (June 01, 2025). *Virginia Public Law and Legal Theory Research Paper* No. 2025-48, *Virginia Law and Economics Research Paper* No. 2025-11. Available at: <<https://ssrn.com/abstract=5278193>>. Access: June 9, 2026.

differ, the underlying transfer-pricing rationale remains the same: remuneration for participation in the development of the intangible must be linked to decision-making authority and to the assumption and control of relevant risks. Legal ownership does not automatically justify entitlement to the economic returns from intangibles, and funding alone is insufficient to claim the intangible-related residual profit. For that reason, the allocation of profits under a CCA must test whether the participants' shares are genuinely proportionate to their expected benefits and actual contributions. This requires looking beyond the contract and asking whether the participant claiming the profit in fact helped create and control the value embodied in the intangible²⁰.

This discussion may have significant implications in the Brazilian context under the new transfer pricing framework. In Brazil and other developing countries, it is common for local subsidiaries to remunerate foreign headquarters or related parties for the use of trademarks, technology, R&D, or other intangibles developed abroad. Under the former Brazilian transfer pricing system, those outbound payments were typically examined from the perspective of deductibility or fixed-margin parameters. Under Law No. 14,596/2023, however, the analysis becomes potentially broader, since the arm's-length principle and the specific rules on intangibles and cost contribution arrangements now require greater attention to the actual contributions made by each party to the development, enhancement, maintenance, protection, and exploitation of the intangible. This raises a more demanding question for Brazilian tax practice: where the Brazilian subsidiary does not merely exploit the intangible passively, but actively contributes to its local development, adaptation, market positioning, user base, or commercial enhancement, could the tax authorities argue that part of the residual profits associated with that intangible should not be fully allocated abroad? At a minimum, the new framework may open space for arguing that the Brazilian entity should receive a higher arm's-length return than a mere routine distributor or service provider, particularly where its functions materially enhance the economic value of the intangible in the Brazilian market.

²⁰ In this respect, the OECD Transfer Pricing Guidelines, Paragraph 8.34 requires consistency between each participant's proportionate contributions and the proportionate expected benefits under a CCA. In the same sense, Paragraphs 6.42, 6.51 and 6.54 state that legal ownership alone does not entitle an entity to returns from intangibles absent the relevant functions, assets, and risks, and Paragraphs 1.92, 1.95 and 1.98 require control over risk and financial capacity, and reallocating risk where those conditions are not met. See: OECD. *Transfer pricing guidelines for multinational enterprises and tax administrations*. 2022. Available at: <https://www.oecd.org/content/dam/oecd/en/publications/reports/2022/01/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2022_57104b3a/0e655865-en.pdf>. Access: April 8, 2026.

In Microsoft's case, the structure was defended on the basis that Puerto Rico bore 25% of worldwide R&D costs and had therefore become entitled to 47% of the returns associated with Microsoft's intangibles in the Americas. Yet a closer reading of the public record suggests that MSPR did not materially contribute to the key functional aspects of development, did not control the relevant risks, and did not play a decisive role in the DEMPE of the intangible. In this sense, the public record suggests that core software development and legal ownership remained largely in the United States, while Puerto Rico appears to have performed mainly operational exploitation-related functions linked to production and distribution. On the available evidence, MSPR is better characterized as a funded operational platform than as a true co-developer of Microsoft's core intangibles. Therefore, the profit allocation appears to have rested primarily on contractual arrangements and financing. When the key development, strategic, and control functions remain concentrated elsewhere, it becomes difficult to justify the allocation of almost half of the residual profits to MSPR.

From a methodological standpoint, the presence of valuable intangibles does not, by itself, render one-sided methods inappropriate. Rather, the selection of the transfer pricing method depends on the accurately delineated transaction and on whether the contribution of one party can be reliably isolated and benchmarked. The OECD Guidelines alert that methods such as RPM and TNMM are generally unreliable for directly valuing intangibles, although they may remain useful for more easily identifiable and comparatively less complex functions. By contrast, the transactional profit split method becomes particularly relevant where each party makes unique and valuable contributions, where the parties' operations are so highly integrated that they cannot reliably be evaluated separately, or where they share economically significant risks. Importantly, the absence of reliable comparables does not, exclusively, justify the use of TPSM. The relevant inquiry is therefore not merely whether Microsoft Windows and Office were unique intangibles, but whether both Microsoft U.S. and MSPR made unique and valuable contributions to the profits generated through their exploitation²¹.

²¹ Because Resale Price Method (RPM), Comparable Profits Method (CPM), and Transactional Net Margin Method (TNMM) are one-sided methods, they are generally less suitable in cases involving unique intangibles and integrated multi-party contributions. By contrast, Comparable Uncontrolled Price method (CUP) is more appropriate where reliable comparables exist, while Transactional Profit Split Method (TPSM) is usually more suitable where both parties make important non-routine contributions. In this respect see: BRAUNER, Yariv. Cost sharing and the acrobatics of arm's length taxation. *Intertax*, Forthcoming, University of Florida Levin College of Law Research Paper No. 2010-19, Available at: <<https://ssrn.com/abstract=1651334>>. Access: June 9, 2026, p. 8, 15-16; and COTTANI, Giammarco; LUDOVICI, Paolo; STRIATO, Marco. Transfer pricing and intangibles. In: LANG, Michael; PETRUZZI, Raffaele; COTTANI, Giammarco (ed.). *Fundamentals of transfer pricing: general topics and specific transactions*. [S.l.]: Wolters Kluwer, 2024, p. 458-461.

This distinction is particularly relevant to the Microsoft arrangement. If MSPR's activities were predominantly limited to manufacturing, distribution and funding, while the core software development functions and control over economically significant R&D risks remained concentrated in the United States, a full contribution-based profit split would not necessarily follow merely from MSPR's participation in the CCA. A residual profit-split analysis provides a more nuanced possibility. Under this approach, comparatively routine contributions that can be reliably benchmarked may first receive an arm's-length remuneration through a one-sided method, while the remaining residual profit is allocated according to the relative value of those contributions that cannot be independently benchmarked. The methodological issue in Microsoft would therefore become whether, after remunerating MSPR's operational and financial contributions, the Puerto Rican entity performed any unique and valuable functions capable of supporting participation in the intangible-related residual profit.

A further difficulty concerns the choice of the profit-splitting factor itself. Microsoft reportedly linked MSPR's assumption of approximately 25% of worldwide R&D expenditure to a substantial share of the returns from the exploitation of Microsoft intangibles in the Americas. Yet the OECD Guidelines do not assume that expenditure is equivalent to value creation. R&D costs may constitute an appropriate splitting factor only where they reliably reflect the relative value of the parties' contributions; costs alone may otherwise be a poor proxy for the value of intangibles, particularly where the parties perform different functions, contribute different assets, or assume different risks²². The same concern applies specifically to development CCAs, for which the OECD requires contributions to be measured by reference to their value and cautions that measurement of current contributions at cost will generally not provide a reliable arm's-length result. Consequently, the decisive question is not how much of Microsoft's R&D expenditure MSPR contractually agreed to fund, but whether that expenditure reliably represented the economic value of the functions, assets and risks actually contributed by MSPR to the development of the relevant intangibles.

Although the court has not yet ruled on the merit of the CCA valuation, the case suggests that the arrangement may ultimately need to be accurately delineated differently from the way Microsoft presented it. Under OECD standards, legal ownership and funding do not by themselves justify the retention of residual re-

²² The OECD TP Guidelines, In particular, paras. 2.171 and 2.181 recognize that R&D expenditure may be used as a profit-splitting factor only where it reliably reflects relative contributions, while paras. 8.23 and 8.26-8.28 require CCA contributions to be evaluated by reference to value and caution against equating cost with value in development CCAs. See: OECD. *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*. Paris: OECD Publishing, 2022. Available at: <<https://doi.org/10.1787/0e655865-en>>. Access: April 8, 2026.

turns from intangibles. Those returns must follow DEMPE contributions and control over economically significant risks. If Puerto Rico is ultimately viewed as having contributed primarily funding and only limited operational substance, the more persuasive conclusion may be that it was entitled only to a more limited return, with the balance remaining in the United States, which was more intensively responsible for the development functions.

3. Conclusion

The Microsoft case suggests that the central weakness of many cost contribution arrangements lies not in their formal legality, but in the gap that may emerge between contractual participation and actual value creation. The case shows that a CCA may remain conceptually valid even where a participant enters through a buy-in and ongoing cost-sharing; however, that formal structure does not, by itself, justify the allocation of substantial intangible-related profits to the offshore participant. The more important learning is that companies adopting CCAs must be able to demonstrate, through contemporaneous evidence, that the participant claiming the return also performed or controlled the economically significant functions associated with the development and exploitation of the intangible, had the financial capacity to bear the relevant risks, and participated in a manner consistent with its expected share of benefits.

For tax administration in developing countries, cases of this kind pose deeper institutional challenges. They require the administration not only to understand transfer pricing methods deeply, but also to scrutinize projections, financing flows, risk control, DEMPE functions, and the internal logic of multinational group structures. The central difficulty is therefore one of administrative capacity: distinguishing genuine co-developers from entities that merely receive contractual residual profit demands specialized audit teams, reliable access to documentation, and familiarity with valuation exercises in settings where reliable comparables are often unavailable²³.

In this context, the application of OECD-style transfer pricing rules to intangibles may be complicated by a less stable macroeconomic environment and by greater volatility in the very assumptions on which buy-in valuations and profit-allocation models depend. Discount rates, expected returns, inflation, exchange-rate behavior, financing costs, and country risk adjustments may fluctu-

²³ On the way in which transfer pricing complexity can erode fairness, equity, and enforceability, especially in developing countries, which is particularly relevant to disputes involving intangibles, buy-in payments, and contested valuation assumptions, where administrative burdens may become especially acute, see NAVARRO, Aitor. Simplification in transfer pricing: a plea for the enactment of rebuttable predetermined margins and methods within developing countries. 22 *Florida Tax Review* (2019). Available at: <Available at: <https://scholarship.law.ufl.edu/fttr/vol22/iss3/21>>. Access: June 9, 2026, p. 759-775.

ate more intensely over time, making projections both more uncertain and more vulnerable to disputes. Therefore, the difficulty is not merely technical, but institutional, as tax authorities may be required to challenge sophisticated valuation models built on assumptions that are themselves highly contestable and especially sensitive to domestic economic instability. As a result, the application of CCAs in developing countries raises a broader question of tax administration design: whether legal convergence with OECD standards is sufficient where the underlying economic variables are more volatile, and the administrative burden of testing complex financial assumptions is correspondingly higher.

The Microsoft dispute should therefore be read less as a self-contained controversy and more as a useful point of departure for further research on the limits of cost contribution arrangements in the transfer pricing of intangibles. In this sense, two lines of inquiry appear particularly relevant. The first concerns the development of more robust frameworks for valuing buy-in payments in cases involving software, platform-based business models, and other hard-to-value intangibles, where comparables are weak and forecasts are inherently unstable. The second concerns the relationship between DEMPE functions, intercompany funding, and risk control, especially in determining when an offshore participant may still be treated as a genuine co-developer rather than as a cash-box entity. From the perspective of developing countries such as Brazil, these issues are not merely theoretical; they are directly connected to the practical application of OECD-based rules on intangibles and cost contribution arrangements, and to the evidentiary and institutional demands such rules impose on tax administration.

