

Comments Received on the Request for Input

Scoping of the future revisions of Chapter VII (intra-group services) of the Transfer Pricing Guidelines

28 June 2018



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20 June 2018

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Commentary on the Invitation for Public Comments on the Scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines

Andrew Cousins, Duff & Phelps Ltd.¹

I welcome the opportunity to comment on the OECD's invitation for public comments on the scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines, issued on 9 May 2018.

My comments are informed by many years of personal practical experience in administering intra-group service charges within multinational enterprises, in my former role as an in-house transfer pricing leader within two large MNE groups. In that capacity, I have developed policies for the charging of intra-group services, implemented them, administered, documented, monitored and defended them. I can state confidently that no area creates a greater compliance burden for less reward than the administration of intra-group services within an MNE, in particular the charging of centralised head office and/or regional management charges to local subsidiaries.

The challenges faced by MNEs primarily relate to the matter of deductibility of those expenses and the avoidance of double taxation. Many (often non-OECD) countries regard receipt of management charges (usually originating from OECD countries) with extreme scepticism, viewing them as a tool to enable base erosion and profit shifting. For many MNEs that we at Duff & Phelps have worked with (either as advisers or as employees) nothing could be further from the truth. The charging out of intra-group services is an enormous administrative burden, generally performed not to realise tax benefits by extracting income from higher tax countries for more favourable tax treatment, but rather simply to avoid potential double taxation that might arise from failing to make such charges. Yet the challenge of obtaining a deduction for intra-group services received is so great in some jurisdictions that many businesses opt to abstain from making the charge and to incur the double taxation rather than attempt the fruitless effort of charging for the services.

¹ The opinions and views expressed in this letter are those of the author and not necessarily those of Duff & Phelps or its clients.

I am not aware of any other area of transfer pricing where such frequent exceptions to general group transfer pricing policy or such elaborate measures to avoid non-deductibility are necessitated. To the extent that the OECD can help reduce the conflicts and administrative burden associated with intra-group services through revisions to Chapter VII of the Guidelines, it will be time well spent.

Benefits test

In several jurisdictions, the most challenging hurdle to securing a deduction for intra-group service payments is demonstrating that a service has been rendered and that the services rendered have provided benefits to the recipient. In practice, this can result in an unending search for a portfolio of documentation (beyond legal agreements, time records and activity descriptions) in pursuit of the elusive conclusive evidence that will convince a tax administration either that a service has in fact been provided or that it has been of any benefit to the recipient.

The OECD would do well to focus attention on whether the need to demonstrate a benefit in the case of intra-group services is consistent with the principles underpinning the Chapter I guidance on the accurate delineation of the controlled transaction. It should be a given that any activity performed by a business is not undertaken needlessly, but rather is undertaken for some party's (or collection of parties') benefit and that the costs associated with undertaking those activities therefore should be deductible somewhere within the MNE. Too often tax administrations cannot accept either that a service has been provided or that it has been beneficial to the recipient entity, with the consequence that legitimate business expenses are not treated as deductible in any jurisdiction.

Whether intra-group services are to be considered a special case or not, the working of Chapter VII would benefit from being detailed in such a way that both tax administrations and MNEs can agree on its practical application, in order to achieve a commonly understood approach towards documentation. The documentation of intra-group services within MNEs is often a weak area. In-house service providers are typically reluctant to suffer the burden of recording their time in the way that an independent professional services firm, for example, would do. Documentary evidence for the benefits of services received is rarer still and harder to demonstrate to the satisfaction of often overly sceptical tax inspectors.

Specific guidelines as to the nature and extent of the documentation that should suffice as evidence for the existence of a service, for the delivery of the service and for the demonstration of the benefit would be very helpful. Section D.3. of Chapter VII currently describes significant documentation requirements for MNEs electing to apply a simplified methodology for low value-adding intra-group services. The OECD should give consideration as to what might be an appropriate level of documentation for other circumstances as well, i.e. high value-adding intra-group services or circumstances where a tax administration has not adopted the simplified approach.

Shareholder activities

The distinction currently drawn in the Guidelines between “shareholder activity” and “stewardship activity” is not clear and serves no useful function. “Stewardship activity” is mentioned in the Guidelines seemingly as a legacy of the 1979 Report but without explanation. I have found no one who is able to explain the distinction satisfactorily to me. If the term “stewardship activity” serves no practical purpose, then it should be dropped. If it serves a purpose, then that purpose needs to be clarified and the resulting difference in treatment from “shareholder activity” clarified.

Illustrative examples would be instructive. One fertile ground for examples could be the use of relatively costly headquarters resources to provide services in order to realise greater consistency of business attributes around the world. MNEs headquartered in developed countries often provide services to subsidiaries in less developed countries where local resources would be much less costly than headquarter resources. In such circumstances, it may well be the case that the entity in the less developed country would likely not hire costly resources from the developed nation if it were a stand-alone entity. For example, engineers supplied by a head office in a developed nation to set up a plant in a subsidiary in a developing nation or to maintain engineering standards in such a plant would likely not be engaged by the subsidiary as a stand-alone entity acting independently because of the vastly higher cost of engaging overseas engineers from a developed nation, compared with local engineers.

Nonetheless, the head office of an MNE group may insist that its engineers perform the work, both to benefit from the specific skills and experience available through parent company resources and to realise consistency in adherence to global standards that the parent has set. In terms of provision of a service, clearly the recipient has benefited from superior skills and experience, resulting in a superior product, greater reliability, etc. However, it is not a service that it would have chosen to pay for (at least not in an amount that reflects the cost of the resources that actually provided the services). The wider group benefits from the reliable and consistent maintenance both of standards and of the brand across the globe, but does this qualify the service (or at least some portion of the associated costs) as related to shareholder activity?

The tax administration of the recipient may take the view that no deduction, or only a limited deduction (based on local costs), should be allowed because the excess costs are viewed as being non-beneficial to the local subsidiary. There is clearly benefit to the group as a whole to using the headquarters personnel, even if the costlier resource might not be desirable through the stand-alone lens of the service recipient.

The tax administration of the service provider on the other hand may take the view that the service is clearly for the benefit of the subsidiary, which enjoys higher quality and reliability than would be possible from engaging a local low-cost service provider, and should be charged in full, notwithstanding the incidental benefits to the wider group. Arriving at guidance that clearly defines the distinctions between “shareholder activity” and “stewardship activity” (whatever it may be) in this sort of circumstance would help

resolve difficulties (and double taxation) arising from these different viewpoints for this commonly encountered situation.

Duplication

We have found that in practice the automatic response of some tax administrations to the receipt in one recipient entity of services from two or more service providers, for example from head office and from a regional hub, is to disallow the expenses as duplicated activities, notwithstanding the fact that the services are separate and wholly distinguishable.

This is clearly not the intention of the Guidelines as they are written. The Guidelines contain a legitimate warning against charging for a service that merely duplicates what the group entity is already doing itself (although in practice such duplication is surely rare). This however is inappropriately interpreted by some tax administrations to mean that the receipt of services from more than one service provider is automatically duplicative, no matter what the service. This leads to considerable practical difficulties for MNEs, often resulting in contrived routing of charges, such as via a hub, to enable a single aggregated charge to be made.

By way of illustration, assume that an MNE operates a global tax department in its head office that contains a centralised transfer pricing function. During the course of the year this function may develop and implement a global transfer pricing policy for the group; it may provide advice to a local entity on the practical implementation of the policy; and it may assist with preparing the local documentation necessary. Meanwhile, a separate regional hub containing its own regional tax function may be responsible for the local entity's day-to-day tax compliance, preparing tax computations and submitting returns. The services provided to the local entity from head office and from the regional hub are distinct and not duplicative, but separate invoicing is actively avoided on the grounds that the costs for tax services will be disallowed by the local tax administration as “duplicative”.

Again, while the theory of the Guidelines is not in doubt, the practical implementation of them is far from consistent and resolution of conflicts far from simple. The OECD should consider what practical measures can be taken to address such difficulties. If it is a question of documentation, it would again be useful, as described earlier, to understand what level and type of documentation is going to be necessary to demonstrate that no duplication of services is occurring, so as to satisfy the requirements for deductibility of costs. However, given the rarity with which duplicative services are surely actually provided, once a satisfactory level of evidence has been amassed, the burden should be on the tax administration to demonstrate that services are duplicative, rather than on the taxpayer to demonstrate that they are not.

Allocation keys for indirect-charge methods

While the identification of reasonable allocation keys is satisfactorily explained in the existing Guidelines, we have observed great variability across MNEs in the threshold for

application of such allocation keys. That is to say, while some MNEs charge out the costs of many cost centres on a direct-charge basis (as described in Chapter VII at B.2.2.1), determining the charge based on the identification of specific services rendered, other MNEs prefer to minimise the level of administrative record-keeping within the cost centres by charging all costs on an allocation basis (as described at B.2.2.2), though the assumptions underlying such allocation methods necessarily result in less precision in determining the charge. Indirect-charge methods naturally tend to be more prevalent as the cost centres increase in size and the administrative burden of tracking the costs grows. Thus, in practice smaller cost centres are able to track their time and expenses far more diligently to specific services recipients.

While detail provided by the direct-charge method is more easily substantiated by the taxpayer than are charges calculated on an allocation basis, the burden of maintaining equivalent levels of record-keeping for large cost centres demands that a practical limit be set on such a direct charge approach. This is already acknowledged by the Guidelines, but in practice this is an easy area for tax administrations to challenge, as detailed documentation to demonstrate the provision of the service or direct benefit to the recipient is absent.

The Guidelines recognise the increased risk of double taxation from the use of an indirect-charge method owing to the obscuring of the relationship between the charge and the services provided. This is therefore an area where supplementary guidance would serve a constructive purpose, in helping to reduce that risk. Consideration of the level of burden at which allocation becomes an acceptable approach would be useful to MNEs seeking to defend before tax administrations the policy that they have adopted. More examples in the Guidelines illustrating what level of analysis and documentation is realistically and practically to be expected would be beneficial.

Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises

Jurisdictions frequently require MNEs to maintain documentation substantiating the appropriate cost base to be included in intra-group services. Indeed, the question of the cost forming the basis of the charge is generally a far more significant matter to both MNEs and tax administrations than the question of the mark-up in a cost-plus method (that is to say, the deductibility for tax purposes of the 100% of the cost far outweighs the question of whether 5% on that cost represents an appropriate mark-up).

Given that the question of the cost determination is typically more significant than the matter of the profit element, Chapter VII would benefit from more extended guidance on determination of the appropriate cost base, with illustrative examples. Section B.2.3 of Chapter VII currently gives some consideration to the costs to be included but this could be developed considerably, building on the principles contained in Chapter II.

Simplified charging of arm's length compensation

At present Chapter VII gives no consideration to the practical administration of the charge for arm's length compensation for intra-group services, though this in itself can be a source of significant administrative burden for MNEs and potential conflict with tax administrations. Typically, MNEs make a year-end adjustment to their charges for intra-group services to match actual results to the targeted cost-plus mark-up.

In this context, it may be observed that independent service providers very frequently provide a service for a particular project on an arm's length basis for a fixed fee, based on forecasts, rather than charging on an actual time-spent basis. This gives the recipient of the service certainty in planning for the costs that it will bear and incentivises the service provider to perform the work efficiently.

If such an approach could be applied within the context of an MNE for intra-group services, it would make for greater administrative simplicity within the MNE – there would be no need to make year-end true-ups, for example – as well as enhanced certainty. Needless to say, costs would still need to be tracked to ensure that such an administratively simple method remained on track. Any shortfall in recovery or overcharge could simply be factored into the following year's charge. In addressing calculation of the arm's length compensation, Chapter VII would benefit from inclusion of such guidance on simplified mechanisms for charging for intra-group services.

Conclusion

The chronic challenges encountered in connection with the administration of intra-group services within MNEs make revision of Chapter VII of the Guidelines a worthy topic.

Recognition that all business costs should be deductible within the MNE, and awareness of the hurdles that have been erected to the detriment of such recognition, should be the starting point for addressing these challenges: the benefits test, its relevance and the associated documentation burden; the distinction drawn between shareholder and "stewardship" activities; and the burden of proof associated with so-called duplicated activities and with the use of indirect-charge methods. In addition, determination of the cost base for inclusion in charges, as well as simplified methods of making an arm's length charge, merit consideration in pursuit of increased certainty and ease of administration.

I enthusiastically endorse the proposal to launch a project to revise and supplement the guidance in Chapter VII on intra-group services, specifically to address issues related to practical implementation. This is an area where the challenges for MNEs in practice far outweigh the theoretical complexity (or simplicity) of the subject matter and where improved guidance can result in tangible benefits.

A handwritten signature in dark ink, appearing to read 'Andrew Cousins', with a long, sweeping horizontal line extending to the right.

Andrew Cousins
Director, Transfer Pricing
Duff and Phelps

Comments on scoping of the future revision of Chapter VII

Thank you for the invitation to comment on the scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines. These comments reflect my personal views and have not been prepared on behalf of or at the request of any other person or organisation.

In determining the scoping of future revision to the guidance I suggest that three matters are considered: (1) explore imaginatively ways of reducing the extent of, or exempting entirely, the charging out of costs of low value centralised services; (2) re-consider whether the benefits test causes more problems than it solves; and (3) provide insightful guidance on distinguishing and valuing high value services.

- (1) explore imaginatively ways of reducing the extent of, or exempting entirely, the charging out of costs of low value centralised services

I will use the term “centralised corporate overheads,” a term which is intended to cover low value-adding intra-group services as defined in the 2017 version of Chapter VII but which, in its omission of “services,” perhaps better reflects the commercial motivation of the activity. The case for simplification of transfer pricing rules in relation to centralised corporate overheads is compelling. The matter is regularly the subject of transfer pricing audits, a cause of double taxation, and consumes a disproportionate amount of compliance effort relative to importance or value. It is a concern for the robustness of the arm’s length principle that it seems to struggle to provide practical solutions for the commonest of commercial activities that seldom present valuation intricacies. However, simplification attempts (by the OECD, by the EU, and by some individual jurisdictions) which focus on simplifying the charging of costs largely from the perspective of the services provider have not found widespread support. One reason is that in the jurisdiction of a multinational enterprise receiving the services the costs charged can be significant relative to the cost-base and profits of that enterprise. For the tax administration of such a jurisdiction there may be an incentive to challenge the charges, and little interest in adopting a simplification regime that applies global allocations. A global corporate overheads rule which allows group enterprises to deduct corporate overheads up to the group ratio of overheads to EBIT (similar in some respects to the general interest limitation rule) could be explored; however, it would require extensive buy-in from tax administrations around the world, with likely onus on developing countries, and the rule would continue to be based on a questionable assumption that group-wide allocations are required. I see no prospect of materially improving the adoption of simplification unless it is accompanied by a reduction in the number of group companies to which costs are allocated. But this will require bold and imaginative thinking, and will involve compromises, perhaps mainly for developed countries.

A perception has been allowed to develop, I believe, that if the costs of corporate overheads are not allocated to all group companies then there is a problem since some companies are undercharged and some are overcharged. This perception should be challenged, since a material improvement could involve making the case for charging the costs of centralised corporate overheads to a very limited number of group companies. Such an approach is sometimes adopted by MNE groups that are structured through, say, regional principal companies each with distribution affiliates that are remunerated by those principal companies through a fee determined by targeting an operating margin. Any centralised corporate overheads that could be allocated to those distribution affiliates would not affect their target operating margin, and those additional costs would be effectively borne by the regional principal companies who are the residual profit-takers. For MNE groups structured in this way it can make little sense for costs to be allocated to all the distribution companies, simply for those costs to be effectively reimbursed by the regional principals. What makes sense is for the costs to be allocated

Comments on scoping of the future revision of Chapter VII

just to the regional principals. Such an approach is not only more efficient and may reduce the scale of potential disputes, but it is also capable of defence under the arm's length principle in that it is the entrepreneurial, value-creating activity of the residual profit-takers that ultimately benefits from the efficient centralising of corporate overheads. It would be helpful if the revisions to the guidance explicitly endorsed such an approach, but it would require revisiting the concept of "beneficiaries" (which usually means the users of the service) as used in the current guidance as well as the benefits test (see point (2) below).

However, not all MNE groups have supply chains and transfer pricing policies that are structured as described above, and it would be unfair to endorse an approach that is available to some without finding ways of enabling all MNE groups to limit the number of enterprises that are charged the costs of centralised corporate overheads. I suggest that one way is to recognise that in all MNE groups there are likely to be a small number of value centres that are effectively residual profit-takers even when they may not be so directly embedded in the supply chain as in the example of regional principal companies. They may operate by exploiting significant intangibles or tangible assets, providing high-value services (see point (3) below), or controlling significant risks, as identified in the Master File. Their income and profits are ultimately affected by the costs that are incurred throughout the MNE group, and they have an interest in the efficient centralising of corporate overheads throughout the group to maximise their returns. A case can be made under the arm's length principle that they could solely be allocated corporate overheads.

The revised guidance could consider how the arm's length principle supports the allocation of centralised corporate overheads to a limited number of value centres, rather than to all group companies. Such an approach endorses and makes more widely available the practical outcome that can already be achieved by MNE groups structured in certain ways. The identification of the types of value-creating enterprises in a MNE Group qualifying for allocation of costs of centralised corporate overheads and the disclosure mechanism for MNEs applying this approach could be part of the scope of the revised guidance.

Objections may be made that such an approach means that the cost base of group enterprises may not be the same as an otherwise comparable independent enterprise. I am not sure that this is relevant to the arm's length principle. What is relevant is the effect on the profits of a residual profit-taker, such as a licensor, were it to bear costs that relate primarily to the business of the licensees, but which also are anticipated to optimise efficiencies for the licensee in generating the income from which royalties are payable, under the hypothesis that the licensor and licensees were unrelated. The answer to that question is complex, and it should be recalled that determining the profits of such an enterprise is already subject to imprecision under the arm's length principle. But tax administrations have the option to turn aside this particular complexity for the sake of administrative simplicity and to lower the costs of dealing with disputes and double taxation. This approach also has the advantage of putting the compromises of simplicity largely on those tax administrations best equipped to bear the burdens: developed countries that are likely to have relatively high anticipated taxable income from their residual profit-taking taxpayers.

The purest outcome, numerically at least, of limiting the number of group enterprises being charged for centralised corporate overheads would be one group company bearing all costs of centralised corporate overheads. This is likely to be the parent company that ultimately earns the economic benefits of

Comments on scoping of the future revision of Chapter VII

operating a unified business that are achieved in part through centralising corporate functions, and which has an interest in overseeing that those functions are performed to standards it sets in an efficient, uniform, and adaptable manner. However, some parent companies generate low levels of taxable profits in their own tax jurisdiction and some MNE groups have very high levels of centralised corporate overheads. Nevertheless, countries may see wider policy objectives being met by designing a corporate overheads transfer pricing regime which allows an enterprise to be exempt from current application of transfer pricing rules in relation to charging out centralised services and to deduct costs of all centralised corporate overheads. Such a regime is likely to require a level of economic nexus, so that the activities are substantially conducted in that country (and costs are not simply recharged from other countries), and may involve limitations on the creation of losses or on the size of eligible MNE groups. The design of such a regime and the disclosure of its adoption by an MNE group could be part of the scope of the revised guidance.

(2) does the benefits test cause more problems than it solves?

The current benefits test in Chapter VII determines whether a transaction should be recognised as an intra-group service. (The test uses the term “activity” not “transaction” but it is an activity performed for one or more group members and therefore appears to convey the same meaning as “transaction” in the rest of the Guidelines.) It is unique to services. When a transaction involving goods or intangibles is considered, we are not authorised to ignore it from the outset if there is a question about whether the recipient has enhanced or maintained its business position. Instead the nature of the transaction and its economically relevant circumstances require to be analysed under the guidance in Chapter I (as supplemented for intangibles in Chapter VI). It is probable that the guidance in Chapter I about accurately delineating the actual transaction (including its contractual terms, the functions of the parties and how those functions relate to the wider generation of value, the circumstances surrounding the transaction, the characteristics of the services provided, the economic circumstances of the parties) subsumes any purpose of the benefits test, and that incorporation of the principles of Chapter I in the revision of Chapter VII may lead to the conclusion that the benefits test is redundant.

Removal of the benefits test would be a helpful outcome. It is difficult to answer the benefits test in principle: how do we know whether an independent enterprise would have been willing to pay for anything or to perform any activity itself, and to what do we turn when parties answer the question differently? Second-guessing willingness or behaviour is not part of the arm’s length principle. It is particularly difficult to apply the benefits test to corporate overheads since they exist to prevent services being bought in from elsewhere or performed by individual companies. Finally, the benefits test can cause problems when it is interpreted to encourage valuation of the transaction based on what it would have cost the enterprise to have acquired the service from a local provider, or on what it would have cost to have performed the activity itself.

The principles in Chapter I which set out how to accurately delineate the transaction including the economic circumstances of the parties seem to provide a much better and comprehensive framework for analysing a services transaction than a test which relies on identifying what an independent enterprise might have been willing to do. The benefits test has already been nudged to one side in the simplified approach in Chapter VII, and revisions to the chapter should consider whether it continues to serve any useful purpose. If the benefits test were to be retained, then care should be taken to align

Comments on scoping of the future revision of Chapter VII

it with the general principles of Chapter I, including both the accurate delineation of the actual transaction and also non-recognition.

(3) provide insightful guidance on distinguishing and valuing high value services

The current version of Chapter VII provides limited or no guidance on how to identify and price high value intra-group services that can drive business performance. Services can in some cases command arm's length compensation that is relatively low, and based on the costs of providing the service; whereas in other cases superficially similar services can command arm's length compensation that is strikingly higher since it is based on results. For examples, procurement activities or the activities of a leadership team can in practice justify cost-based or performance-related compensation, depending on some critical distinguishing factors. The identification of those factors would respond to a pressing need for guidance. The guidance will probably need to cover how the services relate to the wider generation of value by the MNE group, any significant risks for the MNE group that are affected by the services and how such risks are controlled, and the existence of intangibles, including know-how, that can create scarcity and unique propositions. Such guidance would neatly draw on the revisions already made to Chapters I and VI, in particular, and would likely relate to aspects of the recent work on profit splits.

Thank you for considering these comments. I should be happy to discuss any points you think may merit development.

With best wishes

Andrew Hickman

Submitted by email to: transferpricing@oecd.org

20 June 2018

Dear Sir,

Scoping of the future revision of Chapter 4 (administrative approaches) and Chapter 7 (intra-group services) of the Transfer Pricing Guidelines

General comments

AFME¹ and UK Finance² welcome the proposal to review the guidance in Chapters 4 and 7 of the 'OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations' (the guidelines). The guidelines are an invaluable resource, and, given the ever-changing landscape in which multinational businesses operate (e.g. due to regulatory change, technological development, and developments in tax policy), it is important to continually reassess the relevance of each chapter. Therefore, we will keenly consider all consultations on proposed revisions to the guidelines.

Chapter 4 (Administrative approaches)

Effective dispute resolution mechanisms need to be transparent, predictable, cost efficient and involve time-bound processes for all participants. This is necessary to provide legal certainty for all businesses involved in cross border transactions, as well as for tax authorities. We would also note that this certainty encourages greater cross-border investment and the attendant economic benefits which accrue from this investment.

We would, of course, be particularly interested in any new measures that could help give tax payers greater upfront certainty and reduce the risk of dispute in the first place.

¹ AFME represents a broad range of European and global participants in the wholesale financial markets. Its members comprise pan-EU and global banks as well as key regional banks and other financial institutions. AFME advocates stable, competitive and sustainable European financial markets, which support economic growth and benefit society. AFME is registered on the EU Transparency Register, registration number 65110063986-76.

² UK Finance is a new trade association which was formed on 1 July 2017 to represent the finance and banking industry operating in the UK. It represents around 300 of the leading firms providing finance, banking, markets and payments-related services in or from the UK. UK Finance has been created by combining most of the activities of the Asset Based Finance Association, the British Bankers' Association, the Council of Mortgage Lenders, Financial Fraud Action UK, Payments UK and the UK Cards Association.

Chapter 7 (Intra-group services)

As already acknowledged in Chapter 7 of the guidelines, we believe that it is important that companies can apply an appropriate mark-up to low value-adding intra-group services, and, where this happens, we believe that: (i) all tax authorities should respect the mark-up applied by a given company; and, (ii) companies should obtain a tax deduction for the costs of such services somewhere in the MNE group (in order to prevent double taxation.)

Banks are subject to extensive and coordinated worldwide regulation and this reduces the general risks in the banking sector. We are therefore keen to ensure that any recommendations support, and do not contradict, this regulatory environment. In addition, we would welcome the inclusion of additional examples and practical guidance specific to international banks.

Finally, we strongly believe that any measures taken to address cross border tax challenges must be co-ordinated internationally to avoid double or multiple taxation.

Next steps

Should the OECD choose to proceed with the proposed consultations, we would encourage the OECD to engage large non-OECD member countries (including Brazil, India and China). The pace of economic development in these countries is increasing rapidly and so the volume and complexity of transactions with OECD members will continue to increase.

As noted above, we would like to be part of the discussions as the OECD's work develops. However, if you would like to discuss in the meantime, please let us know.

20 June 2018

SCOPING OF THE FUTURE REVISION OF CHAPTER VII (INTRA-GROUP SERVICES) OF THE TRANSFER PRICING GUIDELINES: ABS SUBMISSION

The Association of Banks in Singapore (“ABS”) welcomes the opportunity to comment on the scope of the future revision of *Chapter VII of the Transfer Pricing Guidelines on Special Considerations for Intra-Group Services* (“*OECD TP Guidelines*”). We appreciate the OECD’s efforts to consider taxpayer’s views on the practical application of this guidance.

Background

ABS plays an active role in promoting and representing the interests of the banking community in Singapore and has a membership of 156 local and foreign banks/institutions and representative offices. ABS also works closely with the authorities in supporting their role in developing and maintaining a sound financial system in Singapore.

Established in 1973, ABS has over the past 40 years, brought its members together, establishing common grounds through benchmarking and setting banking guidelines as well as working on projects of mutual benefits to face the challenges of the financial and banking community in Singapore.

Comments

In considering future revisions to the OECD TP Guidelines, it is important that any such revision is complimented by the experience of tax administrations and taxpayers in handling the practical challenges relating to intra-group service transactions. We believe that additional guidance from the OECD in this area will be helpful in minimizing uncertainties or disputes between tax administrations and taxpayers.

In this regard, we set out below our views on some of the areas of feedback sought, as organized based upon the OECD’s request for public comment. In addition to the specific points raised by the OECD under this invitation for public comment, we have further highlighted an additional point around the indirect tax treatment of intra-group services for the consideration of the OECD.

A. Demonstrating that a service has been rendered and/or that the service provides benefit to the recipient

Presumption of benefit

We note that the OECD TP Guidelines provide general guidance on determining whether an intra-group service has been rendered in Chapter VII (Paragraphs 7.6 – 7.8). This guidance focuses on whether the activity provides the service recipient with economic or commercial value to enhance or maintain its business position (i.e. the benefits test) and whether an independent enterprise in comparable circumstances would have been willing to pay for the activity.

This guidance implies that an enterprise would not be willing to incur external costs (e.g. paying an external service provider or incurring salary costs to perform the activity in-house) if there was no clear benefit obtained.

Providing such objective evidence that a benefit has been conferred can be practically challenging and onerous to compile. This is especially so where the benefits of the service provided are indirect (e.g. an activity that does not result in a directly identifiable increase in the MNE's revenue).

Our view is that there should be a presumption that benefits accrue to the MNE if external costs are incurred, and the critical follow-on question is to determine the party within the MNE that benefited from such services rendered. An explicit statement in the OECD TP Guidelines on this point would be helpful in focusing the efforts of the tax administrations and taxpayers on agreeing the party that received the benefit from such services rather than on whether there was a benefit.

Guidance on assessment of allocations

Taking into account the above, it would be helpful if the OECD TP Guidelines provided guidance on assessing the appropriateness of the allocation of services across entities within a MNE Group. This would facilitate easier conversations between the tax administrations and taxpayers – significantly reducing uncertainty for the taxpayers in preparing evidentiary documentation.

As is common with Transfer Pricing transactions, a globally aligned approach is critical, as disagreements between the tax administrations of the service provider and service recipient would likely result in double taxation.

A. Drawing a distinction between (i) activities that do not benefit the local affiliates; (ii) benefits that purely arise from group membership and those that arise from a deliberate concerted action; and (iii) shareholder activities and stewardship activities

The OECD TP Guidelines (Chapter VII, Paragraphs 7.9 – 7.10 and 7.12 – 7.13, and 7.14) outline the principles of shareholder activities, incidental benefits, and centralized services. The theoretical basis for the classification and treatment of such activities is broadly accepted, and further work should focus on the practical application of these principles.

Systematic handling of shareholder activities, incidental benefits, and centralized services

In particular, we would recommend specific guidance from the OECD on a structured step-by-step approach to systematically handle these considerations (shareholder activities, incidental benefits and centralized services), to avoid possible confusion in the application of these principles.

Uncertainty could be created in relation to:

- i. Financial reporting (as contrasted against a broader category of accounting activities) or audit support are referenced at both Paragraphs 7.10 and 7.14 of the OECD TP Guidelines Chapter VII. These paragraphs handle two separate concepts (Shareholder activities and Centralized services), with opposite conclusions on treatment.
- ii. Costs which are ancillary to the corporate governance of the MNE as a whole is provided as an example in Chapter VII, Paragraph 7.10 with no further explanation of

corporate governance. In dealing with both the parent and subsidiary entity, it is observed that strong corporate governance is likely a legal requirement in both the parent and subsidiary entity countries – hence the treatment of these costs is dependent on factual circumstances.

In considering the development of such a structured approach, consideration should be given to differences in the organisational or operating model of MNEs. As the structure of the MNE may greatly influence who, how and in what form services are performed, drawing the attention of tax administrations or taxpayers to this factor would broaden the applicability of the OECD guidance.

Allocation of costs which benefit the MNE Group

As mentioned in section A of this letter (which discussed the rendering and benefits of services), the focus should be on the extent to which the costs were allocated to a service recipient. This is implied given the conclusion that external costs would not be incurred on services unless these benefitted the Group.

B. Identifying in practice duplicated activities

Chapter VII, Paragraph 7.11 of the OECD TP Guidelines make reference to duplication of services – where a service provider is duplicating a service that the service recipient is already performing for itself (or is receiving from a third party).

As an overarching principle, as mentioned under section B of this letter (which discussed shareholder activities, incidental benefits, and centralized services), consideration should be given to differences in the organisational or operating model of MNEs. How services are performed within the organization, and the integration of services provided at the Global, Regional and Local levels are all factors which should be taken into account in deciding whether there are duplicative services.

Global headquarters, Regional headquarters and Local teams

Similar types of services provided by Global headquarters, Regional headquarters and Local teams can lead to confusion as to whether services are duplicated. The OECD TP Guidelines attempts to address this by requesting identification of the services in detail whilst simultaneously highlighting that certain regulated control functions may require functions to be performed at multiple levels and such requirements should not lead to disallowance on grounds of duplication.

Practically however, distinguishing the differences between the services provided (to demonstrate that there is no duplication) in an objectively evidenced manner can be onerous. This may require not only a description of the services themselves, but also the subtle differences between specific projects / outputs from the activity when provided by the Regional team vis-à-vis the Local team.

For example, if the activity relates to the provision of call centre services for credit card customers:

- i. Local call centre in the country may act as a contact point for customers pertaining to Level 1 issues (as defined by the materiality of the request – e.g. waiver of charges up to a certain amount); and
- ii. Customer may then be referred to the Regional call centre, the contact point for Level 2 issues (which may only be different in terms of quantum – e.g. waiver of charges of a higher amount).

In both these situations, the description of the services provided may be almost identical and obtaining details sufficient to distinguish these services may be administratively burdensome. Taking into account that many MNEs have a huge range of activities being performed, demonstrating that there is no duplication for each service can be extremely onerous.

We would welcome guidance from the OECD on the extent of evidence or validation required to be provided by taxpayers to give the tax administrations the comfort that intra-group services are not duplicative.

One possibility for the OECD's further deliberation is a simplified approach to addressing duplication. On the premise that a MNE is unlikely to incur additional external costs as a Group (i.e. fees to external service providers) by unnecessarily duplicating activities, if these costs are allocated appropriately within the Group, in most cases duplication should not be the prime consideration.

C. Finding an appropriate allocation key to recharge intra-group services

The OECD TP Guidelines have stated that allocation keys selected with respect to costs for each relevant category of services should reasonably reflect the level of benefit expected to be received by each recipient of the service.

However, for many types of services, it remains unclear how it can be objectively demonstrated to tax authorities that the allocation key selected reasonably reflects the level of benefit. Save in the rare cases where the services can be directly linked to a key metric (e.g. revenues) or an external quotation can be sought for the service, it can be practically challenging to produce compelling evidence of the appropriateness of an allocation key.

Additional guidance from the OECD including specific suggestions or examples of allocation keys common for various types of intra-group services would be welcomed. This could be further supplemented by a recommended systematic approach for the tax administrations to take into account when considering the appropriateness of allocation keys.

These steps would have the benefit of both reducing uncertainty between the tax administrations and taxpayers, and also increasing global alignment across tax administrations in relation to intra-group services.

D. Indirect taxation implications of intra-group services

In addition to the specific points raised by the OECD under this invitation for public comment, we also wanted to highlight for further consideration the indirect taxation implications of the OECD's intra-group services guidance. Where the tax administrations implement rules applying indirect taxation (e.g. VAT / GST) on intra-group services, including services provided between a parent and a branch, this may lead to a difference in the legal and tax treatment of such service charges.

We would welcome the OECD's consideration on this matter, and request comments around the wider implications of such indirect taxation rules when applied by the tax administrations in isolation.

We trust that the above comments are useful and will be taken into account in relation to this topic. Thank you.

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12 June 2018

Invitation for public comments – Scoping of the future revision of Chapter IV (administrative approaches) and Chapter VII (intra-group services) of the Transfer Pricing Guidelines

AstraZeneca welcomes the opportunity to comment on the proposed future revision of chapters IV and VII of the 2017 OECD Transfer Pricing Guidelines to enable tax authorities and multinationals to have greater clarity as to how to manage administrative issues and intra-group services.

General comments

Multinationals operate across a wide range of jurisdictions with different local direct tax and transfer pricing requirements and often differing interpretations of the OECD Transfer Pricing Guidelines. The differing approaches between tax administrations may result in tax disputes and double taxation for multinationals which is key concern for multinationals operating globally. Transfer Pricing Guidelines that can be clearly interpreted and applied are fundamentally important.

The Guidelines should reflect the economic reality of how multinationals operate, including specific industry characteristics, to allow them to be able to practically apply the Guidelines to their business model. This will enable tax authorities to act more consistently, providing greater certainty and transparency for both multinationals and tax authorities.

Our specific comments are as follows:

Chapter IV (administrative approaches) of the OECD Transfer Pricing Guidelines

Establishing administrative procedures that are consistently applied by tax authorities is important for multinationals to prevent and resolve transfer pricing disputes. In addition to the guidance set out in Chapter IV of the OECD Transfer Pricing Guidelines, we consider that there is scope for additional administrative guidelines.

We would welcome guidance on the International Compliance Assurance Programme ('ICAP') being included as an alternative mechanism for multinationals to minimise the risk of a transfer pricing dispute within Chapter IV of the OECD Transfer Pricing Guidelines.

The current guidance set out in the OECD ICAP Pilot handbook (working document) could be incorporated into Chapter IV once the pilot programme has been completed. Further guidance would be welcome as to how ICAP could be applied as an alternative to transfer pricing risk assessments and audits and how disagreements between tax administrations can be resolved.

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We would also welcome additional guidance in relation to transfer pricing compliance practices. As countries have adopted different approaches to the transfer pricing information that is required to be submitted with the tax return and adopted additional country specific requirements in respect of the local file and the master file, this causes considerable difficulty for a multinational operating globally to keep up to date with all the differing requirements and different deadlines. If there could be agreement as to what each country requires in terms of local file, master file and reporting, this would reduce the compliance burden on multinationals immensely.

Further guidance could be included in Chapter IV on the recommended approaches to prevent and resolve transfer pricing disputes. Currently, tax authorities may adopt differing approaches to assess a taxpayer's transfer pricing arrangements depending on the perceived risk and tax at stake. This often provides taxpayers with uncertainty as to the next steps to seek resolution. For example, guidance could be incorporated to recommend circumstances where a tax audit might be appropriate compared to a transfer pricing risk review or ICAP and to explain the consequences of each process.

The current guidance on APAs contained in Chapter IV of the Transfer Pricing Guidelines is comprehensive. The APA process itself could be strengthened to minimise transfer pricing disputes by the following:

- The APA process is currently a timely and costly process for multinationals. Practical guidance to improve the process to assist tax authorities to reach agreement with taxpayers sooner would be welcome.
- 4.148 of Chapter IV sets out that compliance with APAs will be monitored by most tax authorities over the course of the agreement. Further practical guidance on how taxpayers should document its compliance with an agreement would be helpful as this currently differs greatly from territory to territory.

Chapter VII (intra-group services) of the Transfer Pricing Guidelines

The current Chapter VII Guidelines on intra-group services do not provide clear guidance as to how they should be practically applied. The concern for multinationals is that tax administrations could take differing views on the practical application of the guidance on intra-group services. This causes uncertainty and the risk of double taxation, for example in the case where services are recharged and then denied a tax deduction in the recipient country.

We consider that further guidance on the practical application of Chapter VII would be helpful across the following areas:

- The current guidance on the benefits test in B.1.1 of chapter VII is difficult to apply as it is difficult to determine whether an independent enterprise would be willing to pay for (or perform itself) an intra-group service when compared to inter-group services performed by multinationals. Indeed, it is likely that the benefits test assessment would differ significantly from independent enterprise to independent enterprise as it would be driven by internal policies and economic needs. There is currently little explanation to assist multinationals to make this judgement and for tax authorities to practically assess and gain evidence that this test has been satisfied.
- The examples of shareholder costs in paragraph 7.10 could be expanded to provide a more comprehensive understanding of the intended meaning of the costs referred to in relation to each

shareholder activity. The practical application is complex to interpret. For example, in multinationals, it is likely that key members of the leadership team will support both shareholder activities and services. There is no guidance as to what might be a reasonable basis to apportion costs (e.g. time spent).

- Paragraph 7.11 of the Transfer Pricing Guidelines refers to services covering ‘many levels of activity’ when considering the identification of the duplication of costs. This by itself does not offer multinationals sufficient practical guidance as how to consider and reasonably assess the risk of duplication across a wide range of cost bases and services and further detailed guidance to determine a practical approach would be helpful.
- Paragraph 7.36 of the Transfer Pricing Guidelines suggests that the market value of intra-group services may not be greater than the costs incurred by the service provider. However, in practice this is subjective and difficult to support. Tax authorities are likely to form their own view based as to whether a mark-up is appropriate which may differ to the multinational and so further guidance would be helpful.
- It can be challenging to find an appropriate allocation key for the recharge of services intra-group. In an ideal world, it would be possible to charge all costs directly to the beneficiary. However, this is often not possible and therefore an indirect allocation key needs to be selected. However, indirect allocation keys can be difficult to determine and apply as the allocation might result in an allocation of costs that is disproportionate to the economic and risk profile of the entity. For example, using sales as an allocation key could cause a disproportionate amount of costs being allocated to a low risk distribution entity. A discussion of how to choose allocation keys would be beneficial.

Guidance for low value-adding intra-group services

Additional guidance is needed so that multinationals can make an informed decision as to whether to adopt the low value adding services guidelines.

Multinationals typically operate with a wide range of intercompany services often from global service centres or headquarters. This often will result in a large volume of cross-border transactions with a large cost base recharged from a handful of jurisdictions to a wider range of related party entities for efficiency and to avoid the duplication of services performed.

The services that qualify for the simplified approach are defined in the guidance under section D.1. Whilst the guidance provides examples of qualifying and non-qualifying activities, it is onerous for multinationals to determine the group of costs that qualify for this approach as both qualifying and non-qualifying activities may be commercially interlinked and financially recorded together. The multinational will need to review the cost base in detail to understand whether the costs fall into the simplified guidance or not.

Whether adopting the approach to low value-added services is an appropriate one for multinationals depends on the extent to which tax administrations implement the guidance. For example, if one tax authority adopts the approach and the corresponding tax authority does not, the other tax authority may not accept an unsupported mark up of 5% and may require a functional and economic analysis to support the transaction is arm’s length. This could result in uncertainty and double taxation.

Based on the above, a decision for multinationals to adopt the simplified approach under the current guidance brings with it uncertainty for multinationals. Further clarify on practical application and

consensus from tax authorities as to its application is required before it can become a realistic option for multinationals.

We look forward to participating in further discussions on the proposed revision work.

Yours faithfully



Catherine Harlow
Head of Transfer Pricing

Mexico City, 20 June 2018.

To: OECD Working Party No. 6 on the Taxation of Multinational Enterprises

Re: Invitation for Public Comments Chapter VII of the Transfer Pricing Guidelines on “Special Considerations for Intra-Group Services”

Regarding the invitation for public comments related to the revision of Chapter VII of the Transfer Pricing Guidelines (“TPG”) on “Special Considerations for Intra-Group Services”, we respectfully submit to Working Party No. 6 our comments regarding the practical implementation of the challenge of demonstrating that a service has been rendered. This document exclusively addresses the first portion of the first item of the Invitation for Public Comments which refers to “Demonstrating that a service has been rendered”. The remaining items open to public comments are not addressed by this document.

I. The purpose of the TPG, as expressed in their preface¹, is to provide a framework for the application of the arm’s length principle to evaluate the transfer pricing of associated enterprises, particularly, setting forth the manner in which the corresponding methods should be applied by both taxpayers and tax administration. In contrast, demonstrating that a specific transaction effectively took place is an analysis that should be done prior to determining the arm’s length consideration for such transaction and thus, we consider that it should not be addressed by the TPG.

If a specific transaction is considered not to have taken place, then no transfer pricing adjustment need be made; instead, the transaction’s corresponding tax consequences should simply be dismissed (e.g., the deduction disallowed), and this, by definition, is not an issue that should be addressed from

¹ 15. (...) The Guidelines are intended to help tax administrations (of both OECD member countries and non-member countries) and MNEs by indicating ways to find mutually satisfactory solutions to transfer pricing cases, thereby minimising conflict among tax administrations and between tax administrations and MNEs and avoiding costly litigation. The Guidelines analyse the methods for evaluating whether the conditions of commercial and financial relations within an MNE satisfy the arm’s length principle and discuss the practical application of those methods. (...)

a transfer pricing perspective, but by domestic evidentiary rules first (i.e., analysis) and then domestic tax audit procedural rules second (i.e., consequences and penalties).

II. We consider that demonstrating that a service has been rendered should not be part of the scope of the TPG framework. Demonstrating that a specific transaction did actually take place is a legal and evidentiary matter that tax administrations and domestic Courts should analyze based on the evidentiary rules – both statutory and created by case law – that include the burden of proof standards applicable to domestic proceedings, which vary considerably in each jurisdiction.

Consequently, if the TPG were to include specific guidance on how to verify whether a transaction has indeed taken place may overlap with specific domestic provisions that relate to evidentiary issues. This overlap may generate conflicts between statutory provisions or regulations and the proposed TPG.

Furthermore, in some jurisdictions, the TPG may be indirectly introduced as part of the domestic legislation², which may generate additional conflict with existing evidentiary rules, as the hierarchy and applicability of the TPG and the existing rules may not be clear. Should the proposed TPG guidelines on evidence be applied only to transfer pricing cases or to all cases? Should the proposed TPG guidelines shift the burden of proof if the domestic rules provide differently?

Therefore, the proposed guidance would not provide more certainty to taxpayers, but instead may generate uncertainty, which in turn opens the possibility for abuses by the tax administration.

III. The proposed guidance may have an adverse effect on transfer pricing audits. Tax administrations may improperly rely on the proposed guidance to challenge the existence of transactions, instead of making a transfer pricing adjustment. The proposed guidance may facilitate the work of tax administrations, as disallowing a deduction is much easier than carrying out a transfer pricing adjustment. This concern may be particularly relevant in jurisdictions where the tax administration does not have a specialized transfer pricing department or transfer pricing regulations have been recently introduced.

IV. By providing guidance on whether a service has been actually rendered, the TPG would necessarily cover the burden of proof rules. Chapter IV, Section B.2 of the TPG, referring to the determination of transfer pricing, recognizes the possibility that each jurisdiction determine where the burden of proof lies, as long as tax administrations are prepared to make a good faith showing that its determination of transfer pricing is consistent with the arm's length principle even where the burden of proof is on the taxpayer, and taxpayers are also prepared to make a good faith showing that their transfer pricing is consistent with the arm's length principle regardless of where the burden of proof lies³.

² Such is the case of Mexico, as the article 179 of the Income Tax Law remits to the TPG for guidance on how to interpret the limited existing provisions that regulate transfer pricing.

³ Please refer to 4.16 of the TPG.

V. We must also note that, in the case that the existence of a transaction is questioned, such controversy cannot be submitted to a MAP under Article 25 of the OECD Model Tax Convention, as such controversy would revolve around evidentiary issues. Although such a controversy may result in double taxation, it may not be submitted to one of the ideal means to resolve double taxation issues.

VI. In case the Working Party does not agree with the above recommendations, we recommend that the guidance introduced in the TPG regarding the analysis of whether a service was actually rendered should adequately protect taxpayers' rights. Therefore, the burden of proof must lie with the tax administration and not the taxpayer. Also, the proposed guidance should be based on the principle that taxpayers' activities are carried out in good faith and that questioning the existence of a transaction should only occur exceptionally and where lack of evidence of the transaction's existence is overwhelming.

The proposed TPG should be in line with the Commentary to paragraph 2 of Article 9 of the OECD Model Tax Convention, which states that in MAP proceedings, the State that has proposed the primary adjustment bears the burden of demonstrating to the other State that the adjustment is justified both in principle and as regards the amount.⁴

Therefore, the burden of proof regarding transfer pricing should lie with the tax authority. Otherwise, it may arise several conflicts about not only between tax administrations and taxpayers, but also among countries with different burden of proof standards.

* * * * *

Sincerely,

José Mario de la Garza Marroquín
Presidente de la Barra Mexicana, Colegio de Abogados

Luis Ignacio Vázquez Ruiz
Coordinador de la Comisión Fiscal de la Barra Mexicana, Colegio de Abogados

⁴ Please refer to 4.17 of the Commentary to paragraph 2 of Article 9 of the OECD Model Tax Convention.

June 20, 2018

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Re: Reply to OECD Request for Public Comments on the Scope of the Future Revision of Chapter VII of the Transfer Pricing Guidelines on Special Considerations for Intra-Group Services issued May 9, 2018

To whom it may concern,

We applaud once again the OECD for its commitment to the continued improvement of the Transfer Pricing Guidelines ("TPG"). This submission relates to Special Considerations for Intra-Group Services, in particular the Request for Public Comments on the Scope of the Future Revision of Chapter VII of the TPG. Pursuant to the OECD's request for input, please find attached our preliminary comments and suggestions.

Please do not hesitate to contact Sheena Bassani (s.bassani@barsalou.ca) or Sebastien Rheault (s.rheault@barsalou.ca) should the OECD desire further elaboration on these submissions or should the OECD desire presentation of these or other ideas in the ensuing public consultation meetings to be held in due course.

Sheena Bassani, Of Counsel
Member of the Quebec Bar Association

Sebastien Rheault, Partner
Member of the Quebec Bar Association

**Please take note that the attached comments have been submitted in the personal name of the undersigned and may not represent the views of Barsalou Lawson Rheault.*

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I. Introduction

We understand that the future revision of Chapter VII will seek to align the guidance with Chapter I in particular, but also Chapters VI and VIII, as well as considering whether and how to incorporate the ongoing work on the use of profit split methods and financial transactions. We also understand that Working Party 6 is focussing its efforts on the practical application of the guidance in Chapter VII, rather than addressing potential theoretical disagreements on the underlying principles.

Practical challenges already identified for further analysis include:

- Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient;
- Drawing a distinction between: (i) activities which do or do not benefit the local affiliates; (ii) benefits that purely arise from group membership and those that arise from a deliberate concerted action; and (iii) shareholder activities and stewardship activities;
- Identifying in practice duplicated activities;
- Finding an appropriate allocation key for charging intra-group services;
- Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises; and,
- Assessing the arm's length conditions for services provided in connection with the use of intangibles; services that are highly integrated with the value creation of the MNE group; and/or involve significant risks.

Of the above-listed practical challenges, the last appears to be of the greatest significance, and quite possibly the source of the more significant transfer pricing disputes. We address one aspect of this previously-identified practical challenge (see section II. A., below) and several new ones (see sections II B. to E.) in our comments below.

II. Our Comments

For purposes of informing this scoping exercise, we provide below a selection of targeted comments on how the guidance in Chapter VII could be revised or supplemented to address practical challenges to implementation of the TPG in the context of intra-group services. The purpose of this exercise is to ultimately increase tax certainty for taxpayers and prevent double taxation.

A. Aligning Profits with Value Creation: Remuneration of the Routine Service Provider

A particular challenge may be faced by some taxpayers who perform routine services but are charging unrelated customers directly for the totality of services and benefits conferred on those customers by the group, including non-routine services (highly integrated with the value creation of the group). In some cases, this may even involve the use of group intangibles, or the assumption of significant risks by other group members.

As an example, assume ParentCo is the entrepreneurial entity of a group that has developed the know-how to perform the significant functions involved in the main business operations of the group, including management of the significant risks of Foreign SubCo; on the other hand, Foreign SubCo executes certain functions considered routine in nature, and contracts with local customers, facilitating the provision of services by the group. This scenario can be of some practical difficulty as tax authorities may attempt to classify ParentCo as the service provider to be benchmarked, whereas the facts clearly show that ParentCo should be the residual profit earner. We therefore believe it would be useful to develop specific guidance or examples to address these types of situations.

Aspects of this have already been raised as a practical challenge to be addressed in the future revision of the TPG. We fully agree that it should be an area of focus of Working Party 6, and the above example is meant to demonstrate that the issue can be analysed from many different angles. We reiterate the importance of making the TPG clear in this respect, in order to effectively avoid double-taxation.

B. Government Incentives

Some intragroup services may be eligible for certain types of government incentives (subsidies, grants, refundable tax credits, non-refundable tax credits, etc.). Although Chapter I of the TPG provides broad guidance that such government assistance/intervention must be taken into account, the lack of detailed explanations has seemingly left this open to interpretation. In practice, some tax authorities, at least at the field audit stage, seek to impose non-arm's length conditions on the treatment of such government incentives, or to impose an unreasonable burden of proof on the taxpayer to provide specific evidence that arm's length parties would have reduced the cost to the purchaser of services by the relevant amount of government incentive.

We believe that it would be helpful to elaborate additional guidance to simplify the approach taken in considering the impact of these payments, particularly given that it may be very difficult in practice to find the type of evidence some tax authorities appear to seek before they are willing to accept that any of the benefit of the incentives be passed on to related parties.

Additional guidance could take the form of including an acknowledgement in the TPG of the relevant economic theories that would govern the most common situations, where it is simply not realistic to expect taxpayers to have access to comparable data.

For example, given that most public companies do not report significant tax credits, and those which do, are not obliged to disclose the level of tax credits netted against the corresponding costs, it may be

impossible to find reliable data from comparable companies to support the treatment of the tax credits. However, the economic theory of supply and demand, coupled with evidence that the tested party operates in a reasonably competitive market,¹ leads to the inevitable conclusion that the benefit of government assistance received by the service provider would be largely negotiated away in the form of lower pricing of the services. In other words, the government assistance is used as leverage to win or retain the contracts that keep the business operational, or to hire additional resources to perform more work. This is also consistent with the purpose of many tax credits, in industries or job sectors where price elasticity of demand is expected.

C. Simplified Approach for Low Value-Adding Services

On the face of it, par. 7.48 clearly establishes the principle that no inferences should be drawn about markups pertaining to activities not qualifying for the simplified approach. However, in practice we are now seeing tax authorities suggesting that services not qualifying as low value-adding services be remunerated above the 5% markup identified for low value-adding services. We would therefore suggest a further clarification to help demonstrate the point that is being made by par. 7.48 (see blue underlined text in the citation below):

7.48 The fact that an activity does not qualify for the simplified approach, as defined under paragraph 7.45, should not be interpreted to mean that that activity generates high returns. For example, in an application of the TNMM to services not qualifying for the simplified approach, a benchmark study may include comparable companies for which calculated markups are lower than 5%. The profitability of the comparable companies (including those earning less than a 5% markup), nevertheless remains the best indicator of arm's length remuneration for the benchmarked services, and no inferences should be drawn from the markup applicable under the simplified approach. The activity could still add low value, and the determination of the arm's length charge for such activity, if any, should be determined according to the guidance set out in paragraphs 7.1 to 7.42.

D. "Round-trip" Service Fees

Another practical challenge involves low-value adding service providers (Foreign SubCo)² receiving certain other routine services from the related party who is also the residual profit/loss earner (ParentCo) of the business. In such a case, the transactional approach would mitigate in favour of charging a fee from ParentCo to Foreign SubCo. However, since the latter is the least complex party and if its profits are tested pursuant to the TNMM, presumably any such service fee charged by ParentCo to Foreign SubCo will end up being charged back to ParentCo, either directly or indirectly. Arguably, it would also be unnecessary in such a case to markup that portion of the fee before Foreign SubCo charges it back to ParentCo. However, such "round-trip" charges are cumbersome and may have some

¹ For example, the government granting the tax credits may have published comments or other documents which reveal or imply that the tax credits are intended to help make the locally-residing companies more competitive globally; or perhaps the government was lobbied by companies who submitted papers demonstrating their need for the credits in order to compete for business.

² Limited risk distributors may also face a similar challenge.

unintended tax consequences in the jurisdiction of origin. It would be an area where Working Party 6 could perform additional work with a view to proposing practical solutions.

E. Indirect-Charge versus Direct-Charge Method

Par. 7.24 provides useful examples of when an indirect-charge method may be necessary. We propose the following addition to par. 7.24 (see blue underlined text in the citation below) in order to address another common example where the indirect-charge method may be necessary. In particular, where the time spent on providing services to one group member will be lesser as a result of having spent time on providing same or similar services to another group member, the indirect-charge method which considers total cost of providing that service, will more fairly allocate the costs amongst the various benefitting group members.³

7.24 In some cases, an indirect-charge method may be necessary due to the nature of the service being provided. One example is where the proportion of the value of the services rendered to the various relevant entities cannot be quantified except on an approximate or estimated basis. This problem may occur, for example, where sales promotion activities carried on centrally (e.g. at international fairs, in the international press, or through other centralised advertising campaigns) may affect the quantity of goods manufactured or sold by a number of affiliates. Another case is where a separate recording and analysis of the relevant services for each beneficiary would involve a burden of administrative work that would be disproportionately heavy in relation to the activities themselves. Another common example would be where time is initially spent developing financial and accounting tools for one entity, which then only require very brief customization for the additional entities intended to benefit from the tools; charging out cost of time spent using a direct charge method would disproportionately allocate most of the cost of those tools to the first entity whose data was integrated with the financial and accounting tools. However, arms length parties would presumably require an indirect approach, whereby total costs of developing the tools would be allocated amongst the parties who were intended to benefit. In such cases, the charge could be determined by reference to an allocation among all potential beneficiaries of the costs that cannot be allocated directly, i.e. costs that cannot be specifically assigned to the actual beneficiaries of the various services. To satisfy the arm's length principle, the allocation method chosen must lead to a result that is consistent with what comparable independent enterprises would have been prepared to accept.

III. Conclusion

Although not comprehensive, it is hoped that these targeted submissions will assist the OECD in their efforts to further refine the scoping exercise for future revisions to Chapter VII of the TPG.

³ Additional guidance could also be provided on how to approach this situation when the work spans over the course of two or more taxation years; the answer may simply be for the service provider to allocate costs incurred in each period to all the entities who will ultimately benefit from the project, based on the determined allocation key, with a true-up at project completion as required. It may also be relevant to provide additional guidance and considerations in the event that the expenses meet capitalization requirements.

The BEPS Monitoring Group

Submission on Revision of Chapter VII of the Transfer Pricing Guidelines on Special Considerations for Intra-Group Services

These comments have been prepared by the [BEPS Monitoring Group](#) (BMG). The BMG is a network of experts on various aspects of international tax, set up by a number of civil society organisations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam, and Tax Research UK. These comments have not been approved in advance by these organisations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives. They have been drafted by Sol Picciotto, with contributions and comments from Jeffery Kadet and Tommaso Faccio.

We appreciate the opportunity to provide these comments, and are happy for them to be published.

June 2018

GENERAL COMMENTS

Although the issue under consideration here seems a simple one, it raises problems which demonstrate the failure of the continuing adherence by many OECD members to a rigid interpretation of the arm's length principle (ALP). The OECD set out on this wrong path in 1995 with the adoption of the Transfer Pricing Guidelines (TPGs). They resulted from conflicts among OECD members due to the US adoption of the comparable profits method. OECD members agreed to include in the TPGs a version of this, the transactional net margin method (TNMM). They also included a new one, the profit split method (PSM). These methods were described as 'transactional', which is misleading. Regrettably, no further work was done on the PSM, which has remained a fall-back, generally used only after other methods have been applied. During the BEPS project only a scoping note for future work on the PSM was published. There have been two discussion drafts and consultations since 2015, and no final report on the PSM has yet been released. It seems that any agreed report on this will be of limited scope, due to these continued disagreements.

Rules on transfer pricing concern the allocation of profits of MNEs. This central aim was obscured when the 1995 TPGs became focused on the pricing of transactions. The mandate from the G20 for the BEPS project was to reform the rules to ensure that profits of multinational enterprises (MNEs) could be taxed 'where economic activities occur and value is created'. By failing to address this issue directly in the actions on transfer pricing, the OECD has clearly failed to meet this objective. This seems due to the continued reluctance among many specialists on transfer pricing to accept the need to agree objective criteria for apportionment

of profit. This need is even more urgent in today's digital world, where attempting to decide an appropriate allocation of profit by focusing on the pricing of transactions is simply fruitless.

This present consultation concerns attribution of costs, not profits. An integrated MNE by its nature engages in many activities which benefit the whole group, and hence entail joint or overhead costs. Yet it is clearly inconsistent to seek to adopt an approach which would apportion costs while profits continue to be attributed by transactional methods. This is especially so when the method used is a one-sided one (cost-plus, resale-minus, and the TNMM, which is the most commonly used). Since these methods attribute profits by reference to those of comparable independent enterprises, it is simply inappropriate to allow a further deduction of central service costs.

Indeed, this fundamental point applies more widely. The adoption of the functional analysis / transactional approach in the 1995 TPGs required all joint production functions to be treated not as costs to be charged, but as separate transfer transactions to be priced. This includes the main profit drivers of an MNE: capital, research and development (R&D), and risk-taking. MNEs exert centralised control over all these activities, and they benefit (or harm) the firm as a whole. Also, they entail largely non-physical activities, responsibility for which can easily be attributed to an entity located anywhere. This is recognised as the main source of BEPS. It cannot be adequately tackled while there is a continuing insistence on basing transfer pricing on functional analysis, treating all affiliates of a MNE as independent entities transacting with each other at arm's length.

There was an attempt during the BEPS project to depart from this approach, in Action 4 on the limitation of interest deductibility. The initial proposals, that the MNE's third party interest costs should be apportioned among affiliates, recognised the reality that the treasury function is highly centralised, and affiliates are often loaded up with debt to maximise interest deductions. We supported the apportionment approach, even in the absence of a similar treatment of profits, as the only practical way of dealing with excessive interest deductions, which are a major source of BEPS. In other areas, the continued insistence on functional analysis has meant that the BEPS project outcomes have made the TPGs far more complex and obscure.¹

Hence, we do not agree with the premise in the request for comments that the concern is only about the practical application of the guidance in chapter VII, and not the theoretical basis. Unless and until Working Party 6 faces up to the fundamental difficulties of the current interpretation of the ALP, none of the problems of transfer pricing will be resolved. This will no doubt be covered up by further revisions to the TPGs, using language which may be approved by consensus, but conceals continuing differences. This particularly disadvantages smaller countries which lack the resources to develop convincing technical arguments to justify a preferred interpretation. It also leaves smaller and middle-sized MNEs that might not have the resources to invest in comprehensive functional analyses at increased risk. Overall,

¹ This is shown in detail in the most authoritative account of the BEPS project outcomes on transfer pricing to date, by J. Andrus and R. Collier, *Transfer Pricing and the Arm's Length Principle After BEPS*, Oxford University Press, 2017. They trace in detail how the TPGs have been made more complex and unclear on the key points: (i) the notion of control of risk ('very complex', para. 6.35; 'most confusing' para. 7.32; imposing 'only limited burdens on MNEs desiring to transfer risk to tax advantaged locations' para. 7.13, and leaving 'clear potential for heated disagreement' para. 7.16); (ii) the returns which can be attributed to a cash-box entity ('quite mysterious' para. 6.46, 'most confusing' para. 7.32, will 'give rise to substantial amounts of controversy' para. 7.31, and leaving 'a rather confused muddle, at least for now' para. 7.42); and (iii) how to allocate the difference between projected and actual returns from an intangible ('far from clear, para. 7.56, 'manifestly inadequate' para. 7.58). They conclude that the result has been to make the transfer pricing process 'far more complex' (para. 7.70), mostly due to the 'level of factual detail' now required for the functional analysis (para. 7.71).

however, no-one (save the army of transfer pricing consultants) gains from the ad hoc and subjective rules resulting from the transactional approach to the TPGs, which foment confusion and conflict.

Tax advisers are as much to blame for this as the government representatives on WP 6. While business pleads for simpler rules to provide certainty, a large majority of tax advisers continue to defend fundamentalist interpretations of the ALP, which lead to increasingly confused and complex elaborations of the TPGs.

SPECIFIC COMMENTS

The present chapter VII is built on unsound foundations. It begins by using language referring to charging of costs, which seems to accept that these are joint costs or overheads to be apportioned. However, the discussion is based on the independent entity fiction, and attempts to identify the charge ‘which would have been made and accepted between independent enterprises in comparable circumstances’ (TPGs 2017, para. 7.19). Section B.2 dealing with determining the charge begins by suggesting that a direct charge method is preferable, but quickly accepts that this ‘may not always be appropriate’. This is hardly surprising, since it will be inherently impossible to identify a truly comparable price from an independent supplier for services which a MNE has decided should be performed internally. Hence, it suggests that ‘indirect charge methods’ should be allowed, in plain words ‘apportionment’. Yet the discussion of calculation of the compensation in Section B.2.3 reverts to pricing based on the transactional approach in chapters I, II and III of the Guidelines. The incoherence of the approach is starkly revealed in the discussion section B.2.3.2 of whether a profit element can be included. While it makes sense to apportion joint costs, the notion of adding a profit element adds to the confusion created by the transactional approach. To avoid both this incoherence and confusion, we strongly suggest that the profit element concept for these intra-group be completely eliminated from Chapter VII

In our view, it makes no sense to consider the allocation of costs separately from the method used to attribute profit. The most commonly used methods under the current approach are one-sided methods (cost plus, resale minus, or TNMM), since it is rarely possible to identify a true CUP. These methods are based on functional analysis, under which MNEs generally endeavour to characterise affiliates as limited risk’ producers or distributors. Where profits have been determined on such a basis, it does not seem appropriate to make charges to an affiliate deducting a proportion of costs incurred elsewhere from profits calculated on the basis of costs prior to such a deduction. Where an affiliate’s profits have been determined on such a basis, it is simply not appropriate to make any additional intra-group charges against that affiliate. We suggest that Chapter VII be amended to reflect this.

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June 20, 2018

SCOPING OF THE FUTURE REVISION OF CHAPTER VII (INTRA-GROUP SERVICES) OF THE TRANSFER PRICING GUIDELINES

Dear Colleagues,

Business at OECD (BIAC) is pleased to have the opportunity to comment on the OECD's public consultation document titled *Scoping of the Future Revision of Chapter VII (Intra-group Services) of the Transfer Pricing Guidelines* ("TPG") ("TPG Ch. VII Scoping Request") issued 09 May 2018. We welcome the opportunity and are confident that through the revision of Chapter VII, the OECD can help both tax administrations and taxpayers strike a balance between the practical application of the TPG and related tax objectives.

These issues are of particular and significant importance for the many multi-national enterprises ("MNEs") that have centralized intra-group service centers. In our members' experience, the effort in this area to support intra-group service payments on audit normally significantly exceeds the underlying risk or actual profit potential for the respective local jurisdiction, i.e., a lose/lose for both taxpayer and tax administration when viewed next to other uses of scarce resources.

In more a more detailed appendix attached, we provide comments on certain areas we believe could be helpfully addressed in the scoping exercise. Addressing these areas would, we believe, increase the efficiency and usefulness of the OECD's TPG. Our comments are organized into two sections – "General Comments" and "Detailed Comments" – with each section containing two main categories: "Practical Challenges" and "BEPS Actions 8-10." The appendix develops the general comments and themes below:

- The overarching goals for any changes to the TPG should be simplification and avoidance of double taxation. These objectives can be worked towards by outlining clear rules with explicit examples, while also providing safe harbours where possible to reduce time incurred and controversy between taxpayers and tax administrations.
- We strongly encourage that ambiguity be avoided. If possible, it is preferred to keep the current wording in place rather than introduce new grey areas from Base Erosion and Profit Shifting ("BEPS") measures or other ongoing work to which there is not yet clear guidance (i.e., Profit Splits and Financial Transactions). As such, when scoping potential changes, we

recommend that the OECD focus on areas in which there is an opportunity for clarifying existing guidance rather than diving into new concepts that are still under development.

- Consistency in application by all countries should be strongly encouraged by the OECD TPGs, regardless of whether the respective business is providing intra-group services or receiving the benefit of intra-group services. Inconsistency in approach is already troubling on an international level, and will often lead to double taxation. However, this can be even more problematic within a country as it makes the rules difficult to comply with and erodes trust between the tax administration and taxpayer.
- In scoping revised, practical guidance, we would strongly recommend that the OECD take into account changes in traditional documentation sources (e.g., a web conference versus in-person meetings). Further, we encourage any work on impacts of digitalisation on the business model (and the related services performed) be coordinated with, and subject to, the Task Force on the Digital Economy's ("TFDE") ongoing work.
- Allocation keys should be clear, simple, easy to manage, auditable and consistently applied. When that is the case it demonstrates that there is no concerted effort to artificially shift costs between entities. However, the allocation key's accuracy depends on the underlying circumstances. As such, when scoping changes around what makes an allocation key appropriate, the guidance should be clear that the key needs to be straightforward and consistently applied, but that guidance should also maintain flexibility and not mandate a one-size fits all approach.
- Not all jurisdictions have uniformly enacted the BEPS measures. We strongly believe that any BEPS-related guidance provided should remain in line with the principles outlined and agreed to in the BEPS process, and be accompanied by discouragement of divergence from these guidelines.

As the OECD is the pre-eminent standard setting organization for international taxation, we also encourage the OECD to involve other, non-member jurisdictions (e.g., Brazil, India, and China), as a part of the Inclusive Framework ("IF") in the scoping and drafting process to ensure true multilateral implementation and uniform adoption of the rules. Further, *Business at OECD* would welcome additional involvement in the developing and drafting of such rules once the parameters are scoped.

Sincerely,



Will Morris

Chair BIAC Tax Committee

Appendix

A: Introduction

1. We have split our comments into two areas. Each area is addressed first in section B (General Comments) and then in section C (Detailed Comments) of this Appendix.
2. The first category of comments, “Practical Challenges,” addresses the following topics listed in the TPG Ch. VII Scoping Request:
 - Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient;
 - Drawing a distinction between: (i) activities which do or do not benefit the local affiliates; (ii) benefits that purely arise from group membership and those that arise from a deliberate concerted action; and (iii) shareholder activities and stewardship activities;
 - Identifying in practice duplicated activities;
 - Finding an appropriate allocation key for charging intra-group services; and
 - Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises.
3. The second category of comments, “BEPS actions 8-10 alignments,” addresses the following topics listed in the TPG Ch. VII Scoping Request:
 - Aligning the (Chapter VII) guidance with Chapter I, in particular, but also Chapters VI and VIII, as well as considering whether and, if so how, to incorporate the ongoing work on the use of profit split methods and financial transactions; and
 - Assessing the arm’s length conditions for services provided in connection with the use of intangibles; services that are highly integrated with the value creation of the MNE group; and/or involve significant risks.

B: General Comments

Practical Challenges

4. Currently, many intra-group services are subject to intense scrutiny from some tax administrations. Many countries (both developing countries and existing OECD members) are increasingly challenging the deductibility of intra-group services charged by questioning the benefits arising from such services. Tax audits tend to focus on the documentation substantiating the benefits from the charge. In many cases, the quantity of documentation required (e.g., emails, presentations, policy documents, etc.) is disproportionately high when compared to the underlying risk and potential tax at issue. Further, this process often leads to prolonged controversy and potential double taxation (a clear violation of one of the main objectives of the OECD TPGs).
5. Prevention of double taxation should remain an objective of scoping and developing updated guidance on intra-group services. Guidance should seek to strike a reasonable balance between (1) ensuring a benefit was received by the local group company in question and (2) requesting the appropriate level of detail and respecting the deduction. Clear and practice guidance, including homogeneous documentation to be required, would be very useful to reduce controversy.

6. While scoping possible changes, options for simplified approaches should be studied and strongly encouraged for intra-group services, which represent a very limited portion of a MNE's intra-group transactions as well as for small and medium enterprises ("SMEs").
7. During this scoping review, specifically regarding whether a service has been rendered or whether a service is beneficial, the OECD should consider the current environment in which MNEs operate, which has increasing competition and significant pressure for cost reduction. MNEs generally would not incur an expense to provide a service, unless it is necessary and beneficial – as the return (i.e., tax benefit) would be less than the amount of the initial expense borne). Thus, in our view, there should be a general presumption that most intra-group services generate a certain benefit, and, from there, address the more appropriate question of whether the allocation of those costs between group entities is consistent and appropriate.
8. Another general theme of scoping these proposed changes should be consistency in approach by all countries. We strongly believe that any revised guidance should encourage local jurisdictions to maintain an unchanging approach to intra-group services – regardless of whether the entity is acquiring or providing services from/to related entities. If all jurisdictions follow a similar approach, it would provide additional certainty for taxpayers and also encourage investment by reducing the potential for double taxation.
9. Certain sections of the new TPG guidance on low value-adding intra-group services ("LVAIGS") could be used as a model when scoping guidance for services which are not purely supportive/non-core to the business, but nevertheless would reasonably require some kind of grouping/simplifications/etc.

BEPS Actions 8-10 Alignments

10. While alignments to the updated wording of other Chapters of the TPG are obviously needed and should be included within the scope of review, there is a clear risk that such alignments may drive more uncertainty and potential for double taxation issues, if they leave space for uncertainty and potentially contradictory interpretations.
11. Traditional transaction methods and the transactional net margin method ("TNMM") are likely to remain the only manageable methodologies in the vast majority of cases and very complex methods may often result in being too complex to design/manage to represent a reliable solution. The forthcoming project should review what methodologies may be available, but we would caution against the introduction of less tried measures that may introduce more uncertainty.

C: Detailed Comments

Practical Challenges

12. As mentioned above, intra-group services are subject to intense scrutiny. Many countries are increasingly challenging the deductibility of intra-group services charged by questioning the benefits arising from such services. The amount of documentation required is disproportionately high and often leads to a prolonged controversy process and double taxation.
13. In scoping and developing revised, practical guidance, we would strongly recommend that the Transfer Pricing Unit work with the TFDE on issues related to the continued digitalisation of business models and operations, with any substantive work done in coordination with the TFDE's efforts.

14. Further, intra-group services are often provided in ways that are no longer documented using traditional methods. Interactions between the service provider and the entity benefitting from the service tend to occur more and more frequently through web platforms, video conferencing, instant messaging, apps, etc. These internet platforms facilitate the combination of several, previously separate, transactions. For example, when a potential purchase is booked, it is very possible that the business's web platform will coordinate/perform various tasks and services required to conclude the transaction, which may be performed all over the globe by separate affiliates. These services may include credit checks, legal review, accounting/bookkeeping, payment processing, invoicing, etc.; however, the platform will not generate a documentary trail. The originating entity making the booking simply sees the transaction's process and status within the system and receives a charge for the internal services. This simple example is just one of many that demonstrate the difficulty of providing evidence when there's no longer a tangible audit trail in the digitalising world. It would be welcomed that these practical aspects be taken into account in the scoping of potential changes with future inclusion of practical guidance and examples.
15. The focus during audits is often on the quantity of documentation and not on the quality. While it's relatively easier to demonstrate if the services have been provided by the service provider and received by the user of services, our members' experience has been that during tax audits, the tax authorities often focus not on the provision of the service, but on whether a benefit has both been received and can be evidenced. Proportionality should be taken into consideration in these processes to avoid excessive administrative burden.
16. The forthcoming project should consider whether substantive changes to the existing concept of "benefit test" are required. During this review, it should be considered whether such standard should be replaced by something more akin to a "process test." In lieu of attempting to justify and measure the value of services, the focus could be shifted to the process of determining and charging for intra-group services (with a presumption that the respective services are reasonable). More specific guidelines may be developed, but a taxpayer could be considered to satisfy this new process test if:
 - A detailed procedure is followed to define the allocable cost pool, i.e., shareholder and duplicative costs are excluded from the pool and other identifiable costs are directly allocated and segregated;
 - Reasonable allocation keys are used to spread and allocate common costs;
 - Key personnel are interviewed every [3] years unless facts or circumstances change; and
 - Appropriate documentation is maintained to enable the tax authorities' review of the process, including, for example, a global intra-group services report, pricing studies, notes from interview/functional review, related contracts, etc.
17. Alternatively, if the OECD decides to retain the concept of benefits test, we recommend that it consider limiting its application (potentially through the application of a threshold) so such would only apply to low-value adding services where such represent a material amount of the total costs of the service recipient (e.g., greater than 10 percent). Similar to the note above, proportionality is important when analysing intra-group services to avoid excessive administrative burden for both taxpayers and tax administrations.
18. Moreover, the TPG should endorse that if the overall profitability (or loss) of the service recipient is tested using the TNMM (provided such is the most appropriate method) that the

intra-group services should also be assumed to be at arm's length and no further documentation should be required (as the overall level of return will already have been calculated under the arm's length principle).

19. The scoping of revised guidance on the key practical aspects (i.e., demonstrating that services have been rendered and their benefits; determining costs and allocation keys) should be guided by two fundamental principles stated in paragraph 7.2 of the TPG:
 - Nearly every MNE group must arrange for a wide scope of services to be available to its members, in particular administrative, technical, financial and commercial services.
 - It is not in the interest of an MNE group to incur cost unnecessarily, and it is in the interest of an MNE group to provide intra-group services efficiently.
20. We believe more work could be done and detailed direction could be provided on aggregation of services. Examples and guidance would be helpful in determining whether a set of activities should be viewed as, and/or priced as, a single service.
21. Further, the revised guidance should generally encourage simplified approaches. When costs are properly booked in the statutory records of the supplying entity and the nature of services is clearly useful to the group, there should be a strong presumption that all the related charges are deductible in the jurisdiction of the purchasing entity. Further, when the local affiliate does not have the respective resources needed to perform the service (e.g., no accounting department), there should not be a burden to prove such services were rendered/a benefit was received – which would simplify and reduce the number of services that would be subject to the detailed review.
22. In particular, as outlined at paragraph 8 of the general comments above, when scoping and making changes, commentary regarding consistency in approach by all countries would be welcomed. There are always two sides to a service transaction – the provider and recipient – and the provider should generally be entitled to the costs incurred, plus the corresponding return (if any) and such should be analysed consistently regardless of whether such services are received or performed in the respective jurisdiction.
23. When scoping guidance on how local benefits should be reasonably demonstrated (provided the existing TPG structure is retained), we would welcome additional examples and practical guidance. While the existing TPG includes certain examples on shareholder services, low-value adding services, etc., there is a need for adding more examples on shareholder services, duplicative services, defining the cost base, choice of allocation keys, etc. Many OECD Members (e.g., the U.S.) have detailed examples that could be leveraged in this process. Such examples will provide additional certainty and may facilitate a meaningful dialogue between the taxpayers and tax administrators during a tax audit. These examples may be placed as an appendix to the TPG, similar to the examples on the profit split method. The scope of further examples should include the following, among others:
 - Shareholder services (e.g., stewardship services)
 - Other services (e.g., duplicative services including examples of duplications and role of regional centres, services providing incidental benefits, treatment of pass-through costs, etc.)
24. Demonstrating the appropriateness of allocation keys may be challenging. One common example where this is the case is related to certain supportive activities, as there is often no

pragmatic way to verify or even quantify an increase in sales attributed to such supportive activities. In addition, there is often a time lag to be considered between the rendering of a service (costs that are allocated within the MNE today) and the intended effect (cost decrease or sales increase in the future). These factors can make it difficult to substantiate allocation keys and to connect a certain benefit to every individual charge incurred.

25. MNEs do not allocate costs strictly for tax purposes. They frequently also do so for financial statement and management reporting purposes, in order to most accurately evaluate the performance of their constituent business units. To this end, it is in a MNE's own non-tax business interest to have a proper allocation of costs for internal accounting purposes. The forthcoming project should explore whether, where a taxpayer follows the same cost allocation methodology for internal management and tax purposes, and follows such methodology consistently worldwide, its allocation should benefit from an administrative "thumb on the scale," such as a rebuttable presumption for reasonableness (e.g., in the context of allocating global management fees).
26. The example above shows the difficulties in connection with the documentation of benefit for single charges. For this reason, we would support a simplified benefits test applied in connection with low value-adding intra-group services as referenced in paragraph 7.60.
27. Distinguishing routine, low-value services versus high-value or services creating IP, remains a critical issue and should be included within the scope of the forthcoming project. Several jurisdictions are currently taking the position that routine R&D functions are creating significant value and/or IP locally, so it would be helpful to develop additional, practical guidance about services that should and should not be considered to create IP or unique value. Generally, additional examples would be welcomed in future guidance about (1) low-value services, (2) mid/high value services, and (3) services generating IP.
28. Section D of Chapter VII of the TPG provides specific guidance relating to LVAIGS. Within section D, paragraph 7.47 identifies activities that would not qualify for the simplified LVAIGS approach (paragraph 7.48 then usefully clarifies that the fact that an activity does not qualify for the simplified approach should not be interpreted to mean that that activity generates high returns).
29. However, the wording of paragraph 7.47 could be interpreted by some tax authorities as excluding simplifications. On the contrary, many types of services listed in paragraph 7.47 are typically provided to various (or all) entities within an MNE group and require some kind of grouping/simplifications/etc. to be manageable.
30. While it is understandable that a simplified profit mark-up can only apply to LVAIGS, it would be important to consider the development of guidance for services which are not purely supportive/non-core to the business, but nevertheless would benefit from clear guidance addressing pragmatic and realistic approaches to their charging mechanisms. In particular, useful elements could be derived from the following sub-sections of section D:
 - D.2.1: Benefit test
 - D.2.2: Determination of cost pool
 - D.2.3: Allocation of costs
 - D.3: Documentation and reporting.
31. Whether there is a need for exploring a safe harbour that would allow the recipient of intra-group services to deduct the cost up to a pre-determined threshold should also be considered

during this scoping review. One potential option (others should be considered and vetted as well during the process) would be a safe harbour threshold amount based on the percentage of total group cost that is charged to a local affiliate, considering the local affiliate's respective size to that of the global group. A safe harbour would avoid having to go through the process of demonstrating benefits from the services and could be developed to operate similar to the interest limitation rules or similar tests, and should ease the burden on both the taxpayer and tax administration.

32. To similarly avoid controversy, we recommend that the OECD consider allowing for the charging of costs, without any mark-up, for low value-adding intra-group services. This should result in a low-risk environment LVAIGS that would benefit tax administrations and taxpayers. Also, if not generally adopted, no mark-up scenarios should be considered for services in which the standard market practice is billing at cost (e.g., oil and gas sector).
33. Alternatively, if the OECD decides to retain the approach of having a mark-up, it should be clarified in the TPG that the safe harbour mark-up (5 percent) prescribed in the existing TPG (see paragraph 7.61) can coexist with country specific guidance on similar services even if they provide for no mark-up¹ or provide for a different mark-up² from that of the TPG's 5 percent guidance.
34. If such guidance is not provided, taxpayers may end up in a situation where a centralized service provider may charge a differing percentage mark-up, which may be challenged in the recipient jurisdiction if such is above the OECD prescribed range even though such is reasonable and consistency applied across all countries.
35. Some jurisdictions impose stringent exchange control requirements and other regulatory requirements. Although these requirements may apply to a broader spectrum of intercompany transactions, they can make it particularly challenging to charge affiliates in such jurisdictions for intra-group services. The forthcoming project should evaluate possible administrative measures and simplifications relevant to this context. Such measures might include, for example, rules under which, subject to specific conditions (e.g., reasonable efforts to comply with or secure an exception to the requirements), the service provider could deduct its costs of providing services but defer or avoid recognition of services income, given the inability to charge.
36. We agree that additional guidance is needed on how to determine the appropriate costs that should be included in the service provider's cost base for purposes of pricing and/or testing the pricing of the transaction. For example, commentary could be provided regarding whether stock-based compensation or third-party software costs for which the service provider is not charged by the MNE group parent should be included in such base?
37. The cost base of the services should also be reviewed when applying the Cost Plus Method or TNMM, as costs incurred rendering services in-house can be higher than those of outsourced activities and looking only at the mark-up added on total costs may lead to inaccurate comparisons.

¹ The U.S. and the Netherlands have rules for no mark-up on LVAIGS.

² Several other jurisdictions provide a set amount (e.g., Australia at 7.5 percent) or a range (e.g., Hungary and the Czech Republic at 3-7 percent) outside of the 5 percent recommended in paragraph 7.61 of the TPG. Some others (e.g., the U.K. and Singapore) follow the OECD's 5 percent recommendation.

BEPS actions 8-10 alignments

38. The revised guidance on risk and intangibles in relation with services could drive a higher risk of “double-counting,” i.e., tax authorities attributing a reward to risks and/or intangibles which are already separately remunerated as part of other intra-group transactions. When scoping potential changes or additions, it is important to address carefully the wording of the revised guidance to prevent such double counting.
39. When scoping and considering potential guidance, the most reliable solution may be a “residual” approach. In such a case, assuming that the TNMM is found to be the most appropriate method for assessing the arm’s length nature of the entity’s results, tax authorities should be discouraged from separately challenging the price specific intra-group services, provided the choice of the service recipient as tested party is appropriate under the facts and circumstances
40. The revised guidance should also encourage solutions which are both practical and less exposed to extreme interpretations. We developed a simple example of intra-group advertising services (an activity quite common to many MNE groups) to illustrate this issue:

Group A sells consumer goods for which advertising represents a significant value driver, although impossible to value with exact precision. Each local subsidiary has a small team dedicated to advertising activities (although most of the budget is spent with independent service providers providing both services of buying advertising space and creative services). Other subsidiaries perform a coordination activity for neighbour countries with a small dedicated “regional” team. Lastly, the corporate headquarter has a team dedicated to developing global strategies and global campaigns.

Even in this relatively simple scenario, the new guidance on BEPS actions 8-10 alignments could drive significant uncertainties, if not carefully and clearly worded. Tax authorities in the headquarter country and in the countries performing regional coordination activities will believe that a significant return should be attributed to the activities performed (and risks controlled) in their country. At the other-end, tax authorities in the local jurisdiction will require a return for the local activities.

41. The example above also raises an ancillary question that should be an area for additional guidance in the forthcoming project – i.e., whether activities are duplicated because they are of the same nature (i.e., marketing). In the example above, such services are not duplicated and a distinction can be drawn based upon the differences in scope, risk, and objectives pursued.
42. Lastly, it would be helpful if the revised guidance address practical examples like the one described above. In such a case, in our view, the transfer pricing method should be based on external comparables (if available). In this respect, it would be important to stress the weaknesses of complex methodologies outside traditional approaches. For example, in a case like this, the use of a profit split approach would potentially result in a high level of complication and uncertainties and likely isn’t proper based upon the risks and functions at play (considering the constraints on the local operating subsidiary and the fact a large portion of the budget is outsourced).

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To:

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Milan, 19 June 2018

Public comments on the scope of the future revision of Chapter VII of the Transfer Pricing Guidelines on Special Considerations for Intra-Group Services

Dear Sirs,

Borioli & Colombo Associati, an Italian law firm of the BKR International network, greatly appreciate the work undertaken by the OECD in the revision of the transfer pricing guidance following the BEPS project.

In this respect, we provide hereinafter our observations on the scoping of the future revision of Chapter VII of the OECD Transfer Pricing Guidelines. In such effort we are going to focus on

what we are seeing as the main issues stemming from the definition of intra group services, as both commentaries and authors have since long pointed out¹:

- a. Evidence of the provision of the service
- b. Arm's length price of services provided and criteria for its determination
- c. Low value adding intra group services

a. Evidence of the provision of the service

The benefit test

The first issues TPGs deal with relate to the determination of whether the services have been effectively rendered and the criterium adopted for this verification is the provision of economic or commercial value to enhance or maintain the business position of the group member entity. According to the TPGs, this effect can be determined by considering whether an independent enterprise in comparable circumstances would have been willing to pay for that activity if performed for it by an independent enterprise or would have performed the activity in-house for itself.

Even if the TPGs recognize that such an analysis quite clearly depends on the actual facts and circumstances, and it is not possible in the abstract to set forth categorically the activities that do or do not constitute the rendering of intragroup services, some guidance should nonetheless be identified for avoiding (or, at least, reducing) tax assessment risks and it should probably be more significant and effective than the only “willing-to pay” test as stated at par. 7.6. In fact, under a certain point of view, some intra group services or costs find their origin only in the entity's membership in the MNE as far as it is such membership that makes the services more complicated or at least more problematic to be rendered or received because of the greater and greater presence of mutual interest of the parties, their economic integration and their functional amalgamation.

For example, in case the Group headquarter decides that all the local entities should adopt the same IT infrastructure or marketing strategy, exploiting some specific group intangibles (marks, tradenames or know how) it may happen that an independent party could be hardly available or willing to pay for such shared infrastructure or intangibles. Notwithstanding such attitude an enhanced business position may be gained because of the effects of the group synergies, e.g. because of economies of scale indirectly determined by a unitary technological platform or marketing policy.

¹ All references to “paragraphs” are made to the paragraph of the 2017 version of the OECD Transfer Pricing Guidelines for Multinationals.

Under such circumstances, differences between group synergies (dealt with at par. 1.157) and incidental benefits (dealt with at par. 7.12) and their reciprocal effects should be deeper analysed together with the concept itself of “shareholder’s activity”, as recent court cases have shown².

The great frailty of the “willing-to-pay” test seems basically due to the evidence that the amount to pay could reasonably be positioned only at the “cost of production” level a third independent party not being available to pay more than this. Centralization of costs in a group service provider should have economic sense just on this perspective of reducing costs and increasing efficiency while a transfer pricing analysis of intra-group services should be considered from *both* the perspectives of the service-provider and the associated enterprise receiving the services, even if the TPGs give explicitly preference to the MNE as a whole, at least for low value-added services (par. 7.51).

This being the case, the problem becomes to identify more objective conditions to recognize the benefit a group entity is obtaining when sharing services from the unique group service centre³. In fact, Tax authority of the service provider will seek to ensure that if chargeable intra-group services have been provided, the associated enterprise benefitting from the service is paying an arm’s length price comprehensive of an appropriate mark-up on cost for such services while Tax authority of the recipient will be seeking to ensure that the services satisfy the benefit test and that the recipient was being charged arm’s length prices for the intra-group services.

As any other issue relative to intra group transactions the effectiveness and arm’s length price of the provision of such services should be supported by sound functional analysis and profit and loss evidence of their necessity for the business scope and by material evidence of the provision itself.

² See, e.g., the different evaluation on the role of shareholder’s financial assistance in case of guarantee fees made by the Canadian Federal Court of Appeal and the Court of Justice of the European Union (CJEU).

In *Canada v. General Electric Capital Canada Inc.*, 2010 FCA 344 (*CanLII*), the Court maintains that the guarantee fees paid by GE Canada to GE Capital US does not exceed the amount which a person dealing at arm’s length person would have paid in similar circumstances”: *The [Crown] submits that the [GE]’s credit rating would be equalized with that of GECUS by reason of affiliation in the absence of a guarantee arrangement. On this theory, the [Crown] claims that the [GE] could have borrowed the same amount of money at the same interest rate without an explicit guarantee as it did with such a guarantee. As a result, the [respondent] did not receive an economic benefit from the guarantee. In this case, the arm’s length price for the guarantee is nil. The guarantee arrangement was simply a clearer indication of the implicit support that already existed in favour of the [GE]”* (par. 17).

Differently, CJEU in case C-382/16 *Hornbach-Baumarkt* according that stated that “*there may be a commercial justification by virtue of the fact that Hornbach-Baumarkt AG is a shareholder in the foreign group companies, which would justify the conclusion of the transaction at issue in the main proceedings under terms that deviated from arm’s-length terms. Since the continuation and expansion of the business operations of those foreign companies was contingent, due to a lack of sufficient equity capital, upon a provision of capital, the gratuitous granting of comfort letters containing a guarantee statement, even though companies independent from one another would have agreed on remuneration for such guarantees, could be explained by the economic interest of Hornbach-Baumarkt AG itself in the financial success of the foreign group companies, in which it participates through the distribution of profits, as well as by a certain responsibility of the applicant in the main proceedings, as a shareholder, in the financing of those companies*” (par. 56).

³ According to European Union Joint Transfer Pricing Forum (EU JTPF) report of the meeting of 4th February 2010, at par. 27, it is stated that “*It is not always possible to provide incontrovertible evidence that links a particular associate to the benefit derived from a particular service. A reasonable interpretation should be made of available evidence supported by any MNE representations. The principle that all costs are allocable should be remembered and therefore if a service cost is not felt to be attributable to one particular associate it must be allocated to another subject to the respective domestic law which may not allow a full deduction of those costs*”.

The shareholder activity

As a consequence of the “benefit test” approach the issue arises about certain intra-group service activities providing a benefit only to the parent company, the so called “shareholder activities”. Such activities, therefore, should fail the benefit test for the subsidiaries that are not allowed to deduct the relative cost if reversed on them. But sometimes it may be difficult to distinguish such intra-group service activities provided to benefit only the parent company (see footnote 1). The effect is that the benefit test for the cost charged to subsidiaries risks to fail its objective.

Even if such activities are exemplified in the TPGs⁴ quite often disputes arise because of the opposite views taken by Tax Administrations on these costs, their exact nature and amount. Moreover, some overlapping could also be found in respect of these and other “similar” costs giving rise to a “duplication” of costs being the latter the “*service that another group member is performing for itself, or that is being performed for such other group member by a third party*” (par. 7.11).

The previous analysis is to be read also with reference to the “Centralised services” at par. 7.14 because while the list at the paragraph is quite exhaustive many of those services could overlap with activities performed in-house by the single entity giving rise to another risk of duplication. The point at stake with all these different hypotheses is that that “benefit” risks to become partly unidentifiable. In fact, because a benefit obtained by a group entity when a service is provided by a central service provider be characterized as such, it must be direct, effective and not incidental. In all the previous cases a Tax Administration could reasonably doubt that the costs paid by the local entity respond to such characteristics. The consequence of this situation is that the cost will be disregarded and considered not deductible.

In connection with the above, some more guidance and considerations should be inserted even in the form of examples.

b. Arm’s length price of services provided and criteria for its determination

Zero-profit service provider centre

TPGs analyse quite extensively the issue of determining whether the amount of the charge, if any, is in accordance with the arm’s length principle at section B.2 of chapter VII. Reference is made to direct and indirect methods. The direct charging method is generally held as appropriate when the provision of services are readily identifiable, which makes it possible for the provider to charge the recipient for every specific service it provides while the indirect charging method is regarded as a second hand choice and should be used when direct charging is not possible. In any case, the method to be used to determine arm’s length transfer pricing for intra-group services should be determined according to the general guidance of TPGs Chapters I, II, and III.

⁴ Exemplification is contained also in the *United Nations Transfer Pricing Manual* (2017), par. B.4.2.14 and in Annex II of the EU JTPF) report of the meeting of 4th February 2010.

In this context, a first somewhat contradictory element that should be kept in mind is that the group choice for providing services internally through a service provider centre is normally based on a cost saving evaluation and more tailored solutions which may, and normally as well, contrast to a profit-making approach of a third party provider. Differently said, application of the arm's length principle fails to capture the effective nature of the transaction. The TPGs show to be aware of this situation when they state that *"it need not always be the case that an arm's length price will result in a profit for an associated enterprise that is performing an intra-group service"* (par. 7.35).

Notwithstanding these considerations, conflicts between Tax Administrations and taxpayers continue to arise because of the different classification of the services actually provided and the divergent assumption on the market price evaluations for the services provided.

Moreover, internal service providing centres find their justification in the group framework with the typical purpose of reducing costs. Consequently, to adopt a pure separate entity approach and a profit mark-up remuneration could give rise to some paradoxical results just because this approach is basically the opposite to the one inspiring such service provision.

Some deeper guidance on these issues could be released maybe explicitly admitting the possibility of a zero-profit service provider centre, on the condition that duly documentation is submitted. In fact, under certain conditions the multinational enterprise may evaluate the "benefit" it obtains from a certain organizational structure for its internal service provision under a different perspective than the simplistic "willing to pay" approach (and the corresponding "willing to gain" hope). Actually, par 7.35 already makes it clear that *"the issue may arise whether it is necessary that the charge be such that it results in a profit for the service provider"* even if, in a "normal" arm's length transaction, an independent enterprise normally would seek to charge for services in such a way as to generate profit, rather than providing the services merely at cost. Occasionally also some Courts have dealt with such issues admitting that the "benefit test" should not always be viewed in terms of mere profitability as *"there are numerous non-monetary factors which a businessman considers while doing business"*⁵.

⁵ Cfr. The Indian Income-tax Appellate Tribunal of the Delhi bench in Knorr-Bermeresse India P. Limited v. ACIT 2015-TII-51-HC-P&H-TP, according to which the Revenue could not decide what was necessary for a taxpayer and what was not. The requirement of services should have been judged from the view point of the taxpayer as a businessman.

With almost the same words, see the Italian Court of Cassazione, sec. V, n. 21405/217 according to which, *if the enterprises not allowed to erode its own taxable basis by using a disproportionate cost, on the otherhand the Revenue Agency could not challenge the substance and the convenience of entrepreneurial choices. In other words, the challenge on the need for a certain business strategy cannot ground by itself an alleged tax deficiency.*

In this regard, one of the problems that often arises is the fact that all the preliminary business analyses are obviously performed *ex ante*⁶, but the assessment of the profitability of the service provider comes *ex post*. In these cases, necessary attention should be put on the contractual agreement and the economic constraints upon the provider, in particular giving due emphasis not only to the functions performed but also, and probably largely, on the (entrepreneurial) risks assumed. In fact, in case of intra-group services provision these risks are quite often transferred to the “owner” of the business model so justifying a (very) low *ex ante* attribution of profit.

A possible option is to expand the reasoning at par. 7.37 that already states that “*it should not be overlooked that there may be practical reasons why a tax Administration in its discretion exceptionally might be willing to forgo computing and taxing an arm’s length price from the performance of services in some cases, as distinct from allowing a taxpayer in appropriate circumstances to merely allocate the costs of providing those services*” (emphasis added). Essentially, the point may quite often be that the “*practical reasons*” are simply economic and business reasons and, as a consequence, the profit requirement in the service provision should be relinquished not “*exceptionally*” but “*normally*” because of the existence of such economic conditions. Of course, detailed documentation must be made available to Tax authorities to justify such economic and business decision.

c. Low value adding intra group services

The “simplified approach”

As regards “*Low value adding intra group services*” the first observation we think should be made is to make more evident that the “simplified approach” of Section D, Chapter VII, is a mere option to the MNE. In fact, even if the last sentence of par. 7.43 states plainly that “*MNE groups not electing to apply the simplified approach set out in this section should address transfer pricing issues related to low-value-adding services under the provisions*” of the previous sections of the Chapter VII, it may be observed that the 5% mark-up of par. 7.61 has often become a sort of mandatory benchmark for “simplifying” the assessment by Tax authorities instead of the MNE’s.

Consequently, disputes arise if in the particular case the MNE adopts the “ordinary” approach of estimating an arm’s length remuneration for the services provided by a group service centre on the basis of facts and circumstances relative to the group itself.

⁶ In fact, it is common experience that price setting is often based on budget items.

Definition of “Low value adding intra group services”

It is a common experience that this sort of services is one of the most scrutinized category of intercompany transactions by Tax authorities. Consequently, it is very supportive to have some guidance in the TPGS that give the definition of “*Low value adding intra group services*” at par. 7.45 stating that they:

- *are of a supportive nature,*
- *are not part of the core business of the MNE group (i.e. not creating the profit-earning activities or contributing to economically significant activities of the MNE group),*
- *do not require the use of unique and valuable intangibles and do not lead to the creation of unique and valuable intangibles, and*
- *do not involve the assumption or control of substantial or significant risk by the service provider and do not give rise to the creation of significant risk for the service provider,*

and giving some more detailed exemplifications at par. 7.49.

Notwithstanding this guidance, the exact perimeter of these “supportive functions” cannot be considered sufficiently clearly defined even considering the exclusion of the “non-core business activities” and some examples are given at par. 7.49.

Admittedly, starting from the previous definition of such services as provided at par. 7.45 (their supportive nature, not being part of the core business of the MNE, not requiring the use of unique and valuable intangibles and not involving the assumption or control of substantial or significant risk) if a comparability analysis as defined at par. 1.33 were run it would present a very logical drawback. In fact, these services are provided internally from a group service provider just because this option is more efficient both functionally and economically than to have recourse to external providers. The obvious implication is that finding a controlled transaction with the “*conditions that would have been made had the parties been independent*” is quite hard if not impossible because justification of this choice is to be traced back in the existence of the multinational group itself.

Consequently, the same service can be called as a supportive rather than a core business practice depending on the economic facts and circumstances of each single MNE situation, always being coherent with its business model actually adopted. For instance, the same IT services may be merely supporting the conduct of core business (e.g. email systems) or be the core business service of an IT company developing proprietary software tools.

Pooling of relevant costs and allocation keys

The point of this issue is that pooling the costs relevant to the application of such approach may give rise to some uncertainty. In fact, notwithstanding the adoption of a documentation set as the one proposed at par. 7.64, the appropriateness of the choice of including a service in the pool may be reasonably challenged by Tax authorities so frustrating and discouraging this approach. If according to par. 7.56 it is for the MNE to pool “*all costs incurred by all members of the group in performing each category of low value-adding intra-group services*”, both direct and indirect, such a determination would hardly be accepted by Tax authorities without an assessment is made or an effective global exchange of information mechanism is at disposal. In

fact, the provision that the costs of “*all*” members of the group must be accounted for in the calculation evidently appears somewhat too pretentious.

At this regard, the problem of a common criteria for evaluating these services should be adopted notwithstanding, for example, differences in the local accounting or tax rules. Very practical problems may emerge when you operate such a pooling, estimating the degree of ancillary contribution to the entity of group value chain of an asset or the kind of risk assumed by a provider of the same or *similar* service in different jurisdiction.

Further, depending on the side of the transaction (i.e, if the assessed entity/tested party is the service provider or the service receiver) also the extension of the perimeter of the pooled services may suffer criticisms. In fact, for what aforesaid an entity might consider a service provision as ancillary while another with a different core business cannot make the same choice.

Consequently, because the “simplified approach” should aim at simplifying administrative costs of MNEs, scope of par. 7.64 should be enlarged as to provide an effective “safe harbour effect” for the ones who decide to adopt it⁷, while granting at the same time some room for Tax Administrations to challenge the taxpayer’s analysis. Envisaging a sort of *simplified* functional analysis giving reason of the choices made by the group entities could be a “second best” (or the only) compromise possible.

The profit 5% mark-up

The choice for the adoption of a fixed profit mark-up for low value-added services, instead of a range of values, was aimed at representing a good element of certainty to be relied on for business planning activities and for Tax Administrations when assessing an MNE business model and its value chain remuneration system⁸.

Nonetheless, under a different perspective, this choice might be considered as a limitation because of the greater relevance that some of these services are assuming (e.g., drafting contracts and judicial litigation, arbitration panels, administrative procedures for international operations; verifying authenticity and reliability of accounting records, and assistance in the preparation of budgets, maintenance of accounting records and preparation of financial statements with regards to the all foreign entities of the group) and because of the technological evolution (e.g., processing and management of accounts receivable and accounts payable, compilation of customer or client billing information, credit control checking and processing; installing, maintaining and updating IT systems used in the business; information system support IT helpdesk, implementing and maintaining of IT security systems; supporting, maintaining and supervising of IT networks).

⁷ This issue is considered relevant also by the European Union Joint Transfer Pricing Forum. See the JTPF report of the meeting of 4th February 2010, at par. 29: “*An area that commonly gives cause for concern is the quantitative and qualitative content of a cost pool*”.

⁸ In Italy, this approach has been recently fully endorsed by the Ministerial Decree 14 May 2018 giving official guidance on transfer pricing issues.

In the first case, some kind of services such as IT, finance or tax are increasingly being seen as integral to the operations of any MNE and owing to their relevance and growing complexity, both for the risks they entail and for their economic value, it could be hard to continue defining them as low value-added services, at least in certain conditions, with the consequence of making the 5% fixed profit mark-up not at arm's length.

In the second one, the evolution of digital services and devices entails simplification, reduction of cost, more routinely activities in providing these services, with the same result of making the 5% mark-up no more an arm's length rate.

Even though these issues have been largely debated in the 2015 OECD public consultation on BEPS Action 10 proposal for modifications to chapter VII TPGs, recent experience is showing that the simplification hoped for has not always been reached because of uncertainties on the effective nature, boundaries and characterization of such services.

A possible solution could be the introduction of a sort of "elastic safeguarding clause" admitting a range of tolerance around the 5% rate (e.g., +/- 25%). Of course, even this solution is hardly able to overcome all the difficulties epitomised previously, also because Tax Administration will quite reasonably be "tempted" to get the position more favourable to itself (and more unfavourable to the taxpayer), it echoes the same methodological answer adopted for the "ordinary" comparability analysis at par. 3.60 where it is stated that "*If the relevant condition of the controlled transaction (e.g. price or margin) is within the arm's length range, no adjustment should be made*". Introducing the "safeguarding clause" and a reference to par. 3.60 could represent an improved and more realistic compromise.

* * * * *

Best regards,

Borioli & Colombo Associati
p. il Team Transfer Pricing
Giorgio Borioli



20 June 2018

By email: TransferPricing@oecd.org

Tax Treaties, Transfer Pricing and Financial Transactions Division
Centre for Tax Policy and Administration
The Organisation of Economic Cooperation and Development
By email

The Capital Markets Tax Committee of Asia – Transfer Pricing Sub-Committee’s Submission with regard to Scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines

Dear Sir/Madam

The Capital Markets Tax Committee of Asia¹ (“We” or “CMTC”) – Transfer Pricing Sub-Committee refer to the invitation for public comments by the OECD on revising the guidance in Chapter VII of the OECD Transfer Pricing Guidelines (“TPG”), “Special Considerations for Intra-Group Services” and enclose our submission regarding our views and comments on the TPG (“Enclosed Submission”).

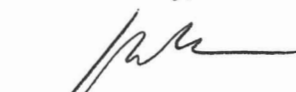
CMTC is a financial services industry body consisting of 42 financial institutions operating in Asia who are represented through their regional tax directors. CMTC’s membership comprises major commercial banks, investments banks, securities houses, insurance companies and asset managers with a presence in Asia

We welcome the opportunity to submit our comments on the TPG and appreciate the OECD’s effort in addressing the practical challenges that are faced by tax administrations and taxpayers in applying the guidance in Chapter VII of the TPG.

In addition to providing our views on the specific issues related to the practical challenges on Chapter VII of the TPG (in particular within the Asia-Pacific region), we would also recommend that additional guidance be provided to minimize uncertainties and interpretational conflicts amongst taxpayers and the tax administrations.

Should you have any questions about this submission, please do not hesitate to contact Ms. Suet Ping Liu / Mr. Sachin Agarwal, representative of the Capital Markets Tax Committee of Asia – Transfer Pricing Sub-Committee, at +852 3413 4337 / +852 3604 3311 respectively.

Yours faithfully,



Ms. Suet Ping Fan

Chair person, Capital Markets Tax Committee of Asia

Enc.

¹ Refer to Appendix 1 for the list of members of The Capital Markets Tax Committee of Asia.

The Capital Markets Tax Committee of Asia – Transfer Pricing Sub-Committee’s Submission with regard to Scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines (the “TPG”)

1. Executive summary

The Capital Markets Tax Committee of Asia (“We” or “CMTC”) – Transfer Pricing Sub-Committee welcome the opportunity to submit our comments on the TPG and appreciate the OECD’s effort in addressing the practical challenges that are faced by tax administrations and taxpayers in applying the guidance in Chapter VII of the TPG.

In response, we have set out our key observations and suggestions below with detailed comments contained within Section 2:

Observations

- In some cases within the Asia-Pacific region, for multinational enterprises (“MNEs”) in the financial services sector, the local regulators (“Regulators”) are the first to question intra-group services charges. For example, in Malaysia, Bank Negara recently issued final circulars on standards on Intercompany Charges Paid to Foreign Shareholders / Related Entities. These set out specifications requiring External Auditors to carry out specific assessments in relation to Intercompany Charges Paid to Foreign Shareholders / Related Entities by Financial Institutions.

The focus of Regulators while reviewing intra-group service charges is on the profitability and general concerns around the nature of intra-group services and corporate governance. In relation to profitability, Regulators tend to challenge intra-group services charges for entities that have low profitability or are loss-making, despite the macro or business factors that could lead to such profitability or loss. In some cases, the local Regulators have restricted intra-group services charges purely due to the reason that the MNE does not have “adequate profitability”. In other instances, Regulators within the Asia-Pacific region (such as Malaysia and Indonesia) have taken a view to restrict intra-group services if they relate to general management or oversight functions or for services that are seen to breach the independence of local entities. For taxpayers, as there is no recourse or action that can be taken, this often leads to taxpayers facing risks of double taxation and causes distortions in Transfer Pricing Documentation specifically Country by Country Reports and Local Files.

- Given the complexity and variety of related party transactions within the financial services sector, there is also a tendency for tax administrations within the Asia-Pacific region to heavily focus on intra-group services for tax audits. These tax audits tend to be time-consuming due to a lack of prescriptive guidance on evidence required to support the deductibility of intra-group services charges. For example there have been situations where, tax administrations have requested contemporaneous proof of services rendered and benefits (emails, evidence of participation in meetings, meeting memos etc.) which are over and above the transfer pricing documentation requirements. These documents may not be readily available or relevant personnel may no longer be employees of the company and as a result it becomes onerous and inefficient for the taxpayer to trace the evidence. As such, the administrative burden in providing evidence and continuing with the process of dispute resolution (which may take up to 4-5 years) in many cases outweighs a taxpayer’s potential legitimate reduction of tax leakage on transfer pricing adjustments, leaving the taxpayer with a resource and cost decision to make. Ultimately, this may result in taxpayers having no practical choice but to give up their deduction claims, even though services were provided by associated service providers in substance, and benefits were realized by the taxpayers, thus diminishing the arm’s length standard.
- It is key to note that improving the guidance in Chapter VII of the TPG while helpful may not be sufficient to reduce the incidence of, and administrative burden of tax audits on what is essentially a

relatively routine matter. Moreover, given that existing dispute resolution mechanisms may not be practical or cost-efficient for such cases, we suggest the OECD consider other steps to achieve global consistency, which would benefit not only taxpayers, but also tax administrations who would be able to redirect resources to other priorities.

Suggestions

Based on these observations, we suggest that the OECD incorporate the following:

1. Modify or further clarify the TPG. Specifically:
 - a) The TPG should acknowledge and make explicit that there should be a presumption that any activity performed by a MNE is seen as contributing to value generation or value protection, i.e. the presumption has to be that if a MNE decides to perform an activity, this activity has some kind of commercial benefit, as the MNE will incur cost (in the form of personnel cost and external provider costs) to perform the activity. As such, any activity that is actually performed in relation to a 'service' either has to be a service benefiting the recipient (or another group entity) or the provider (as direct beneficiary or as shareholder).
 - b) We are of the view that the assumption has to be that a MNE allocates its resources efficiently and therefore the expected benefit should exceed the cost. In this regard it is key to note, that MNEs would not incur cost for tax purposes (i.e. achieving deductions). As such, there should be a presumption that the expected benefits exceed the costs as no MNE would incur costs unless it expects a benefit that exceeds those costs. Therefore, tax administrations should be precluded from making an assessment of whether the service fee exceeds the expected benefits and the focus of a tax administration should instead be assessing whether the allocation keys are appropriate.
 - c) Potential for "self-election" in the transfer pricing documentation to declare low value-adding intra-group services are not duplicative and provide benefits without further detailed analysis. Alternatively, there should be a presumption in the TPG that a benefits test is not required in the documentation of low value-adding services.
 - d) Provide a prescriptive list of evidence that taxpayers can prepare on a contemporaneous basis to support the intra-group services charges.
2. Strengthen effort in achieving global consistency. Specifically:
 - a) Where activities are classified by the service recipient's tax administrations as not providing a benefit to the recipient and by the service providing entity's tax administrations as not being of a shareholder activity in nature, this leads to double taxation. It is therefore important that the guidance on intra-group services is to be updated and the revised guidance would not allow for gaps that would lead to double taxation.
 - b) In relation to low value-adding services, we suggest that the OECD adopt a Multilateral Competent Authority Agreement ("MCAA") type of agreement for different jurisdictions to agree on how to incorporate the Chapter VII guidance on low value-adding services into Article 9 of their tax treaties.
 - c) The OECD should also introduce a prescriptive threshold for the implementation of the simplified approach and urge the tax administrations to include a more defined threshold in local transfer pricing guidelines or legislations.

- d) In practice, we observe that there is a gap in how OECD members and non-OECD members view and adopt the TPG. The release of the second edition of the UN Practical Manual on Transfer Pricing for Developing Countries ("UN Manual") provided an endorsement of the arm's length principle stipulated in Article 9 as well as the TPG. However the UN Manual also contained approaches specific to developing countries showing limitations and potential issues on critical topics. These include India's view to deviate from the use of safe harbors for low value-adding services and the omission of a list of low value-adding services (contained within the TPG). We would urge for consistency between both guidelines, specifically as tax payers have faced strong resistance to intra-group services in China and India.
 - e) We recommend the OECD to strengthen its effort in achieving global consistency which contains a necessary balance between appropriately allocating to MNE group members charges for intra-group services in accordance with the arm's length principle and the need to protect the tax base of payer countries.
3. CMTC members have noted that there may be a gap in the understanding of tax administrations' knowledge of how intra-group services fit into how a MNE operates which often raises the question on (all or part of) the intra-group services being duplicative or non-beneficial to the service recipients. As such we recommend to include an opening section within Chapter VII that:
- a) Explains the operating model of a MNE with specific focus on the multiple-tiered operational structure of a MNE group (i.e. Global, Regional and Local).
 - b) Explains why and how intra-group services are considered to be rendered within a MNE group.
 - c) Explains the reasonableness of intra-group services being charged at different tiers (i.e. headquarter level, regional level and local level) and how local entities may benefit from these multiple tiered charges.
 - d) Urges the tax administrations to communicate with local regulators to set out the fundamental mechanics of the operating model of MNEs, and how the arm's length standard generally operates in relation to intra-group services within such structures.

2. Detailed comments and suggestions

2.1 Practical challenges and suggestions - Chapter VII of the TPG

We have set out below our comments that are primarily aimed at addressing the observed practical challenges mentioned in the TPG in the Asia-Pacific region, namely:

- Demonstrating that a service has been rendered;
- Demonstrating that the service rendered provides benefits to the recipient;
- Identifying duplicated activities in practice;
- Applying a consistent allocation key for all recipients for intra-group services; and
- Identifying shareholder activities and stewardship activities.

Our comments and recommendations are set out in the table below.

Table 1 Practical challenges mentioned in the TPG in the Asia-Pacific region and recommendations

| Aspect | Practical challenges and examples | Suggestions |
|-------------------|---|--|
| Services rendered | <p>We observe that there are practical challenges for taxpayers to demonstrate that a service has been rendered in the Asia-Pacific region.</p> <p>For example, in an audit that a CMTC member has experienced in China, the tax administration has asked the taxpayer to demonstrate that services have been rendered to the service recipient in China. However, the tax administration is often not explicit in terms of evidence required. In addition, the taxpayer has experienced difficulties in collecting the requested evidence as the requirement could be extremely onerous. The tax administration may request contemporaneous proof (such as emails, evidence of participation in meetings etc.) which may not be readily available as the relevant personnel are no longer employees of the company. It then becomes onerous and inefficient for the taxpayer to trace the evidence.</p> <p>Another example is in relation to “on-call” services. We note that the OECD has attempted to address the issue on on-call services in the TPG (Paragraph 7.16 to Paragraph 7.17 of Chapter VII) which states, “An intra-group service would exist to the extent that it would be reasonable to expect an independent enterprise in comparable circumstances to incur “standby” charges to ensure the availability of the services when the need for them arises...” and “...the benefit conferred on a group company by the on-call arrangements should be considered...” However, some tax administrations have shown reluctance to consider services having actually been rendered when an on-call arrangement is in place.</p> | <p>We note that the OECD has attempted to address the issue on whether intra-group services have in fact been provided in the TPG (Paragraph 7.5 to Paragraph 7.18 of Chapter VII).</p> <p>We recommend the OECD to modify the guidance to include:</p> <ol style="list-style-type: none"> 1) A presumption that any activity performed by a MNE is seen as contributing to value generation or value protection, i.e. the presumption has to be that if a MNE decides to perform an activity, this activity must have some kind of commercial benefit, as the MNE will incur cost (in the form of personnel cost and external provider costs) to perform the activity. As such, any activity that is actually performed in relation to a ‘service’ either has to be a service benefiting the recipient (or another group entity) or the provider (as direct beneficiary or as shareholder). 2) A prescriptive list of evidence that taxpayers can maintain on a contemporaneous basis to demonstrate that a service has been rendered in order to reduce the uncertainty of taxpayers. Specifically, in relation to “on-call” services, we recommend the OECD to emphasize further in the TPG the need and the rationale to recognize services rendered under on-call arrangements. |
| Benefits received | <p>We observe that there are practical challenges for taxpayers to demonstrate that the service rendered provides benefits to the recipient in the Asia-Pacific region.</p> <p>We note that the OECD has attempted to address the issue on demonstrating benefits by introducing the concept of a “Benefits test” (Paragraph 7.6 to Paragraph 7.8 of Chapter VII). However, the term “Benefits” has not been well defined in the TPG. For example, we observe that there are intra-</p> | <p>We are of the view that the assumption has to be that a MNE allocates its resources efficiently and therefore expected benefit should exceed the cost. In this regard it is key to note, that MNEs would not incur cost for tax purposes (i.e. achieving deductions). As such, there should be a presumption that the expected benefits exceed the costs as no MNE would incur costs unless it expects a benefit that exceeds those costs. Therefore, tax</p> |

| Aspect | Practical challenges and examples | Suggestions |
|-------------|--|---|
| | <p>group services provided to service recipient which bring economic and commercial value beyond direct benefits.</p> <p>We have also observed that in certain jurisdictions in the Asia-Pacific region, it is particularly hard to provide evidence that the intra-group services rendered at headquarter level or regional level are beneficial to all affiliates across the world. For example, in an audit that a CMTC member has experienced in China, the tax administration has asked the taxpayer to demonstrate that global advertising and marketing campaigns benefitted the service recipient in China to in relation to its intra-group charges on marketing activities. This may be due to a lack of knowledge or recognition on the multiple tiered corporate structure of MNE groups.</p> <p>Another point of contention and challenge by local tax authorities is the benefit test and local cost comparison (for similar local services), without any reference to the MNE's corporate policies. Many taxpayers are faced with administrative burden around proving benefits, which appears to be very difficult to manage in practice as it requires considerable effort to quantify benefits provided, especially on low-value adding services. We have seen in practice that many tax administrations are asking for quantitative benefit tests for intra-group services. The administrative burden in providing quantitative evidence and engaging in a potentially lengthy audit outweighs a taxpayer's potential legitimate reduction of tax leakage on transfer pricing adjustments, leaving the taxpayer with a resource and cost decision to make. Ultimately, this may result in taxpayers having no practical choice but to give up their deduction claims, even though services indeed provided benefits and service fees were allocated properly, thus diminishing the arm's length standard.</p> | <p>administrations should be precluded from making an assessment of whether the service fee exceeds the expected benefits. The focus of a tax administration should instead be assessing whether the allocation keys are appropriate.</p> <p>The OECD should also consider the potential for "self-election" in the transfer pricing documentation to declare low-value adding services are not duplicative or provide benefits without further detailed analysis. Alternatively, the TPG can include a presumption that a benefit test is not required in the documentation of low value adding-services.</p> <p>We also recommend the OECD to include an opening section within Chapter VII that: (i) explains the operating model with specific focus on the multiple-tiered operational structure;(ii) explains why and how the intra-group services are considered to be rendered within a MNE group;(iii) explains the reasonableness of intra-group services being charged at different tiers (i.e. headquarter level, regional level and local level);(iv) how local entities may benefit from these multiple-tiered charges, and (v) urges the tax administrations to communicate with local regulators to set out the fundamental mechanics of the operating model of MNEs and how the arm's length standard generally operates in relation to intra-group services within such structures.</p> |
| Duplication | <p>We observe that there are practical challenges for taxpayers to identify duplicated activities in practice in the Asia-Pacific region.</p> <p>We note that the OECD has attempted to address the issue on identifying duplicated activities in the TPG (Paragraph 7.11 of Chapter VII). In particular, the TPG states</p> | <p>We recommend the OECD to provide guidance on identifying duplicated activities and specify the criteria or documents to prove that such activities are not duplicated in nature.</p> <p>Although the TPG has already implied that activities should not be presumed to be duplicative, such guidance should</p> |

| Aspect | Practical challenges and examples | Suggestions |
|-----------------|--|---|
| | <p>that “Some regulated sectors require control functions to be performed locally as well as on a consolidated basis by the parent; such requirements should not lead to disallowance on grounds of duplicated.” This guidance may be useful for MNEs to rely on and explain why the same type of intra-group services would be performed locally as well as on a consolidated basis by the regional office (a two-tiered structure) and/or the head office (a three-tiered structure). However, in practice and due to an apparent lack of understanding, taxpayers face difficulties in explaining to tax administrations, the multiple tiered operational structure of MNEs and how charges are not related to duplicated activities even though they may appear to be the same type of intra-group services.</p> <p>As a result, taxpayers are spending too much time and incur additional administrative burden, in proving that activities are not duplicative, especially in the case of low value-adding services.</p> | <p>be expanded to increase tax certainty.</p> |
| Allocation keys | <p>We observe that there are practical challenges for taxpayers to apply a consistent allocation key for all recipients for intra-group services in situations where tax administrations have challenged the appropriateness of the particular allocation key.</p> <p>For example, in audits that CMTC members have experienced in Korea and China, although the taxpayer in their opinion have selected appropriate allocation keys which reflects the underlying need for/ consumption of the particular services, the tax administrations have challenged the selection of the allocation keys and asked the taxpayers to perform calculations on intra-group services charges using different allocation keys to test whether it will result in preferable outcome from a local tax perspective.</p> <p>Another example is in an audit that a CMTC member has experienced in China where the taxpayer had to change an allocation key for the particular services in order for the tax administration to allow the deduction of the relevant charges. The taxpayer had to change the allocation key for the particular services at a regional level accordingly in</p> | <p>We recommend the OECD to modify the guidance in the TPG to include suggestions on suitable allocation keys for common types of intra-group services. We also recommend the OECD to include guidance for tax administrations to follow when questioning on allocation keys to look beyond tax outcome but instead focus on the appropriateness of aligning the benefit with the selected allocation keys.</p> |

| Aspect | Practical challenges and examples | Suggestions |
|---|---|---|
| | order to achieve consistency. | |
| Shareholder activities and stewardship activities | <p>We observe that there are practical challenges in identifying shareholder activities.</p> <p>For example, Paragraph 7.10 of Chapter VII includes an example of costs associated with shareholder activity which is “costs relating to reporting requirements (including financial reporting and audit) of the parent company...” On one hand, an internal audit which relates to reporting requirements of the parent company of a MNE could be considered as shareholder activity as the parent company is performing controlling functions as a shareholder. On the other hand, an internal audit may bring economic or commercial value to enhance or maintain the business position of the local subsidiaries/branches (e.g. recommendations are generally provided in an internal audit on how to implement improvement measures across the group). As such, it could also be considered as beneficial activities.</p> <p>In addition, we also observe that the definition of “stewardship activities” is brought from the transfer pricing guidelines published by the OECD in 1979 which can be considered as outdated.</p> | <p>We recommend the OECD provide further clarification on “shareholder activities” to reduce the uncertainty of taxpayers in identification of chargeable and non-chargeable activities. We also recommend the OECD to revamp the definition in particular on “stewardship activities”.</p> |

2.2 Adoption of the “Low value-adding intra-group services”

In 2015, as part of the Base Erosion and Profit Shifting (“BEPS”) Project, Chapter VII of the TPG was updated to introduce a simplified approach to determine the arm’s length charges for low value-adding intra-group services. We welcome the idea of the introduction of the simplified approach for low value-adding intra-group services as it lessens the compliance burden of taxpayers and allows tax administrations to free up resources for identifying or examining transfer pricing cases where the risk of encountering BEPS issues is more substantial.

However, we observe that although there are some countries in the Asia-Pacific region which have introduced Actions 8-10 of the BEPS Project into the local transfer pricing legislations, they are silent on the implementation of the simplified approach for taxpayers to determine the arm’s length charges for low value-adding intra-group services. This gives rise to uncertainty for taxpayers. As highlighted in the Summary of Revisions to Chapter VII of the TPG in OECD’s Actions 8-10 Final Reports, “*In order for the simplified approach...to be effective it must be adopted and applied on a geographic scale that is broad as possible and it must be respected in both intra-group service provider and intra-group service recipient countries.*” As such, there is a need for tax administrations to clarify their positions on the recognition of simplified approach on low value-adding intra-group services.

Therefore, we suggest that the OECD adopt a MCAA type of agreement for different jurisdictions to agree on to incorporate the Chapter VII guidance on low value-adding services into Article 9 of their tax treaties.

Paragraph 7.63 of Chapter VII also indicates that *“Tax administrations adopting the simplified approach to low-value-adding intragroup services...may include an appropriate threshold to enable them to review the simplified approach in cases where the threshold is exceeded. Such a threshold might, for example, be based on fixed financial ratios of the recipient party...or be determined by reference to a group-wide ratio of total service costs to turnover of the MNE group or some other appropriate measure.”* While we appreciate the fact there are differences in business size of MNEs and other domestic situations which result in difficulties in setting an universal threshold that would be applied globally, we suggest the OECD strengthen the need for introducing a prescriptive threshold for the implementation of the simplified approach and urge the tax administrations to include a more defined threshold in their local transfer pricing guidelines or legislations.

2.3 The need for achieving global consistency and acceptance of the TPG

Where activities are classified by the service recipient's tax administrations as not providing a benefit to the recipient and by the service providing entity's tax administrations as not being of a shareholder activity in nature, this leads to double taxation. It is therefore important that the guidance on intra-group services is to be updated and the revised guidance would not allow for gaps that would lead to double taxation.

In this regard, we appreciate the OECD's effort in revising Chapter VII to provide protection against common types of base eroding payments such as management fees and head office expenses. However, in practice, we observe that there is a gap in how OECD members and non-OECD members view and adopt the TPG. The release of the second edition of the UN Manual provided an endorsement of the arm's length principle stipulated in Article 9 as well as the TPG. However, the UN Manual also contained approaches specific to developing countries showing limitations and potential issues on critical topics. These include India's view to deviate from the use of safe harbors for low value-adding services and the omission of a list of low value-adding services (contained within the TPG). We would urge for consistency between both guidelines, specifically as tax payers have faced strong resistance to intra-group services in China and India.

As such, we recommend the OECD strengthening its effort in achieving global consistency which contains a necessary balance between appropriately allocating to MNE group members charges for intra-group services in accordance with the arm's length principle and the need to protect the tax base of payer countries.

Appendix 1 – List of members of The Capital Markets Tax Committee of Asia

1. AIA
2. Allianz
3. American Express
4. ANZ
5. AXA Asia
6. Bank of America Merrill Lynch
7. Bank of China
8. Barclays
9. Beijing Gaohua Securities Co. Ltd.
10. BlackRock
11. BNP Paribas
12. Citigroup
13. CLSA
14. Credit Agricole CiB
15. Credit Suisse
16. Daiwa Capital Markets Hong Kong Limited
17. DBS
18. Deutsche Bank
19. Eastspring Investments (Singapore) Ltd.
20. Fidelity Investments (HK) Ltd
21. First Abu Dhabi Bank
22. Goldman Sachs
23. Hang Seng Bank
24. HSBC
25. ICBC Standard Bank
26. ING
27. JPMorgan Chase Bank, NA
28. Macquarie Bank
29. Manulife
30. Morgan Stanley
31. National Australia Bank
32. Natixis
33. Nomura
34. Prudential Corporation Asia
35. Rabobank International
36. Royal Bank of Canada Capital Markets
37. Royal Bank of Scotland
38. Societe Generale
39. Standard Chartered Bank
40. Swiss Reinsurance Company Limited
41. UBS
42. Westpac

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20 June 2018

Mr. Jeff VanderWolk
Head of the Tax Treaties and Transfer Pricing Division
Centre for Tax Policy and Administration
OECD

Subject: OECD Discussion draft on the future revision of Chapter VII, “Special Considerations for Intra-Group Services”, of the Transfer Pricing Guidelines

Dear Mr. VanderWolk

I welcome the opportunity to respond to the OECD’s discussion draft on a future revision of Chapter VII, “Special Considerations for Intra-Group Services”.

As Mr. Andrew Hickman, former OECD Transfer Pricing Unit Head pointed out in his article¹ of 30th May in MNE Tax, one key transfer pricing issue with head office recharges is that the amount charged is seen as excessive by some tax authorities and “regularly the subject of transfer pricing audits, a cause of double taxation, and consumes a disproportionate amount of compliance effort relative to its importance or value.”

Most routine head office recharges are based on the TNMM transfer pricing method, with a mark-up added to the cost base and allocated to operating companies around the group using a suitable activity driver, such as turnover or headcount.

The above transfer pricing framework, whilst generally accepted, does have some technical limitations. One such limitation is that the entire analysis is one sided, entirely from the service provider’s perspective. An arm’s length price is agreed when both the buyer and seller are satisfied with the price and terms. Whether the service recipient will, at arm’s length, accept a management service fee is rarely discussed in transfer pricing analysis. Under some circumstances where the service recipients do not find the price reasonable, this could lead to non-arm’s length outcome. Therefore, some of the aforementioned tax authority challenges may be a rational response as the price charged may have deviated from the local arm’s length price.

The Big Mac index was invented by The Economist in 1986² as a convenient and humorous way of looking at prices of an identical basket of goods (in this case, a Big Mac hamburger) in different countries. The USD price for a Big Mac in January 2018 for some countries is summarised in the table below.

| Country | US Dollar price |
|-----------|-----------------|
| Argentina | 4.0 |

¹ <https://mnetax.com/improving-the-oecd-transfer-pricing-guidance-on-intragroup-services-27885>

² Source: <https://www.economist.com/content/big-mac-index>

| Country | US Dollar price |
|----------------|------------------------|
| Australia | 4.7 |
| Brazil | 5.1 |
| Britain | 4.4 |
| Canada | 5.3 |
| Chile | 4.3 |
| China | 3.2 |
| Colombia | 3.8 |
| Costa Rica | 4.0 |
| Czech Republic | 3.8 |
| Denmark | 4.9 |
| Egypt | 1.9 |

Let's assume the senior management of a UK headquartered multinational group decided to provide employees with an additional benefit by contracting with McDonald's to allow every employee to claim a free Big Mac hamburger for lunch. Given the marketing potential and high-volume order, the company secured a deal to bulk-buy Big Macs at 50% discount to the UK price, or USD\$2.2 each. Under transfer pricing principles this head office cost will then be recharged to local companies. However, the Egyptian subsidiary may find the price excessive and object to the transfer price, as the local Big Mac price was only US\$1.9.

Some may dismiss the above example as theoretical and facetious. However, this market price effect is a genuine problem often encountered by MNEs. As the transfer pricing advisor for a major UK-based international group, one of my duties is to organise and prepare local files for about 60 countries. Most of these local files were prepared centrally with the assistance of a big4 firm. The cost is then divided and recharged to each group company receiving a local file report. One emerging market finance manager contacted me to say the cost is excessive and more than her previous transfer pricing spends. I requested her to seek two quotes from local big4 advisors. One of the quotes was similar to the intra-group fee, the other quote was lower.

How could a bespoke transfer pricing local file cost less than a standardised report based on a template shared across about 90 companies? The culprit is probably big4 scale rates. A UK big4 transfer pricing manager may have a scale rate of around £500 per hour. That same manager in some emerging market countries may have a scale rate as low as £50 per hour. Country cost differential is a well-known issue. Therefore, management service fee based on services provided from one country may not be appropriate for all countries, and could be above local price for some low-cost countries.

Existing transfer pricing guidelines already require the transfer price to reflect market conditions and to make reasonably accurate adjustments to eliminate the material pricing effects of any comparability differences. Are we doing this?

I suggest that, where the economic circumstances of the management service recipients are significantly different, an economic adjustment is factored to the process to eliminate the material effects of local economic differences.

If there are significant local cost differences between the service recipients, a local cost adjustment factor can be added to the recharge framework. This could work as illustrated below.

| | Co A | Co B | Co C |
|----------|-------------|-------------|-------------|
| Turnover | 500 | 400 | 300 |

| | | Co A | Co B | Co C |
|---|---|-------------|-------------|-------------|
| Management fee of 100 allocated by turnover | a | 42 | 33 | 25 |
| Local economic factor | b | 50 | 45 | 10 |
| Management fee weighted by local factor | c | 208 | 150 | 25 |
| Re-scale Management fee to 100 | d | 54 | 39 | 7 |

In the above example, 100 of management fee is allocated to three group companies, Co A, Co B and Co C using turnover as the allocation key. However, Co C is operating in an emerging market country where local costs are significantly lower than other group companies. We can adjust for this local cost differential with a suitable economic indicator, an industry and market equivalent to the Economist's Big Mac index. Subject to further review, per capital GDP or median company salary may be possible cost adjustment factors.

Using the local cost adjustments factors shown in row b, we can re-apportion and re-size the recharge to arrive at a different allocation, shown in row d. The revised fee allocation for Co C is significantly lower than before, reflecting lower local costs.

In summary, I suggest the following for OECD's consideration:

- For routine support services, the existing framework of adding a mark-up to service costs and allocating the resultant fee using a suitable activity driver is, in general, an appropriate transfer pricing method
- Where market conditions between service recipients are materially different a reasonably accurate local adjustment should be made to remove the material effects of the market condition differences

I appreciate the opportunity to submit my views on this subject. Should you wish to discuss my response further then please do not hesitate to contact me.

Yours sincerely

Clive Tang

In-house transfer pricing specialist

London, UK

**REPLY TO THE OECD’S REQUEST FOR COMMENTS ON THE
“SCOPING OF THE FUTURE REVISION OF CHAPTER VII (INTRA-GROUP SERVICES) OF THE
TRANSFER PRICING GUIDELINES”
FROM CMS**

CMS is a European Economic Interest Grouping that coordinates an organisation of independent law firms¹

Contacts for follow-up. This contribution was prepared by the CMS Transfer Pricing Group and, in particular, by the following experts:

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We would like first to welcome the OECD initiative to consult companies and practitioners in the framework of its most recent considerations on the subject of intra-group services. We were very interested in reviewing, in light of Actions 8-10 of the Action Plan on Base Erosion and Profit Shifting, the Invitation for Public Comments on the subject of “*Scoping of the future revision of Chapter VII (intra-group services) of the transfer pricing guidelines*” released on 09 May 2018 (further referred to as the “Discussion Draft”).

We thank you for giving us the opportunity to share with you our comments and would be pleased to provide you with any additional detail you would be interested in.

*

The Discussion Draft mentions a certain number of items as examples of issues on which the OECD seeks comments. We have chosen to comment on the following:

- Demonstrating that a **service has been rendered** and/or that the service rendered provides benefit to the recipient, in the specific case of “on-call” services;
- Whether and, if so, how to incorporate the ongoing work on **financial transactions**;
- Whether and, if so, how to incorporate the ongoing work on the use of **profit split methods**;
- Enhancing the certainty in determining an **appropriate allocation key** for charging intra-group services.

In addition to the above, we have also made a suggestion on how the **safe-harbour rule** for mark-ups applied to low value-adding intragroup services (5%) could perhaps be expanded to afford more flexibility to both taxpayers and tax administrations alike.

Our comments are the following.

- *Demonstrating that an “on-call” service has been rendered and/or that the “on-call” service rendered provides benefit to the recipient*

Our main comment with respect to establishing that a service has indeed been rendered and has provided a benefit to its recipient is in relation to the specific case of “on-call” services. Indeed, paragraph 7.17 of Chapter VII from the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017*² seems to conclude that the benefits derived from “on-call” arrangements could be assessed in hindsight: *“Thus, the benefit conferred on a group company by the on-call arrangements should be considered, perhaps by looking at the extent to which the services have been used over a period of several years rather than solely for the year in which a charge is to be made, before determining that an intra-group service is being provided.”* This does not seem consistent with the numerous other indications contained in the OECD Guidelines which recommend to avoid judgment in hindsight³.

² Hereinafter, references to paragraphs from the *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017* shall take the form “OECD 2017, §” followed by the paragraph number in question and general references to the text shall take the form “OECD Guidelines”.

³ See for example OECD 2017, § 3.73, § 3.74, §8.20 or § 9.24

Moreover, in our experience, unrelated parties would not proceed in such a manner: once a contract for an on-call service has been negotiated, the service provider which has borne standby costs, even where no service was eventually called upon, would not accept to forego their remuneration and would not agree to a contract which would include such a clause.

However, what unrelated parties would do, upon finding that the on-call service has not been effectively used, is revise the contract for future periods of time. Typically, such contracts often include a revision clause according to which the parties agree to meet every few years in order to verify whether the level of services provided is adequate with respect to their actual needs, and to bring the services up to or down to the appropriate level going forward. Such renegotiations do not involve retroactively modifying amounts due.

| |
|---|
| <ul style="list-style-type: none"> • <i>Whether and, if so, how to incorporate the ongoing work on financial transactions</i> |
|---|

In our experience, there are two main approaches used when dealing with financial services provided – one based on the CUP method, one based on a Cost Plus approach. As regards financial services, these two methods, while appropriate to specific situations, display some incompatibility with each other (see further explanations below). Besides, in our experience, tax administrations often leverage such incompatibility in order to proceed to a reassessment.

Indeed, it is often the case that:

- Where the taxpayer has used a Cost Plus approach (i.e. invoicing the external cost of debt incurred, plus their internal costs, plus a margin) the tax administration demands that a CUP analysis be performed for each benefitting entity;
- Where the taxpayer has performed a CUP analysis at the level of the borrowing entities, the tax administration demands that the taxpayer establishes that the lending entity has earned a margin on its total costs incurred and that this margin is appropriate. This is for instance the case in situations in which a subsidiary which is benefitting from a loan from its parent entity has a better credit rating than its parent entity, which therefore invoices the interests with no added mark-up (or at a loss, given its own cost of debt).

As a general rule, both approaches could be applied to any lending situation but the fact of the matter is that they will not produce the same results. As a result of this, clear guidance from the OECD would be most welcome.

In our view, it is critical to recognise that the potential incompatibility between the Cost Plus and the CUP methods, when applied to financial services such as inter-company lending, derives from the following inherent features of each of them:

- Since the Cost Plus approach only takes into account the cost of debt (and internal financing costs) of the lender, the resulting interest rate is bound to be the same for all related borrowers (when the lender provides the same type of financing to several borrowers);
- Conversely, since the CUP approach replicates the conditions that would have applied to each individual borrower should it have borrowed from a third party (by determining the credit risk profile of the borrower and then determining the arm's length interest rate that applies to this credit risk profile for a given type of borrowing), the resulting interest rate will very often be different for each different related borrower (when the lender provides financing to several borrowers, even if it is the same exact type of financing to each of them).

We submit that the most appropriate method should be determined in accordance with the role played by the lending entity:

- A Cost Plus approach would make more sense where the lending entity is acting as a financial intermediary (as a pass-through), taking limited to no risks, and whose main function is mostly to enable easier access to funds for related borrowers.
- Conversely, a CUP method (applied to the borrowing entities) would make more sense where the lending entity is acting in a capacity (and with risks) comparable to that of a financial institution with respect to other group entities. It indeed replicates the credit rating process that such financial institution would apply to its clients.

We therefore believe it would be beneficial to both taxpayers and tax administrations if the OECD could elaborate on these different roles for the borrowing entity and how they lead to one approach being more relevant than the other.

- | |
|---|
| <ul style="list-style-type: none"> • <i>Whether and, if so, how to incorporate the ongoing work on profit split methods</i> |
|---|

We are of the opinion that the Transactional Profit Split Method ("TPSM") is not, with only rare and limited exceptions, an appropriate transfer pricing method when dealing with the provision of intra-group services.

Indeed, outside of certain very unusual types of success fee situations, unrelated parties involved in providing or purchasing a service do not take into account either the provider or the beneficiary's profits – much less share them – and this even when the service being provided is a very high value-adding service such as R&D or top-of-the-range strategic advice consulting.

Even high-value-adding, top-of-the-range services are, most of the time, one-way processes where the service provider is mandated by its client to deliver a given type of assistance, in accordance with given specifications. So long as the assistance is provided in accordance with such specifications, pre-agreed fees are due. Neither the service provider, nor its client, are

willing to share the other party's risks, or to share its own profit with the other party. The service provider will only agree to bear its own delivery and service performance risk (and will not agree to revise its own profit depending on the performance of its client in using the service it delivered), and vice-versa: the client will only agree to pay a fee in accordance with the ability of the service provider to follow the specifications (and will not agree to share with the service provider its own ability to derive a profit from the service it received). Only in rare occasions would a different situation, such as a success fee, be agreed upon by both parties.

In this respect, we do not believe that the dichotomy between low *vs* high value-adding services is the correct metric for analysing whether the TPSM could be relevant. Indeed, suggesting that the TPSM should be applied to services simply because they are determined not to be low value-adding would lead parties to apply prices which are not at all at arm's length.

We believe that the proper key to determining in which (rare) circumstances a TPSM could be contemplated as being appropriate is the accurate delineation of transactions, as described in Chapter I.D. of the OECD Guidelines⁴. Indeed, we believe that the accurate delineation of a transaction will lead to the conclusion that the TPSM is an appropriate method when said accurate delineation will have previously demonstrated that the transaction at hand is actually not the provision of a service (which is generally a one-way process).

For example, it could be the case that a transaction is described as the provision of contract R&D services, but that the accurate delineation of the transaction in question establishes that it is in fact a co-development of an intangible. Therefore, the transaction must be redefined and accurately delineated, and perhaps in this new context it may be that the TPSM could be taken into consideration. Such situations of an initially inaccurate delineation of a transaction should stay rare, so long as the parties actually act in accordance with their role of, respectively, service provider, and order giver.

Other cases of situations where the TPSM would be determined to be appropriate should therefore stay quite rare as well. This could be the case:

- If, in a given situation, it is determined that no other method is applicable (for instance due to lack of data), in which case the TPSM could be a last-resort method, to be used with extra care that it does not lead to a result that is not in line with the functions and risks of each party; and,
- If, in a given industry or for a given type of service, it is determined that profit split is actually used between third parties (for instance *via* specific forms of success fees), provided that an analysis has been made regarding how often this is the case in that industry or for that type of service, as well as regarding whether the inter-company service is actually comparable to that situation or that specific type of service, and finally whether the pricing terms observed between third parties (e.g. success fee)

⁴ OECD 2017, § 1.33 and following.

actually lead to a sharing of profit (e.g. a success fee computed as a fraction of the benefit the client receives from the service) or are instead mere types of conditional lump-sum payments that are not correlated to profit.

- ***Enhancing the certainty in determining an appropriate allocation key for charging intra-group services.***

We believe that provision of more extended list of appropriate allocation keys for different types of intra-group charges for low value adding services would be beneficial for both taxpayers and tax authorities.

In our opinion, specifying allocation keys applicable for services indicated in 7.49, would result in more certainty for taxpayers. In addition, tax authorities would access to practical tool for purpose of assessing the adopted cost allocation methodology in cases where they do not characterise with high complexity.

Furthermore, a practical guidance on how to approach sharing of information regarding allocation keys based on time actually spent by employees (e.g. manhours) on provision of low value adding services between service provider and its related party/tax authorities, in the view of adopted EU General Data Protection Regulation (or other similar data protection regulations) would be much appreciated.

- ***Additional comments on the safe-harbour rule for the mark-up applied to low value-adding intragroup services (5%)***

The OECD Guidelines still exclude⁵ “*services of corporate senior management*” from the scope of low value-adding intragroup services. Regardless of whether or not such services should or should not be included in such a category, the result is that taxpayers may not apply the 5% mark-up rule, and must perform a benchmarking study in order to support whichever mark-up they have applied.

However, it is a fact that such benchmarking studies have been performed time and again, as they effectively consist in performing a benchmarking study of strategy and management consulting firms, a great number of which are independent. Such studies conclusively demonstrate that a 5% mark-up is at arm’s length for such services.

⁵ OECD 2017, § 7.47

Therefore, we believe it would be a welcome step towards simplification and lessening administrative burdens – for taxpayers and tax administrations alike – to extend the benefit of the 5% mark-up safe harbour rule to services of corporate senior management.

19 June 2018

Tomas Balco
Head of the Transfer Pricing Unit
Centre for Tax Policy and Administration
Organisation for Economic Co-operation and Development

By email: TransferPricing@oecd.org

Dear Tomas

Future revision of Chapter VII of the Transfer Pricing Guidelines on Special Considerations for Intra-Group Services

Thank you for the opportunity to comment on the scope of future revisions to the Chapter VII of the OECD's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (the 'Guidelines' or 'the OECD Guidelines') on Special Considerations for Intra-Group Services.

This letter considers the specific points raised in the invitation for public comments issued on 9 May 2018 (the 'Invitation for Comments'). It has been written from the perspective of the UK with input from other countries.

Significant challenges remain with the practical application of Article 9 and the arm's length standard to intra-group services, even after the revised guidance recommending a simpler approach to low-value adding intra-group services as part of the BEPS process. Double taxation is commonplace despite the relative simplicity of pricing intra-group services (in comparison with, for example, intangibles) and the broad agreement amongst countries as to how services should be priced. It is essential that businesses are able to claim deductions for payments made in exchange for services through proportionate administrative procedures and have certainty that they will not be taxed twice. Clear guidance that is consistently applied by tax authorities throughout the OECD Inclusive Framework would be extremely helpful and would go a long way to minimising disputes, reducing administrative costs in applying mutual agreement procedures, and preventing double taxation. It is particularly important that consistency and balance is achieved between jurisdictions with significant outbound investment and those with significant inbound investment.

The main issue with intra-group services is ensuring deductions for the costs incurred in providing the services to the group as a whole. Any mark-up on costs, although important, is of secondary concern to groups given the relative size of the cost base.

Among the challenges that it will be important to address is the one-sided guidance on applying a benefit test to service recipients. This is a key concern because groups often incur costs that are intended to benefit the group widely rather than targeted narrowly at individual entities. Businesses are also incentivised to be efficient, which may include centralising activities in one jurisdiction or utilising low-cost locations. However, costs are not the sole consideration as availability of skilled/competent personnel, ease of doing business, legal framework and lack of corruption, proximity

to the business operations, and many other factors will all be taken into account in determining where and how services should be provided to benefit the group as a whole.

The benefit test as currently set out in Chapter VII considers the benefit only from the perspective of the service recipient, and this is often interpreted on a very narrow basis. In addition, some countries impose onerous evidentiary requirements that are disproportionate to the amount and nature of the service being provided. Revisions to Chapter VII must ensure that any analysis of services, as for other transactions, looks at the arm's length approach that would be agreed between third parties. This means that the position of the service provider must also be taken into account, as well as consideration of the wider benefits for the group and the recipient entity.

Further comments in relation to the matters raised in the Invitation for Comments are set out in the attached appendix.

If you would like to discuss any of the points raised in this letter, please do not hesitate to contact either me (alobb@deloitte.co.uk) or John Henshall (jhenshall@deloitte.co.uk).

We would be happy to speak on this topic at any future Public Consultation meeting if it would be helpful.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Alison Lobb'.

Alison Lobb

Deloitte LLP

APPENDIX I – Further comments to observations made in the Invitation for Comments

Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient;

Multinational businesses are focused on generating value and subject to shareholder oversight. It is therefore extremely unlikely that businesses will perform activities on behalf of members of the group that are not intended to be beneficial. However, it is common for deductions to be denied by tax authorities for intra-group service payments on the grounds that the rendered service has not provided a benefit to the relevant entity.

Excessive information requests from tax authorities can mean that the costs and time taken to support a deduction are disproportionate to the value of the deduction. This can lead to businesses relinquishing valid claims for deductions for charges and suffering economic double taxation.

The G20/OECD Base Erosion and Profit Shifting Project has provided clarity on the requirement to delineate transactions appropriately. If this is done correctly, with due consideration for what is arm's length, consideration should be given to whether the additional 'benefit' test can be removed from the chapter on intra-group services. This would bring the position on services in line with other transactions such as the sale of goods and the provision of intangible assets.

If a benefit test is to be retained in Chapter VII of the OECD Guidelines it is essential that it require consideration of the position of both the service provider and the service recipient (a two-sided approach, consistent with Chapter I requirements). This would include consideration of the broader benefits that the group receives from the activities and whether they directly or indirectly benefit the group company receiving the service. In many cases, adhering to group level best practice standards, together with utilising central expertise and collateral, will benefit the group as a whole in the long term, including the service recipient. It is not enough to say, for example, that because local rules do not require certain activities that there is no benefit. It is part of the package of being part of a group, to operate internationally in a consistent way that meets the regulations and requirements suitable for doing business in many countries. The group company will be benefitting directly or indirectly from being part of the group (e.g. from intra-group sales, group synergies, network effects, international customer referrals, exclusivity of supply etc).

An alternative option would be for audits that consider the benefits test to have an automatic referral into the MAP process where the service provider is in a treaty jurisdiction. This would ensure that both the provider and recipient of the service are considered together.

The scope should address evidential requirements for services to ensure that they are proportionate and, if possible, consistent from country to country. There are situations currently where it is the requirements to provide extensive detailed information related to the benefit test that mean businesses do not pursue a deduction, leading to *de facto* double taxation.

Activities which do or do not benefit the local affiliates and benefits that purely arise from group membership and those that arise from a deliberate concerted action

Any analysis as to whether the service rendered provides benefits to group entities must look at the entirety of benefits received. A subsidiary of a group may, depending on facts and circumstances, be required to adhere to global standards which may be different from and/or more complex than those imposed at a local country level. Adherence to global standards may similarly be required of third party suppliers in many cases. Groups impose these standards in order to maintain quality standards and protect reputational damage, which drives value for the whole group. Adherence to these types of standards is required in order to access the third party and internal revenues generated through the group companies' status as part of the group. It should not be the case that double taxation arises as a result of disallowances of these costs and the OECD Guidelines should provide clear examples to demonstrate this.

Shareholder activities and stewardship activities

Paragraphs 7.9 and 7.10 of the Guidelines discuss 'Shareholder activities' and provides guidance on a narrow range of activities that are performed relating to group members even though those group members do not need the activity e.g. costs relating to the preparation of consolidated financial statements of the group as a whole. Paragraph 7.9 specifically distinguishes 'shareholder activity' from broader 'stewardship activity' (the term used in earlier versions of the Guidelines). This reference to 'stewardship' could be removed as it causes confusion and there is no distinction between the treatment of 'stewardship' type activities and any other non-shareholder activity.

There are occasional, limited circumstances where a service that is 'shareholder' in nature should be charged to another group member. One example is where a benefit arises to other entities in relation to their shareholders in the context of dual listed company arrangements. The current definition of 'shareholder activities' should be adapted to allow shareholder services to be charged in such circumstances.

It would be helpful if the Guidelines could be expanded to include further examples of activities which would and would not be considered 'shareholder activity', particularly in the context of M&A activity and business development as these are areas that can lead to disputes. Illustrations setting out different facts and circumstances would also be helpful and would reduce uncertainty. For example, a divisionalised business which acquires a new unrelated division may consider the costs to be 'shareholder costs' but costs associated with entering into a new market in relation to an existing division and which will benefit the group as a whole will be considered intra-group services.

Identifying duplicated activities in practice

Duplicated activities are not undertaken by businesses for any sustained period. Groups are incentivised to remove inefficiencies in order to maximise returns for shareholders, and any short term duplication would be identified and stopped as part of normal efficiency and management procedures. It would be helpful if an explicit statement that duplication is rare in practice could be included at an appropriate point in the Guidelines.

While it is right that entities should not be charged for activities that they are undertaking themselves already, in practice many of the challenges in this area are where the service comes under the same broad heading (e.g. HR services) but there is a difference between local activities (payroll, hiring, terminations etc) and group-wide activities such as development programmes and long-term incentive plans that are designed and implemented on a group basis but which benefit employees of many group companies. To the extent that these intra-group services were not provided, it would be necessary for the local affiliate to incur costs in setting up its own development programmes and long term incentive plans or risk losing key personnel. The cost of undertaking such activities on a local stand-alone basis

may exceed that of the appropriate portion of centralised costs. Choosing not to do so and risking the loss of key personnel would also entail local costs such as hiring and training new employees, and possible business losses through lack of continuity.

Consistency between group company policies and procedures is of benefit to the group as a whole, including the local entities, as it reduces inefficiencies and frictions in international trade.

Finding an appropriate allocation key for charging intra-group services

The current guidance is proportionate and pragmatic when it confirms that ‘a balance should be struck between theoretical sophistication and practical administration, bearing in mind that the costs involved are not generating high value for the group’ (paragraph 7.60). This should remain the cornerstone of the approach to intra-group services. Any allocation keys proposed by tax authorities should be mindful of this consideration and should be based on data that is already available for commercial purposes, and, importantly, is sufficiently accurate.

Often, allocation keys based on turnover or headcount are the most appropriate, and the Guidelines should continue to point to these as the most likely appropriate allocation keys albeit that facts and circumstances must be taken into account. Turnover and headcount can often be used to give reasonable approximation of the size of the business entities relative to each other.

The current guidance on allocation keys generally works well but further examples would be helpful for groups and tax authorities in relation to the practical application of the rules.

The appropriate allocation key will partly be determined by the level of accuracy it is possible to obtain from the available data. For example, tax authorities may suggest that timesheets should be completed. In our experience timesheets in a business that does not use them as the basis for dealings with clients/customers can be extremely unreliable, as there is no business incentive or cross-check on the business people completing them. Often they are not completed in real time and in sufficient detail to accurately reflect the activities undertaken. In most cases an allocation key based on reliable business data (perhaps turnover or headcount) combined with functional analysis interviews with department leaders will lead to a more reliable result. In addition, timesheets cannot accurately capture all the beneficiaries when a single activity may benefit multiple group entities.

In some cases, it is clear that the combined use of more than one key would be most appropriate. Guidance should be provided on the ability to use combined allocation keys where appropriate, and on considerations for weighting the comparative value. It should be clear that it may not be possible to determine a precise split but that any consistent approach that provides a reasonable outcome should be acceptable.

Consistency is an important issue in relation to allocation keys. For any given accounting period, allocation keys should be consistent where the same/similar services are being provided unless the facts and circumstances suggest that to do otherwise would give a more robust arm’s length result. Consistency should in general also be applied from year to year, but this can vary more with circumstances such as business changes or changes to the nature/type of the services being provided. Sometimes allocation keys are amended because new data becomes reliably available across the group and is more appropriate. An example of this is where data such as, say, numbers of new customer contracts would be the most appropriate allocation key for a back-office legal team that is responsible for the production, maintenance and agreement of relatively standard customer contracts, but that new systems are required on a global basis for this data to be reported consistently and accurately across all markets. Once such consistent systems are in place, this data could be used as the allocation key in place of turnover, which could have been used as the most reliable proxy for size of business in the absence of reliable specific information.

Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises;

In general, the costs to be included in the cost base should be the fully loaded costs of the employees engaged to deliver the services, including an apportionment of business overheads. This will include not only salaries and bonuses but also pension contribution costs and other employment costs including employment taxes. At arm's length, a service provider would expect to make a margin over and above the costs it incurs in delivering the services. Benchmarking ranges looking at the return for service providers will look at the return on total costs. For these reasons, it is essential that the cost base captures all elements of the costs incurred locally in delivering the services.

The Guidelines should include a clear statement that businesses incur costs to generate value or to meet legal or contractual obligations and those costs should be allowed as deductions in arriving at taxable profits. Any specific domestic corporate tax provisions denying deductibility of costs should apply equally to third party or domestic costs as to costs incurred on cross-border intra-group services. In some cases domestic denial of deductions for intra-group service costs creates double taxation. It can hinder the operation of the international tax framework (including double tax treaties and the OECD Guidelines) to provide an appropriate balance of taxing rights between countries but at the same time allow for the development and growth of international trade.

It is important that in audits it is the transactions (accurately delineated) that have taken place that are considered. The Guidelines should ensure that they do not lead tax authorities to imagine or question how a business is run. If a group could have procured identical services of the same quality at a lower cost locally that are wholly consistent with group standards and protocols and with the same group-wide benefits of consistency and efficiency, then it might have chosen to do so. However, there may also have been local costs incurred in relation to design of specifications, dealing with suppliers, contracting, management time, quality assurance and monitoring, etc. In addition, in many cases it is not possible to procure identical services if, for example, the required skills are not readily available or quality control cannot be managed effectively. The subjectivity involved in this type of analysis mean that it is impossible for businesses or tax authorities to come to an answer that is reliable and commensurate with the arm's length standard.

Purchasing power parity

It is occasionally suggested that cost bases should be adjusted for purchasing power parity. Routinely including adjustments for disparities in purchasing power would increase complexity and increase subjectivity. There are a number of challenges with adjusting for purchasing power parity, not least of which is that there are not reliable, up-to-date indices on costs that are readily available for all sectors and businesses. Encouraging the use of such adjustments is likely to create as many distortions as it solves and would increase the costs and time required to determine appropriate costs.

In many cases, costs arising in a particular jurisdiction – jurisdiction A – may be a direct result of strategic decisions made by, and investment, know-how or capital provided by, personnel located in another jurisdiction – jurisdiction B. In this situation, it would not be appropriate for purchase price adjustments to have the effect of moving profits attributable to this decision from jurisdiction B to jurisdiction A. This is particularly the case where jurisdiction A has been selected chiefly because of its ability to lower costs.

For these reasons, alongside the challenges of applying the arm's length principle to such adjustments (comparable data will in most cases already include any considerations of the cost base), purchasing power parity or similar concepts should not be included as part of the scope of work to update Chapter VII.

Assessing the arm's length conditions for services provided in connection with the use of intangibles; services that are highly integrated with the value creation of the MNE group; and/or involve significant risks.

Chapter VI provides detailed guidance covering Special Considerations for Intangibles. To the extent that any specific additional points need to be addressed, this guidance should be compatible with the existing Chapter VI guidance and also the guidance in Chapter I on the control and management of risks through the making of decisions.

Low-value adding services

The option of a simplified approach in relation to low value-adding intra-group services introduced during the BEPS process is helpful. However, there are some practical issues with its application that the revisions to Chapter VII could usefully address.

- The 5% mark-up on costs is a useful safe harbour. However, no importance should be attached by tax authorities to this rate. For example, 5% may be above the median for a range that is looking at services that do not meet the definition of low-value added. This means that low-value added services, using the simplified approach, would get a higher return. This may not be logical in economic terms, but does make sense as a simplification. It is one of the limitations of the safe harbour approach, and has no bearing on the return for services that are not part of the simplified approach.
- Paragraph 7.64 of the Guidelines includes detailed documentation and information requirements in relation to the simplified approach. It is not clear why these are a requirement here and why they are necessary as an additional requirement over and above usual local file and master file requirements. In fact, in many cases they act as a barrier to application of the simplified approach as it is not clear how or whether all countries accept its use. These should be removed and replaced with paragraphs setting out the importance of consistency in approach to low-value intra-group services on a bilateral basis (service provider and service recipient). In addition, the simplified approach should be applied consistently by groups across countries that participate (but should not be prevented from applying if some countries refuse to accept it).

NVB Response to the OECD Consultation on the scope of the future revision of Chapter IV (administrative approaches) and Chapter VII (intra-group services) of the Transfer Pricing Guidelines

The Dutch Banking Association or Nederlandse Vereniging van Banken (hereafter: NVB) is the representative voice of the Dutch banking community with over 60 member firms, large and small, domestic and international, carrying out business in the Dutch market and abroad. The NVB strives towards a strong, healthy and internationally competitive banking industry in the Netherlands, whilst working towards wider single market aims in Europe.

This memo is in response to the invitation of the OECD, published 9 May 2018, to provide comments on the scope of the future revision of Chapter IV (administrative approaches) and Chapter VII (intra-group services) of the Transfer Pricing Guidelines.

The NVB would like to thank the OECD for this opportunity and welcomes the initiative to revise the guidance in Chapter IV and Chapter VII of the Transfer Pricing Guidelines.

The OECD has asked for comments on a number of issues. If and insofar the NVB has any comments or views we have listed these issues below.

Chapter IV – Disputes Resolution

- Additional guidance that could be provided on advance pricing arrangements;
NVB: APAs should be more actively encouraged, as a mechanism for dispute prevention. This could be achieved by, for example, fast track procedures for more straightforward areas.
- Any other mechanisms or issues relevant to the administration of transfer pricing and/or to prevention and resolution of transfer pricing disputes for which guidance to be developed as part of the revision of Chapter IV of the TPG.
NVB: Alignment with the EU Council Directive on Tax Dispute Resolution Mechanisms in the EU is preferred.

Chapter VII –Intra-Group Services

- Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient;
NVB: This will always be difficult in practice. The OECD could consider alternative methods, e.g. group members are permitted to deduct group overheads up to an agreed percentage of Earnings / EBIT and/or Capital.
- Drawing a distinction between: (i) activities which do or do not benefit the local affiliates; (ii) benefits that purely arise from group membership and those that arise from a deliberate concerted action; and (iii) shareholder activities and stewardship activities;
NVB: It would be useful to elaborate on the influence of group membership on the credit rating of subsidiaries.
- Identifying in practice duplicated activities;
NVB: Guidance on the role of regional service centers would be useful, as tax authorities often fail to understand that head office may delegate part of its activities to a “regional head office”. This means there are for example costs of local HR, regional HR and central

HR, but this does not necessarily mean there is duplication.

- Finding an appropriate allocation key for charging intra-group services;
NVB: It would be helpful to have more guidance on the use of single versus multiple allocation keys; some examples of general allocation keys that may be appropriate for specific industries; and an indication of specific allocation keys that would not normally be acceptable.

EBIT
www.ebit-businessstax.com

**Comments on the
Scoping of the future revision of Chapter VII
(Intra–group services) of the OECD’s Transfer
Pricing Guidelines**

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Sent via upload TransferPricing@oecd.org

Brussels, 20 June 2018

Dear Jeff,

EBIT's Members are grateful for the opportunity to provide comments on the OECD's public consultation running from 9 May – 20 June 2018 with regard to the scoping of the future revision of Chapter VII (intra-group services) of the OECD's Transfer Pricing Guidelines (TPG).

The comments provided in the present EBIT position paper are in line with the submission by EBIT from January 2015 to the OECD <http://www.ebit-businessstax.com/pdf/pwc-ebit-comments-on-beps-action-10-proposed-modifications-to-chapter-vii-of-the-tpg-low-value-adding-intra-group-services.pdf>

Comments

There are a number of issues that EBIT believes are important for Working Party 6 to undertake further analysis. In line with the OECD's request for feedback we will focus primarily on the practical application and challenges with regard to the guidance in Chapter VII.

Symmetry in the allocation / deduction of costs

Countries' views on the allocation / deduction of cost vary resulting from, for example, the qualification of the costs as a shareholder activity. The country of the 'recipient' may view the transaction as a shareholder activity, while the country of the 'provider' may view the transaction as the rendering of a service. In such a case, because of the disagreement between the countries, the costs are neither allocated for tax purposes to the 'recipient' nor to the 'provider', which leads to unresolved double taxation. EBIT Members consider that it would therefore be useful if the OECD TPG would stipulate that all costs should be allocable and deductible. Another area where asymmetry can arise is where costs cannot be charged to the recipient of the service due to certain restrictions (e.g. currency controls). It would therefore be useful if the OECD could provide guidance on the allocation of the excess as a shareholder cost or other shared cost for the MNE group.

In addition to paragraph 7.10 of the OECD TPG, EBIT would welcome more extensive, detailed guidance and examples of activities that would actually qualify as shareholder activities. With regard to stewardship, we would also welcome it if the TPG indicate that if the stewardship activities benefit the operations of the local entity (e.g. internal controls and policy development, the local entity should also bear the costs. This is further complicated by MNE groups which may have regional and/or business headquarter structures where benefits and deductibility can be challenged in all jurisdictions (global headquarters, regional or business 'provider' jurisdiction, and the 'recipient' jurisdiction).

Head-office costs

In addition to the symmetry in the allocation and deduction of costs, EBIT would welcome guidance from the OECD on its view regarding the qualification of head-office services especially in relation to the guidance on the assumption of risks as set out in chapter 1 and the guidance with respect to the control over DEMPE as described in chapter 6. EBIT would for instance appreciate guidance on how to view the functions and responsibilities of a MNE group's management board and clarification under which conditions the management board's activities could establish control and management of certain risks or control over DEMPE functionality of an intangible developed by the management board's (and head-office) functionality. EBIT notes that a cross border misalignment of interpretation and characterization may result in partial double taxation.

Such misalignment could be established if the country of the 'recipient' would view the transaction as the provision of a services entitled to a profit mark-up on related expenses, while the country of the 'provider' would view the transaction as a license giving control over DEMPE related to an intangible created by head-office. In such cases, because of the disagreement between the countries on the qualification and nature of the transaction, the transaction price may not be fully tax deductible at the level of the 'recipient' but fully taxed at the level of 'provider', which could lead to partial unresolved double taxation.

Misuse of local comparables

Services may be rendered through foreign affiliates, the charge of which is based upon the costs incurred in the foreign country. In a number of cases, we have experienced that the initial higher charge for the service was rejected and replaced by a lower charge based on local comparables' cost bases in the country of the service recipient. EBIT considers that such comparison with local comparables may be appropriate for risk assessment purposes, but should not serve as a direct basis for rejecting the initial (higher) charge from the services provider.

As such, elements to consider might be for example the complexity of the services rendered and the available knowledge and skills at the level of the service provider. The costs to be included in the cost base of the remuneration for the provision of the services should be the costs incurred in providing the service, and the mark-up applied should be the arm's length mark-up in the country of the actual service provider. As also stated in EBIT's submission letter to the OECD of January 2015, EBIT Members urge the OECD to add a specific reference that random limitations on deductibility of intra-group service charges should be avoided by tax administrations.

Benefits Test

One of the more difficult issues in applying the OECD's guidance on intra-group services is the use of the benefits test, i.e. whether the activity provides a respective group member with economic or commercial value to enhance or maintain its business position (would an independent party have been willing to pay for the activity or have performed the activity in-house for itself). It would also be useful to confirm the specificity of the benefit received and whether it could be shown that the recipient is the "ultimate beneficiary" of that service. In EBIT Members' view the benefits test should be considered to be fulfilled when adequate information (through the master file and local file) is available demonstrating the arm's length character of the service provided / received. As indicated in paragraph 1.11 OECD TPG, related parties may engage in transactions that unrelated parties would not engage in. This does not mean, however, that the transaction does not satisfy the arm's length principle. However, taxpayers concerned are not able to demonstrate that the benefits test is fulfilled because of the reference to independent parties. Therefore, the adequate documentation should be sufficient.

Many MNE groups have centralized the provision of services in order to operate more efficiently. The focus has been on sharing group synergies, but countries should be prepared to share costs as well, since it is the natural consequence.

Direct-charge versus indirect charge methods

EBIT stated in its submission letter to the OECD Discussion Draft on BEPS Action 10 of January 2015 that we do not necessarily agree with the statement in paragraph 7.23 OECD TPG that the direct-charge is the default method and to be preferred. EBIT is concerned about the prescriptive language in the following sentence: “indirect-charge methods (...) should be allowable provided sufficient regard has been given to the value of the services to recipients and the extent to which comparable services are provided between independent enterprises. These methods of calculating charges would generally not be acceptable where specific services that form a main business activity of the enterprise are provided not only to associated enterprises but also to independent parties.” EBIT strongly believes that MNEs should be free to decide the best method for their group structure, i.e. either one of the direct or the indirect charge methods, as long as they adhere to the agreed OECD guidance. There is simply not a “one size fits all” or default method that is suitable for all MNEs.

Broad geographical application of the simplified approach to low value-adding intra-group services

Upon publication of the BEPS Action 8-10 Report, the summary on the Revision of Chapter VII indicated that for the simplified approach to be effective, it must be adopted and applied on a geographic scale that is as broad as possible and respected in both service provider and service recipient countries. A two-step approach for its implementation was developed:

- A large group of countries endorsing the application before 2018;
- Further analysis on threshold and implementation issues for countries that have a concern in order to have an even more widespread application. This follow-up work would allow additional countries to adopt the simplified approach.

Currently, to the knowledge of EBIT, only the transfer pricing country profiles indicate¹ whether the country concerned has a simplified approach with regard to low value-adding intra-group services but no further analysis has been undertaken yet. EBIT regrets to see that not even all OECD Member countries follow the guidance on the simplified approach.

EBIT urges OECD to continue the analysis and the follow-up work to obtain a more broad geographical use of the simplified method as put forward by the BEPS Action 8-10.

5% profit mark-up for low value adding services

Although paragraph 7.61 of the OECD TPG states that the 5% profit mark-up should not be used without further justification and analysis as a benchmark for the determination of the arm's length nature for services that do not fall within the definition of low value-adding services, nor for familiar services that do not fall within the elective, simplified scheme, EBIT urges the OECD to provide additional clarification and guidance that the ‘safe harbour’ of the 5% profit mark-up does not by definition entail that non-low value-adding activities / services should be remunerated with a profit mark-up of at least exceeding 5%. This in order to prevent misinterpretation between MNEs and authorities of the scope and reach of the application of the 5% profit mark-up ‘safe harbour’.

¹ Item 16 of the country profile

Demonstrating that a service has been rendered and / or provides a benefit to the recipient

The OECD TPG guidance should encourage simplified approaches. The objective would be to simplify and reduce the number of services that would be subject to detailed review. It is important to keep in mind that there are two sides to the service – services provider and recipient. The service provider should be entitled to recover the costs incurred with the corresponding margin. We would also welcome clarification on whether third party costs form part of the service that should be marked up or whether these can be considered pass-through costs with no mark-up.

Identifying in practice duplicated activities

It is important to take into account that even if the activities are in the same area (e.g. marketing) they often refer to different steps in a chain or different responsibilities. The distinction can be shown by describing the specific scope of the activities of each company including the objective pursued.

Finding an appropriate allocation key

- The allocation keys should be clear, easy to manage, auditable and consistently applied in order to prove that there is no intention to load a specific entity.
- Different allocation keys could be appropriate depending on the circumstances (e.g. sales, number of users/computers, number of employees, number of postings, time spent...).

EBIT's Members trust that the above comments are helpful and hope that they will be taken into account by Working Party No. 6 of the OECD on the Taxation of Multinational Enterprises. EBIT is always ready to discuss with the OECD and any other stakeholders.

Yours sincerely,

European Business Initiative on Taxation – June 2018

For further information on EBIT, please contact EBIT's Secretariat via Bob van der Made, Telephone: + 31 6 130 96 296; Email: bob.vandermade@pwc.com).

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Tax Treaties, Transfer Pricing and Financial Transactions Division
Centre for Tax Policy and Administration
Organisation for Economic Cooperation and Development
By email

SCOPE OF THE FUTURE REVISION OF CHAPTER VII OF THE TRANSFER PRICING GUIDELINES ON SPECIAL CONSIDERATIONS FOR INTRA-GROUP SERVICES

20 June 2018

Dear Sir / Madam,

By means of this letter, EY would like to share its comments on the scoping document relating to the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines (the Ch. VII Scoping Document), as released by the OECD on 9 May 2018.

We appreciate the opportunity to provide comments and to contribute to the public consultation and discussions regarding the upcoming revision of Chapter VII of the Transfer Pricing Guidelines (the TPG). Our comments in this letter are structured as follows:

- Firstly, we will outline the need for stronger global adoption of the simplified approach for low-value adding services;
- Secondly, we will discuss a key overarching recommendation relating to the contribution of control over risk that needs to be considered for intra-group services; and
- We will then discuss our comments to the specific issues raised in the Ch. VII Scoping Document.

This letter presents the collective view of EY's global international tax network. If you have comments or questions, please feel free to contact any of the following:

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Yours Sincerely,
On behalf of EY

Ronald van den Brekel

Stronger global adoption of the simplified approach for low-value adding services

The current guidance in Chapter VII of the TPG was updated to introduce a simplified approach for low-value adding services.

A survey in our network has shown that charges for low value adding services are one of the top ranking issues leading to double taxation. We believe that the simplified approach for low-value adding services is a step in the right direction in providing tax certainty while at the same time reducing administratively burdensome tasks. In order to continue widespread adoption of the simplified approach, the OECD is strongly encouraged to pick up on its goal of achieving geographic scale on this topic.

To achieve this, we urge the OECD to consider implementing the approach in a multilateral and binding way, for example by having Inclusive Framework Members agree to a Multilateral General Competent Authority Agreement on the issue. Such could, for example, be done in the context of the work of the MAP Forum of the Forum on Tax Administrations. This would also limit the amount of tax controversy around an area that in itself is not creating high tax risks.

Contribution to control over risk

We understand that as part of the redrafting of Chapter VII of the TPG, Working Party No. 6 on the Taxation of Multinational Enterprises (WP6) will be aligning the guidance in Chapter VII with the guidance contained in Chapter I of the TPG. We feel that as part of this project, WP6 should clarify the distinction between the assumption of risk, and the contributions to control over risk by other affiliates within a multinational enterprise (MNE). Specifically, the guidance in Chapter VII should clarify that once risk assumption is determined according to the six step analytical process as defined under Section D of Chapter I of the TPG and risk is allocated to one of the enterprises, then any contributions to control over risk by other affiliates of an MNE should be considered a service on behalf of the affiliate assuming risk, rather than constituting a basis to share in risk assumption.

The guidance in Section D of Chapter I TPG is concerned with accurately delineating the taxpayer's actual transaction. It is based on this section of the TPG, and this section only, that a taxpayer's arrangements can be respected, or alternatively recast, re-characterized, or disregarded. Once a transaction is accurately delineated, then such issues as risk assumption, characterization (e.g., contract research and development, full-fledged distribution), and the form of payment (including by implication the allocation of residual returns) are considered *settled*. At that point in time, the transaction may be priced in accordance with the arm's length principle.

The guidance on risk in Section D of Chapter I of the TPG is process-based, rather than subjective or determinative. The processes are 1) *fact-finding*: identify risks; 2) *fact-finding*: determine the contractual allocation of risk; 3) *fact-finding*: determine who performs control or risk mitigating functions, who historically has borne upside and downside of risk outcomes; 4) *interpretive*: interpret the information – are contractual terms followed, and is the entity contractually assuming risk exercise control over that risk and have the financial capacity to assume risk? If the answer to the question posed in 4) is 'yes', then the analysis with respect to risk is complete and the transaction is defined. If the answer to the question is 'no,' then step 5 determines the entity or entities who are considered to assume the risk.

For example, assume that a taxpayer's contractual arrangements pass the risk analysis test contained in Chapter I of the TPG, and accordingly constitute the accurate delineation of the transaction. As stated in paragraph 1.87 of the TPG, "where a party contractually assuming a risk

applies that contractual assumption of risk in its conduct, and also both exercises control over the risk and has the financial capacity to assume the risk, then no further analysis is required,” and the transaction is priced. Paragraph 1.94 of the TPG states that this conclusion does not change merely because there are other affiliates of the MNE that may be considered to be contributing to the control over risk. Paragraph 1.94 of the TPG is important in practice because it prevents the possibility of a contractual arrangement being routinely re-characterized due to a subjective determination that other affiliates within the MNE are contributing to control over risk, notwithstanding that the contractual allocation of risk was accurately delineated.

In undertaking the task of aligning the guidance in Chapter VII with Chapter I of the TPG, we strongly encourage WP6 to clarify and make clear that once risk assumption is determined under the accurate delineation of the transaction in Chapter I of the TPG, then contributions by other affiliates of the MNE to the control over risk should be considered services performed on behalf of the entity assuming the risk.

With paragraphs 1.87 and 1.94 of the TPG as background, paragraph 1.105 of the TPG makes the obvious point that all contributions to value – including control over risk contributions by an affiliate of an MNE group on behalf of the affiliate assuming the risk – should be appropriately remunerated, and that “compensation which takes the form of a sharing in the potential upside and downside may be appropriate.” By definition, this last clause can only be appropriate if such sharing in the potential upside and downside of the risks follows from the accurate delineation of the transaction.¹ After the actual delineation of the arrangement, the contribution to the control should be priced. This implies that the party contributing to the control will only be compensated with a share in the potential up- and downside if the contractual arrangement as accurately delineated includes a form of a sharing in the potential upside and downside of the risk. An example would be if the arrangement agreed between the party assuming the risk and the party contributing to the control of that risk stipulates that the payment to the contributor is contingent upon successfully performing the service.

An alternative interpretation of paragraph 1.105 of the TPG is that it serves as a “trumping” rule, such that when an affiliate, other than the affiliate contractually assuming risk, exercises *some* control over that risk, then the affiliate exercising some control over that risk should share in the upside and downside of that risk; that is, they should also be assuming the risk. This interpretation of paragraph 1.105 of the TPG effectively *re-characterizes* the contractual risk assumption, notwithstanding that the contractual risk is irrefutably respected under the analytical process. That is, this incorrect interpretation of paragraph 1.105 of the TPG imposes an arrangement that is *directly contrary* to the accurate delineation of the transaction.

Thus, the first mentioned interpretation of the relationship between paragraphs 1.87, 1.94 and 1.105 of the TPG is internally consistent and preserves the ability of the overall guidance on risk to be administrable. The second interpretation makes the paragraphs entirely contradictory. We strongly encourage WP6 to clarify these points in interpretation, with appropriate cross-references to Chapter I of the TPG, in the revised Chapter VII.

¹ Paragraph 1.105 of the TPG is part of step six of the analytical process, which is concerned with pricing the transaction. Thus step six only applies when the accurate delineation of the transaction is *already* established.

Our comments to the specific issues raised in the Ch. VII Scoping Document

The comments in this section will address the specific issues raised in the Ch. VII Scoping Document, namely:

- ▶ Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient;
- ▶ Drawing a distinction between: (i) activities which do or do not benefit the local affiliates; (ii) benefits that purely arise from group membership and those that arise from a deliberate concerted action; and (iii) shareholder activities and stewardship activities;
- ▶ Identifying in practice duplicated activities;
- ▶ Finding an appropriate allocation key for charging intra-group services;
- ▶ Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises; and
- ▶ Assessing the arm's length conditions for services provided in connection with the use of intangibles; services that are highly integrated with the value creation of the MNE group; and/or involve significant risks.

Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient

We recommend that the upcoming guidance in Chapter VII of the TPG to acknowledge and make explicit that there should be a presumption that any activity performed by a multinational enterprise (MNE) is seen as contributing to value generation or value protection, i.e. there should be an underlying presumption that if an MNE decides to perform an activity, regardless of the location of the performance of those services, then this activity provides some kind of commercial benefit. As such, any activity that is actually performed in relation to a "service" either has to be a service benefiting the recipient (or another group entity) or the provider (as a direct beneficiary or as a shareholder). In addition, there should be a presumption that the expected benefits exceed the costs, as no MNE would (structurally) incur costs unless it expects a benefit that outweighs those costs. The guidance in Chapter VII should make explicit that tax administrations be precluded from making an assessment of whether the service fee exceeds the expected benefits. While we fully appreciate the importance of the benefit test, we strongly feel that the benefit test should not be used gratuitously by tax administrations to render the receipt of intragroup services non-deductible. In practice, we feel that tax administrations should focus more on assessing whether the allocation key is appropriate, and less on the determination of a service being rendered and / or providing benefits.

A major point of contention and challenge by tax administrations is the challenge of the benefit test when analyzing intra-group services. Many taxpayers are faced with an unnecessary administrative burden around proving benefits, which appear to be very difficult to manage in practice as proving a benefit can be very subjective given the lack of clarity in Chapter VII on benefits. We have seen taxpayers being asked to provide quantitative benefit tests demonstrating that the intra-group service provide a clear traceable and financial benefit to the service recipient. In many cases, we have seen tax administrations compare the charge of the intra-group service to a local third party service provider in the jurisdiction of the local affiliate, and attempt to use this as evidence that no benefit has been provided, or to significantly decrease the value of the service rendered. The administrative burden in providing quantitative evidence in many cases outweighs taxpayers' potential savings on the tax leakage which would arise from an adjustment to the services charge, leaving the taxpayer with a resource and cost decision to make. Ultimately, this results in an

adjustment being made, even though the services provided indeed provided a benefit and were allocated properly, thus diminishing the arm's length standard.

Given this common and practical challenge, we strongly urge the OECD to make clear that qualitative examples of expected benefits are sufficient to prove benefits for intra-group services. Quantitative benefits for intra-group services should not be a pre-requisite for sustaining a local deduction for the charge. For low-value adding services, paragraph 7.54 and 7.55 of the TPG currently state that if the simplified approach is applied then sufficient evidence is provided to pass the benefit test, however we have seen in practice that tax administrations may ask for more strenuous determination of benefits for low-value adding services.

Drawing a distinction between: (i) activities which do or do not benefit the local affiliates; (ii) benefits that purely arise from group membership and those that arise from a deliberate concerted action; and (iii) shareholder activities and stewardship activities

Similar to our point above regarding whether a service is actually rendered and / or provides a benefit to the service recipient, there should be a presumption that any activity performed by an MNE is seen as contributing to value generation or value protection, i.e. there should be an underlying presumption that if an MNE decides to perform an activity, regardless of the location of the performance of those services, then this activity provides some kind of commercial benefit. In this case, the key in drawing a distinction if an activity benefits a local affiliate or another member of the group lies more in the allocation key selected (including the determination of shareholder / stewardship activities), and less in the benefit test.

Regarding benefits that arise purely from group membership without any concerted action, these benefits should clearly not be considered services and in our view does not warrant any further discussion or guidance in Chapter VII of the TPG. What Chapter VII of the TPG should acknowledge, is that deliberate concerted action by or between affiliates that result in benefits should not immediately be considered the provision of a service that can be adequately rewarded with a cost plus remuneration. In this respect, Chapter VII should cross reference other chapters of the TPG.

Importantly, the guidance in Chapter VII should be treated as a closed system in the sense that when activities may be classified by a tax administration in the jurisdiction of a service recipient as not providing a benefit to the local affiliate, but the tax administration in the jurisdiction of the service provider considers as a non-shareholder activity, the inconsistency in the characterization should not lead to double taxation.

Identifying in practice duplicated activities

From the perspective of a service recipient, proving that duplicated activities were not performed is an administratively burdensome task and counter-intuitive. Given this, and in the same spirit of our comments above, we urge the OECD to put less emphasis on requiring taxpayers to demonstrate that activities performed are not duplicative. In practice, it is very difficult for a taxpayer to prove a negative outcome, i.e. the onus is on the taxpayer to demonstrate that an activity performed by the service provider is not the same activity performed by the service recipient. The TPG already implies that activities should not be presumed to be duplicative, however this guidance should be expanded to increase tax certainty. See paragraph 7.2 of the TPG, which states "It is not in the interests of an MNE group to incur costs unnecessarily, and it is in the interest of an MNE group to provide intra-group services efficiently." Proving activities are not duplicative is an unnecessary administratively burdensome task that if relieved, would allow both tax administrations and taxpayers to focus their resources in more value adding activities.

Another issue with duplicated activities is that even if the services provided are not duplicative in nature, they may be perceived to be duplicated by a tax administration. This is especially common in MNE's that have global level services, regional and business unit type services, and then local services. We have seen tax administrations take a position that multiple intra-group service charges from various providers is an indication of duplication. This is clearly not the case, and the guidance in Chapter VII should emphasize that MNE groups structure their operations in sometimes unique and different ways, and as a result the method to structure their services charge will reflect that.

Finally, in our view, one instance in which an MNE may be seen as performing duplicative activities in the context of the provision of intra-group services will be in the case of post-acquisition / mergers of MNEs. This may arise when an acquiring MNE has mechanisms in place to allocate services which may be similar or duplicative to mechanisms already in place of the target MNE. However, it is not economically rationale for an MNE to continue to incur additional costs, based on our experience, MNE's will identify and eliminate any duplicative activities in post-acquisition / merger scenarios. We urge the OECD to consider an exemption for duplicative activities for a certain period of time in post-acquisition / merger scenarios. This would not only increase tax certainty, but also work to eliminate barriers to cross border trade.

Finding an appropriate allocation key for charging intra-group services

Selecting and applying a proper allocation key, in our view, is the most fundamental aspect for charging intra-group services. As we discussed above, we strongly feel that from a practical implementation perspective, tax administrations should be encouraged by guidance in Chapter VII of the TPG to focus less on the issue of a service being rendered, the service providing benefits, and / or being duplicative; as the presumption should always be that an MNE will attempt to allocate its resources as efficiently and effectively as possible, and therefore would not attempt to provide unnecessary services or duplicative services that do not provide a benefit to the recipient or the group itself. The main question should be to assess which party or parties within the MNE receives the benefit from those activities performed. This question can be answered by examining the allocation key selected for charging out intra-group services.

We have observed many challenges taxpayers face around the selection of appropriate allocation keys which typically arise under examination by the tax administration during a tax audit. A main challenge faced is that tax administrations unnecessarily challenge the allocation key used by a taxpayer and may ask the taxpayer to recalculate and demonstrate the results if a different allocation key is used, or insist that only a direct charge of the cost providing the service is appropriate, rather than an indirect allocation. This, in our view, is an unnecessary and burdensome task and contradicts the burden of proof principles that the taxpayer has already demonstrated by preparing proper transfer pricing documentation. To alleviate this, we urge the OECD to set out guidance and best practices in Chapter VII of the TPG (or an appendix) for tax administrations to follow when assessing the allocation key selected by a taxpayer. This will also provide transparency and increased tax certainty to the taxpayer.

Another point of contention that we have observed is around the bundling of many different types of activities into a single intra-group service charge accompanied by a single, global allocation key used. From the taxpayer's perspective, this bundling of services and selection of a single global allocation key may provide the most reasonable split of charges based on benefits. However, we have seen tax administrations, without justification, challenge the use of a single allocation key for the provision of bundled services. We recommend that the guidance in Chapter VII of the TPG further address this, and perhaps provide examples in which a single global allocation key may be an acceptable indicator of benefits provided.

Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises

The question of what costs that should or should not be included in the cost base when determining the remuneration of services is a question of comparability and sufficiently covered in Chapter III of the TPG.

What we have seen in practice is the question of whether a mark-up should be applied to third-party costs incurred by a service provider, or if these third-party costs should be charged out "at cost". Again, in our view this is a matter of comparability covered under Chapter III of the TPG as well as sufficiently covered under paragraphs 7.35 – 7.37 of the TPG when discussing whether to add a profit element.

A further issue that continues to give rise to issues of inconsistency in treatment of the cost base concerns share based compensation. We suggest that the OECD study "Employee Stock Option Plans: Impact on Transfer Pricing" be reviewed and included as part of the guidance contained in Chapter VII of the TPG. This will assist taxpayers and tax administrations in determining what amounts of share based compensation should be recognized in transfer pricing methods that rely on salary and other forms of remunerations as a detriment or in testing of the arm's length price, e.g. application of the cost-plus or transactional net margin methods.

Assessing the arm's length conditions for services provided in connection with the use of intangibles; services that are highly integrated with the value creation of the MNE group; and/or involve significant risks.

For services in connection with the use of intangibles and / or highly integrated with the value creation, we do not feel that specific guidance in Chapter VII of the TPG needs to be developed to address this. The guidance in Chapter VI of the TPG for special considerations for intangibles is already sufficient in this regard.

Relating to assessing the arm's length conditions for services which involve the management / control over certain significant risks, please refer to our comments above in the section titled "Contribution to control over risk".

FBF/ COMMENTS ON THE SCOPE OF THE FUTURE REVISION OF CHAPTER IV (ADMINISTRATIVE APPROACHES) AND CHAPTER VII (INTRA-GROUP SERVICES) OF THE TRANSFER PRICING GUIDELINES

Submitted by e-mail: TransferPricing@oecd.org

June 18, 2018

Dear Sir,

The FBF, as the voice of the French banking sector representing the interests of over 400 banks operating in France, encompassing large and small, wholesale and retail, local and cross-border financial institutions, is pleased to provide comments on the public discussion on the scope of the future revision of Chapter IV (administrative approaches) and Chapter VII (intra-group services) of the Transfer Pricing Guidelines.

We understand that The OECD is considering starting two new projects to revise the guidance in Chapter IV (administrative approaches) and Chapter VII (intra-group services) of the Transfer Pricing Guidelines. In this context Public comments are invited on:

- the future revision of Chapter IV, “Administrative Approaches to Avoiding and Resolving Transfer Pricing Disputes” of the Transfer Pricing Guidelines, and
- the future revision of Chapter VII, “Special Considerations for Intra-Group Services”, of the Transfer Pricing Guidelines.

1- As far as future revision of Chapter IV is concerned, French financial institutions (FIs) underline that, from a practical point of view, the administrative approaches intended to avoid and resolve transfer pricing disputes as recommended within the OECD guidelines, are very rarely implemented. In this regards, it is very difficult to make any reservations as to the efficiency of any scheme in force. It should be noted however that in case of tax audit, it is usually not possible for the audited entity to ask for corresponding adjustments from the other tax administration, as a prerequisite from the French tax administration. Another point which does not favour the use of mutual agreement procedure is the fact that engaging in such a procedure does not freeze the payment of the tax adjustments. Also there is a total uncertainty on the delays under which a possible agreement may be reached and the final adjustments which will be due. For all these reasons, this procedure is difficult to use and therefore inefficient.

Irrespective of this remark, French banking sector is of the view that, for purpose of improving the resolution of disputes by the competent authorities, **implementation of an “upstream” mutual agreement procedure which would thus intervene before the occurrence of the disputes, is the only interesting solution to consider.** This procedure could be framed

within a delay in order to push the tax administrations to an agreement and reinforce legal security for companies. This could be applied to an ongoing issue concerning the banking sector: the capital dotation of EU branches. As there has never been any agreement between European tax administrations, French banks are facing a double taxation issue for many years.

2- As far as future revision of Chapter VII is concerned, as preliminary remark, French banking industry is of the view that, as long as it is proved that the arm's length principle is complied with under the "benefit test analysis", determining whether or not "intra-group services" have been effectively provided must fall under the responsibility of the tax administration i.e. **the burden of proof regarding the existence of intra-group services should be on tax authorities rather than on taxpayers.** This should be the case also regarding "duplicated service's which do not qualify, at first sight, as intra-group services.

Regarding **shareholders activities**, it is imperative that a notion of "**expenses of higher interest group**" should be introduced for purpose of treating as "intra-group services" all services performed by a parent company solely because of its ownership interest in one or more group members.

To be more specific, the purpose is to allocate as intra-group services, all expenses engaged by the parent company even though this expense would not have been incurred by an entity on a standalone basis and this only because the expenses is engaged for the "group higher interest". This could be the case, for instance, regarding expenses linked to a litigation involving only the parent company but which may have a major impact on the group as whole. An example can be found in the strategy direction. Also, allocation of exceptional costs by the head of the group should be authorised in certain specific situations.

Another improvement is a more clear definition of direct (which are invoiced as such) and indirect services (which are invoiced with a distribution key).

Best regards,

From: Ferrovial Group

Reference: Comments on Chapter VII of TP Guidelines

Date: 20 June 2018

EXECUTIVE SUMMARY

Under the actual transparency scenario in the tax field with increment of reporting activities, Tax Administration are in a better position to understand the scope of the intercompany charges of MNE. Historically harmful practices reduced the tax invoice of MNE but in the new frame of transparency in a global business world MNE faces a heavy compliance and administrative work to find an allocation criteria for its centralized resources when the only reason for this costs are the worldwide entities.

MNE with centralized functions and an international presence are under the scrutiny of (i) the head office local authorities to allocate their centralized costs and (ii) under pressure of the local authorities recipient of the charges to avoid them. This uncertainty increase when the intercompany transaction is "an immaterial transaction" such as a service or the use of an intangible (more if they are soft intangibles). In this case the prove of the provision of the support is immaterial and therefore of difficult demonstration and evaluation

When MNE implements a general policy for all their worldwide entities which are under the some profile of (i) business activity, (ii) functions developed (differences between organic and inorganic entities) and (iii) risks supported, with no exceptions applicable to implement a tax planning structure, the tax authorities should collaborate to give certainty to the MNE and approve their policies. This agreement will avoid discussion between tax administrations and unnecessary costs to the MNE. The simplicity in the administration should be consider a key point in the Guidelines, the MNE focus their efforts in reach more clients and incomes and cut their costs in the administrative issues that don't generates value for them.

The certainty should be a general acceptance criteria impose to the worldwide tax administrations under OECD and not subject to bilateral or multilateral procedures between the tax administrations that drives to a long discussion process between them and adds uncertainty to the system.

When entities are related party under the TP rules and have intercompany transactions, but (i) the transactions are approved by a third party (ex. PPPs the lenders of the project approve all the intercompany of the shareholders with the SPV) the transaction should be consider an arm's length transaction and (ii) when intercompany transactions of the partners of an SPV are agree previously to set up the SPV, the intercompany is agree between independent parties but invoiced during the life of the project between related companies; considering the agreement is made between independent parties the transaction should be consider arm's length.

CHALLENGES POINTED

- 1- Effective services provision and benefit test.

- a. Sometimes the reality in the MNE is that the recipient entity will not be willing to pay for the services provided by the provider. Under the actual definition of services this case will fall under shareholder activities (7.10 last paragraph), however frequently in MNE the recipient entities cannot give value to the services provided but from a strategical point of view of the MNE this support is a key factor to implement its successful business model. This successful business model could be: management procedures; importance to the efficient management of the cash; access to vendors, clients, partners or lenders, etc... Some them seems obvious for a business efficiency but when the competitors are struggling with difficulties and your MNE is still standing up, this soft intangibles could be the key factors difference. This support is more connected with soft intangibles than services transactions but due to the difficult definition and valuation its defense with the tax administrations would be uncertain.
- b. In a centralized Group, the central services entity need a structure to provide the services but in specific years because business reasons it would be impossible to demonstrate the effective provision of some services. Ex. Construction local entity submits a bidding offer to the Local Administration, the bidding process is stopped during a period of time because administrative reasons so effective services are not provided during that year but will be provided next years. The Group entity with the central provision of services position has a personal structure that have to be allocated to the local entities also in that year.

2- Distinction between

- a. **Activities which benefit or not the local affiliate.**
According with the value chain functions if the local entity has not this function in-house an external support would be necessary. When the MNE head office has this functions and an allocation policy without distinction between entities with the same functional profile, the benefit test should be approved to present a simplify approach to MNE and offer a legal certainty.
- b. **Benefit that arise from group membership and those arise from deliberate concerted action.**
The benefits of the Group membership most of the times are soft intangibles because as a difference with the services an action from the provider is not necessary. Under the actual approach of the Directives the synergies should be taken into account to evaluate the other transactions but it is not an specific transactions by itself.

In some sectors a specific business activity inside the Group which complete other activity could be a competitive advantage. Ex. Construction division in a Group with a

infrastructure management division give certainty regarding the deadlines and quality of the Construction, which are key factors to start the operational period of the infrastructure. At the same time, infrastructures division offers commercial opportunities to the Construction entities. In this scenario the synergies more than considerations to analyze other transactions should be a soft intangible transactions by themselves.

c. Shareholder activities and stewardship activities.

To give certainty to the taxpayer some actions such as:

- i. Include a close list of services/cost which would not be consider shareholder activities.
- ii. Inclusion or exclusion of the list should be supported by the MNE.

3- Duplicate activities in practice.

When same functions are duplicated in a Group with a waterfall structure (ultimate parent of all the Group, parents of each business division, local parent of each of the business, local operative entities, etc...), the services provided are in most cases of the same nature but of different type: starting in general policies at the top of the structure and reaching a most local and operational approach when we go down. The structural costs of MNE could not be put under question and therefore only the allocation criteria could be an issue. As we mention before, when the allocation criteria is consistent for all the worldwide entities (considering the different business models and functional profile of the recipients, ex. Organic and inorganic growth entities) without any planning the criteria chosen should not be questioned.

4- Finding an allocation key for charging intragroup services

- a. The on call services are not a problem for allocations, usually time reports can be done to calculate the charges. The problem in most of the cases is the comparable to this time report allocation of costs (hourly rate). The structure costs of an organization should not be argued, so if the hourly rate is cheapest or more expensive should not be the question. Therefore external comparables should be not necessary when:
 - i. Calculation methodologies of the centralized departments of MNE are (i) calculate the hourly/rate based on the structure costs plus a market mark-up divided by the hours worked and (ii) allocated the hourly/rate based on a time report, and
 - ii. Internal comparables are not available because the centralize services are provided only to Group companies.
- b. Services at disposal need a personal structure to provide the services when they are necessary for the business. This services could need an action of the provider or can be "passive services", which generate a value for the recipient but not need an action of the

provider (ex. Internal procedures of investment; access to key parts for the business such as lenders, providers or clients). The “passive services” are more connected with the soft intangibles than with services but as not protected intangibles its definition and valuation is not easy an neither the demonstration to the tax administration of the recipient country. The “passive services” usually don’t exists in the market because as competitive advantages are provided only within the Group. The valuation of this transaction should be related with the benefit generated for the recipient entity, ex. Previous experience in Construction sector in bidding generates incomes when the local bidder is awarded and therefore part of the income should be shared the experience credentials entity.

The services at disposal are usually allocated base on different allocation keys depending the type of the services and the business (sales, number of users, etc). Tax administration sometimes question the allocation keys but when general policies without tax planning structures and tax benefits are taken by the companies as a measure of easy administration of the MNE it should be accepted and approved in a frame of certainty and cut of costs to MNE and tax administrations.

5- Which costs included and which excluded from the cost base remuneration.

In both type of the services, on demand and at disposal, all the costs necessary for the provision of the service should be included, direct and indirect, we cannot put under question the business model and therefore its structure.

Recharge of costs of services provided by a third Group entity throughout coordination centers should be accepted without a mark-up for the transaction (ex. Included in the services provided as coordination center).

6- Assessing arm’s length conditions for services provided in connection with:

a. The use of intangibles

Soft intangibles most of the times are connected with services provided, sometimes is difficult to desegregate the part of services and intangibles because the personal structure providing the services and generating the intangibles are the same and an allocation of which part is each of the transaction is not easy.

An aggregated charge of services and intangibles should be approved to give certainty to the model if this is the best method. Also a possible allocation of personal to provision of services and generation of the intangible could be an option, but as in most of the allocation criteria this option has a subjective part in the methodology that it is under the scrutiny of the tax administrations when defined in the TP policy.

b. Services that are highly integrated with the value creation of the MNE group

Typically are under request services and therefore its own evaluation criteria is easier to be done.

Regarding the valuation and considering the lack of accuracy of the external comparables, in the frame of certainty it would be highly recommended have a market value interquartile range for different type of services of high value and medium value as in the case of the low value services.

c. Involve significant risks

The services provided under high risks can be remunerated with a success fee commission. This commission should be understand as high risk is equal to high profitability, because in some way the remuneration of the successful projects should compensate the loss of failure ones. When services provided to a Group entity not reach the scope of the service, they will not be remunerated. This commission usually should be supported with internal comparable of the some type of services or when not internal comparable exists with valuation methods as the Lehman or Double Lehman formula.

In the infrastructures management industry the high risk services are the bidding services provided by entities of the Group with personal structure and knowledge to attend the bidding requirements and prepare the best bidding offer. This services are key factor for the business because (i) base on the offer could be a successful project or not, (ii) depending of the previsions the lenders would issue the finance and (iii) in case of success an incorrect prevision could drive to the bankruptcy of the project. When the bidding services fail, the bid is not awarded and all the costs supported are not remunerated in any manner.

June 20, 2018

Tax Team Grande Stevens
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Sent via email to TransferPricing@oecd.org

Comments on the scope of the future revision of Chapter VII

Dear Sirs,

We are pleased for the opportunity to submit our comments on the subject matter based on our professional experience.

The scoping document issued on May 9, 2018, requested views of interested parties on how Chapter VII could be revised or supplemented to address the issues related to the practical implementation of the TPG in the context of intra-group services, thus increasing tax certainty for taxpayers and preventing double taxation.

Specific practical issues have been identified for comments, which will be discussed further below. Before entering into their discussion, however, we wish to submit a few basic general remarks.

In the preparation of our comments, we have reviewed the subsequent versions of the Transfer Pricing Guidelines from the first edition in 1979 through the 2017 one. Complexity of transfer pricing has progressively forced to expand the guidelines from the 107 pages of the 1979 first edition through the 262 pages of the 1995 and the 375 pages of the 2010 edition up to the 612 pages of the latest edition. Specifically, chapter VII (initially Chapter IV in the 1979 edition) has expanded from the initial 14 up to current 25 pages. Its structure is based on the 1979 framework with following amendments and additions on details but remains essentially unchanged conceptually, particularly from the 1995 edition to date, except for the inclusion of the specific section D.21 on low value-adding services.

It is remarkable the effort made by WP6 and representatives of OECD member States and any further non-member participants to provide the business and professional communities with directions to streamline tax treatment of intra-group transactions and, specifically, service fees.

We wonder, though, if the structure of Chapter VII should be re-considered taking into account it is still based on the 1979 Guidelines' framework at times where multinationals were organized on a per-Country basis with local affiliates ordinarily carrying out a complete and independent business cycle from production to sales and collection. At that time, the benefit of centralized services was indeed subject to uncertainty as linguistic, accounting, communication, currency and further barriers would have required almost all business functions be carried out in every local market and, thus, the benefit of cross-border services was doubtful and the risk of duplication and incidental benefits were much more significant than in the current business environment. Nowadays, business activities are often organized as integrated functions with monthly, weekly, or indeed even daily interaction between personnel of separate affiliates carrying out business not only in

their domestic market but very often cross-border and with a regional or global role inevitably linked with the business activity ordinarily carried out by each affiliate in its own Country yet in various Countries at once.

While in the '70s and 80's cross-border services were somehow an exception, today they have become the rule, day-to-day practice.

Furthermore, Chapter VII focuses on the cost side. The benefit test and its ancillary caveats on duplicative effects and incidental benefits address intra-group services from the perspective of the affiliates being charged intra-group service fees because of the underlying concern of tax authorities that MNEs may exploit cross-border charges for BEPS purposes.

The underlying concern somehow impacts on the structure of Chapter VII, which is based on the assumption that intra-group services are not the rule. This is clearly proven by each paragraph of Chapter VII, which follows the path below:

- Intra-group service fees should not be deducted unless benefit test is proven as a matter of fact (7.7);
- Parent company services are not chargeable as a default by being shareholder activities unless is proven that they qualify as stewardship services (7.10);
- If an affiliate has internal resources managing a specific function, any charge related to same function should not be deducted unless is proven that duplication is only temporary or driven by risk management objectives or proven not to be duplicative based on a detailed analysis of facts and circumstances (7.11);
- Being part of an MNE is incidental by default and, thus, services related to acquisitions, divestitures and the like are not deductible unless it is proven an active promotion of the group attributes enhancing the profit potential of the affiliate (7.13).

All the above pushes a significant burden of proof on MNEs that we believe is disproportionate and gives rise to controversy and double taxation.

In the current business environment, cross-border intra-group services are no longer an exception. They are common practice. As a result, it would be helpful if Chapter VII would be amended to apply the guidelines on low value-adding services as general set of rules or replace the benefit test or clarify its qualitative nature as discussed further below.

The simplified method

The inclusion in the 2017 version of Chapter VII of specific paragraphs under section D.2 on low-value-adding services somehow acknowledges that benefit test is nowadays overwhelming by recommending that *Tax administrations (...) should generally refrain from reviewing or challenging the benefits tests when the simplified approach has been applied* (7.54).

We hope that the prudent remark on low value-adding services will be extended to the whole Chapter VII, as there is no logical reason to treat differently all other services. A high value-adding service is by nature beneficial to the recipient even more than a low adding-value because of its value. Once it is proven its supply, testing whether a high adding-value service is specifically beneficial to the recipient is contradictory.

As a result, the simplified approach allowed by WP6 with respect to low value-adding services could be generalized to all intra-group services (perhaps by further enhancing simplicity) by specifically listing and identifying the unique features of all other services that may compel exceptions and expanded analyses.

Generalizing section D.2 to all services with specific paragraphs restricted to the high value-adding would streamline Chapter VII and increase certainty.

Besides, Chapter VII somehow leaves to the discretion of each tax administration whether adopting the simplified approach (7.53). OECD members are all developed Countries with significant volumes of cross-border in-flow and out-flow transactions. All of them have resident MNEs doing business abroad and, vice-versa, foreign investors with local affiliates. OECD members may therefore face transfer pricing issues not only as import but also as export service Countries. The perspective of the supplier should also be considered in the assessment of the impact that uncertainties surrounding subjective tests such as the benefit one may have in the current business environment on the tax collections of export vs. import Countries.

As a result, all the above factored in, we would hope that all OECD members would unanimously agree that the simplified approach should be the standard general rule. Discretionary authority to apply the simplified approach is a source of unnecessary controversy.

Proof of supply and benefit test

Based on the above, we believe that the benefit test may be replaced or clarified by specifying its exclusively qualitative nature. Benefit test is still outlined as one of the two key pillars of Chapter 7, although section D.2 on low adding-value services somehow acknowledges that it should not be subject to strict enforcement in that context.

Paragraph 7.6 identifies the benefit test as *conditio sine qua non* of whether “*an intra-group service has been rendered*”. Paragraph 7.6 further emphasizes that evidence of the benefit is met if “*the activity provides a respective group member with economic or commercial value to enhance or maintain its business position*”.

If benefit is proven, the supply is deemed as proven. However, from a logical standpoint, the benefit of services cannot be the only proof of supply. It should be given by any further evidence that a service was rendered, e.g., minutes of meetings, conference calls and presentations on subject matters, etc.

Proof of supply is a matter of fact. Proof of benefit is a matter of judgment, which cannot objectively determined by inevitably implying subjectivity. As a result, it is subject to different views by individual tax inspectors that may lead taxpayers in the position of being unable to meet the burden of proof requested in a tax audit. While we understand the underlying rationale to applying the benefit test, practical experience shows that is a source of widespread controversy and double taxation.

Although paragraph 7.4 specifies that the benefit does not need to be proven as actual but only as an “*expected benefit*”, further clarifications would be helpful to specify scope and nature of the benefit test. In particular, it would be helpful if the guidelines clarified whether the benefit test should be interpreted as a qualitative test by excluding reference to quantitative elements. Quantitative analysis, indeed, is relevant to measure the arm’s length value of any proven services allowed for deduction. As a result, benefit test should be clarified as being a qualitative test. If not, quantitative analysis could be disguised to disallow deduction of the whole service fee, while by contrast only the value of the service should be assessed by recognizing deduction, at least partially.

A paradigmatic example of the controversy stirred by the benefit test is the recent Italian Supreme Court *Yahoo! case* (n. 25566 of October 27, 2017). In such a case, the Italian Revenue Service had disallowed the deduction of approximately € 0.7 million paid by Yahoo! Italia Srl to its parent Yahoo! Europe Ltd. for the implementation and maintenance of the web portal related to its mobile business unit. The Supreme Court confirmed the prior Court decisions against the taxpayer by

arguing that “no evidence has been submitted that the costs, although actually incurred, provided benefits to the company corresponding to the amounts that were charged” (paragraph 3.8). The Supreme Court essentially applied quantitative analysis concepts to deny that the benefit test was met, although the nature of the supplied services were qualitatively linked to the business of the taxpayer, which was providing advertising services to businesses on its web portal with almost € 10.2 million and 1.06 million EBIT.

In our view, by being qualitative in nature, the benefit test should be interpreted as evidence that the supplied services are within the scope of the in-house or outsourced functions related to the business activity carried out by the beneficiary. Arm’s length test should only matter as a second step to quantify the deductible amount.

A general tax concept ordinarily applicable for business income purposes by tax legislation of various Countries is the concept of “*in the course or furtherance of business*”, which recognizes deduction of any expenses incurred by businesses to carry out their activity. In that perspective, disallowance of intra-group service fees should be restricted to cases where their scope is outside the business of the beneficiary. For example, expenses incurred for travel and lodging related to a marketing event should be deemed as meeting the benefit test. By contrast, same expenses incurred by executives during their weeks off work should be disallowed.

Identifying the benefit test as a qualitative test based on the concept of “*in the course or furtherance of business*” may facilitate its consistent application in the Countries by relying on widespread business income concepts.

For further clarity, consideration may be given to strike out the benefit test by replacing it with the concept of expenses being incurred “*in the course or furtherance of business*”, which would avoid inconsistent application of quantitative analyses to the benefit test.

Indeed, the benefit test as currently outlined in Chapter VII is somehow discriminatory by requiring multinationals to prove expenses beyond what ordinarily be requested between third parties, which are only subject to proof of supply of service and the “*in the course or furtherance of business*” test without any additional proof of quantifying the benefit.

As transfer pricing guidelines are purported to treat multinationals as third parties, no additional burden of proof should indeed be requested against them.

We therefore hope that Working Party No. 6 would reconsider whether the benefit test as it currently stand is up to date with the current level of integration in the business activity of any multinational in the wake of the digital economy and globalization.

Proof of supply should perhaps be separated from testing whether services are connected with the business activity of beneficiaries under the concept of *in the course or furtherance of business*. Once that the above two separate tests are met, the arm’s length value of the services should be ascertained based on quantitative analyses, which however should not lead to the disallowance of the service charge as a whole.

Shareholder activities, duplication, incidental benefits and centralized services

Paragraph 7.9 through 7.14 of Chapter VII have developed a series of positive examples that help identifying services that should be recognized as providing benefits to affiliates. Although listed as examples on the application of the benefit test, indeed, they may also be seen as examples of services rendered or not *in the course or furtherance of business* by affiliates being charged.

Paragraphs 7.9 and 7.10 outline examples of services that, although *prima facie* may be seen as undeductible, may eventually be allowed as deduction if the parent company is actively involved in the management of its subsidiaries

Paragraph 7.11 on duplication clarifies that the nature of the services should be tested *in detail* before disallowing an expense as duplicative. Indeed, the marketing example may apply to many other business functions from R&D to sales and even credit collection that may be managed at multiple levels or different affiliates. In the current environment, disallowance of deduction on the basis of the duplication test should be subject to strict interpretation.

Paragraphs 7.12 through 7.14 provide further examples of services that, although *prima facie* presented as undeductible, they may become deductible if affiliates benefit from attributes of the parent company enhancing their credit rating or providing further benefits from centralization of services.

We believe that current examples provide useful guidelines to ascertain whether service charges should be allowed as deduction as long as supplied *in the course or furtherance of business* by affiliates being charged, which however will require an in-depth case-by-case analysis that can hardly be generalized.

Rather than adding further examples identifying the deduction as an exception to the rule, recognizing that facts and circumstances analysis is necessary before disallowing deduction of intra-group service charges when the level of taxation of the recipient is proportionate to the tax benefits of the beneficiary would allow to restrict disallowance to scenarios where BEPS practice is ascertained as a matter of fact.

Key allocations

Paragraph 7.23 recognizes that direct charges are *difficult to apply in practice*, which has become a wider issue in the current wake of integrated business models.

Indirect-charge methods have therefore become very common standard, which may perhaps be recognized as such by Chapter VII.

A consistent application on indirect-charge methods should per se exclude the risk of arbitrary tax-driven allocations.

Paragraph 7.25 identifies some key allocation methods such as turnover, staff employed or orders processed.

EBITDA is a further key allocation method that should be expressly recognized. It has become a common standard in other areas of tax legislation such as interest deduction limit. Similarly, EBITDA may prove a valid proxy for intra-group service charges as it may be more consistent than turnover with respect to groups with affiliates carrying different functions, such as production vs sales or services. In such a case, a turnover basis charge would overcharge trading subsidiaries with respect to manufacturing or service companies.

Besides, similarly to what generally accepted standard for transfer pricing purposes and indeed specifically recognized in Chapter VII under paragraph 7.59 with respect to low value-adding service costs, it could be accepted that a single method may be sufficient without need of embarking into different criteria based on different services. The accurateness of allocation should be balanced with reasonableness and cost management, which may otherwise increase significantly. Experience shows that adoption of different methods based on the nature of services will often lead to comparable charges applicable with a single method, such that the difference in the amount may not be so significant to justify a transfer pricing adjustment. Safe harbor ratios with

respect to the outcome of applying different methods may be identified to increase certainty and minimize the risk of controversy.

Challenges on methods of allocation should be restricted to cases of significant inconsistency of the method applied by a multinational by taking into account not only the impact of a different method in a single Country but on the various affiliates as a whole, as well as on the tax liability of the supplier. A narrower approach focusing on a mere single Country impact would stir controversy and double taxation leading to increase the inventory of MAP proceedings with incremental costs to the collectivity and Public expenditure of Countries without material tax collection benefits.

Cost basis

Paragraph 7.31 identifies costs method are the best options if no CUP is available. Both traditional cost-plus and TNMM version are allowed.

We believe that both versions of cost bases should be allowed. Consistency of methods over multiple years should be a key element to assess whether adoption of one or the other is tax-driven or, by contrast, just the most practical approach.

As transfer pricing is not an exact science, reasonableness should be the main driver to test whether intra-group service charges do not comply with the arm's length approach.

Traditional cost plus method may be preferred in some instances, particularly if the supplier carries different activities and, therefore, the allocation of G&A expenses may lead to inconsistencies.

Besides, although already recognized by paragraph 7.35, further guidance may elaborate on the consistency of anticipated costs (ex ante) approaches by multinationals.

Experience shows an increasing trend to apply actual cost basis. As long as consistently applied throughout the years, the anticipated cost approach may be similarly responsive to the arm's length principle as third party service agreements generally do not provide recovery of all actual costs incurred by suppliers.

In the third party commercial practice, suppliers and customers do bear their respective share of risks. Customers may prefer certainty of prices agreed in advance rather than refunding all costs incurred by suppliers, which may be caused by inefficiencies or incorrect *bona fide* estimates by the supplier.

As a further approach, anticipated cost basis subject to adjustments if costs exceed agreed ratios or for unexpected services beneficiary to the affiliates could be a valid solution coherent with third party experience.

As a result, we believe that no fixed single formula should be forced but the traditional case-by-case approach would be preferable if methods are applied consistently by a multinational throughout the years.

Services in connection with the use of intangibles, highly integrated with value creation and/or involving significant risks

In our view, as noted above, section D.2 on low-value adding services could be considered as the standard framework of Chapter VII by increasing certainty and reducing complexity of guidelines.

Such a framework could be generalized to all service activities, even if deemed high-value or risky, subject to elaborating specific sections on the key features of those services that may compel

specific rules, such as functional and comparability analysis or the application of value-added transfer pricing methods such as profit split, or enhanced documentation requirements compared to the standard on all other services.

* * *

As outlined above, we hope that WP6 and OECD member States will consider whether adopting section D.2 as the standard set of general guidelines of Chapter VII, subject to exception on services related to intangibles of high value or risky that may require further specific guidelines.

Thank you again for the opportunity to participate in the discussion on the subject matter.

Sincerely,

Gaetano Pizzitola

Daniele Sabatini

Grant Thornton International

Scoping of the future revision of Chapter VII (intra-group services) of the OECD Transfer Pricing Guidelines

Grant Thornton International Ltd welcomes the opportunity to provide input on scoping of the future revision of Chapter VII. We appreciate the work that the OECD has undertaken on the wider BEPS project, and would like to make the following comments on this further guidance.

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June 20, 2018

Subject: Input on the scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines

Following the Actions 8-10 report describing the *low value-adding intra-group services* (2015)¹, we appreciate being granted the opportunity in this invitation to provide comments on the scoping of future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines ("TPG").

A Benefit test

Generally, intra-group services are provided to group members from an administrative, technical, or commercial perspective. To assess whether intra-group services are performed for the benefit of group entities, the TPG refers to the benefit test. An analysis must be made "whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed by an independent enterprise." (§ 7.6 TPG). In practice it is challenging to actually demonstrate whether an intra-group service can be considered to be of a value-adding nature and whether the benefit in fact is materialized from a non-financial perspective.

The benefit test is mainly focused on whether the payment justifies the received economic value of the intra-group services in addition to local activity. Group entities also rely on services provided by others in order to achieve their commercial goals. From an arm's length perspective parties are able to outsource certain activities to other third or related parties, e.g. devising a global marketing strategy. However, in practice the benefit test analysis is often reduced to a top-down documentation approach of the centrally performed services, describing: whether a service has been rendered to a recipient, an adequate determination of the cost base and the selection of the most appropriate allocation key(s). Usually if these elements have been sufficiently described, the charges are generally not challenged or rejected. Within multinational enterprises, the top-down approach is generally consistent with the manner of internal business reporting and hierarchy. From a theoretical perspective it could be argued whether bottom-up approach would be more appropriate in order to perform a genuine benefit test.

However by doing so, local tax authorities might deny any charges which do not directly increase the profitability of the activities performed within their jurisdiction, e.g. strategic management. Non-OECD members in particular are often less keen to accept central costs labelled as 'management services'. They may also ask for a huge amount of detailed support that would simply not be required at arm's length from a third party service provider. This could result in losses at the central level of a group, whilst such services are of significant importance for the long term development of global continuity and profitability of business.

Many of our clients face practical difficulties in obtaining a deduction for group costs anywhere. The parent jurisdiction may deny a deduction for costs it considers should have been recharged. Accordingly, we urge the OECD to address this issue of double taxation by providing strong guidance in support of group service charges.

B Shareholder activities

Shareholder activities are generally seen as being the opposite of beneficial intra-group services, solely performed by a group member in its capacity as shareholder. Costs relating to shareholder activities are incurred because of the obligations and responsibilities due to ownership in one or more other group entities. These responsibilities are usually local financial reporting requirements, stock exchange listing or elements described in § 7.10 TPG.

The qualification of certain activities characterized as shareholder activities is often challenged by local tax authorities. In addition, local tax administrations have issued their own examples relating to shareholder activities which are not always aligned with the TPG. This could be a potential source for double taxation as different tax authorities may have disparate views. Also, in some cases deductibility is seen as a domestic tax matter meaning that it does not fall within the parameters of the corresponding tax treaties.

¹ OECD (2015), *Aligning Transfer Pricing Outcomes with Value Creation*, Actions 8-10 - 2015 Final Report.

We would suggest B.1.2. to include wording related to the liabilities that would materialize if the shareholder-related activities were not performed. Additionally, an analysis must be made of who within the group is able to control, manage and ultimately reduce these risks. For example, local financial regulators could demand quarterly consolidated financial reports due to a local stock exchange listing of a group entity. All group entities report their financials to this listed entity, who subsequently provides the consolidated financials to the respective regulator and, is thereby, the only group member who is able to control the liability of financial penalties. By analysing which group members are able to contribute to reduction of the liabilities relating to those of a shareholder, it may be possible to isolate the shareholder activities performed within the group. Furthermore, it may be helpful for the guidance to comment on whether, if some 'shareholder' costs actually increase the revenue generating power of several group entities, those costs could and should be shared.

In practice, shareholder activities are often intertwined within other corporate functions especially, internal audit, finance, accounting and C-suite.

C Allocation keys

In the TPG, under the application of the indirect-cost charge method, the selected allocation key should be based on an appropriate measure of the usage of the service that is also easy to verify (§ 7.25). The TPG currently describes a few scenarios of the application of the most appropriate allocation keys.

However, as business models have changed significantly since the introduction of the original text of Chapter VII, costs could be allocated using 'new' digital allocation keys, e.g. users, devices, bites etc. Due to the fact that digital business models are a relatively new phenomenon, local tax authorities are generally not as comfortable accepting digital allocation keys as being appropriate.

Also, during a starting phase a local group entity generally requires significant assistance from group members to set up operations without reporting generating revenues (or having many employees) in the first few years. This will usually result either in the service provider absorbing the costs related to the intra-group service or the other operating entities subsidizing the new venture. In some cases, neither situation reflects economic reality.

In practice, an improved dialogue between taxpayers and tax authorities can often resolve this by explaining, upfront, the business conditions and challenges. Additional wording and examples on this specific point in the TPG would be enlightening in order to create the appropriate level of awareness.

Closing remarks

On behalf of the global network of Grant Thornton International Member Firms, with the contribution of our colleagues, we respectfully submit our input on Scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines.

We are grateful for the opportunity to provide our input and would be pleased to discuss or clarify our response. Please contact the undersigned or any of the contacts below.

Yours Faithfully,



Daniel Powers

Global leader - Tax Services
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ICC Comments on the OECD discussion draft on the scope of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines

The International Chamber of Commerce (ICC) welcomes the opportunity to comment on the Organisation for Economic Co-operation and Development (OECD) discussion drafts on the scope of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines.

Chapter VII (intra-group services)

ICC considers that a revision of Chapter VII represents an important opportunity to enhance clarity and effectiveness in an important area of intra-group transactions, which is of interest to all Tax Authorities and Multinational Enterprises (MNE's). However, it is important that the revised guidance minimises the risk of inconsistent interpretation and implementation, particularly for developing countries and Small and Medium-sized Enterprises (SMEs).

The risk for developing countries is linked to the fact that, traditionally, less well-resourced Tax Authorities tend to disproportionately focus their audits on intra-group services. These services are easier to challenge than some other transactions. In a post-BEPS environment, the risk of double-non-taxation is relatively minimised and the solutions to eliminate double taxation are strengthened. There is therefore a risk that a disproportionate focus on intra-group services may lead to double taxation issues whose ultimate results could be limited in terms of additional tax income for the country revenue and have a negative impact on a country's attractiveness vis-à-vis the global tax community. In general, the provision of intra-group services should be encouraged where it results in an MNE achieving economies of scale etc.

The risk for the increasing number of SME's growing internationally is linked to the fact that they may be less equipped to deal with complex tax environments and would be particularly penalised in the case of revised guidance that either lacks clarity, or is burdensome and requires additional resources to implement.

More generally, MNE's continue to experience double taxation issues in many jurisdictions and this inevitably leads to a significant amount of resources devoted by both Tax Authorities and MNE's to resolving issues which, as far as possible, should be prevented in the first instance.

Given the significant challenges noted above, ICC respectfully calls upon the OECD to develop revised guidance that is both balanced and effective.

As stated in the OECD invitation for public comments, concerns are predominantly related to practical application. ICC's foremost concerns and suggestions in this area are noted below:

- Developing pragmatic and clear solutions to prevent double taxation (as well as double non-taxation) should remain a primary objective of the revision of Chapter VII of the transfer pricing guidelines.
- The revised guidance should strongly encourage tax authorities to apply the same requirements for the documentation of services that are charged to other jurisdictions and services that are acquired from other jurisdictions.
- Simplifications should also be considered for services which do not technically qualify for the simplified approach applicable to low value-adding intra-group services (LVAIGS) but are supplied

on a large scale to the entire MNE group or part of it: typically this type of intra-group service necessitates a simplified framework in order to facilitate testing their benefits, determining their cost and allocating it, etc. Pragmatic, simplified guidance, potentially inspired by the guidance on LVAIGS, would be particularly helpful in this context. In addition, no mark-up scenarios should be considered for those activities which do not represent either relevant amounts or the core business of the MNE (i.e. LVAIGS) as well as services in which the standard market practice is the billing at cost (e.g. oil & gas sector).

- Further simplifications should be considered for SME's.
- The revised guidance should acknowledge the more recent technological evolutions and promote pragmatic approaches to auditing intra-group services provided utilising highly digitalised techniques, which may be almost impossible to document using traditional approaches.
- The cost base of the services should also be considered when applying the Cost Plus method, as costs incurred rendering services in-house are usually much higher than those of outsourced activities. Only considering the mark-up added on total costs may lead to inaccurate comparisons.
- Practical examples would be helpful to address elements which could be more easily subject to controversial interpretations.

ICC further recommends an alignment of Chapter VII with new guidance developed under BEPS Actions 8-10, particularly the updates made to Chapter I, VI and VIII, as well as the ongoing work on profit splits and financial transactions. It is ICC's view that this area in particular presents a high risk to leave room for diverging interpretations and increased complexities, which could have a significant impact, particularly for developing countries and SME's.

The revised guidance should promote simplified approaches, where possible, and acknowledge the fact that in many cases traditional transaction methods or the TNMM may represent more reliable solutions, considering that very complex methods may lead to less reliable results.

ICC respectfully suggests that the OECD considers including two specific points within their scope. In the first instance, we believe that the OECD should make it clear that benefits need to be intended at the point the decision is made to incur costs in providing the service but (as with many product development projects for example) benefits may not arise if the development is not successful.

Secondly, many large multinational enterprises may have different departments with similar names and roles but who do not duplicate services. For example an MNE may have a Group Human Resources (HR) team as well as regional and business specific HR teams. If the taxpayer can document the different roles each plays, the burden of proof should be on the tax authority to prove duplication before any transfer pricing adjustment.

ICC remains available to provide further input and expertise to support the future steps of the process. ICC welcomes and encourages the OECD's continued engagement with the business community in order to address pragmatic and effective approaches.

June 18, 2018.

Mr. Jeff VanderWolk.
Head of the Tax Treaties and Transfer Pricing Division
OECD Centre for Tax Policy and Administration.
2, rue André Pascal,
75775 Paris Cedex 16, France.

Dear Mr. VanderWolk:

Reference is made to your communication dated May 9, 2018, in which you requested comments on the future contents of Chapter IV (*“Administrative Approaches to Avoiding and Resolving Transfer Pricing Disputes”*) and Chapter VII (*“Special Considerations for Intra-Group Services”*) of the OECD Transfer Pricing Guidelines.

The Mexican Institute of Public Accountants (hereinafter referred to as “IMCP”) is the most important professional organization with more than 25,000 Mexican Public Accountants as members across the country and represents the professional interests of Public Accountants in Mexico. In order to fulfill its professional objectives, the IMCP is organized in several Vice-Presidencies and one of them is headed by C.P.C. Mario E. Morales, whom acts as our Vice President of Tax Affairs. Several professional working Commissions report to Mr. Morales, in all areas associated to the analysis of taxation-related issues. The Transfer Pricing Commission (*Comisión de Precios de Transferencia del Instituto Mexicano de Contadores Públicos de México, A.C.*)¹, was formed 14 years ago by recognized professionals with transfer pricing experience and is part of the Vice-Presidency headed by Mr. Morales. The Commission has monthly national meetings for the analysis and discussion on the taxation implications of transfer pricing legislation or doctrine.

In this respect, as part of our June 2018 national meeting the Commission organized a roundtable for the discussion of the information requested by the OECD, taking into account the recent release of the communication requesting public comments on the future of Chapters IV and VII of the OECD Transfer Pricing Guidelines.

Notwithstanding such time constraints for responding to the request of reference, the Transfer Pricing Commission of the IMCP agreed to provide comments which are regarded as necessary areas to be analyzed in the upcoming technical review of the contents of the two chapters before mentioned. It is important to note that our comments were selected based on the practical and real-life experience of our members on issues referred to in both Chapters. Our comments, broken-down per chapter, are the following:

¹ The current members of the Transfer Pricing Commission of the IMCP are the following entities: Deloitte México; EY México; Calderón, González y Asociados; Oliver Consulting; Baker Tilly México; PwC México; Corporación Interamericana de Entrenimiento; KPMG México; Chévez Ruiz Zamarripa y Cía; Salles, Sainz Grant Thornton México; Teléfonos de México; Sánchez Salgado and Natera Consultores.

1.- Comments on Chapter IV (administrative approaches)

a.- Legal and operating independence between the APAs, examination and Competent Authority functions for all Tax Administrations.

Even if the content of this Chapter was updated after the original release of the Transfer Pricing Guidelines in 1995 by incorporating useful real-life and practical situations, and even after important peer-review recommendations were released in this regard², as practitioners we still encounter situations in which due to legal, budget limitations or other reasons, all relevant functions associated to transfer pricing are still maintained or executed by the same operating organization within the same Tax Administration³.

This Commission agrees with former OECD's recommendations in the sense that all transfer pricing-related functions within a Tax Administration should be assigned to and managed by separate and different teams in order to increase the confidence of taxpayers as well as to ensure the level of desired objectivity in the resolution process of double tax controversies. In the different sections of Chapter IV, we have not detected a direct and straightforward statement associated to this recommendation, thus, we suggest the insertion of explicit language in this respect, according to the following: *"In all cases, Tax Administrations have to ensure that in their organizational and legal structures, functions associated to tax policy, APAs, MAP APAs, double tax cases, tax enforcement and competent authority, are assigned to separate areas, to increase the desired level of independence and objectivity"*.

b.- Possibility to involve recognized independent professional associations in the technical resolution of complex transfer pricing controversies.

With the objective of avoiding or reducing costly, unexpected, uncertain and burdensome consequences in transfer pricing-related cases, we consider that OECD could contemplate the involvement of independent professional associations as a technical option for the Tax Administration or the affected taxpayer to have a qualified expert opinion on transfer pricing disputes. This Commission considers that the use of an independent expert opinion on transfer pricing in their tax jurisdiction will serve as a valuable element in the local resolution of a complex transfer pricing case. This opinion should be issued by recognized chambers or organizations in the taxpayers' tax jurisdiction, deeply involved in the discussion of transfer pricing and tax legislation, administrative practices of both the taxpayer and the Tax Administration, applicable deadlines, etc.

² Paragraph 151 on page 36, and page 71 of the document *"Peer review of Mexican Transfer Pricing Legislation and Practices"*, issued by WP6 of OECD's CFA, 2005.

³ In the case of Mexico, by the Large Taxpayers' Administration of the Tax Administration Service (AGGC).



The use of such independent element for the resolution of complex cases at the local level could be managed, monitored and formalized by the tax authority, upon request of the one of the parties of the respective audit, with the sole objective of adding the independent expert opinion as additional support in the resolution of the case. The recommended participation of such external organizations may increase the level of confidence in the analysis, and could be useful to save important costs, expenses and limited resources for both parties.

c.- Additional recommendations for Tax Administrations in the resolution of Advanced Pricing Agreements.

Even if it is true that Tax Administrations are legally empowered to process and to analyze APA requests on a case-by-case basis, with the sufficient level of detail applicable to that case, it is also true that in cases involving APA renewals (with no substantial changes in facts and circumstances with respect to a previous filing), it could be questionable that Tax Administrations disregard all or most of all previous technical aspects associated to the settlement of that case, with the objective of adopting a completely new transfer pricing approach. Such position may only generate uncertainty to the filer, and reduce confidence in the effectiveness of the APA program as a whole.

We understand that in all APA-related cases, taxpayers and tax authorities should cooperate and work collaboratively in an effective manner, by developing robust and updated functional analyses and methodological tests. In cases involving APA renewals flexible approaches are recommended to be adopted, specifically with respect to detailed information already contained in previous filings of the same APA, in cases involving compliant taxpayers.

However, we consider that in scenarios involving no substantial change, it would be completely questionable to encounter situations where, as a result of changes in the structure of the technical staff involved in the analysis of APA renewals, the Tax Authority assumes a completely different view with respect to the technical solution proposed by the APA filer, departing from the transfer pricing methodology approved by the same Authority in recent fiscal years. As indicated above, this type of uncertain situations only give rise to tax uncertainty and lack of confidence in the APA program as a whole. We consider that the OECD should include a consistency recommendation for Tax Administrations in this respect, in the Annex dealing with APAs.

2.- Comments on Chapter VII (intra-group services)

a.- Concerns on the treatment of services expenses and generation of “benefits”

Aside from the valuation possibilities to quantify the benefits associated to services received by taxpayers in a controlled transaction, we have observed that there is an increasing and ongoing assumption frequently made by Tax Authorities (especially during the course of examinations), in the sense that in all cases (or in the vast

majority of them), services provided by related parties always lead to the generation of “benefits” (in their view, taxable profits); while this assumption cannot be regarded as valid in many instances.

Even if it is true that the objective of any rational economic agent when paying for a service is to obtain a benefit in the form of increased income, efficiencies, profits, or alternatively in the form of decreasing costs and expenses, in many cases these objectives cannot be achieved despite of the interest and efforts of the taxpayer funding them (in both, independent and controlled situations). There could be a variety of real-life situations in which taxpayers incur in service expenses, and the end-result is negative for them despite of the initial interest and efforts made to produce a positive profitability scenario. In our view, it is an incorrect assumption to expect that, as a rule, all types of service expenses should necessarily give rise to the generation of benefits or profits, because those results depend on the specific circumstances of the case.

Therefore, for the sake of clarity and tax certainty, we consider it reasonable and necessary to insert some language in Chapter VII of the guidelines providing that it would be an incorrect assumption for Tax Administrations to expect clear benefits in all intercompany services rendered by related parties, because there could be cases in which the expected benefits or profits could not be immediately obtained by any taxpayer, due to valid commercial or market-related reasons.

Our recommended general language for this Chapter would be the following: *“Even if taxpayers may incur in service expenses with the initial objective of increasing income, profits or efficiency levels in their operations, as well as to decrease costs or expenses, there is no guarantee that the results of the taxpayers’ operations will necessarily give rise to taxable profits. Tax Administrations should not automatically assume or expect for-granted-profits in controlled operations involving service expenses, since there could be specific cases in which Multinational taxpayers (same as independent entities) may end up reporting adverse results due to commercial or other valid economic situations (e.g. promotional or marketing expenses). In any case, Tax Administrations are encouraged to perform a detailed analysis of the specific facts and circumstances of the case to support its conclusions, before even assuming the existence of clear benefits in a controlled transaction involving intercompany services rendered by a related party.”*

b.- Lack of definition of key concepts or principles associated to BEPS and transfer pricing.

The recent results of the Business Erosion and Profit Shifting (BEPS) Initiative completed by OECD’s working groups have given rise to important taxation concepts, which are necessary to be fully understood under the new realities of today’s international taxation. Such concepts are closely linked and associated, therefore, the tax implications of them may affect key operating, financial, taxation, budget and strategic aspects in the operations of global taxpayers. Important examples of these taxation concepts, associated to intercompany services are the

concepts of “value creation” and “DEMPE” activities (involving intangible property, activities related to the development, enhancement, maintenance, protection and exploitation of such property). In the context of a tax examination, clarity and legal certainty are necessary elements for the proper treatment and definition of the economic returns impacting the “value creation” and DEMPE activities of global taxpayers. Thus, it is necessary to preserve reasonable taxation levels along borders, avoiding arbitrary and uncertain tax assessments. However, this latter goal could be hardly achieved in cases in which there are no recognized general principles defining the meaning of those concepts, with the implicit risk that different Tax Authorities involved in a controlled transaction, may have different views or levels of understanding about them.

We consider that it should be regarded as a priority work for the OECD, the development of common definitions for the new taxation concepts of “value creation” and “DEMPE” activities, which have multiple implications and references to international taxation as well as to transfer pricing, as a result of the BEPS work. The absence of such general recognized principles and definitions shall only lead to arbitrary tax assessments, inefficiency of double tax cases work (or MAP work), questionable determinations in terms of tax policy for those countries who undertake the unilateral effort of defining these concepts, tax uncertainty, excessive and complex work transferred to arbitration stages, etc.

At a subsequent stage, and once the desired general definitions are released by OECD, it would be easier for the tax community worldwide to develop and provide some examples illustrating the application and/or interpretations of such concepts.

We sincerely hope you find the previous comments useful in your analysis. Please do not hesitate to contact me in case you have additional comments or questions.

Best regards.

Gabriel Oliver, CPC.
President, Transfer Pricing Commission
Instituto Mexicano de Contadores Públicos de México, A.C.

C.c.: Mr. Mario. E. Morales, CPC. Vice President, Taxation. IMCP.
Mr. Jose Besil, CPC. President, IMCP.
Mr. Tomas Balco. Head of the Transfer Pricing Unit, CTPA, OECD.

Joseph L. Andrus

20 June 2018

Mr. Jefferson Vanderwolk
Mr. Tomas Balco
Tax Treaty and Transfer Pricing Division
Centre for Tax Policy
OECD

Dear Jeff and Tomas:

This responds to your request for comments on the proposal to undertake work to update Chapter 7 of the OECD Transfer Pricing Guidelines on services transactions. I agree that the time for such an update is long past due and encourage you to move the project forward.

The nature of the global economy has changed significantly since Chapter 7 was written. A much larger share of the economy now involves trade in services and those changes make a thorough update highly advisable.

The current Chapter 7 primarily addresses transactions involving the provision of administrative services between entities that make and sell tangible goods. The chapter only tangentially addresses the transfer pricing challenges faced by businesses that exist primarily to provide services to third parties. That very large part of the economy includes telecommunications companies, internet service providers, professional service firms including law and accounting firms, companies providing financial management services, investment banks, management consulting firms, providers of oil field services, providers of research services, and many other types of service firms. These firms often operate on an integrated basis across national borders, with highly skilled and highly compensated professionals providing services to related entities in other geographic locations. Because of the nature and high value of the intercompany services provided between entities comprising such firms, and because of the integration of the firms' services offerings and the free flow of information and knowledge between various parts of the firms, cost plus methodologies are often not appropriately applied to the transfer pricing issues these firms face. Accordingly, such firms can face difficult transfer pricing issues without much relevant guidance.

My observation has been that the TP Guidelines do not specifically or adequately address the transfer pricing challenges faced by these types of service providers. While general transfer pricing principles, including the principles set out in Chapters I – III and VI of the TPG, may apply to many situations faced by such firms, the application of the applicable transfer pricing

methods to these types of entities could be much better illustrated if specific attention were directed to the issues arising in such businesses. I would therefore encourage that as part of the project on services, the OECD consider addressing specifically the application of transfer pricing rules to global firms that are in the business of providing services, and specifically encourage that a number of examples drawn from the operations of such firms be included in the Guidelines.

Respectfully submitted,

Joseph L. Andrus

To Tax Treaties, Transfer Pricing and Financial Transactions Division, OECD/CTPA Date June 20, 2018

From KPMG International Ref KPMG Comments on Services Chapter VII

cc Stephen Blough, KPMG LLP, United States

Comments on the scope of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines

Professionals in the member firms of KPMG International (“KPMG”) welcome the opportunity to engage with the Organisation for Economic Co-operation and Development (“OECD”) as it embarks on its project to provide additional guidance on the transfer pricing of services transactions in Chapter VII of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (“OECD Guidelines”). KPMG commends the OECD for engaging the business community on this project at an early stage.

KPMG agrees with the OECD that the focus of the new guidance should be on the practical application of the underlying principles of Chapter VII. A common hardship faced by taxpayers in regard to services transactions is that while tax authorities might agree on the theoretical principles for the transfer pricing of these transactions, they may have divergent views on the practical application of those principles. The result is often significant uncertainty and compliance burden for taxpayers. Additional guidance from the OECD that reduces some of that uncertainty and compliance burden will be greatly welcomed.

KPMG provides some specific suggestions related to the proposed OECD guidance below.

Recognizing the global aspect of an MNE’s business

OECD guidance should recognize that many, if not most, MNEs by their nature incur significant costs centrally in running their global businesses, which are appropriately deductible against income earned either where incurred or in other jurisdictions. Further many functions such as finance, human resources and legal will often have activity at both the headquarter (or other centralized service provider) and local levels. Associated with these structures are transfer pricing payments to the center for beneficial services received. These charges are properly understood as normal transactions associated with typical business structures, not as inherently high-risk transactions.

However, tax authority practices in some jurisdictions with respect to such charges involve very detailed factual assessments with a high burden of proof on the taxpayer to support the charges. While tax authorities are rightly focused on the activities of and benefits received by entities in their jurisdiction, their evaluations often implicitly or explicitly treat the business decisions of taxpayers to adopt centralized structures as subject to challenge under the arm’s length principle. For example, tax authorities often require detailed documentation of benefit of activities of the center, when there is some local headcount; in other cases tax authorities deny deduction for services provided by the center on the basis that similar services could be provided locally at lower cost. These practices amount to challenges to the business judgment of the taxpayer regarding efficient operation of its business, while imposing administrative burdens on both tax authorities and MNEs that are far out of line with the risks associated with these transactions.

KPMG believes therefore that the OECD could significantly advance the interests of sound tax administration by providing additional guidance regarding indicators of risk with respect to intercompany services charges, and streamlined procedures where low risk is indicated.

Indicators of Risk

As discussed above, KPMG does not believe that payments of management and related services charges to headquarter or other centralized service centers are inherently high-risk transactions but rather are generally routine transactions inherent in the typical structure of global businesses. KPMG does not dispute that services transactions with elevated risk meriting closer examination exist – for example, services transactions closely intertwined with valuable intangibles or highly integrated with value creation of the group could fall in such category – but believes that the OECD could usefully identify indicators of risk that could assist tax authorities in focusing their efforts and significantly reduce the compliance burden of taxpayers with respect to routine transactions. Such indicators could be based on information contained in the Chapter V documentation package inclusive of master file, local file and country-by-country reports.

One indicator of low risk that KPMG recommends adopting is the existence of a principled and consistently implemented global policy for determining charges for centralized services to group companies. Such a policy would incorporate methods used for distinguishing beneficial from shareholder and other non-beneficial activities, including a description of the division of responsibilities between the center and local organizations, along with identification of reasonable allocation keys and consistent mark-ups. It would also set out the principles applied for determining whether any exception to the policy should be made. In financial services, for example, an exception could arise where the full allocation under the policy to a regulated entity in a particular country would cause that entity to be in breach of local regulatory requirements.

This approach would be documented at the global level, such as in the master file. The OECD could consider providing companies the opportunity to expand the existing section on services arrangements in the master file to document their uniform, global transfer pricing policies for centralized services—with the benefit that such documentation would support low risk treatment of the transactions inclusive of streamlined procedures.

Streamlined procedures

As noted above, taxpayers face very high administrative burdens in responding to tax authority requests for detailed local documentation of the beneficial receipt of centrally provided services, well out of proportion to the risk associated with these transactions. Streamlined procedures for low risk services transactions could include allowing benefits and charging policy (including allocations) to be supported at the group-wide level as described above, with local documentation limited to conformity with the global approach.

Further, the OECD could emphasize that if the taxpayer demonstrates on a global basis that beneficial services were rendered and received, there should not be additional challenges from tax authorities as to who should have provided those services. As discussed above, many MNEs have shared service centers in high cost jurisdictions for perfectly valid business reasons, yet face substantial administrative burdens responding to detailed requests from tax authorities to show that the services were not duplicative or could not have been provided locally at lower cost. The OECD could emphasize that for transfer pricing purposes, tax authorities should not challenge the MNE's business decisions regarding the division of activities and responsibilities between central and local where the taxpayer demonstrates the benefits of the shared services on a global basis.

The addition of low value added services guidance in 2015 touched upon certain aspects of simplification, however local jurisdiction adoption to date is low. KPMG recommends that the OECD encourage greater adoption of the low-value services safe harbor and also expand some of the principles to the rest of the chapter, such as simplifying the demonstration of benefit.

Services provided in connection with the use of intangibles

For services provided in connection with the use of intangibles; services that are highly integrated with value creation of the MNE group; and/or involve significant risks, the general principles for interpreting and applying the arm's length principle should apply in conjunction with specific principles for services such as the benefit test.

In particular, the most appropriate method should be chosen based on the specific facts of the transaction under consideration; for example, the most appropriate method choice should not depend on whether a transaction is characterized as a service, as opposed to some other or mixed character, but rather on the overall facts of the specific case.

With respect to services provided in connection with the use of intangibles, the OECD might observe that such services could variously involve situations where:

- Valuable intangibles are used by and in the jurisdiction of the service provider, in connection with providing the services;
- Services that are provided as part of a bundled transaction in which the service recipient also obtains use of or access to valuable intangibles, and
- Services that may affect a transfer of intangibles from the service provider to the service recipient (e.g. training in proprietary methods) or creation of intangibles by the service provider for the service recipient (contract R&D).

The guidance would benefit from an emphasis that the overall principles of the most appropriate method should be applied to examine such transactions. The most appropriate method evaluation might, depending on the specific facts of the transaction, consider methods commonly used for services and also those for intangible transactions. The most appropriate method should be determined based on all of the facts of the transaction at issue.

For transfer pricing purposes, the facts may indicate that a transaction or bundle involving both services and intangibles may be most appropriately analyzed in aggregate, without the necessity of detailed determination of the character of the transaction as services, intangible transfer, or a combination of both. The OECD should recognize this while also recognizing that for other tax purposes such determination of character may be necessary.

About KPMG International

KPMG is a global network of professional services firms providing Audit, Tax and Advisory services. We operate in 154 countries and territories and have 200,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

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Comments on future revision of Chapter VII of the Transfer Pricing Guidelines on Special Considerations for Intra-Group Services

June 2018

Scope of Document

According to the OECD invitation for public comments on the scope of future revision of Chapter VII of the Transfer Pricing Guidelines (hereinafter – “**TPG**”) on Special Considerations for Intra-Group Services, KPMG-Ukraine prepared the executive summary with respect to the issues related to the practical implementation of the TPG in the context of intra-group services, thus increasing tax certainty for taxpayers and avoiding double taxation.

Since the most common subject of controlled transactions is intra-group services (hereinafter – “**IGSs**”), it is important that taxpayers pay attention to how these transactions are carried out to ensure that they are consistent with the arm’s length principle. To manage transfer pricing risks of estimation of IGSs by tax authorities properly, taxpayers should be ready to disclose information about two main issues: whether the IGSs have been rendered and whether an arm’s length fee was charged for the services. Therefore, we suggest adding the following provisions to the TPG.

Recent tax disputes on transfer pricing regarding the IGSs have shown that proving the subject matter of the services and the fact of their provision is as important for tax authorities as determining the mark-up of the contractor of these services. However, we see that the issue of recognition of intra-group services is not covered in details in the current edition of the TPG, despite the importance of this issue. We deem it necessary to dwell upon such aspects in the TPG as confirming (documenting) the fact of services provision, as well as recognizing the profit from their provision (benefits test), including a focus on duplicate services.

Determining the fact of intra-group services provision

For the purposes of eliminating challenges regarding the evidence that intra-group services were rendered and provide benefits to the customer of the services we suggest including the following provisions in the TPG:

- description of minimum package of documents confirming the fact of services provision;
- general approach (or general principles) for assessing the impact of IGSs on the activities of a local entity (hereinafter – “**LE**”).

Minimum package of documents

We suggest including particular examples of supporting statements in the document proving that the IGSs have been rendered and/or that the services rendered provide a benefit to the customer of the services and identifying duplicated activities. Such examples may include:

- indicating responsible individuals in the organizational chart of the multinational enterprise (hereinafter – “**MNE**”) who are in charge of the IGSs (hereinafter – “**Responsible Individuals**”);
- employee manual of Responsible Individuals shall include a distinct list of responsibilities and authorities relating to IGSs;
- policies, instructions, methodologies and manuals specifying entities’ / organization’s approach to the execution and documentation of IGSs shall be prepared, duly authorized and updated;
- Responsible Individuals shall disclose all details of the IGSs: their nature, benefits, calculations and substantiations of cost and fees, counterparties, etc. in working papers;
- relevant working papers shall be reviewed and authorized by the management according to the requirements established by internal policies and/or instructions;
- relevant working papers shall be kept during the period stipulated by the legal acts of relevant jurisdictions;

- relevant working papers shall explicitly define the list of activities performed for the purposes of rendering the IGSs with a clear specification of region / country / subsidiary to which these IGSs are rendered;
- determination of the forms of final deliverables of rendered IGSs (e.g. reports of marketing research, prepared accounting reports, legal advice in the form of memorandum, etc.).

Assessing the impact of IGSs on the LE's activity

The service provider agrees to properly document the nature and scope of the services provided and the calculation of the remuneration. The documentation must be prepared in such a way that an expert third-party could gain insight into the calculation of the remuneration. The contractor provides services for the benefit of the customer of the services. In turn, the customer obtains or expects to obtain financial benefit and should be able to prove the economic value of services received and the willingness to pay an independent party for the provision of such services.

According to the type of IGSs, there may be one or several different types of benefits related to this service type that may be assessed and described in a MNE's Master File. Benefit test allows determining whether a service should be considered as an intra-group service under the arm's length principle or not.

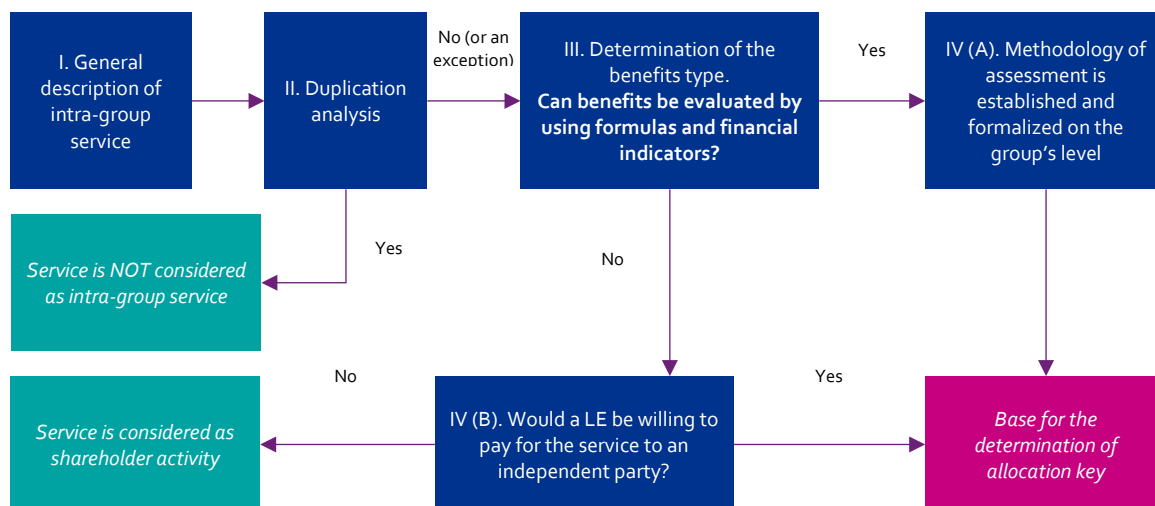
The main categories of benefits are cost savings, revenue growth and other value contributions connected with processes efficiency / quality, risk reduction, market performance, etc.

Another essential issue is identifying duplicated activities, because normally no benefit is gained from duplicated services. An exception may be where the duplicated service is undertaken to reduce the risk of a wrong business decision such as obtaining second legal opinion on a matter.

It is important to emphasize that duplicated services will not qualify as intragroup services if their expediency is not proved by benefit test.

As a practical recommendation to avoid cases of duplicated activities where the intra-group service provided already exists in the group entity, the Group's Master File should include a distinct distribution of intra-group services specifying providers and recipients for each scope of services and whether third parties are involved for their provision.

The tax authorities will pay special attention to the determination of the fact of service provision; thus, the taxpayer should prove it by benefits test. For example, for assessment purposes a MNE can check the following steps which help to answer the questions of real benefits (Picture 1). Such assessment can be used in practice for analysis of intra-group transactions in terms of determination of cost allocation key.



Picture 1. Steps for providing benefits test

The transfer pricing regulations do not prescribe one specific method of allocating residual service costs as being acceptable. As long as the cost base is determined correctly and it generates an arm's length result, it is generally up to the service provider to decide on an appropriate allocation method. Taking into account that indirect charging methods often necessitate some degree of estimation or approximation, the most essential part to acknowledge is the benefits test, i.e., there needs to be sufficient support for the value created to the LEs receiving an IGSSs.

We hope that such comments will be useful.

Please do not hesitate to contact us in case of any questions or additional comments.

Kind regards,

Transfer Pricing Group, Tax & Legal Department

KPMG-Ukraine

MEMORANDUM

FROM: Paolo Ludovici
TO: Jefferson VanderWolk - Tomas Balco
SUBJECT: Comments on the future revision of Chapter VII of the Transfer Pricing Guidelines on "*Special Considerations for Intra-Group Services*"
DATE: 20 June 2018

Dear Jeff and Tomas,

We would like to thank you for providing us with the opportunity to comment on the scope of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines ("**TPG**"). Please find below some of our considerations related to the questions at hand. We appreciate this scoping exercise and, to this end, Ludovici Piccone & Partners ("**L&P**") suggests to revise and/or supplement the guidance provided in Chapter IV to reflect the latest developments and practical issues encountered in practise while dealing with administrative procedures.

COMMENTS TO THE SPECIFIC QUESTIONS

1. Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient

It is very likely that the benefit test should require an approach akin to the one expressed with reference to the lack of definition of control in Art 9 (1) of the OECD Model Tax Convention. Stated otherwise, the TPG should make clearer that the benefit test is a matter of domestic law as each country should contain a similar definition in its own system. For instance, very frequently in the Italian tax system the benefit test is confused with the so-called "inherence test", often leading to discretionary valuation by tax officials. Moreover, this analysis depends on the facts and circumstances of the case. Along this line of reasoning, we concur fully with para. 7.7 of the TPG where it is stated that "*it is not possible in the abstract to set forth categorically the activities that do or do not constitute the rendering of intra-group services*". In general terms, the benefit test consists of two phases: the first, (i) aimed at determining whether the service has been actually rendered and, the second, (ii) aimed at establishing whether the service provided a benefit for the recipient. To this end, OECD is very much welcomed to add more

examples in this topic to provide further clarifications about its practical application. In this regard, we suggest the following example to provide additional clarity in describing the two above mentioned phases.

Example: provision of services related to the support to the sales

Company Alpha ('Alpha') located in country A is the parent company of a Multinational Group engaged in providing high tech consultancy services ('Services') to third clients. Company B ('Beta') is a subsidiary of Alpha located in country B and is responsible for providing the same kind of services to third clients located in country B. Company B is completely autonomous and it is able to provide the Services to its local clients with its own assets and personnel. It may happen that a client of Alpha has a subsidiary ('Client') in Country B that has interest in obtaining the Services. In this case, Alpha puts in contact Beta with the client and helps Alpha in formulating the commercial offer to the client. In the case above described, Alpha is providing to Beta a service that may be divided in the two following categories:

- agent service: Alpha puts in contact Beta with the subsidiary of its client located in Country B.
- marketing service: the marketing and sale team of Alpha help Beta in formulating the commercial offer to the client.

With respect to the case above described, the demonstrations required by the benefit test may be given as follows:

Demonstration that the Services have been rendered

From a practical standpoint, the demonstration that Services have been rendered should be given by providing reliable documentation, keeping in mind that this exercise should not be too burdensome for the taxpayer. In particular, the proof may be given by providing to the tax administration the following documents:

- the exchange of the e-mails between Alpha, Beta and the Client from which it is possible to assess that Alpha put in contact the Client with Beta. Of course, it is not necessary to produce all the e-mails but only the few necessary to demonstrate the activities performed by Alpha;
- the exchange of e-mails regarding the preparation and the drafting of commercial offers and the commercial offer;
- indication of the persons of Alpha and Beta involved in the transaction that might give more information and details about the transaction in case tax administration is willing to perform interviews;
- the documentation that demonstrates that Beta provided the Services to the Client (e-mails, contracts, the bill and the payments).

We believe that it is not necessary to attach the documents mentioned above to the local file or to the Master File. However, the taxpayer has to store the documents that will be shown to the tax administration in case of tax audit.

Demonstration that the Services rendered provided a benefit

Once it is determined that the intra-group Services have been rendered, it is necessary to demonstrate that they provided economic value that enhanced the commercial position of Beta. In the case under examination, it is quite easy to identify the benefit for the recipient, as the Services provided by Alpha allowed Beta to acquire a new client. Therefore, in this case there are no doubts that the Services provided by Alpha enhanced the commercial position of Beta.

We are aware that multinational companies make use of a big variety of services for which the valuation of the benefit for the recipient might not be as easy as in the case previously described. In general, we believe that it is not possible to categorize which services provide benefit and which do not. For answering this question the nature of the business operated by the taxpayer and the specific features of the industry in which it operates has to be carefully taken into account. To this end, taxpayers should do their best efforts to put tax administrations in the conditions to understand the business, while the tax administrations should use judgment and good sense in performing the benefit test.

2. Drawing a distinction between: (i) activities which do or do not benefit the local affiliates; (ii) benefits that purely arise from group membership and those that arise from a deliberate concerted action; and (iii) shareholder activities and stewardship activities

In our view, the first topic: "*(i) activities which do or do not benefit the local affiliates*", may be addressed following the ordinary benefit test described by the TPG and addressed in para. 1.1.

With respect to the second, "*(ii) benefits that purely arise from group membership and those that arise from a deliberate concerted action*", we believe that in light of the huge variety of services and situations that might be used by multinational enterprises, a case by case approach has to be adopted. To this end, the examples included in the TPG (see para. 1.167-1.173) already provide sufficient guidance.

Shareholder activities are non-chargeable as they refer to costs of the juridical structure of the parent company itself, costs relating to the reporting, legal or regulatory requirements of the parent company, costs of raising funds for the parent company acquiring participations, etc. Moreover, according to letter e) of para. 7.10 of the TPG, "*Costs which are ancillary to the corporate governance of the MNE*" are included in the

shareholder activities. However, the economic definition of activities included in corporate governance, encompasses practically every sphere of management: action plans, internal controls, performance measurement and corporate disclosure. In arm's length conditions, there might be companies willing to pay for such services. Therefore, in our opinion OECD is very much welcomed to add more examples in order to better define the perimeter of the ancillary activities.

3. Identifying in practice duplicated activities

The identification of duplicated activity requires a factual and in-depth analysis. For example, Company A decides to centralize the purchase of the ERP basic system, E-Soft, that will be used by the entire Group. Company A then charges a fee to the other companies of the Group for the use of the software. Company B is a subsidiary of Company A that uses E-soft basic system (and pays the fee to Company A for the use) and buys also an E-Soft extension that is needed in light of the specific activities performed by Company B. In this case, the tax administration responsible for auditing Company B will see that the latter pays a fee to Company A for the use of E-soft and an additional fee to the IT software provider for the use of the same software. Therefore, from a preliminary analysis it may appear that Company B is paying twice for the use of E-soft. However, a more accurate analysis will show that Company B is paying to Company A the fee for the use of the basic version, while is buying from the IT service provider an extension that is required to improve its day to day business, but no other companies of the Group use.

From a practical standpoint, the identification of duplicated activities is based on a factual analysis aimed at understanding the nature and the type of the service rendered. To this end, taxpayers should take into account that the officers of the tax administration are tax experts, therefore they cannot immediately understand the specificities of all services provided within a multinational group. Therefore, taxpayers have to make their best efforts to put the tax administration in conditions to understand the nature of the services provided, so that they can perform their analysis. The tax administration should use judgment and good sense in challenging duplication issues, keeping in mind that this demonstration cannot be a too burdensome exercise for the taxpayer.

In our opinion, it would be too burdensome for taxpayers to prepare in advance a detailed description about why the services provided are not a duplication. However, under a specific request of the tax authorities, taxpayers have to be ready to provide the clarifications requested.

4. Finding an appropriate allocation key for charging intra-group services

As a general rule, the selection of the allocation key should follow the nature of the

services provided and their actual usage. Therefore, it would be very welcomed if the OECD could provide more examples of the use of the allocation keys.

5. Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises

The attribution of costs has to be made on a case by case basis where the starting point is always the understanding of the nature of the service provided. For example, assume that a multinational Group, engaged in the insurance industry, decides to centralize at the parent company level the risk – management activity and to provide related services to the other companies of the Group. In this case, the parent company renders the service through a dedicated team employed by the parent company that operates from its offices and uses its facilities. Moreover, in order to provide the service, the team uses specific dedicated software. With respect to this example, the costs to be included in the cost base are: the employee expenses, the expenses related to the software used and offices costs (cost of the building and related utilities). As a result, the cost base consists of direct costs (personnel expenses and the software) and indirect costs (building expenses and related utilities) that have to be apportioned according to appropriate allocation keys. In particular, the indirect costs related to the building expenses might be allocated using as allocation key a ratio where the numerator is the number of the employees employed in the risk – management unit and the denominator is the total number of employees of the parent company. This cost base should then be increased by an appropriate mark-up and apportioned among the other group's member that use the service.

At last, we would like to point out that in our opinion the cost base should consist of actual costs. Budget costs may be used to establish prices on a monthly basis but at year-end the prices charged must be adjusted in light of the actual costs incurred. Allowing the use of budget costs, without any adjustment in light of the actual costs, might create room for unfair tax advantages and, therefore, an unfair tax competition with companies that do not have cross-border transactions.

6. Assessing the arm's length conditions for services provided in connection with the use of intangibles; services that are highly integrated with the value creation of the MNE group; and/or involve significant risks

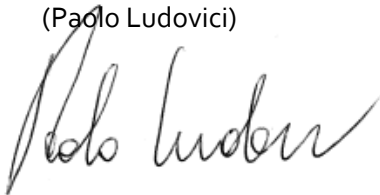
It is important to accurately delineate the transactions involving the provision of services in order to understand whether they are contributing at creating an intangible or they are simply connected to its use. In the first case, the guidance provided by chapter VI of the

TPG should be applied. In the second case, it is necessary to also establish whether they can be evaluated separately or following the guidance on combined transaction contained in para. from 3.9 to 3.12 of the TPG.

For intra-group services, the transfer pricing methods most widely applied are the comparable uncontrolled price method, where applicable, the cost plus method and the transactional net margin method (on a net cost basis). However, in cases of services that are highly integrated with the value creation it may be necessary to revert to the profit split method.

We very much hope that you will find our comments useful and we look forward to working with you on these important issues over the next months.

(Paolo Ludovici)

A handwritten signature in black ink, appearing to read 'Paolo Ludovici', written in a cursive style.

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19 June 2018

Dear Sirs/Madams

OECD scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines

These comments are presented by Arendt, Arthur Cox, Chiomenti, Cuatrecasas, Gide Loyrette Nouel A.A.R.P.I., Gleiss Lutz, Homburger, and Macfarlanes LLP following the call for public comments by the OECD on the possible future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines.

The OECD is seeking public comments on how the guidance in Chapter VII of the Transfer Pricing Guidelines could be revised or supplemented in order to address issues related to the practical implementation of the Transfer Pricing Guidelines in the context of the provision of intra-group services.

Executive summary

We do not see an urgent need for large-scale changes to Chapter VII – the guidance is generally clear and transfer pricing practitioners have developed well-established and generally-accepted approaches to the key issues in the pricing of most services.

However, it is clear that some changes would be needed now in order to maintain consistency between Chapter VII and the revised Chapters, and that further revisions are likely to be needed when the ongoing work on the use of profit split methods and on financial transactions is completed. We have suggested specific areas in which further guidance might be helpful or where further cross-referencing to other Chapters would be helpful.

Commentary

General comments

At a general level, it may be helpful to reconsider the current terminology. A tax ‘group’, is a legal concept defined by local statute, and not all of the related parties in a tax jurisdiction may belong to a particular tax group. It may, therefore, be more appropriate to refer to ‘related party’ services rather than to ‘intra-group’ services.

Second, we have identified a valuable body of guidance on a range of issues and services in other Chapters of the Transfer Pricing Guidelines which we would welcome being cross-referenced more extensively in Chapter VII. This would be consistent with the approach in Chapter IX (on Business

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Restructurings) which has successfully drawn on existing guidance in the Transfer Pricing Guidelines in order to comment on how restructurings should be approached.

Third, it has been a feature of practical transfer pricing that the most difficult and detailed issues are (understandably) not addressed clearly by existing guidance and must therefore be addressed by the courts, or by reference to decisions made by other courts. Given that no guidance can ever cover every situation or every question, this will always be the case. Having regard to the ongoing work on financial transactions, for example, courts in various jurisdictions have addressed, and sometimes appeared to have settled on a consensus approach to, a range of key issues including:

- the impact of implicit group support on creditworthiness and the consequent pricing of loans and guarantees;
- the method(s) for pricing a financial guarantee; and
- the allocation of cash pool benefits between the participants.

Given the emerging consensus on the treatment of issues such as these in the area of financial transactions (and in the use of the profit split method), and the delay in the publication of a draft chapter on financial transactions in particular, it might be helpful to note in Chapter VII how key case law may help to answer certain questions in relation to related party services.

Fourth, on timing, the complexity of financial transactions suggests strongly to us that the ongoing work on financial transactions will remain ongoing for some years to come, even if it results in the publication of a 'final' new Chapter during that time. It may therefore be advisable to publish only draft revisions to Chapter VII until a new financial transactions Chapter is published, and then to keep Chapter VII under review until the ongoing work on financial transactions is officially completed.

Commentary

Intra-group loans

The 2017 OECD Transfer Pricing Guidelines do not specifically address transfer pricing matters related to intra-group loans, and therefore previous guidance has been reviewed as a starting point to these comments.

The OECD Transfer Pricing and Multinational Enterprises Report of 1979 focused its attention on loans between affiliated companies in Chapter V (Loans) with useful guiding principles for both taxpayers and tax authorities. For example, it was provided that, once a loan is granted between related parties, a remuneration should be recognized if, under the same conditions, the application of interest would be envisaged in a financial transaction between independent parties.

Given the foregoing, an official position undertaken by the OECD to be included in the Transfer Pricing Guidelines would be important in clarifying the applicability (or otherwise) of the arm's length principle to non-interest-bearing loans, possibly providing for the exceptions given by specific economic conditions (such as the start-up phase).

Another important clarification of the OECD Transfer Pricing and Multinational Enterprises Report of 1979 concerned the granting of capital contributions which were deemed to be legitimate, although not generating interest. Capital contributions were not to be considered an exception to the general principle of remunerability of interest-free funding for transfer pricing purposes, but as a different and specific case. A clear, updated position which clarified that capital contributions do not fall in the general principle of remunerability for transfer pricing purposes would be of value.

Considering the lack of specific rules or guidelines on intra-group loans in certain jurisdictions (for example, Italy), it is paramount that the OECD implement an in-depth analysis of intercompany financings. This will provide MNEs with a common framework whereby financial restructuring of groups

could be effective without significant risks of ex post tax assessments (for example, transfer pricing adjustments on interest rates of cross-border loans which may result in a double taxation at group level).

With regard to the benchmark analysis of intercompany financings, it should be clarified that the financial market of the borrower is relevant for the purposes of the comparability analysis. There is some debate on this point between tax authorities, for example, the Italian Revenue Agency may argue that the market of the lender is the only market of reference. In our opinion, the borrower-market-approach is economically reasonable when determining the interest rate, given that the lender tends to consider the borrower market as the reference market as it is more representative of the risks that the lender will bear in relation to the financial transaction.

(Non) remunerability of intra-group guarantees

The granting of intra-group guarantees still represents an uncertain matter which has not been adequately tackled by the OECD. The current lack of guidelines on intra-group guarantees has been acknowledged by the OECD itself in the 2017 Transfer Pricing Guidelines (see page 93 of Chapter I, footnote No. 5).

An official clarification from the OECD regarding the remunerability of the intra-group guarantees and/or the provision of specific conditions in which no remuneration would be due given particular factual and economic circumstances (for example, the start-up phase of a newly-established company or indirect benefits for the guarantor from the financial resources of the secured loan agreement) would be welcomed.

Further, in cases in which a guarantee fee is due, additional guidelines by the OECD on calculation methods to determine the guarantee fees at arm's length would allow a certain degree of certainty for both taxpayers and tax administrations.

Irrelevant or scarcely significant intra-group services

In order to achieve a reduction of compliance obligations, and to provide a more complete guidelines framework, it is considered appropriate that the OECD provides an accurate definition of "residual transactions" based on specific qualitative and quantitative criteria to expressly exclude transactions of low economic importance from all the intra-group services that require a specific benchmark analysis. Transactions of low economic importance would, for example, include transactions that were of irrelevant, but recurring amounts (for example, 0.5% of the overall intercompany transaction).

Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient

Chapter VII addresses this issue in paragraph 7.6 (in terms of whether an unrelated party would have paid for the services), paragraph 7.8 (in terms of services performed for one member of the group), paragraph 7.9-7.10 (shareholder activities), paragraph 7.11 (duplication), 7.12-7.13 (incidental benefits) and paragraph 7.14 (activities which are often centralized). However, there is little explicit discussion of how it can be shown that services have been rendered and provided benefits.

We identified relevant guidance on this issue in Paragraphs 1.49, 1.158-1.160 and 1.162 of the Transfer Pricing Guidelines, although it is related to confirming that an unrecognized service has been provided rather than checking that a purported service has been provided. It does not appear that the work in progress on profit splits and financial transactions is intended to provide further guidance on this issue.

Therefore, there does seem to be a need for more guidance in this area. We suggest this further guidance include examples of inputs (financial and other), outputs and outcome of services that would indicate that particular types of services had been provided, and had resulted in a benefit.

Drawing a distinction between: (i) activities which do or do not benefit the local affiliates, (ii) benefits that purely arise from group membership and those that arise from a deliberate concerted action; and (iii) shareholder activities and stewardship activities

Chapter VII addresses this issue in the paragraphs mentioned immediately above in respect of demonstrating benefits, in paragraphs 7.12-7.13 in respect of incidental benefits, and in paragraphs 7.9-7.10 in respect of shareholder activities.

Our review of other guidance highlighted further useful discussions of incidental benefits from group membership as opposed to benefits arising from deliberate actions in paragraphs 1.49, 1.158-1.160 and 1.162, to which reference could be made in Chapter VII.

We have noted that the ongoing project on financial transactions is also said to be addressing this issue in the context of implicit group financial support and synergy benefits from cash pooling and captive insurance, and when this new Chapter of the Transfer Pricing Guidelines is finalized then relevant references to it could be made in Chapter VII. Given all of this advice which is or will be available outside of Chapter VII, we do not see a pressing need for any further guidance on this point to be drafted and added to Chapter VII at this point.

Identifying in practice duplicated activities

Chapter VII addresses this issue in paragraph 7.11. This guidance is rather limited, mentioning only the concepts of “different, additional, or complementary”. In our review of other guidance, this is not an issue which arises, and therefore, there appears to be a need for more guidance, particularly in terms of examples of how the key concepts would apply in a range of other situations.

Finding an appropriate allocation key for charging intra-group services

Chapter VII addresses this issue in paragraph 7.23 (broad selection criteria), paragraph 7.25 (ease of measurement, link to usage) and paragraph 7.59 (examples of allocation keys for various low value-adding services).

An MNE group electing for application of the simplified methodology must prepare a specific set of documentation that should provide sufficient evidence that the benefits test is met given the nature of low value-adding intra-group services. The OECD requests “a description of the benefits or expected benefits of each category of services”.

In order to increase the effectiveness of this guidance, the OECD may wish to consider in further detail a practical approach of this information with examples of documentation that could show the description of the benefits of each service and make reference to what information tax authorities might expect to obtain. This would help to manage the expectations of MNE groups regarding documentation which should be produced and maintained, and prevent excessive demands for information from tax authorities.

Low value-adding intra-group services

Under paragraph 7.49 of the Transfer Pricing Guidelines, there is a list of examples that “would likely meet the definition of low-adding services”. However, it should be noted that there is a risk that tax authorities may consider this list to be exhaustive – with the consequence of qualifying other intra-group services not included in the list as non-low-value adding services. There may be additional activities that could be included on this list depending on the facts and circumstances of the case at stake, and therefore it should be clarified that the list is merely demonstrative and not exhaustive.

According to paragraph 7.61 of the Transfer Pricing Guidelines, a mark-up equal to 5% of the relevant cost of low value-adding services is considered to be sufficient for proving that a controlled transaction occurred at arm’s length without providing a benchmarking analysis.

The 2010 EU Joint Transfer Pricing Forum Report on low value-adding intra-group services provides for an arm’s length range between 3% and 10%.

We suggest that 2017 OECD Transfer Pricing Guidelines includes the range of 3-10%, as indicated by the Joint Transfer Pricing Forum Report, considering that the use of a range would decrease the

necessity to make adjustments due to year-end reconciliations and would contribute to an effectively simplified and flexible approach without requiring taxpayers and tax administrations to make reference to a single number.

The question of allocation keys is also addressed (by implication) in other guidance in paragraphs 1.162 and 8.10 of the Transfer Pricing Guidelines and in paragraph 57 of the profit split discussion draft, and was raised there as a question for public comments. It is said to be a topic which will be covered by the ongoing financial transactions project.

Therefore, this issue appears to be fairly well-covered by existing and impending guidance to which reference could be made, and there is no pressing need for further guidance to be drafted.

Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises

Chapter VII addresses this issue in paragraph 7.56-7.57. This guidance is short but clear and covers the main aspects.

This issue is not discussed in any of the other guidance that we have reviewed, and does not seem to one that will be covered by the ongoing profit split and financial transactions projects. We do not see a major need to add to what is already covered by Chapter VII, although an example of the two-step allocation of indirect costs to services cost centres and then the fully-loaded costs to service recipients might be helpful.

Assessing the arm's length conditions for services provided in connection with the use of intangibles; services that are highly integrated with the value creation of the MNE group; and/or involve significant risks

Chapter VII addresses these issues in paragraphs 7.3 and 7.41-7.42 (intangibles), paragraphs 7.41, 7.47 and 7.50 (high value-adding services) and paragraph 7.50(b) (significant risks). This guidance is rather brief.

However, the issue of services connected with intangibles is also addressed in paragraphs 6.10, 6.54, 6.79, 6.100 and 6.101 of the Transfer Pricing Guidelines. The issues of higher value or higher risk services are also addressed in paragraphs 6.10, 6.54, 6.79, 6.100, 6.101 and 8.26 of the Transfer Pricing Guidelines. They are also addressed in paragraphs 93-100 of the profit split discussion draft.

Therefore, there is already a large body of guidance on these three issues and we do not see a need to add to what is in Chapter VII, beyond substantial cross-referencing to other relevant guidance that is, or will be, in the rest of the Transfer Pricing Guidelines.

Conclusion

We welcome this opportunity to provide comments on important issues that affect so many taxpayers worldwide, and look forward to reviewing the results of this call for public comments.

Yours faithfully

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Milan, 20 June 2018

Via e-mail: TransferPricing@oecd.org

Working Party No. 6 on the Taxation of Multinational Enterprises

Comments on the scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines

Dear Sirs,

we would like to thank you for the opportunity to submit our comments on the OECD Invitation for Public Comments “*Scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines*” released on 9 May 2018 (the “**Invitation**”). In this respect, please find hereinafter some of our observations.

1. General remarks

First of all, we respectfully confirm that, based on our experience, all the challenges listed in the Invitation surrounding the practical application of the guidance contained in Chapter VII of the OECD Guidelines¹ are in fact currently faced by several multinational enterprises (“MNEs”) and frequently give rise to disputes between taxpayers and tax administrations. This is due not only to the absence of a detailed guidance in Chapter VII but also to the lack of consistency among domestic transfer pricing rules and audit practices in many countries, in combination with the increasing

¹ OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (Paris: OECD Publishing, 2017).

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complexity of global business models of MNEs. The intention of Working Party No. 6 to revise Chapter VII by aligning it to the most recent developments brought by the BEPS project and by providing further guidance on its practical application is consequently highly welcomed. Indeed, without a broad alignment of the approaches to be adopted by both taxpayers and tax administrations with reference to the main practical issues concerning intra-group services, MNEs will continue facing uncertainties and experiencing disputes which may result in double taxation.

Such alignment could also be fostered by the OECD with a specific recommendation aimed at stimulating the domestic implementation by tax administrations of the recently introduced guidelines on “low value-adding services”, which already represent a significant step towards the elimination of some of the above mentioned issues.

2. Observations on specific topics

Among the list of practical challenges provided by the Invitation, we highlight here below those which, in our opinion, would particularly need detailed guidelines.

2.1 First, we note that one of the most relevant issues faced by both taxpayers and tax administrations when intra-group service transactions are audited concerns the demonstration that the latter have actually been rendered and that they have enhanced or maintained the business position of the service recipient (so-called “benefits test”). Based on our experience, some tax authorities do not challenge the deductibility of intra-group service fees on the basis of transfer pricing rules, but by applying general internal law principles or provisions concerning the existence of the intra-group services and the existence of a corporate benefit.

For example, the Italian tax authorities (“ITA”) usually require taxpayers to demonstrate that the services *(i)* have actually been rendered, *(ii)* provide benefits to the service recipient and *(iii)* are useful to the service recipient, both in the sense that they do not duplicate activities carried out by the service recipient and in the sense that there is a reasonable “proportionality” between the benefits received and the compensation paid. Where the ITA considers that the proof given by the taxpayer in this respect is not sufficient, it typically raises a challenge grounded on the

principle that the costs incurred by the service recipient are not inherent to its activity and, therefore, are not deductible (*i.e.* no transfer pricing adjustment is performed). Since the proof sought by the ITA is substantially the same as the benefits test required under the OECD Guidelines (which are often recalled by tax auditors), it is our opinion that more detailed guidance should be provided in Chapter VII in this respect. In particular, the Guidelines should establish that these types of assessment should fall within the scope of application of Article 9 of the OECD Model Tax Convention.² This statement, although not directly relevant for the deductibility of the costs (which could in any case qualify as non-deductible in either case), would have a crucial impact in those jurisdictions (such as Italy) where transfer pricing adjustments benefit from a penalty protection regime.

Moreover, it would have the effect to make it possible for the taxpayer to access to mutual agreement procedures under the relevant double tax treaties or (where applicable) the Convention on the elimination of double taxation in connection with the adjustment of profits of associated enterprises dated 23 July 1990, No. 90/436/CEE (the “Arbitration Convention”).

For such reasons, we would suggest to refine the description of the benefits test and to clarify that it falls within the (wider) functional analysis that taxpayers should conduct in order to establish the relationship between the relevant services and the group’s value chain.³ Moreover, it would be useful that the OECD Guidelines reiterated within Chapter VII the need to accurately delineate the transaction (and thus to properly identify the transaction as a service) in order to avoid conflict of characterizations by different tax administrations.

The same holds true for cases where the corporate services are provided (or functions executed) on a multi-jurisdictional basis due to the matricial organization of the MNE. Also in these cases, indeed, it would seem appropriate to provide a coherent guidance on how to prove that such

² OECD, *Model Tax Convention on Income and on Capital, Condensed Version 2017* (OECD Publishing, 2017).

³ Paragraph 7.32 of the OECD Guidelines currently states that “[i]t may be necessary to perform a functional analysis of the various members of the group to establish the relationship between the relevant services and the members’ activities and performance”.

multi-jurisdictional services/activities meet the “benefits test” and may be explained and justified from a transfer pricing perspective.

2.2 We also note that the proof that the intra-group services have been actually rendered and benefitted the receiving entity requires a careful analysis of the facts and circumstances of the case, which is generally characterized by a certain margin of discretionality. This is the case, in particular, with reference to those services which are provided for by the parent company on a centralized basis (the “centralized services”). Tax authorities often challenge the deductibility of the costs for such intercompany services arguing that the latter have not been actually rendered or that they have not enhanced the business position of the service recipient based on the fact that the taxpayer did not prove that the benefit test has been met. Considering the complexity of today’s MNEs’ business models, we would suggest to strengthen the guidance provided by Chapter VII by clarifying the level of detail that must be documented by the receiving entity and by introducing some concrete examples of what type of evidence would be sufficient. Indeed, our experience shows that there may be cases where it is almost impossible to document that a service described in a contract has effectively been rendered. For example, it happens very often that within MNEs services are rendered on a day-by-day basis simply through conference calls or instant messaging systems and not with written opinions as could happen with external advisors.

Another issue that comes into play is the identification of the portion of the costs incurred by the parent company for the purpose of providing the intra-group services. For example, it often happens that the top management of the MNE regularly dedicates time to the definition of strategic aspects of group activities that benefit also the subsidiaries. In those circumstances – as it is extremely difficult to have the top management preparing timesheets – costs are often charged indirectly by identifying a specific percentage of the total cost of the people involved that may approximate the percentage of the time spent by the top management in order to define the strategic aspects of group activities.

In our opinion, Chapter VII should provide further guidance and identify specific audit procedures – perhaps including interviews to the personnel involved in the country of the service supplier – based on which taxpayers would be able to prove the benefits derived from the services received and


the costs incurred for rendering them at the level of the service provider (possibly by considering certain safe-harbors when services are low-value adding and there is evidence of no duplication of the same services or costs).

2.3 As a last remark, we highlight that another area of concern usually relates to the identification of appropriate allocation keys for charging intra-group services. Indeed, the tax authorities of most countries frequently argue that the allocation keys selected by the taxpayer do not lead to arm's length results and often require the production of time-sheets showing the time spent in the provision of the services which may not always be available to the receiving entity. While we acknowledge that allocation keys have to be selected on the basis of the facts and circumstances of the case, we believe that more specific guidance could be provided in Chapter VII on this issue, for instance through a number of detailed examples and specific safe-harbor rules aimed at identifying recommended allocation keys which, if adopted by the taxpayer under specific circumstances, should not be challenged by the tax administrations. This would help reducing the uncertainties and the disputes currently faced by MNEs in the context of intra-group service transactions.

* * *

Please feel free to contact us at TP@maisto.it with any questions or comments concerning this letter.

Sincerely yours,

Maisto e Associati


CHAPTER VII

MEDEF COMMENTS

France is one of the countries where the number of MNEs (around 472 above 750.000 turnover threshold) and the number of HQ located in the EU (31) is the highest. We are therefore deeply concerned by all the issues related to intragroup services and their re invoicing.

If the reality of the expense /fee does not generally create an issue by itself, it is the amount that is sometimes -if not very often- difficult to demonstrate. The main reason is due to 1/the large number of subsidiaries which can benefit from the service (high level of centralisation at the HQ level), 2/ the imbrication of services. Bearing the burden of proof for each and every subsidiaries might lead to time-consuming investigations although the financial impact at stake is generally very low.

Elimination of double taxation issues should also be bore in mind when applying chapter VII.

Therefore, in order to simplify as much as possible the demonstration, we would therefore suggest the creation of safe harbours: the main objectives being to reduce compliance costs and to avoid additional layers of documentation.

- If the HQ company charging management fees applies the same method to all other countries concerned (or 90%), then the tax authorities of all other countries should not challenge the management fees.

External auditors will have to issue a report proving that the methodology is the same for all (or let's say 90%) subsidiaries.

With that report proving the consistency of the method, the tax authorities of other countries and of the country of the HQ parent company should then accept automatically the management fees.

- When the allocation method is attributing the amounts according to a low margin based on the turnover (low added value services), the method should not be called into question.

Mexico City, June 20th, 2018

Mr. Jeff VanderWolk
Head of the Tax Treaties and Transfer Pricing Division
OECD Centre for Tax Policy and Administration.

On behalf of the Transfer Pricing Commission of the Mexican Federation of Economists Colleges, herein you will find our comments regarding Chapter VII (intra-group services) of the Transfer Pricing Guidelines, we hope you can find them useful:

1. “Demonstrating that a service has been rendered and or that the service provides benefits to the recipient”

Chapter VII of the Transfer Pricing Guidelines discusses some special considerations for Intra-Group Services, such as when and how an intragroup charge may be considered a service. It goes on and gives very specific guidance on how the arm’s length charge should be. From identifying an Intra-Group Service to determining the arm’s length compensation, there is a very important process that, in many cases, provides the grounds to the tax authorities to consider (or nor) a deduction.

Demonstrating that a service has been received and provide benefits is not a straightforward process. In some cases, the evident lack of structure of the recipient clearly indicates the need to be supported, whether in its core activities or eventually in administrative activities along the company’s value chain. On these cases, it is relatively easy to demonstrate the service indispensability, along with the evidence of the activities performed by the service provider (i.e. scope, frequency, personnel involved, etc.). Nevertheless, in some other cases when there isn’t an immediate or evident benefit (i.e. the risk management itself) demonstrating the service reception could be extraordinarily difficult and most of the times, a time expensive activity for the taxpayer. As a suggestion, we suggest the use of a “contrario sensu” approach, in which the only the services which evidently do not provide a benefit, because their effect on the taxpayer’s profitability, should be questioned and without prove in contrary, disregarded.

Considering the previous, it may be very helpful to have guidance for both, taxpayers and tax authorities; so that there is more certainty on what information should be kept or elaborated to demonstrate the reception and benefits received from the service. This should be done for both, low value services and high value services, providing with minimum standards for both categories. In this process, it should be taken into consideration the costs for this documentation should not be very high for the taxpayers.

2. “Drawing a distinction between: (i) activities which do or do not benefit the local affiliates; (ii) benefits that purely arise from group membership and those that arise from a deliberate concerted action; and (iii) shareholder activities and stewardship activities”

In our view, the distinctive feature of a service is the activation of the service provider infrastructure (functions, assets, risks) on the recipient’s benefit. As the OECD guidelines suggest, there is a “deliberate concerted action”, which leads to the service provider to deploy resources with the expectation to maintain or to increase its benefits and such action is linked to the recipient’s needs, due to its own infrastructure (or lack of it). The lack of relationship between the service provider activities and the recipient’s needs must be enough to draw a distinction from other activities like incidental benefits, duplicative, shareholder, and stewardship activities which because of the lack of a deliberate action or a disconnection between the recipient needs will lead to the disallowing of a potential deduction.

3. “Identifying in practice duplicated activities”

The identification of duplicative activities can be a relatively straightforward process, in which the comparison of the service features against the recipient’s organizational structure (obtained via an organizational chart) must be quite enough to demonstrate the duplication of activities.

4. “Finding an appropriate allocation key for charging intra-group services”

The use of an appropriate allocation key must be directly related to the characteristics of the functions that are “activated” on the benefit of the services recipient. A relatively easy example can be taken from the information technology services. On such function, the recipient usually receives support taking into consideration the number of users, the active licenses, the number of equipments, etc. Consequently, the allocation key must considered such variables: i.e. (total cost of the IT function/users).

5. “Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises”

Determining the costs that should be included in the intra-group service cost basis would depend, significantly, on the type of service provided and the conditions under which the transactions are being carried out, it would not be possible to generalize it. However, should be considered certain guidelines. One of the elements to consider would be to identify whether the services provided constitute or not the main business activity of the enterprise are provided.

If this were the case, the costs base of the remuneration should include the direct and indirect costs generated by the provision of the service, in addition to the administrative expenses incurred to administer said transaction. Otherwise, if the service does not constitute the main business activity

and is not a recurring service, the ideal would be only to charge the direct and indirect costs that were generated by providing the service, but it would not be feasible to consider a portion of administrative expenses in the base, since is not an recurrent function that requires permanent attention of the administrative area of the provider.

In the event that a cost base cannot be identified to calculate the benefit, an indirect charge method should be used

6. “Assessing the arm’s length conditions for services provided in connection with the use of intangibles; services that are highly integrated with the value creation of the MNE group; and/or involve significant risks”

Broadly speaking if the service provider performs DEMPE functions associated to any intangible, the arm’s length condition of such activities must be tested in comparison to what independent third parties should have been paid using transactional methods. If it is impossible to measure the contribution of such functions via those methods, the alternative must be the use of a residual profit split in order to properly measure the contributions of the parties and assure an arm’s length consideration.

7. Additional comments

Next, we issue some additional comments that are not addressed in the consultation, we hope will be useful

The Guidelines propose an “elective, simplified approach” for low value- adding services seeking to reduce compliance costs in terms of benefits test and demonstration of arm's length charges, in addition to providing tax administrations with targeted documentation enabling efficient review of compliance risks. The approach is complemented by the suggestion of a threshold from which, deeper reviews should be made by the authority. This threshold would be based on fixed financial ratios of the recipient party.

Although the application of the elective, simplified approach supplemented with the threshold could relieve the taxpayer of high costs in the demonstration of compliance; excessive costs can still be generated in transactions not considered low value- adding services. Therefore, the threshold should not be considered only for low value-adding services, if not to any type of intra-group service. The ratio would be calculated on the level of total costs of taxpayers, and It would be used to know what level of proof should be requested by the authorities to demonstrate that the services have been rendered, in this way, the higher the ratio, the higher the level of supporting documentation. This could help to reduce the costs of demonstrating the benefits generated by the service received when it is not significant, as well as helping the authorities to facilitate their inspection process.

The objective would not be to deny the deduction of expenses that exceed the threshold (some services could be a fundamental part of a value chain), otherwise the ratio should be considered only to determine the level of supporting documentation for service verification and the level of depth in a review by the authorities

Participating Members:

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Fernando Pliego Vincent

Allan Pasalagua Ayala

Argel Romero Dominguez

David. S. Barrón Tovar

Milan, 20 June 2018

To: Mr. Andrew Hickman,
Head of the Tax Treaties and Transfer Pricing Division

To: Tomas Balco
Head of the Transfer Pricing Unit

Sent by e-mail
TransferPricing@oecd.org

Public comments on the scope of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines

Dear Mr. VanderWolk, dear Mr. Balco,

Morri Rossetti law firm is pleased to provide its comments in response to the OECD Centre for Tax policy and Administration's public invitation. The comments deal with how the guidance in Chapter VII could be revised or supplemented to address the issues related to the practical implementation of the TPG in the context of intra-group services, thus increasing tax certainty for taxpayers and preventing double taxation.

1. Benefit test

With reference to the benefit test, we focus our comments on the paragraphs below:

7.6. Under the arm's length principle, the question whether an intragroup service has been rendered when an activity is performed for one or more group members by another group member should depend on whether the activity provides a respective group member with economic or commercial value to enhance or maintain its business position. This can be determined by considering whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in house for itself. If the activity is not one for which the independent enterprise would have been willing to pay or perform for itself, the activity ordinarily should not be considered as an intra-group service under the arm's length principle.

7.7 The analysis described above quite clearly depends on the actual facts and circumstances, and it is not possible in the abstract to set forth categorically the activities that do or do not constitute the rendering of intragroup services.

Please find below our comments.

a. Objective and subjective perspective

The starting point for the "benefit test" is to analyze whether or not a service has been rendered; this conclusion depends on whether the activity provides a group member with *"economic or commercial value to enhance or maintain its business position"*¹. Therefore, it can be argued that is not the provision of service *per se* that matters, but also the existence of an economic or commercial value for the recipient of the service should be taken into account.

However, under paragraph 7.6 the existence of such an *"economic or commercial value"* "can"² be determined by considering *"whether an independent enterprise in comparable circumstances would have been willing to pay for the activity"*. This seems to shift the analysis from an "objective" perspective to a "subjective" one (i.e., the standpoint of the third party)³, and it is not clear which of the two should prevail. A possible interpretation could be that the "subjective" perspective has relevance when it comes to establish the threshold of the cost incurred for the service allowable for deduction (which would be the amount that a third party would pay). However, we notice that this assessment – i.e. the amount of the service's cost deductible – should refer to the next stage of the analysis – i.e. of the pricing of the service – not to the preliminary stage (i.e., whether a service has been rendered).

Therefore, we argue that it would be advisable to clarify how the benefit test should be carried out. Furthermore, we believe that the existence of a benefit should be assessed with reference to the functions performed, assets held and risk borne by the recipient of the service.

b. Expected or actual benefit?

Chapter VII does not clarify whether the "benefit" required under the benefit test must "materialized" or it is enough the existence of an "expected benefit", also in the event the benefit does not materialized.

On this issue, the UN Guidelines 2017 clarify that the term benefit includes also "expected benefit", noting that, *"provided the recipient associated enterprise expects a potential economic*

¹ Ch. VII, par. B.1.1., OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2017).

² The use of *"can"* involves that alternative approaches are available; a clarification on this point it is advisable.

³ Ch. VII, par. B.1.1., OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2017).

*benefit from the research and development, the benefit test is satisfied and a chargeable service has been provided, even though the activity may not always actually result in benefits"*⁴.

We believe that a similar clarification should be included also in Chapter VII.

c. Benefit test and services provided to more related parties

A related issue is the fulfillment of the benefit test in case of services provided to more related enterprises within the MNE. This happens, for instance, in case of marketing program designed by one member of an MNE group to be used by associated enterprises. If the marketing strategy is a success in most countries, but a failure in other jurisdictions, the expected benefits in such jurisdictions are not achieved⁵. Hence: how to apply the benefit test? At this regard, the UN TP Guidelines 2017 clarifies that insofar as to each associated enterprise within the MNE group taking up this marketing strategy has "legitimately" expected a benefit, they *"have received a benefit for the purpose of the benefit test"*, despite the fact that some of these enterprises *"do not fully achieve the expected results"*. Our suggestion is to provide a similar clarification on this issue, maybe by providing some examples in the paragraph B.1.5 ("Centralised services") t

d. Benefit test, supply of services and VAT issues

We argue that Chapter VII should provide some clarification for the cases where a service does not meet the benefit test and nonetheless is still relevant for VAT purposes.

Accordingly, it must be remembered that for VAT purposes, supply of services is a broad category which includes "any transaction which does not constitute a supply of goods"⁶.

While understanding that VAT and TP rules are grounded on different principle, our opinion is that it should be advisable to avoid – to the extent possible – mismatch between the qualification of services for VAT e transfer pricing purposes, in order to make easier for taxpayers to comply with both set of rules at the same time.

2. Duplication of services

With reference to the duplication of services, we focus our comments on the paragraphs below:

7.11 In general, no intra-group service should be found for activities undertaken by one group member that merely duplicate a service that another group member is performing for itself, or that is being performed for such other group member by a third party. An exception may be where the duplication of services is only temporary,

⁴ B.4.2.6., United Nation Practical Manual on Transfer Pricing for Developing Countries (2017).

⁵ B.4.2.5., United Nation Practical Manual on Transfer Pricing for Developing Countries (2017).

⁶ Article 24, council directive 2006/112/EC of 28 November 2006.

for example, where an MNE group is reorganising to centralise its management functions. Another exception would be where the duplication is undertaken to reduce the risk of a wrong business decision (e.g. by getting a second legal opinion on a subject). Any consideration of possible duplication of services needs to identify the nature of the services in detail, and the reason why the company appears to be duplicating costs contrary to efficient practices. The fact that a company performs, for example, marketing services in-house and also is charged for marketing services from a group company does not of itself determine duplication, since marketing is a broad term covering many levels of activity. Examination of information provided by the taxpayer may determine that the intra-group services are different, additional, or complementary to the activities performed in-house. The benefits test would then apply to those non-duplicative elements of the intra-group services. Some regulated sectors require control functions to be performed locally as well as on a consolidated basis by the parent; such requirements should not lead to disallowance on grounds of duplication.

Please find below our comment.

- **Relationship with national rules on cost' deduction**

Non-recognition of duplicative services aims at preventing deduction of costs wherever no added business value is provided to the percipient, also allowing at the same time some specific type of "legitimate" duplications (e.g., in order to reduce risk or in case of temporary duplications⁷).

A possible issue could be the different rules applicable by each country in order to deny the deductibility of cost incurred by enterprises. This issue has been addressed by the US TP Guidelines 2017. At this regard, the US TP Guidelines 2017 clarify that "*Transfer pricing rules require the payment of arm's length transfer prices for chargeable services. Principles of domestic law are then applied to determine if such payments may be deducted by the associated enterprise making the payment in determining its taxable income*"⁸.

For example, under the Italian rules, deduction should be granted to costs not only immediately and directly related to the activity of the enterprise⁹ but also in case such relation is indirect, potential, and projected in the future¹⁰. Furthermore, in case a cost qualifies as a deductible expense, issues may also arise on the extent to which the cost's amount is deductible.

⁷ Ch. VII, par. B.4.15., OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2017).

⁸ B.4.1.5., United Nation Practical Manual on Transfer Pricing for Developing Countries (2017).

⁹ Opinion of the Consultative Committee on Anti-abuse rules, 19 February 2001 No. 1; Italian Supreme Court decisions, of 30 July 2007 No. 16826, of 21 January 2009 No. 1465 and 1 of 3 February 2009 No. 3583.

¹⁰ Italian Supreme Court decision of 11 January 2018 No.450.

Chapter VII does not address this issue. A possible solution could be extending the conclusion reached by the UN TP Guidelines 2017 (above mentioned) and referring to the rules developed by the country where the recipient of the supply is resident or established (which is the party entitled to the cost deduction). This would also align the rules applicable to national and cross-border transactions.

3. Low value adding intra-group services

The OECD TP Guidelines 2017 clarifies that a service to be qualify as “low value-adding intra-group services” must be:

- i. of a supportive nature,
- ii. not part of the core business of the MNE group (i.e., not creating the profit-earning activities or contributing to economically significant activities of the MNE group).
- iii. do not require the use of unique and valuable intangibles and do not lead to the creation of unique and valuable intangibles, and
- iv. do not involve the assumption or control of substantial or significant risk by the service provider and do not give rise to the creation of significant risk for the service provider

Please find below our comments.

a. Supportive activity

As per (i), we believe that a definition of “supportive activity” should be provided; the concept seems to refer to the activity of the recipient of the service, the subject who is “supported” by the provider; however, more clarity on this issue should be provided.

As per point (ii) we argue that identifying the core business of the MNE group may be difficult and this could lead to an increase of uncertainty and disputes.

b. Core activity

In order to qualify a service as a low value-adding intra-group service, we believe that reference to the “core activity” of an MNE could be not the most appropriate criteria.

Indeed, it can be difficult to identify what is the core business of an MNE, leading to a subjective approach that may give rise to tax disputes. Our opinion is that some activities should generally qualify as low value-adding services, with no regard to whether or not they constitute the core business of the MNE, as could happen, for instance, with services provided by a toll manufacturing (excluded from the simplified approach, under paragraph 7.47).

It can be argued that, by applying a different approach (i.e., the simplified and not simplified one) to the same activity could go against the principle of neutrality, whereby similar transactions should not be treated differently for tax purposes. Accordingly, within the EU, the ECJ held that the principle of fiscal neutrality, on which the common system of VAT established by the Sixth Directive is based, precludes economic operators carrying out the same or similar transactions from being treated differently in relation to the levying of VAT¹¹. Notably the ECJ has found that distortion is established once it is found that supplies of services are in competition and are treated unequally for the purposes of VAT¹². Therefore, we believe that some clarifications are provided on the relationship between the simplified approach and the principle of tax neutrality, especially within the EU.

*** **

We appreciate the opportunity to provide our comments and we thank you for your attention on this matter.

Please feel free to contact us with any questions or comments concerning this letter.

¹¹ C-363/05, JP Morgan Fleming Claverhouse Investment Trust plc, The Association of Investment Trust Companies vs The Commissioners of HM Revenue and Customs.

¹² C-404/99, Commission v France.

Tomas Balco
Head of Transfer Pricing Unit
Centre for Tax Policy and Administration
Organization for Economic Co-operation and Development

June 20, 2018

VIA E-MAIL to transferpricing@oecd.org

Comments on the scope of the future revision of Chapter VII of the Transfer Pricing Guidelines on Special Considerations for Intra-Group Services

Comments by Guillaume Madelpuech and Jacques Potin, NERA Economic Consulting

These comments represent the views of the authors and not necessarily the views of NERA Economic Consulting.

Dear Mr. Balco,

NERA is pleased to provide comments as part of the OECD invitation for public comments on the scope of the future revision of Chapter VII of the Transfer Pricing Guidelines (the “Guidelines”).

In this respect, the OECD identifies the need for an evolution of Chapter VII in view of “*aligning the guidance with Chapter I, in particular, but also Chapters VI and VIII, as well as considering whether and, if so how, to incorporate the ongoing work on the use of profit split methods and financial transactions*”. The OECD identifies as well six “*practical challenges that require further analysis*”, listed thereafter.

We believe that the OECD has identified aspects where Chapter VII may have to be refined.

We think that, as pointed out by the OECD, the main topic to be addressed should be indeed the relation between Chapter VII and Chapters I and VI as regards “high-value” or “entrepreneurial” services. It may be too often the case that such services are analyzed under the Transactional Net Margin Method, whereas such transactions relate in fact to services for which no reliable comparable can be found. Similarly, the service providers for such services tend to be allocated no risk under the Group transfer pricing policies, whereas, in fact, the service providers may manage

economically significant risk. We think that this would typically contravene the principles in Chapter I. We believe that these situations likely arise from the fact that the current version of Chapter VII fails to address in a satisfactory manner situations with high value-adding services. This point is further developed under Question 6 below.

Another critical aspect – which may fail to be addressed in the OECD’s request for comment - relates to the (lack of) correspondence between (i) the OECD Simplified Approach¹ and (ii) other simplified approaches in certain jurisdictions, such as the US Service Cost Method. From this perspective, we also recommend that, in addition to the revision of Chapter VII, effective monitoring tools be put in place by the OECD to ensure that countries incorporate the OECD Simplified Approach in their local applicable tax law.

1. Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient.

We understand that the Benefit test, as per paragraph 7.6, consists of analyzing “*whether an independent enterprise in comparable circumstances would have been willing to pay for the activity*”. The current wording of Chapter VII does not stipulate explicitly that the taxpayer should prove (as part of the Benefits test) that the price set for the services is correct (quantum of the expense). We recommend that this point be further clarified in a future version. For instance, the OECD could stipulate that the required level of documentation of the quantum of the expense should be proportional to its tax implications (pursuant to provisions of §5.28).

It would also be helpful that the guidance further describes the process for conducting a Benefit test (for situations where a full-scale benefit test would be appropriate). Benefit tests may typically directly identify the actual commercial local benefits that the central services generate for the local legal entity. Broadly speaking, they should cover both benefits arising from revenue increase and benefits arising from cost savings.

¹ OECD simplified approach to determine the arm’s length charges for low value-adding intra-group services

- 2. Drawing a distinction between: (i) activities which do or do not benefit the local affiliates; (ii) benefits that purely arise from group membership and those that arise from a deliberate concerted action; and (iii) shareholder activities and stewardship activities.**

We are not certain that the guidance needs substantial revision in respect of this particular topic.

- 3. Identifying in practice duplicated activities.**

We are not certain that the guidance needs substantial revision in respect of this particular topic.

That being said, the German Regulations provide meaningful guidance in relation to this topic. We think that those Regulations could be further leveraged as part of a revision of Chapter VII.

- 4. Finding an appropriate allocation key for charging intra-group services.**

We understand that these provisions primarily relate to low value-adding services. It could be helpful to include in the revised Chapter VII a process for selecting the most appropriate allocation key.

- 5. Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises.**

We understand that these provisions primarily relate to low value-adding services. We are not certain that the guidance needs substantial revision in respect of this particular topic.

- 6. Assessing the arm's length conditions for services provided in connection with the use of intangibles; services that are highly integrated with the value creation of the MNE group; and/or involve significant risks.**

From an economic perspective, the techniques and challenges for (i) the analysis of the transfer or license of intangibles and for (ii) the analysis of “high value” services or intangibles embedded within the provision of services are largely similar, provided that the discussion on intangibles necessitates to account for the legal rights involved, as well as the time of intangibles’ creation and development.

In this respect, it may be that that Chapter VII would need to be revised to further directly refer to Chapter VI (and Chapter I) to ensure maximum consistency.

Page
June 20, 2018

Sincerely yours,

Guillaume Madelpuech and Jacques Potin

Ref No. 19/06/18-19

Date: 20th June 2018

Kind Attn:

Mr. Tomas Balco,

Head of Transfer Pricing Unit,

OECD Centre for Tax Policy and Administration

By email: TransferPricing@oecd.org

Subject: Comments on the scope of the future revision of Chapter VII (Special Considerations for Intra-Group Services) of the Transfer Pricing Guidelines

Dear Sir,

We are grateful for the opportunity to comment and provide suggestions for the scoping exercise on the future revision of Chapter VII (Special Considerations for Intra-Group Services) of the OECD Transfer Pricing Guidelines ('TPG').

It is a welcome measure by Working Party No. 6 on the Taxation of Multinational Enterprises to start a new project on revision of Chapter VII (Special Considerations for Intra-Group Services) of the OECD Transfer Pricing Guidelines considering that an overhaul of Chapter VII of TPG would immensely benefit all stakeholders. We are positive that revision in guidance on practical implementation of Chapter VII of TPG would go long way in encouraging adoption of standard practices by taxpayers as well as tax administrations across the globe.

In this regard, we are pleased to present our suggestions on the scoping exercise as follows:

1. Indicative list of centralized services has been given at Paragraph 7.14 of Chapter VII of TPG. **Such list should be expanded to make it more detailed by drawing references from the following:**
 - a. Intra-group services given in *Annex 1 to Appendix I of Communication 2011/16 from the European Commission to the European Parliament, the Council And the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the period April 2009 to June 2010 and related proposals – Guidelines on low value adding intra-group services*;
 - b. Centralised activities given at *Paragraph 35 of Australian Taxation Office Taxation ruling TR 1999/1*;
 - c. Routine support services given in *Annex C to e-Tax Guide on Transfer Pricing Guidelines (5th Edition) by Inland Revenue Authority of Singapore*.

2. Indicative list of shareholder activities have been given at Paragraph 7.10 of Chapter VII of TPG. **Such list should be expanded to make it more detailed by drawing reference from the list of shareholder costs given in Annex 2 to Appendix I of Communication 2011/16 from the European Commission to the European Parliament, the Council And the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the period April 2009 to June 2010 and related proposals – Guidelines on low value adding intra-group services.**
3. Cost Contribution Arrangement ('CCA') could be entered into for obtaining services too apart from joint development or acquisition of intangible property. In such case it becomes essential to distinguish an intra-group services from such CCA for services. **The differentiation between the two should be explicitly explained either under Chapter VII or Chapter VIII of TPG.** In making distinction between intra-group services and CCA, reference could be drawn from *Paragraph 12 of Communication 2012/516 from the European Commission to the European Parliament, the Council And the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the period July 2010 to June 2012 and related proposals – Report on Cost Contribution Arrangements on Services not creating Intangible Property.*
4. There is no focused guidance on the documentation aspect for intra-group services either under Chapter VII or Chapter V of TPG. Therefore, **a specific Section under Chapter VII should be introduced to prescribe documentation requirements for provision / receipt of intra-group services.** Guidance could be drawn from *Paragraph 23 and 37 (particularly for cost pools) of Appendix I of Communication 2011/16 from the European Commission to the European Parliament, the Council And the European Economic and Social Committee on the work of the EU Joint Transfer Pricing Forum in the period April 2009 to June 2010 and related proposals – Guidelines on low value adding intra-group services* as well as *Paragraph 104 of Australian Taxation Office Taxation ruling TR 1999/1.*
5. It is not uncommon to encounter payment of 'management fees' towards receipt of intra-group services from group companies. This payment typically relates to availing services of nature of management during initial stages of business carried out by an entity after its incorporation *or* where adherence to group policy is mandated and services towards achieving such integration are provided by another group company. However, in practice receipt of such management services (though fulfilling the benefit test) is often challenged by the tax administration of various countries on account of lack of uniform documentation prescribed in this regard. **It is therefore suggested that prescriptive documentation requirements be given for evidencing the receipt of services of management nature.**
6. Guidance on application of Comparable Uncontrolled Price Method and Cost Plus Method has been given for calculating the arm's length compensation under Chapter VII of TPG. However, depending upon the selection of tested party, Transaction Net Margin Method could also be appropriate to apply especially in case of a group entity receiving such services.

Guidance should be given for application of TNMM in such cases. Further, since the concept of Most Appropriate Method is embedded under TPG, guidance should also be given for discarding the application of Transaction Profit Split Method in case of multiple interrelated transactions relating to receipt as well as provision of intra-group services within an international group.

We sincerely hope that the above suggestions on scoping exercise may be useful to the OECD for future revision of Chapter VII of TPG.

Yours sincerely,

Pankaj Bhuta [B.Com (Hons.), F.C.A.]

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Milan, June 20th 2018

OECD Invitation for Public Comments: Scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines

By email: TransferPricing@oecd.org

Studio Pirola's comments

Studio Pirola Pennuto Zei & Associati welcomes the opportunity offered by the OECD to provide its comments in connection to the new project, aimed at revising the guidance in Chapter VII of the OECD Transfer Pricing Guidelines, "Special Considerations for Intra-Group Services", of particular scientific and academic but also practical interest.

The matter is utmost interesting in light of the recent developments due to BEPS project outcome and to the approach adopted by some tax administrations, often requiring an extensive disclosure and proof of benefit for the intra-group services received by MNE's subsidiaries.

Specifically, we would like to propose some brief comments.

i) The effectiveness, the non-duplication and the benefit tests are strictly connected

In our view, the revised guidance should clearly state the effectiveness and non-duplicative nature of the services are the criteria to be followed in order to judge about the deductibility of the service costs in the hands of the beneficial entity belonging of the MNE Group.

Once the effectiveness and the non-duplicative nature of the services have been demonstrated (we'll provide below some comments on these requirements) there is little room for an additional test, as per paragraph 7.6 of the TPG, directly referred to the actual benefit incurred.

Considering the nature of the services typically part of management service agreements involving MNEs, the possibility to quantify the benefit in terms of costs savings and/or additional revenues directly connected to most of the services, is quite impossible. As a matter of fact, the services typically part of the intercompany agreements are not part of a “core business” and, as such, cannot be benchmarked; moreover, a “with and without” method is not applicable due to the lack of information and, quite often, of comparative data.

We would also like to note that in most cases in which an increase of revenues and/or a reduction of costs is observed, these effects are not directly connected to the intercompany services but incidental in nature and strictly linked to the Group membership itself.

ii) Non duplicative nature of the costs incurred for the services

In our opinion the non-duplicative nature of the costs incurred due to a management service agreement should be investigated based on the following practical principles:

1. The same activities provided for by the Group service provider should not be purchased by the receiving entity on the market. In this respect relevance should be assigned to the services having the same nature and level of complexity/responsibility in terms of functions and business units involved. For example, the strategic marketing services rendered by a Group company cannot be regarded as duplicative in case the receiving company purchases marketing services also from third parties, but the latter are necessary in order to implement the global group marketing strategy;
2. The receiving company has a complex functional structure, in principle suitable to cover the business activities, including the ones rendered through the Group management service agreement. Should this be the case, the Group services have to be regarded as non-duplicative in case they are intended to cover a different level of complexity/responsibility. For example, the Group IT function has the ownership and the responsibility for the ERP (including the rights of use the software and the hardware necessary to run it), while the local IT team provides day-by-day assistance to the users;
3. The receiving company has an operative functional structure, taking care of the ordinary business activities, but the ultimate responsibility and the coordination of the efforts for all or some of the functions is managed centrally and the costs connected with these activities are charged through a management service

agreement. Should this be the case, no duplication can be identified, as the level of responsibility covered by the intra group services is different from the one kept at the subsidiary level. For example, the strategic procurement functions are performed at a group level, thus enabling the group to negotiate with the key suppliers on a global basis (achieving significant cost savings), while at a local level a procurement function is kept in order to manage local activities and/or the supplies of different raw materials. In this case, the costs charged by the group company in which the global procurement function is managed should be regarded as non-duplicative.

iii) The effectiveness of the intercompany services

Considering the nature of the services (i.e. they are not “tangible”), in order to test the effectiveness of the services, reference should be made mainly to (a) the service's inherence with respect to the core business of the recipient company and (b) the roles and responsibilities of the Group employees actually rendering the services.

In this respect the following should be carefully regarded:

1. The nature of the services rendered and the consistency of these latter to the core business of the recipient company; the link shall be in general terms and without any reference to the benefit achieved or expected;
2. The identification of the team dedicated to the provision of the services;
3. The level of competency of the employees involved, with a clear identification of their role and responsibility inside the service provider organization;
4. A clear identification of the procedures adopted in order for the employees to render the services to the recipients in accordance with the management service agreement in force;
5. The resources involved in the provision of services should be part and under the responsibility of the service provider organization.

Moreover, the service provider should keep adequate records showing that the activities has been actually rendered (i.e. list of activities, reports on projects, details of the employees dedicated to each group entity and/or function, ...).

In case the service provider acquires a quota of the services rendered from third parties, accurate records of the services received, based on the official documents provided for by the third parties (list of activities, detailed fee quotes, invoices, ...) should be kept.

iv) Stewardships and shareholders' activities

As far as the stewardship expenses are concerned, considering their nature of services actually rendered by the Group central functions, they should be regarded and treated as intercompany services, following the basic rules and criteria as above.

On the contrary, the shareholders' activities should be identified in the activities rendered by the Group parent company to satisfy its own interest and that are not linked to the business activity of the affiliates. The list of such activities should include the following:

1. Set up and management of the juridical structure of the parent company;
 2. Financial report and audit at a Group level, including the consolidation of reports, the parent company and the subsidiaries' audits carried out in the sole interest of the parent company;
 3. activities connected with the parent company's investor relations, including the communication strategy intended to be addressed to the financial markets, the shareholders, the funds;
 4. compliance of the parent company with the relevant civil and tax law;
 5. activities intended to raise funds for the acquisition of participations.
- v) *Determination of the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises and finding an appropriate allocation key for charging intra-group services*

With reference to the identification of costs to be included in the cost base of group services, it needs to take into account both direct and indirect operating costs, thus excluding financial and extraordinary items.

First of all, in our opinion it is necessary to clearly identify:

1. the functions performed and the risk assumed by the service provider in rendering the group services and, accordingly
2. the costs (strictly connected to the functions involved in the activities covered by the management service agreement) on which the mark-up should be applied.

Focusing on direct costs, reference shall be made to all expenses incurred for materials, products, semi-finished products, equipment and employees directly engaged in rendering the group services.

For the indirect costs or for those costs that are qualified as direct by nature but not exclusively referred to the group services (i.e. employees both engaged in performing activities related to the core business of the service provider and in rendering the group

services), in order to determine the cost base reference shall be made to indirect allocation criteria, i.e. allocation keys.

The choice among the possible allocation keys cannot be, in principle, restricted, since the criteria to be followed should be the adoption of a key consistent with the nature of each group service and the functions involved of the recipient company.

Finally, it is important to further expand on certain costs which, although directly relating to the services rendered, can be regarded as the drivers for the determination of the efficiency (or inefficiency) of the services management, for which the provider should be responsible.

As an example, if the variance of some direct costs is quite important, they may be included in the calculation basis of the mark-up based on a standard level, so that any efficiency (or inefficiency) connected with the services rendered will remain at the service provider level, since an independent firm would never accept to pay a higher price due to inefficiencies in the service provider organization.

Nevertheless, the exclusion of such costs from the calculation basis of the mark-up cannot be regarded as a general principle, as it should be correct to include them based on an “standard” level, representing the allocation of the risks of the services rendered to the recipient companies (determined based on a functional analysis). Internal reports, prepared by the service provider should support this kind of approach for the identification of the cost base.

Sincerely,

Pirola Pennuto Zei & Associati

Tax Treaties, Transfer Pricing and Financial Transactions Division
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By email to: TransferPricing@oecd.org

20 June 2018

Dear Sir / Madam,

Scoping of the future revision of Chapter VII (Intra-group Services) of the OECD Transfer Pricing Guidelines

PricewaterhouseCoopers International Limited on behalf of its network of member firms (PwC) welcomes the opportunity to comment on the scoping of the future revision of the guidance in Chapter VII of the Transfer Pricing Guidelines ("TPG") relating to Intra-Group Services as per the Invitation for Public Comments dated 9 May 2018.

Many multinational enterprises (MNEs) have centralised intra-group services activities and it is our experience that the current compliance burden required to prepare and maintain detailed transfer pricing documentation and computation, conduct benefit analyses, and manage the ensuing tax audits can be significantly out of proportion to the nature and scope of the intra-group charges or the actual tax risk involved.

PwC believes that, through the revision of Chapter VII, the OECD can help both taxpayers and tax administrators achieve an appropriate balance between theoretical sophistication and practical application that is commensurate with the tax at stake in the countries paying and receiving the charges.

Given the ever-increasing focus on intra-group services, the widespread adoption of a uniform approach could be very beneficial. The usefulness and success of the proposed measures will depend on how many countries agree with and adopt the proposed revisions. It is hoped that the OECD will invite and involve a number of non-OECD member countries (e.g., India, China, etc.) to participate in the process of drafting the proposed measures, recognizing the mutual benefits that would inure to both taxpayers and tax administrations.

In particular, we believe there are a number of things that could be included or improved in Chapter VII to reduce administrative burdens (including non-deductible costs) and gain

greater traction from developing countries (bearing in mind also the project to consider transfer pricing alignment on the potential accession of Brazil to the OECD). Examples might include:

- a 'process test' in which the focus would be on robustness of the process of determining and charging for intra-group services, in place of the review of resulting benefits often used, particularly in developing countries,
- the possible inclusion of distribution, manufacturing/production and research and development services in the simplified approach to low value-adding services (in line with Chapter IV), and
- recognition that a recommended simplified approach to the mark-up could coexist with one country's specific guidance on similar services to avoid challenge solely on that basis.

In the remainder of this letter we have identified a number of items that the OECD might consider while developing the revised Chapter VII of the TPG.

A. Introduction

For practical reasons we outline our comments below by following the structure and main sections of Chapter VII of the 2017 version of the TPG.

B. Main issues

Aligning the Chapter VII guidance with Chapter I - actual delineation of transaction

The guidance in Chapter I of the TPG requires delineation of the actual transaction, focusing on what parties actually do and their contribution to value creation. This requirement of delineation of the actual transaction is a more appropriate framework to determine the arm's length nature of the intra-group services charge than the current framework which is heavily tilted towards a benefits analysis. The practical challenges faced by taxpayers in conducting a benefits analysis is elaborated in the next section.

B.1. Determining whether intra-group services have been rendered

Benefits test

Currently, intra-group services are subject to intense scrutiny. Many countries (especially developing ones) are increasingly challenging the deductibility of intra-group services charged by questioning the benefits arising from such services. These audits tend to focus on the documentation substantiating the benefits from the charge, which is a highly subjective test. The quantum of documentation required (e.g., emails, presentations, policy documents, etc.) is disproportionately high and, therefore, leads to a protracted controversy process and double taxation.

The focus during audits is often on the quantum of documentation and not on the quality. While it is relatively easier to demonstrate if the services have been provided by the service provider and received by the user of services, our experience has been that during tax audits, the tax authorities often focus on measurability of benefits, i.e., valuation of the service.

Also, there are often situations where the costs related to services may not be deducted anywhere. For example, because of a different qualification of those costs - state A (service recipient) may consider the costs as shareholder costs; State B (service provider) may consider the costs as being for actual services rendered. This issue may not always be solved in Competent Authority proceedings or audits, with lasting double tax as a result.

The concept of a benefits test could be replaced by a 'process test' in which the focus would be on robustness of the process of determining and charging for intra-group services. The process test should be considered to be satisfied if the taxpayers can demonstrate the following:

- Robust process is followed to determine the allocable cost pool, i.e., shareholder and duplicative costs have not been considered;
- Robust process is followed to identify directly allocable costs and segregate indirectly allocable costs;
- Allocation keys used to allocate common costs are reasonable and are followed consistently for all service recipients;
- Appropriate documentation is maintained to enable the tax authorities' review of the process followed for determining the cost pool, identifying the direct and indirect cost and the rationale for the choice of allocation keys. Such documentation could include a global intra-group services report from the perspective of the service provider, interview notes, service agreements, purchase orders, invoices, etc.
- Full-scope functional analysis (i.e., interviewing the key personnel or departmental heads providing the services) is performed once in three years unless there are significant changes in facts.

If the OECD decides to retain the concept of a benefits test, we recommend it only be applicable to non low-value adding services that represent a material proportion of the total costs of the service recipient (for example, greater than 10 percent). The language in paragraph 7.63 of the TPG on 'threshold for the application of simplified approach' can be reworded to make it applicable for non "low-value" adding services also.

The TPG could make it explicit that determining arm's length price is not tantamount to questioning the business judgement of the taxpayer. Tax officers sometimes seek to substitute their own judgement and question whether a taxpayer should have purchased the services locally or performed the services itself.

In addition to the above, the TPG could make it explicit that tax authorities should respect a taxpayer's decision on where to source the services, and accordingly the price of the services as benchmarked using comparables from the service provider's region. Where tax authorities seek to compare the price of intra-group services with the price of similar services in the local market, this amounts to testing the price charged by an overseas service provider with the price charged by a local comparable, which seems to disregard the basic tenet of comparability. This could lead to unwarranted disallowance of a portion of the intra-group services charged.

Moreover, the TPG could endorse that if the overall profitability of the service recipient is tested using the Transactional Net Margin Method, the intra-group services should also be assumed to be at arm's length and no further documentation should be required (for example, a distributor with a targeted operating margin transfer pricing policy, tested using the TNMM).

Simplified determination for deductibility of intra-group services charge

There is a compelling argument for exploring a simplified determination that would allow the recipient of intra-group services to deduct the cost up to a prescribed threshold without having to go through the process of demonstrating benefits from the services. This simplified determination could be developed to operate similar to the interest limitation rules or as a percentage of sales/cost of the recipient and irrespective of whether the services are low-value adding or not.

A rule for deductibility of intra-group charge similar to the interest limitation rules could ease the burden on both the taxpayer and tax administrator.

Exchange control considerations

It is challenging to charge for services in certain countries due to stringent exchange control requirements. The TPG could acknowledge that deductions should not be denied if the service provider can demonstrate that reasonable efforts were made to allocate the charges to such countries, however, the time, administrative burden and uncertainty involved in repatriating cash from such countries will outweigh the sum involved. In such cases businesses should be able to retain the charge without having to face the challenge on non-deduction.

B.2. Determining an arm's length charge

Usage of simplified allocation keys (reasonable instead of perfect allocation keys)

Para 7.60 of the guidance on low-value adding services provides that there should be a balance between theoretical sophistication and practical administration as regards the selection of the most appropriate allocation key(s). It further provides that there may be no need to use multiple allocation keys if the taxpayer can justify the usage of a single allocation key. The above leeway should be incorporated in the guidance on non low-value adding services also.

Treatment of pass through cost

Para 7.34 of the TPG states that when an associated enterprise is acting only as an agent or intermediary in the provision of services, the return or mark-up is appropriate for the performance of an agency function rather than for the performance of the services themselves. However, this paragraph creates issues in practice where groups have large amounts of disbursements that "pass through" limited risk entities, e.g., fast moving consumer goods ("FMCG") groups with huge advertising and promotion costs that are pushed through commissionaires/limited risk distributors. The OECD should make it explicit in the

TPG that it may be appropriate to pass through disbursements via the balance sheet so that the question on the mark-up becomes void.

Cost contribution arrangements

Chapter VII of the TPG on intra-group services should also deal with services that are provided in a cost contribution arrangement. Accordingly, relevant portions from Chapter VIII might be transferred to this chapter. The rationale is that a cost contribution arrangement for services is a mode for paying service fees, often through an aggregator. This sometimes gives rise to the confusion that the payer is merely paying a reimbursement, whereas clearly the payment is consideration for underlying services. Similarly, the discussion in Chapter VIII to the extent it pertains to development and use of intangibles under cost contribution arrangements, could be made part of the chapter on intangibles.

Transaction involving significant risks / the use of intangibles in connection with services

The revised guidance on risk and intangibles should be drafted in a way that it does not result in “double-counting”, i.e., tax authorities should not attribute a reward to risks and/or intangibles that are already separately rewarded as part of other intra-group transactions.

C. Some examples of intra-group services

More examples in the TPG

While the existing TPG includes certain examples on shareholder services, low-value adding services, etc., there is a need for more examples on shareholder services, duplicative services, defining the cost base, choice of allocation keys, etc. Cue can be taken from the US services regulations, which has numerous such examples. Such examples will provide certainty and may facilitate a meaningful dialogue between the taxpayers and tax administrators during a tax audit. Such examples could be provided in an appendix to the TPG, similar to the examples on the profit split method. The scope of further examples should include the following, among others:

- Shareholder services / stewardship services
- Duplicative services (examples of duplications – role of regional centres)
- Services providing incidental benefits
- Treatment of pass-through cost (examples of charging a mark-up on third party cost incurred by self for providing services vs. no mark-up on outsourced services)

D. Low value-adding intra-group services

Definition of low-value adding services

Certain sections of the definition of low-value adding services could be revisited and made more elaborate. For example, ‘sales, marketing and distribution’ does not qualify for the simplified approach for low-value adding services, implying that they are high-value adding services (para 7.47 of the TPG). Depending on the facts, certain marketing services could be low-value adding. For example, printing of advertising material and conducting market

research. Similarly, depending on the specific facts, an entity performing distribution functions without assuming credit or inventory risk may appropriately be compared to a warehousing or freight forwarding service provider and hence, eligible to be classified as a low value-adding service provider.

The exclusion of all distribution, manufacturing/production and research and development services from the simplified approach seems to conflict with the sample Memoranda of Understanding related to the Safe harbour discussion in Chapter IV of the TPG¹. To that extent, the definition of low-value adding services should be aligned with Chapter IV. Low risk manufacturing services, low risk distribution services and low risk research and development services should be included in the definition of low-value added services.

Simplified mark-ups

PwC recommends the OECD allow for the charging of costs, without any mark-up, for low value-adding intra-group services. This would create a true low risk environment for low value-adding intra-group services, which would benefit tax authorities in both developed and developing countries through the conservation of audit resources for more important transfer pricing issues and would benefit taxpayers in easing their administrative burden regarding these low risk activities. However, if the OECD decides to continue with the approach of retaining a mark-up, it should be clarified in the TPG that the safe harbour mark-up (5 percent) prescribed in the existing TPG (paragraph 7.61) can coexist with the country specific guidance on similar services even if they provide for no mark-up or provide for a range/mark-up that's not similar to the OECD prescribed mark-up (see table below).

There could be a situation where a centralized service provider in the EU (e.g., Hungary) could charge 7 percent on low-value adding services. However, the mark-up could be challenged in the recipient jurisdiction as it is above the OECD prescribed range.

Illustrative list of mark-up prescribed by certain countries / organization for low-value adding services:

| Source | Mark-up / range |
|--|------------------------|
| United States - regulations on Services Cost Method | No mark-up |
| Netherlands - guidance on low value adding services | No mark-up |
| Australia - ruling on intra-group services | 7.5 percent |
| Hungary - guidance on low-value adding services | 3 – 7 percent |
| Czech Republic - guidance on low-value adding services | 3 – 7 percent |
| European Union (EU) Joint Transfer Pricing Forum - guidance on low-value adding services | 3 – 10 percent |
| Singapore - guidance on routine support services | 5 percent |

¹ Note, under the EU's mandatory disclosure rules Directive, arrangements that meet one of the transfer pricing hallmarks, including an arrangement that involves the use of unilateral safe harbour rules, must be disclosed.

Simplified documentation

The level of the transfer pricing documentation to be maintained for the low value-adding intragroup services is burdensome to the extent that it requires the rationale for providing the services and a description of the benefits or expected benefits for each category of services. As such, a documentation file prepared at the group level containing the criteria prescribed by paragraph 7.64 should be sufficient, thus not creating the need for a separate local file for each participating MNE group member.

Further, there should be no need for benefits testing for low-value adding intra-group services. Such services are generally centralized to save cost and for bringing efficiency and they may not have a direct connection with the success/failure of a business, e.g., payroll processing, accounting, IT system maintenance, etc. Appropriate documentation should be key and could replace the benefit test (which is the original idea of the simplified approach under the guidance on low-value added services).

E. Other

Agreement from non-OECD Member Countries

The OECD should endeavour to seek endorsements from countries participating in the Inclusive Framework on the revised guidance on intra-group services. While the tax administrators in certain countries may have an incentive to challenge such charges, however, bringing them on-board will go a long way in minimizing disputes. For example, both India and South Africa have categorically stated in the UN Transfer Pricing Manual that they don't endorse the OECD's low-value adding services guidance. Similarly, China has issued a circular prescribing six stringent tests for such charges to be deductible by the service recipient in China. Certain African countries also have similar stringent requirements. Lack of consistency among tax authorities results, unnecessarily, in uncertainty and risk of double taxation.

Even if the OECD cannot get consistency in approaches agreed on across the whole of WP6, it should endeavour to have the countries individually publish their approaches, and act consistently with these approaches.

For any clarification on this response, please contact the undersigned or any of the individuals below. We look forward to discussing any questions you might have on the points we raise above or on other specific matters raised by respondents to the Invitation for Public Comments and we would welcome the opportunity to contribute to the discussion as part of a public consultation meeting, should such meeting be organised.

Yours faithfully,



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Mexico City, June 19th 2018

OECD Centre for Tax Policy and Administration.

Gentlemen,

Regarding Chapter VII (intra-group services) of the Transfer Pricing Guidelines, please you will find attached the following comments. For ease, we have prepared our comments in a question and answer format.

These are the following:

1. **Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient;**

From a formal point of view, the recipient may have an agreement or even just invoices detailing the nature of the services and the agreed upon compensation. However, signing a service agreement and having an invoice does not necessarily mean the actual provision of the service. Structurally, the reception of a service responds to the necessity to carry out a determined activity that is impossible to internalize, due to the absence of material or human resources, or because of the lack of experience or technical knowledge to internally execute the activity. Consequently, a first approximation of the economic substance of the transaction involves knowing the functional structure of the service recipient. If said structure is incomplete in comparison to its industry peers, it is evident that it would be necessary to look for the missing function from either related or unrelated parties. The provision of the service can be demonstrated by integrating or exhibiting the service logs related to the original request from the recipient and stating the objective of the service, integrating a list of the personnel involved and the activities performed, the dates in which they worked, etc. In such case of reasonable doubt of the existence of the service, additional evidence may be demanded such as videos, interviews, entrance registries, etc. It is important to note that the requirement for information demonstrating that a service was provided must be based on the risk of the taxpayer so that taxpayers with recurring losses, intercompany charges greater than a determined percentage of operating expenses or history of frequent tax disputes, should be required to present additional information that those taxpayers that do not present atypical circumstances in their operations.

Now, how can a benefit be demonstrated? First, it must be clearly defined what is understood as a benefit given that there is no universal concept, and it must be considered that some benefits may be appreciated at a glance, and that others, even when they have been received, cannot be immediately noticed. The first type of benefits can be easily perceived from a financial point of view through cost savings, increase in income and cash flows, and or increase of profits. Other types of benefits, of more ethereal nature, do not cease to be equally valuable because these could have a long term impact on variables like the image of the company (in general terms) or risk reduction. Consequently, it must be accepted that a benefit is received unless the charge lacks economic substance or affects the business position of the recipient (i.e. its financial or operational capacity)

2. **Drawing a distinction between: (i) activities which do or do not benefit the local affiliates; (ii) benefits that purely arise from group membership and those that arise from a deliberate concerted action; and (iii) shareholder activities and stewardship activities;**

The distinctions among activities eligible for providing a benefit to the taxpayer is without a doubt relevant. In our opinion, and in-line with our proposal, the activities that may provide a benefit would have to be those aligned to the taxpayer's value chain and that allow it to obtain a competitive advantage, whether this is financially measurable or not. This type of activities, where there is a deliberate action from the recipient, clearly should be considered as services and therefore deductible, in contrast to incidental, shareholder or stewardship activities that do not imply an "activation" of functions from a company in benefit of the other.

3. **Identifying in practice duplicated activities;** the simplest way to demonstrate the existence of a duplicate activity is by evaluating the received service (at a functional level) against the structure of the recipient. Of course, issuing generic invoices for "management fees" raises considerable doubt with regards to the functions in benefit of the related party, which should lead to the omission of the deduction.
4. **Finding an appropriate allocation key for charging intra-group services;** Given the practical impossibility of assigning the direct cost of services, the use of mechanisms that indirectly assign costs (allocation keys) becomes necessary. The transfer of expenses through allocation keys should ideally be established in relation to the use of the function by part of the recipient and not based on much more indirect indicators as sales or total costs. For example, the transfer of IT functions should be done through some valid variable like number of stations or number of licenses (V.gr. total costs of the function/number of licenses), the services provided by the human resources area considering the number of employees (cost of the function/employees, etc.)
5. **Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises;**

Ideally, and from a conservative point of view, the recommendation is to only transfer direct costs incurred in the provision of the service. Naturally, the transfer of the indirect costs is feasible, but this implies the risk that inefficiencies are also transferred to the recipient. Perhaps an acceptable approach could be the transfer of the total costs, only when the service provider proves that it follows a similar mechanism of cost allocation with independent parties.

6. **Assessing the arm's length conditions for services provided in connection with the use of intangibles; services that are highly integrated with the value creation of the MNE group; and/or involve significant risks.** There are cases where these services are linked to the use of intangibles (for example, in the franchise agreement it would be adequate to consider the services as linked to the intangible and, given the potential impossibility to segregate them, to consider them as a unit at the moment of evaluating its arm's length condition. Supposing this is also made among independent related parties). In the case of services that decisively contribute to value creation in the group, and in consideration of the eventual lack of comparables (which is almost a fact in countries without available information for local transactions), perhaps the best way to evaluate their arm's length condition is by the use of the Residual Profit Split Method in order to guarantee an appropriate return for each participant considering the functions, assets, and risks assumed.

Jesús Aldrin Rojas M and Daniel Sánchez on behalf of QCG Transfer Pricing Practice.

Comments on the scope of the future revision of Chapter VII of the Transfer Pricing Guidelines on Special Considerations for Intra Group Services

We would like to take advantage of the invitation for Public Comments on how the guidance in Chapter VII of the Transfer Pricing Guidelines (in the following "TPG") could be revised or supplemented to address the issues related to the practical implementation of the TPG in the context of intra-group services.

Based on the above, we would like to thank you very much for your efforts and for the ongoing interest with which the OECD is working on this topic. We also truly appreciate if we could participate in a public consultation if any.

These comments are sent on behalf of the Rödl & Partner Transfer Pricing Group and have been compiled by the transfer pricing professionals mentioned below.

With best regards

| | |
|---|--|
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Demonstration that a service has been rendered and/or that the service rendered provides benefits to the recipient

Demonstrating that a service has in fact been rendered is a time consuming and often expensive procedure. Tax authorities of different countries more and more want MNE's to provide a thorough proof of the performed activities. This might be in context with a Transfer Pricing documentation or in the framework of a transfer pricing audit. The extent of proof could be high. Various documents are required (e.g. digital footprints like e-mails, protocols, memos, travel documents or project-related status updates), which demonstrate the performance of the service.

We would recommend, that the actual proof, that a service has in fact been rendered, should consider materiality aspects. It is crucial to find a reasonable balance between the obligation to ensure a transparent and clear flow of services and the compliance effort to demonstrate it. It is important not to burden the taxpayer with disproportional high efforts to proof every transaction in detail.

In case of directly charged services records of activities, attached to the invoice of the intra-group service or electronic time recording should be sufficient. Records containing the people involved and the hours spend on different tasks seems to be reasonable. Additional compliance requirements would lead to disproportional und unnecessary high effort.

Indirectly charged services could be proofed on the basis of group charts, organizational charts and by naming the people involved. The organizational structure of a company often already gives a detailed insight which entities are in charge of performing certain intra-group services. An organizational chart of an entity for example, which shows that a group entity employs the personnel responsible for the performance of a specific service and is therefore capable of performing the service and the service recipient does not employ an employee in this department, should be considered sufficient proof.

However, if more than one group member performs a service, for example if the ultimate parent entity and its subsidiaries have an IT department we recommend to add a clarification not to automatically expect a duplication of services. The fact that a tax payer maintains its own IT-department but additionally receives intra-group services from its parent entity for IT-services, does not automatically lead to a duplication of services. In our opinion a clearer statement regarding this matter is necessary (see also comments in context with duplicated activities).

A service not only needs to be actually performed but also has to be in the interest of the recipient. The obligation to proof an economical or commercial benefit requires additional evidence. A precise benefit cannot always be described. However, most of the services rendered are obviously in the interest of the receiving entity. Thus, detailed documentation or clarification of a benefit should only be provided for services, not obviously in the benefit of an entity. This might be an issue particularly in context with shareholder-related activities (e.g. controlling services, accounting services, etc.).

As mentioned in marginal number 7.32 TPG the benefit of a service will not necessarily incur immediately with the performance of an intra-group service but sometimes has long-term effects or does not lead to the expected benefit at all. In our opinion should documents, which proof that a service is in the interest of the recipient, be sufficient, since every prudent and conscientious manager's intension is to satisfy the company's interests to gain an economical or commercial benefit. Whether the service led to an actual benefit is barely provable. Further proof of actual reached benefits shall not be asked for.

The benefit of a service is often questioned in cases where loss-making entities have to pay for intra-group services from a group member. The argument, made by some tax authorities, that a service has no benefit solely based on the argument that the company is suffering losses, is in our opinion inconsistent with the arm's length principle. If an independent third person in a comparable situation would have been willing to pay for this service, because it's in the company's best interest, a benefit is gained regardless of the current profitability situation of that entity. We would therefore welcome a clearer statement regarding the rendering of intra-group services to loss-making entities.

Drawing a distinction between: (i) activities which do or do not benefit the local affiliates; (ii) benefits that purely arise from group membership and those that arise from deliberate concerted action; and (iii) shareholder activities and stewardship activities

TPG (July 2017) extended the definition of shareholder activities by the introduction of marginal number 7.10 and, thereby, widening the costs considered as those associated with shareholder activities:

- "d) Costs relating to compliance of the parent company with the relevant tax laws;
- e) Costs which are ancillary to the corporate governance of the MNE as a whole."

The 2017 TPG Guidelines also defined stewardship activities in marginal number 7.9 as "... a range of activities by a shareholder that may include the provision of services to other group member, for example services that would be provided by a coordinating centre [...] detailed planning services for particular operations, emergency management or technical advice (trouble shooting), or assistance in day to day management."

Stewardship activities are generally accepted to be those related to the supervision and care-taking of an organization (MNE in this context), whereas shareholder activities are those aimed at incrementing and protecting the value of the parent's investment in the subsidiaries .

We would like to include some commentaries in relation to the issues mentioned in marginal number 7.10d) and e) in the following paragraphs.

- On the issue of compliance (marginal number 7.10.d TPG), given that the current legal and tax compliance climate in most countries, especially in a BEPS world, is becoming ever more complex, MNEs have been driven to reassess their compliance processes and resource requirements. Hence, in many cases MNEs have to centralise their compliance processes and policy across all subsidiaries to navigate the increasingly onerous regulatory environment.

Therefore, the parent company of an MNE, in consideration of the above stated fact, may decide to establish, as for example, a group-wide Transfer Pricing policy for setting, implementing, monitoring and documentation of transfer prices to which all group-companies must adhere. If, by the creation of this policy, certain costs are incurred because the parent company must engage independent Transfer Pricing advisors to counsel the group, then the MNE should be able to charge these costs to its subsidiaries using an appropriate allocation key. If the establishment of these group-wide Transfer Pricing policies not only enable the parent company, but also its subsidiaries to comply with the

relevant tax laws, then all group companies would have benefited from these services and would have been willing to pay for them.

Thus, the services involved in the compliance of tax laws including the implementation and monitoring of these policies should be chargeable to the subsidiaries as well as assumed in part by the parent company, since these services provide an economic benefit to the Group.

Additionally, both the parent company and the subsidiaries of an MNE face reputational risks if they were not to be in compliance with tax laws in their respective countries as their stakeholders and the public at large would not be understanding of practices which could be construed as tax evasion. To the extent that all the entities of an MNE are subject to non-tax compliance pressure by their stakeholders and would benefit from tax compliance costs incurred by the parent company, these costs should be charged as intra-group service fees.

In conclusion, we would like to suggest to provide examples of what type of tax compliance would be considered shareholder activities, since tax compliance encompass a wide range of activities.

- Further guidance is needed in relation to the matter of corporate governance (marginal number 7.10e) TPG), which pursuant to the UK Corporate Code “the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies”. In essence, corporate governance include many functions which could be considered as shareholder activities such as audits, monitoring of financial and business performance, etc., but it also includes other services such as planning, formulation of policies and strategies as well as decision making among others. Therefore, corporate governance also includes many aspects of stewardship of the MNE which impacts definitely on the functioning and business operations of its subsidiaries, not only for the benefit of the Parent Company as the shareholder but also for the benefit of the routine operations of the MNE itself and of its subsidiaries.

It would be most helpful to define corporate governance more clearly, as it seems to be a broad term and in our opinion, it would be erroneous to ascribe corporate governance activities, as a whole as shareholder activities, because some of these corporate governance activities are in effect activities which clearly benefits and create an economic value or advantage for the subsidiary. Thus, MNEs should not be prevented from charging costs relating to corporate governance to subsidiaries.

We would like to illustrate this point with reference to members of the Board of Directors of the Parent Company, e.g. the Chief Financial Officer. This executive member of the Board will have an extensive job description which ultimately includes many areas of corporate governance and the performance of the functions within these areas usually benefit not only the shareholders but also the subsidiaries of the MNE which the executive supervises and which performance he/she monitors as ever more MNEs have centralised management functions.

In addition, as these senior executives of the MNE generally are not remunerated on an hourly basis nor are their remuneration structures based on an hour-by hour justification of their activities, we would like to suggest that the total costs incurred from the rendering of services by these executives should be split or be assigned as an estimation of the percentage in proportion to the time dedicated to the undertaking of these activities (e.g. 70% services :30% shareholder), whereby the cost arising from these services may be then charged to the respective subsidiaries as intra-group services. The

estimation of percentage of time dedicated to each activity shall be made according to the description of his/her activities. Otherwise, it would be time-consuming, burdensome and costly to have to constantly provide evidence or proofs of the actual time spent on each type of activity in order to prove that these services provided by these executives are consistent with the arm's length principle.

Consequently, the documentation and proof for the allocation of the costs associated with the rendering of these intra-group services would not be disproportionately onerous for the MNE and its local subsidiaries, given characteristics of the remuneration of these senior executives mentioned above.

A second issue on costs associated with corporate governance is in relation to those services rendered by Head Offices or Regional Head Offices which are related to the size of the MNE itself. Some MNE are so large that some of these corporate governance services such as monitoring, risk management and implementation of MNE-wide corporate policies (or business strategies), must necessarily be implemented/executed by two or three levels of management (e.g. global, regional and sub-regional), as it would not be feasible for some local entities of the MNEs to carry out for themselves due to their reduced human or economic resources.

Many of these smaller local entities have very few employees, through whom it would be sufficient to operate in the context of start-ups or small market size. Nevertheless, these employees would, perhaps, not be able to put into practice, for example marketing and sales strategies or risk management by themselves. If the parent company or any regional or sub-regional company, which are directly or indirectly its shareholders, were to undertake any of these activities on its behalf, it should not be considered as shareholder activities if the services provided in the context of corporate governance were to pass the benefit and willingness tests, in addition to being services which are not duplicated (i.e. additional, complementary and different) at any level.

Identifying in practice duplicated activities

Before providing more detailed comments on how marginal number 7.11 TPG could be revised and/or supplemented in order to facilitate the identification in practice of duplicated activities, we would like to emphasize that the duplication of activities and consequently the duplication of costs is uneconomical for every enterprise which aims at maximizing profits. Avoiding the duplication of activities is thus of fundamental interest for every multinational group. Consequently, it is very unlikely that multinational groups duplicate activities in order to implement BEPS practices. Therefore, it might be worth thinking about completely removing the necessity to perform an analysis if intra-group services are duplicated activities. If this should not be possible, we believe that at least the documentation effort imposed on the taxpayer should be reduced to the lowest level possible.

We believe that statements contained in marginal number 7.11 TPG that "Any consideration of possible duplication of services needs to identify the nature of the services in detail,..." and that "Examination of information provided by the taxpayer may determine that the intra-group services are different, additional, or complementary to the activities performed in-house" underline the main issue with respect to duplicated activities: the need to understand if activities are really duplicated based on proper documentation. In this respect, Chapter VII should be supplemented by concrete indications under which circumstances the taxpayer has to prepare which kind of documentation, in any case by trying to reduce

the effort imposed on the taxpayer to the lowest level possible. This could generally be achieved by the following approach:

- The documentation need should in a first step be reduced to cases where intra-group services might seem to be duplicated activities based on the functional analysis of the service recipient.
- In a second step (and only if a potential duplication is identified in step one), within his transfer pricing documentation, the taxpayer should provide a qualitative comparison of the intra-group services and the functions performed by himself (or the services provided by the third party) which documents that the intra-group services are not duplicated activities.
- If the taxpayer has followed the two steps, the burden of proof should be shifted to the tax authorities.

In addition, marginal number 7.11 TPG stipulates that the following situation should not be deemed as duplicated activities "Another exception would be where the duplication is undertaken to reduce the risk of a wrong business decision (e.g. by getting a second legal opinion on a subject). ... Some regulated sectors require control functions to be performed locally as well as on a consolidated basis by the parent; such requirements should not lead to disallowance on grounds of duplication." The aforementioned service is also a key area where the enterprise/competent tax authority for the service provider and the competent tax authority for the service recipient might have conflicting opinions in practice. It is quite common that majority of the control result at the local level is the same as the one at the group level so it might be challenged by the competent tax authority of the service recipient regarding whether actual services are provided and benefit the service recipient or it is just a going through of formalities. We therefore would recommend OECD to provide more guidance on this regard such as what kind of the supporting documents should be sufficient and is recommended to be prepared so as to allow a common consensus among all parties in this regard.

Finding an appropriate allocation key for charging intra group services

We believe that a key aspect when defining an appropriate allocation key for charging intra-group services is that the appropriateness of an allocation key has to be analyzed on a case-by-case basis, i.e. an allocation key might be appropriate for a specific intra-group service under certain circumstances while the same allocation key might not be appropriate for the same intra-group service under different circumstances. This principle – according to our understanding actually reflected in the following passages of marginal number 7.25 TPG, i.e. "The allocation should be based on an appropriate measure of the usage of the service that is also easy to verify.." and "Whether the allocation method is appropriate may depend on the nature and usage of the service." – should remain valid also when modifying/supplementing Chapter VII.

It might however be useful to supplement the actual guidance contained in marginal number 7.25 TPG by providing a non-binding list which suggests which kind of allocation key might be deemed as appropriate for which kind of service, e.g.:

| Type of Service | Allocation Key |
|-----------------|------------------------|
| HR Services | Headcount |
| Accounting | Turnover |
| IT Services | Number of workstations |
| | |

Such a list should be accompanied by wording which states that:

- in case the taxpayer adheres to the list, he does not have to provide further documentation on the appropriateness of the allocation key used;
- in case the taxpayer does not adhere to the list, he does only have to document that the allocation key used is appropriate and not why he has deviated from the list. The use of allocation keys has an intrinsic vagueness. Tax authorities should generally accept the choice of an allocation key chosen by the MNE. Only in cases of obviously inappropriate keys alternative keys should be used by tax authorities to examine, whether the cost allocation is reasonable.

Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises

Currently, the TPG offer only very limited information on how to calculate an appropriate cost base, if a cost based method is deemed to be the most appropriate method for an intra-group service.

On marginal number 7.19 TPG states it should be considered that the charge for intra-group services should be that which would have been made and accepted between independent enterprises in comparable circumstances. That means that intra-group services should not be treated differently for tax purposes than comparable transactions between independent enterprises. The value of a service and the costs of the service provider have also be taken into consideration.

Furthermore, marginal number 7.31 TPG stipulates that, if the cost plus method is applied, there should be a consistency between the controlled and uncontrolled transactions in the categories of cost that are included. Therefore in general, costs which an independent third party service provider would include in the cost base for the provision of a comparable service should also be included in the cost base of an intra-group service provider.

However, from a practical standpoint, we would appreciate a more detailed description on how to calculate an arm's length cost base and what costs could or should generally be included in the cost base, in order to provide a first indication for the taxpayers, consultants and local tax authorities. Service providers often struggle to identify all costs or cost groups that can or should be part of the cost base, especially regarding costs that are not directly attributable to a specific intra-group service. This problem frequently concerns overhead costs or other type of costs that are not direct cost or are not directly

chargeable. The addition of an "example catalog" or "sample calculations" to, for example, section C. of Chapter VII ("Some examples of intra-group services", beginning with marginal number 7.38) would be very beneficial for all parties and would provide a first indication of what costs generally should be included in the cost base, based on the most common types of intra-group services. Of course, such an "example catalog" or "sample calculations" cannot to be seen as enumerative or fixed, but more as a practical assistance for the taxpayers and tax authorities in their day to day business. Additionally it could be stated that general expense might be calculated on an average level (e.g. calculated out of P&L).

Another challenge a lot of service providers are facing while trying to calculate an arm's length cost base is the ability to allocate accrued costs to a specific intra-group service. Often costs are not directly attributable and/or chargeable to a specific service. For example, a lot of service providers do not have electronic time recording implemented in their company and therefore cannot allocate personnel costs to one specific intra-group service that was rendered to one specific associated enterprise. In many cases those costs are booked into collective cost centers that do not allow a subsequent division and allocation of costs to a specific service, as this oftentimes is not technically feasible for enterprises. Therefore, we would appreciate the introduction of facilitation measures regarding the possibility of allowing an estimation of allocating certain cost groups that otherwise cannot be allocated correctly or only can be allocated with a great effort for the service provider. We think that it is important to find a balance that is practical and reasonable for both the tax payers and the tax authorities. However, it is crucial not to burden the taxpayer with a disproportional high effort to allocate every type of cost for the calculation of the cost base. Aspects of materiality should also apply for the allocation and inclusion of costs in order to calculate an at arm's length cost base.

Furthermore, there are certain cost types that can cause uncertainty on how to allocate them to the cost base. This concerns in particular depreciation costs where the tax depreciation rate of fixed assets differs from the actual economic depreciation rate. The revised Chapter VII should include a clarification that the allocation of costs to a cost base can be executed based on the actual economic useful life of fixed assets and do not mandatorily have to be based on the tax depreciation rate, as this often does not reflect the economic reality of multinational enterprises or the arm's length principle. The same applies to the inclusion of imputed costs in the cost base. Most companies include them in their calculations with customers and suppliers and therefore should also be allowed to include them in the cost base for intra-group services.

There are certain types of intra-group services that pose a particular challenge for multinational enterprises regarding the determination of an arm's length cost base. This especially applies for intra-group services in relation to the implementation of a group-wide ERP-System. Typically, the headquarter of a multinational group is responsible for the group-wide implementation of the ERP-System (in the form of a blue print or pilot-version) and therefore acts as the service provider for this particular intra-group service. The implementation of a group-wide ERP-System is usually a project that often takes several years until the implementation date and accrues a substantial amount of costs. The question arising in this connection is how to define the costs of a pilot, which are in favor of more than one entity and how to allocate these costs. Problems arise when the pilot will be used over a period of more than one year (which is regularly the case) and uncertainties exist which and how many entities will use the pilot and from what point of time onwards.

Example: Comp. A is the parent company of an MNE and is developing a new ERP-System for the group. The ERP-System consists of different modules needed for different purposes (e.g. tools for warehousing, production, procurement and distribution). The initial costs (internal and external) for creating a blueprint and pilot amount to EUR 5 mil. It is not clarified yet, which entity will use which modules and from which year on.

The service recipient or rather the tax authorities in the jurisdiction of the service recipient often do not accept charges (e.g. advance payments) for the implementation of an ERP-System, before the service recipient is actually able to fully use the ERP-System. This causes problems and potential tax risks for multinational enterprises. We would welcome further guidance on these issues, especially if implementation costs already accrued by the service provider can be allocated to associated enterprises even if the ERP-System is not live for those associated enterprises yet. One solution could be that the initial costs are allocated to the economical time of use (depreciation). The respective annual amounts of depreciation should be allocated to those entities using the ERP-System in the respective year (maybe pro-rata-temporis) by applying reasonable allocation keys. Another solution could be the application of the rules regarding CCA entry/withdrawal (marginal number 8.44 TPG), although the services are rendered under the rules of Chapter VII of the TPG.

We would strongly suggest that the revised TPG contain a clear statement, that the use of planned costs for the calculation of intra-group services is appropriate, as this will reflect the arm's length principle and portray the actual market conditions enterprises operate in. A third party service provider usually develops his cost calculations based on planned costs rather than actual cost, as that is not even possible most of the time. The revised Chapter should also clarify, that there is no hierarchy regarding the use of planned costs versus actual costs, in order to prevent potential uncertainties. Thus, service provider might face a loss or exceed the budgeted results. That approach would consider profit center structures of MNE's. This clarification should be made whether the service rendered is low value-adding or not.

The revised Chapter VII should recognize that a proof that costs which are part of the cost base are operationally necessary for the rendering of a specific intra-group service is not necessary. The efforts of a taxpayer to demonstrate that an intra-group service has been rendered, which is not a duplication of services, that the service rendered provides a benefit to the service recipient and that the price for that intra-group service is at arm's length, are already extensive. Any kind of additional burden of proof for the taxpayer would be unreasonable.

We would welcome additional guidance regarding the topic of so called service bundles, meaning a composition of various individual services of the same topic. Often, headquarters of multinational groups provide such service bundles for all their group members in order to provide services that are consistent in content and cost and therefore provide a benefit for the group as a whole as well as for the individual group-company. Arguments that certain individual services that are part of the service bundle could maybe be sourced cheaper from a local third party service provider and therefore makes the whole service bundle not at arm's length should be considered invalid. Furthermore, a reference should be included in the TPG that in the case of service-bundles the assessment of the price for that service bundle should only be performed in context with the overall concept and the total cost of that service bundle. An isolated view regarding individual services should not be considered adequate, as the overall benefit results from the service bundle as a whole and therefore has to be assessed accordingly.

Assessing the arm's length conditions for services provided in connection with the use on intangibles; services that are highly integrated with the value creation of the MNE group; and/or involve significant risks

Arm's-length remuneration for Intra-group service in consideration for long-term benefits

Marginal number 7.23 TPG stipulates "While every attempt should be made to charge fairly for the service provided, any charging has to be supported by an identifiable and reasonably foreseeable benefit. Any indirect-charge method should be sensitive to the commercial features of the individual case (e.g. the allocation key makes sense under the circumstances), contain safeguards against manipulation and follow sound accounting principles, and be capable of producing charges or allocations of costs that are commensurate with the actual or reasonably expected benefits to the recipient of the service. " On the other hand, marginal number 7.32 TPG stipulates that "it may be necessary to consider not only the immediate impact of a service, but also its long-term effect, bearing in mind that some costs will never actually produce the benefits that were reasonably expected when they were incurred.... the determination whether the charge in such a case is arm's length should consider expected benefits from the operation and the possibility that the amount and timing of the charge in some arm's length arrangements might depend on the results of the operation."

As such, for high-value added service which are related to the core business of the MNE group, how to considering the long-term benefit when determining the arm's-length remuneration for the current service provision might be a topic requires more detailed guidance. It is commonly in practice that an investment in marketing campaigns, on-line e-commerce platform built-up and production flow optimization might have different impacts to group subsidiaries at different periods due to the different phase that each subsidiary is in at the service provision time and the sequence of the rolling-out of the projects to different entities. However, the fundamental investments at the beginning of the project might be huge which also requires to be considered partially allocated to the local subsidiaries by considering the later roll-out of the system/project to local entities in the following years. However, to proof the benefits that the local entities to be received from these projects might be difficult at the time of the service charge, which will then lead to the disagreement of the competent tax authority of the service recipient. We therefore recommend OECD to provide more detailed guidance on this regard for guiding the enterprises and the competent tax authority to reach a feasible solution in practice.

Clarification on whether additional service charges in relation to the license of the intangible assets is allowed.

Marginal number 7.27 TPG stipulates that "The compensation for services rendered to an associated enterprise may be included in the price for other transfers. For instance, the price for licensing a patent or know-how may include a payment for technical assistance services or centralised services performed for the licensee or for managerial advice on the marketing of the goods produced under the licence. In such cases, the tax administration and the taxpayers would have to check that there is no additional service fee charged and that there is no double deduction."

This article is not quite clear to us whether separate service charge for providing services in relation to the intangible assets license is allowed. Both circumstance (i.e. the service fee is included in the license fee or separately charged) might be possible in the license agreements signed between independent parties. As

these interpretations lead to disputes, we would recommend OECD to provide more clear guidance in this regard.

Remuneration for services provision that are highly integrated with the value creation of MNE group

Cost plus method might not be the most appropriate pricing method to remunerate this type of the service even if the service provider is sheltered from all the risks by the legal agreement. Marginal number 7.41 TPG has provided an example on such type of the service provision, which mentioned that "the additional functions of identifying commercially valuable areas and assessing the risk of unsuccessful research can be a critical factor in the performance of the group as a whole in cases that agreements where the research company has discretion to work within broadly defined categories."

The pricing policy to be adopted for such services might be more dependent on the actual functions and the capability to control the relevant risks of the involved parties instead of the relevant clauses set in the legal agreement as illustrated in the two instances in marginal number 7.41 TP (i.e. the first one as undertaking of detailed programs laid down by the principal party while the second one as extending to agreements where the research company has discretion to work within broadly defined categories). However, what kind of documents should be prepared and submitted to the competent tax authority for assessing the functional and risk profile undertaken by the involved parties and then assessing the reasonableness of the TP policy adopted might be a controversial topic in practice, especially by considering the confidentiality of the intangible assets. We therefore recommend to provide more detailed guidance on this regard.

Furthermore, more guidance for the interaction between chapter VI (mainly marginal number 6.79 TPG) and chapter VII would be needed.

Is a service still to be treated as high value-adding if the service provider already receives a share of the return of an intangible which was created using the rendered service?

Furthermore, the question arises whether specific aspects for high value-adding services still need to be considered when applying the CUP within an internal comparison. We still believe that the cost-plus method will be the only method which can be applied in most cases. The question appears whether a suggestion for a mark up (e.g. 20 per cent) for cases should be made, in which no comparable could be identified.

Another aspect is where a bundle of services is rendered. E.g. a group entity is performing R&D functions (maybe together with the OEM customer), negotiating contracts with the customer, organizing the procurement etc. The nomination for producing and invoicing however is with another group entity. In those cases the service provider renders a bundle of high value-adding services. It might appear the remaining function of the producing and invoicing entity is just routine (e.g. contract or toll manufacturing).

It should be stated, that a remuneration could be related to the bundle as such without the need to split it up to the distinct single services. Additionally, we recommend an approach which allows to calculate the bundle remuneration retrograde, i. e. the service provider shall receive a remuneration to an amount that leaves an arm's length profit with the service recipient (considering the functions rendered and risks borne by the service recipient).

Paris, June 20, 2018

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Submitted by email to: TransferPricing@oecd.org

Subject: Scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines

Dear Working Party No. 6,

Thank you for the opportunity to comment on the OECD's public consultation document titled: Scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines ("TPG").

This contribution focuses mainly on concerns relating to the "weakest players" in the transfer pricing arena, i.e. Small and Medium Enterprises ("SMEs") and Developing Countries.

After a brief introduction, this document analyzes certain features of SMEs and certain features of transfer pricing audits which are important for this discussion; it analyzes then some new challenges, concluding with a suggestion to consider, in the scoping of the project, simplifications that would be consistent with arm's length practices within SMEs.

I am fully available to provide clarifications or further inputs if needed.

Sincerely,

Alberto Pluviano
SATIS RES Consulting

Introduction

1. Already today, the existing environment based on the current version of Chapter VII, represents a source of growing concerns in relation to the “weakest players” in the transfer pricing arena, i.e. SMEs and Developing Countries.
2. On one hand, SMEs are increasingly developing their activity internationally and many of them represent innovative, young start-up businesses in new technological sectors, which are naturally more inclined to conceive their activity as not-constrained within one specific country border.
3. On the other hand, tax audits in many Countries appear to focus systematically on transfer pricing matters and often they do not seem to make significant distinctions in the approach to very large multinationals or SMEs; in addition, generally tax inspectors seem to consider that they are not empowered to address double-taxation issues at their level.
4. Even more critical issues could potentially materialize for SMEs (in particular innovative start-ups) with the introduction of the alignments to the guidance developed under BEPS Actions 8-10.

SMEs features

5. SMEs are significantly penalized in organizing and documenting the transfer prices of intra-group services for reasons linked to both their structure and their size:
 - Intra-group services within a SME are normally provided by a limited number of resources, often covering multiple responsibilities; therefore, it is much more difficult to strictly define the scope and sizing of each type of intra-group service exchanged within a SME.
 - Key people may move from one to another entity very flexibly and implicitly transfer activities which can be partially involving intra-group services.
 - Exchanges within a SME are more informal among a limited number of people who know each other well, and therefore it will be much more difficult and burdensome to constitute a formalistic documentation for tax audit defense purposes only.
 - SMEs will often have limited access to professional expertise for designing and documenting their transfer pricing policies; in addition, the budget required to ensure proper staffing and advice to safely address and document intra-group services may be unaffordable for certain SMEs.
6. The situation will be even worse for start-up businesses operating in new technological sectors for the following reasons:
 - The business itself will often be more “immaterial” by nature.
 - The provision of intra-group services will often be based on new and constantly evolving technologies (web-platforms, instant messaging, applications); in many cases these tools will simply not be equipped with features allowing a documentation complying with traditional approaches.
 - Young creators will naturally think their business as international (not necessarily global, but at least naturally spreading also to neighbor Countries). This type of young

entrepreneurs may not even suspect that while establishing a startup, innovative, largely immaterial business, they should immediately plan for formalistic, physically auditable documentation.

Transfer Pricing audits features

7. As mentioned above, tax audits in many Countries appear to focus increasingly on transfer pricing matters. This leads a growing number of tax inspectors to be involved in these matters and, often, challenge the transfer pricing outcomes of the audited entity.
8. An indirect driver to aggressive tax audits seems to be the public opinion: in fact, there seems to be a lag time between the implementation of BEPS Action Items and the perception of the related issues in the public opinion: the positive effects of “BEPS” measures seem to be still largely ignored, while at the same time the tide of public concern about Multinational Enterprises’ (“MNEs”) taxation seems to be still growing; this may also influence the attitude of tax authorities.
9. The above comments should not be perceived at all as criticism of tax inspectors across the world: their mission is naturally to investigate and challenge transactions. However, it appears important to make a realistic assessment of the issue in order to promote the development of effective guidance which would provide reasonable standards to follow for tax inspectors and MNEs globally.
10. The concerns highlighted above are particularly serious in relation to auditing intra-group services, because such issues will typically drive tax inspectors to ask for very significant documentation and justifications.
11. Unfortunately, the size of the group is often not particularly taken into account by tax authorities in determining their audit patterns; this is why the concern is particularly serious in relation to SMEs, which may find themselves facing impossible situations to manage with their limited resources.
12. In addition, tax inspectors often seem to consider that they are not empowered to address double taxation issues even when, on the other side of the transaction, there is a high-tax jurisdiction, fully committed to the outcomes of the BEPS project. A typical reaction of tax inspectors, when such issues are raised by taxpayers, is that tax inspectors’ duty is to make their own assessment of the audited entity and that double taxation issues should be addressed at a later stage in the process. Again, there is no intention here to criticize tax authorities’ behavior, which deserves all due respect; however, this type of attitude may have devastating consequences for SME’s, because many of them will simply not be in a position to afford the costs, time and resources needed to escalate a double taxation issue to a level where the issue will be solved.
13. Finally, Developing Countries may tend to devote their limited resources to auditing intra-group services as an area of understandable concern, but also easier to challenge in comparison to other transactions; however, aggressive approaches may drive particularly negative outcomes:
 - discourage SMEs from operating in the Country; and
 - push larger MNEs who can afford the process to eliminate double taxation to follow all the steps required, whose ultimate results could therefore be limited in terms of additional tax income for the Country.

New challenges

14. The alignment of the guidance with Chapter I and Chapter VI is likely to promote more sophisticated analyses of intra-group services and implies significant risks of penalizing SMEs if their specific features and possible impacts will not be taken into account.
15. In particular, the alignment with the updated guidance in Chapter I on risk should consider the specific features of SMEs, within which the limited size of the organization would require simplified and pragmatic approaches to address the topic of “control over risk”.
16. The alignment with the guidance in Chapter VI on intangibles may raise particularly challenging issues in the case of highly innovative start-up businesses, considering that intangibles will often be core to the business, but also difficult to analyze because of their innovative nature; the consequences for the pricing of intra-group services may represent issues conceptually very difficult and, potentially, may bring the young start-up businesses to become the type of taxpayers more vulnerable to unpredictable outcomes of tax audits.

Conclusions

17. The situation described above brings to the conclusion that specific approaches for SMEs may be advisable.
18. My suggestion is therefore to include in the scoping of the project an objective of investigating the issues related to SMEs, in order to assess the opportunity of developing specific guidance for intra-group services exchanged within SMEs.
19. This suggestion should not be perceived as proposing “special measures” for one category of taxpayers. In fact, the suggested approach actually aims at keeping consistency with the arm’s length principle, but recommends to focus on behavior. In other words, a central question should be: what level of refinement in the methodology, precision in the calculations and details in documentation a SME would implement when purchasing services from an independent third party supplier?
20. The approach could also be usefully analyzed in relation to small transactions within large MNEs: also in these cases the methodology, calculations and documentation implemented with a third party supplier would probably be simplified, with decision power delegated to low ranking officers and simplified controls over the performance and usefulness of the service.
21. The overall suggestion is therefore to consider, in the scoping of the project, simplifications that would be consistent with arm’s length practices within SMEs and, more in general, for small transactions.

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01 June 2018

Tax Treaties, Transfer Pricing and Financial Transactions Division

To the kind attention of:

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REF: Scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines – Invitation for Public Comments

Dear Sirs,

We appreciate this opportunity to contribute some general thoughts to the revision of Chapter VII of the Transfer Pricing Guidelines. Intra-group services are one of the most common transactions in a MNE context and it is no understatement to say that during audits tax authorities' interest is often focused on charges for services.

From a practical point of view, the essence of the matter is that there is a lack of homogeneity and consistency between the guidance provided by the OECD Guidelines and the domestic rules of each country, and between the OECD Guidelines and the guidance provided by other international bodies as well. Definitely, this will increase uncertainty for taxpayer(s) and the number of disputes that might arise, notwithstanding the following OECD statement «(...) *Such disputes may arise even though the guidance in these Guidelines is followed in a conscientious effort to apply the arm's length principle* (...)».

In the following, we will provide some comments concerning the starting scenario for analyzing Chapter VII and thoughts on some selected issues.

Setting the stage for Chapter VII

As is well known, the Chapter under analysis is fully devoted to intra-group services. It provides in par. 7.38-7.42 some examples of activities that can be considered intercompany services. Following to the final BEPS Report on Actions 8-10¹ the Chapter was supplemented with new Section D, concerning low value-adding intra-group services.

The paramount issues are as follows:

1. Definition of “service”: Some years ago UNTACD noted: “(...) *Services are usually perceived as intangible, invisible, perishable and requiring simultaneous production and consumption, while goods are tangible, visible and storable, and do not require direct interaction between producers and consumers. But a conceptual distinction between goods and services is not as straightforward as this characterization suggests. First, some services have elements of tangibility (e.g. a consultant's printed report), visibility (theatre) and storability (voice-mail). Second, most goods are intended to provide a service or function. Third, there are few “pure” goods or services: nearly all goods require non-factor services for their production, most services require physical assets and intermediate goods and, at the point of sale, most goods and services are jointly and simultaneously supplied – airline travel requires aircraft and other equipment, and cars need to be marketed and distributed. (...)*”². Nowadays, all these features are intensified. Group business model continuously progress: The current environment is experiencing the shift from value chain/Global Value Chains (GVCs) to Block Chain. We wonder if this shifting is free from issues concerning the identification of services and the fashion these services are rendered between group members. A complicating factor is the rise of new business and pricing models such as software as a service (SaaS). In addition, the issues posed by digitalization increase uncertainty for both taxpayers and tax administrations, as the boundaries between tangible goods, intangibles and services become blurred. This observation bring to the following needs: i) considering specific transfer pricing guidance for digital business model, encompassing the potential transactions (including services) that might take place; and ii) providing additional provisions that can fill a gap between Chapter VII and other relevant ones (e.g. Chapter VI and Chapter VII).
2. Kind of intra-group services that the OECD Guidelines would encompass in Chapter VII. The question might appear challenging, but it originates from the observations that some services seems to be «missing» and/or need additional clarification. In first instance, we suggest to expand both analysis and guidance to more valuable services, that are rendered in practice between group members and for which an arm's length remuneration is required. Probably, the

¹ OECD, Aligning Transfer Pricing Outcomes with Value Creations – Actions 8-10 Final Reports.

² UNTACD, The Shift toward Services, World Investment Report 2004.

definition of «*medium-skill services*»³ and «*high-skill services*»⁴ provided by UNCTAD is not yet consistent with reality, but it gives an idea of the categories of services for which additional guidance is needed, as these services involve most of BEPS concerns and are the cause of many transfer pricing disputes.

The increasing importance in transfer pricing disputes of related-party financial transactions imposes specific guidance. Sometimes, funding is the most important transaction within multinational groups and one of the challenging in the post BEPS environment. Probably, debating financial transactions in Chapter VII is excessive in respect to the scope of the Chapter itself and, for this reason, we welcome the release by the OECD of distinct guidance on this matter.

Determining whether intra-group services have been rendered

a) Benefit test

In the general framework of the OECD Guidelines, intra-group services are debated in a different fashion if compared to the other intercompany transactions, as it is required to consider the benefit test and the willingness to pay test, in order to assess whether or not the services have been rendered to a group member. We observe the importance of this criterion but, at the same time, we acknowledge that in practice tax authorities frequently challenge it.

In first instance, the definition of the benefit test (i.e., the activity that provides a respective group member with economic or commercial value to enhance or maintain its business position) sets forth in the Guidelines seems to leave room to too many and different interpretations that may jeopardize the deductibility of the relevant costs in the home country of the recipient. In certain cases, the benefit is in the nature of the service(s) rendered; in others, it requires a certain level of «*business judgement*» in order to assess the specific (f)actual circumstances.

We wish for a revision of the definition of the characteristics of the activities underlying the benefit test. In this regard, we would suggest taking into consideration the concept of activity that result in an *identifiable* economic or commercial enhancement (or that maybe anticipated doing so) for the recipient. Additional clarifications would also be welcome with reference to circumstances where the activities rendered do not (actually) provide a group member with benefits, but they allow to satisfy the willingness to pay test. R&D services are illustrative of this situation.

The benefit test with reference to «*on-call*» services requires specific comments. The present version of the OECD Guidelines states that «*(...) the benefit conferred on a group company by the on-call arrangements should be considered, perhaps by looking at the extent to which the services have been used over a period of several years rather than solely for the year in which a charge is to be made, before determining that an intra-group services is being provided. (...)*». We wonder if the benefit test for these «*call off contracts*» could be grounded on the *promptness* of the activities provided. In this sense, according to our view, the statement of the UN TP Manual is demonstrative: «*(...) The expected economic*

³ « These are complex services that require more advanced skills, and may offer considerable scale economies and agglomeration effects. Examples include financial and accounting services, standardized programming work, routine data analysis and processing or back-office services such as ticketing and billing. Specialized training would generally be required (and so also the necessary training institutions). The building of competitive capabilities may also call for a large local market where the skills accumulate over time. Some services may require a minimum critical mass of different skills in one location to provide the whole package.» UNCTAD, World Investment Report 2004, The Shift towards Services.

⁴ «This is the most creative and skill-intensive end of offshored services, with the most stringent entry requirements. Examples include R&D (from all sectors), design services, architectural drawings, new software development, animation, medical testing or analysis and technology systems design. These require advanced skills at high levels of specialization, often with strong educational institutions. They involve agglomeration economies, with different skills, enterprises and institutions interacting with each other to share work, stimulate knowledge flows and allow specialized skills to be fully utilized. Needless to say, the location would have to be attractive enough to retain a large number of qualified personnel.» UNCTAD, *supra*, no. 3.

benefit to the recipient of being able to call on such services **without delay**⁵ when needed may be a sufficient business advantage to satisfy the benefit test, even if the contingency requiring the service never arises and actual services are never or infrequently provided. (...)»⁶. We believe that the rationale of «on-call» services is providing support to a group member in case of urgency, **immediately**⁷ or within a **short**⁸ period of time⁹. We are conscious that this approach will imply a substantial change of the views expressed by the OECD that makes reference to an extend period of time («a period of several years»)¹⁰. However, we wonder if a change might be introduced, considering the actual features of «stand by contracts» in practice (or in the vast majority of cases).

The second issue related to the matter under discussion is documentation. The topic of the appropriate documentation for benefit is an unsolved issue in the OECD Guidelines. Disputes in various countries draw the attention to the fact that *tangible evidence* of benefit must be provided but, in the vast majority of cases, this evidence is denied or considered inadequate. We wonder if consensus might be reached on a basic «documentation package» that might provide taxpayers with a greater level of certainty in case of tax audit. However, we acknowledge that this achievement depends on how and the extent to which tax authorities around the world would accept and implement this prospective «documentation package» into their respective set of rules.

b) Shareholder activities

According to the present version of the OECD Guidelines no intra-group service is consider to be rendered if «*such an activity would be one that a group member (usually the parent company or a regional holding company) performs solely because of its ownership interest in one or more other group members, i.e., in its capacity as shareholder.(...)*». We believe that the concept of shareholder activities needs to be revised considering as follows:

- Criteria for the identification of «pure» shareholder activities (the «*sole effect criterion*» in the US Internal Revenue Code). Based on the approach followed by the EU JTPF¹¹ a benefit test would be required, in order to assess whether, according to the specific circumstances of the case, the activity provided is really a shareholder one (and, consequently, it does not justify a charge to group members).
- Whether the benefit and willingness to pay test are satisfied, some guidance would be welcome with reference to the criteria for performing the analysis of the (additional) benefit(s) produced by the activity rendered by the shareholder. As previously mentioned, this will imply a revision/integration of the concept of benefit.
- If an additional benefit is assessed, further issues arise with reference to the criteria to be used for allocation purposes. We consider that the approach proposed by the EU JTPF («*That attribution will be informed by the type of industry, the type of company and the service provided leading to the conclusion that a case by case approach can be the only viable approach.*») is in accordance

⁵ Emphasis added.

⁶ UN TP Manual, B.4.2.11.

⁷ Emphasis added.

⁸ Emphasis added.

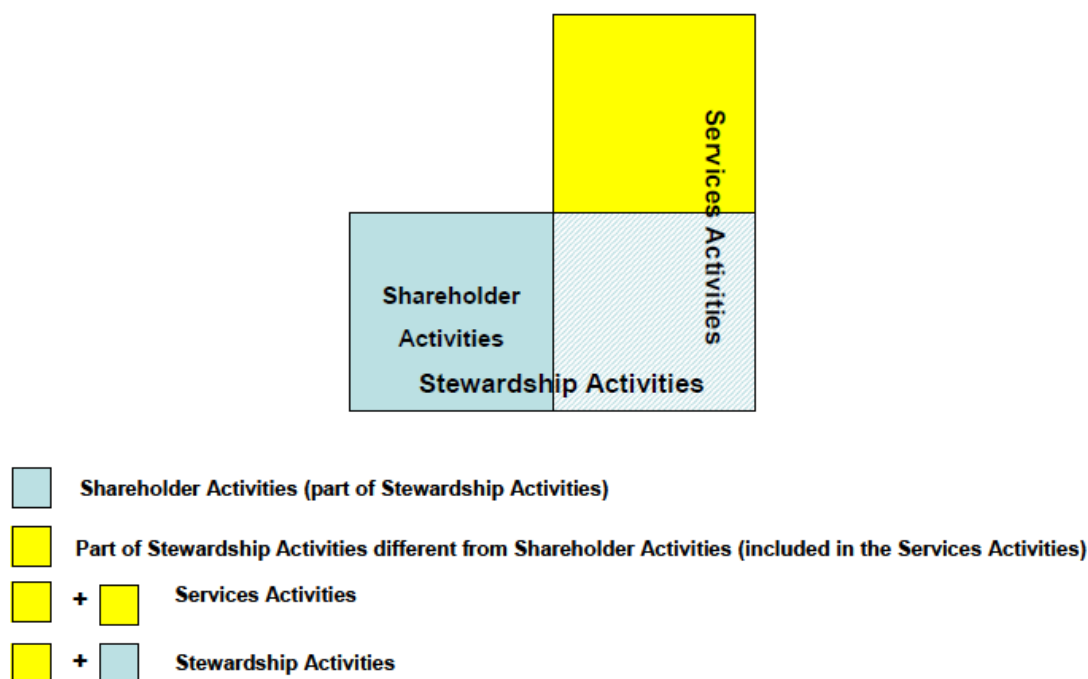
⁹ Based on the UN TP Manual wording.

¹⁰ Also considering that, the EU JTPF confirms the approach envisaged in the OECD Guidelines stating, «A member of the group may not require an on call service in any one year but that fact does not necessarily mean they will not buy into the service the next year. (...)». JTPF REPORT: GUIDELINES ON LOW VALUE ADDING INTRA-GROUP SERVICES. DOC: JTPF/020/REV3/2009/EN.

¹¹ JTPF REPORT: GUIDELINES ON LOW VALUE ADDING INTRA-GROUP SERVICES. DOC: JTPF/020/REV3/2009/EN.

with the facts/practice. Nevertheless, we welcome some «*coordination comments*» concerning this matter and the general guidance provided by the OECD in par. 7.23-7.26.

We also welcome further clarification with reference to the distinction between «*shareholder activities*» and «*stewardship activities*». The definition provided in the Guidelines is too broader (from a certain point of view, vague) and it would be advisable clarifying the «*relationship*» (if recognized by the OECD) provided in the following picture¹²:



(Hopefully) this additional envisaged guidance might protect taxpayers from the negative effect deriving from criticism of the tax authorities during audits.

c) Duplication

Notwithstanding the fact that the issue of duplication has been revised following the «*OECD DISCUSSION DRAFT: BEPS ACTION 10, PROPOSED MODIFICATIONS TO CHAPTER VII OF THE TRANSFER PRICING GUIDELINES RELATING TO LOW VALUE-ADDING INTRA-GROUP SERVICES*», there are still some open points for which additional explanations/guidance would be expected.

According to the general rule, duplication prevents the allocation of the relevant costs to group members. We believe that further guidance is required in relation to cases where, from (duplicated activities) both the provider and the recipient gain an additional and identifiable benefit. In such situations some of the major issues that might arise deal with the «*quantification*» of the benefit (i.e., what if the benefit is higher in the provider than in the recipient or if the benefit for the recipient is reasonably expected in the following years) and the practical application of the willingness to pay test.

In addition, we would like to encourage:

¹² Final Report on Shareholder Costs prepared by Prof. Maisto. DOC: JTPF/024/REV1/BACK/2008/EN.

- The provision of some guidance concerning double dipping, as several audit issues deal with outlays claimed as separate expenses and included again in the management fee category. In this regard, the consideration to be given should outline the approach to be followed, considering for instance: Whether the service is one that is likely to have been charged in another form than as a service fee and, if so, whether it has already been charged in that other form.
- The development of some examples of services that are not duplicative in principle. In this respect, we believe that the view expressed by BIAC¹³ with reference to «*complementary*» and «*supplementary*» services provides for interesting and remarkable suggestions on this matter.

Some concerns may be expressed with reference to the second exception provided by the OECD Guidelines, e.g. duplication is undertaken in order to reduce the risk of a wrong business decision. This definition seems to be ambiguous as, in general terms, for an enterprise, risk management is dealing with the impact of volatility. Further, this exception seems to underline some shortcomings (low or nonexistent control over risks) in the internal structure of one or more group member. In this respect, we believe that further consideration should be given to the FAR (Functional, Assets, Risks) analysis where such services may appear, at first, duplicative in nature, but may actually create *identifiable* benefit for the recipient(s).

d) Incidental benefits

The post BEPS review of the OECD Guidelines has expressly defined some interrelation between incidental benefit and group synergies. We think that, in some cases, there is a fine line between the two concepts. Whether an incidental benefit exists or not and whether an additional benefit deriving from the active promotion of the multinational group could be clearly identified, in practice, is a pure factual analysis, that cannot disregard the outcome of the FAR analysis, as noted by the OECD itself. However, we note that the heart of the problem concerning this matter is twofold:

- «*Pure*» incidental benefits cannot be considered intra-group services if the willingness to pay test is not satisfied (par. 7.12). We believe that this reasonable affirmation should be counterbalanced considering one of the general statements surrounding the application of the arm's length principle: «*The mere fact that a transaction may not be found between independent parties does not itself mean that it is not arm's length.*». The consequence is: What if the willingness to pay test is not satisfied due to the lack of uncontrolled transactions in the market place?
- Meaning of «*active promotion*» (i.e., What the term stands for). The wording used is vague and leaves room to individual interpretations. We wonder if some example in this context might be useful (for instance: Could the provision of a security be considered as a fact that «*positively enhances the profit-making potential of particular member of the groups*»?)

e) Passive association

The matter is complex and subject to different interpretations according to scholars, practitioners and case law. Considering the state of the art, we would suggest to provide new guidance on this issue. Due to the (objective) complexity of the argument we believe that it requires further study.

Based on our preliminary comments in setting the stage for Chapter VII, we wonder if it is the right place to discuss and provide guidance on passive association or if it needs to be supplemented by a specific (new) Chapter dedicated to financial transfer pricing services.

¹³ BIAC Comments on the OECD DISCUSSION DRAFT: BEPS ACTION 10, PROPOSED MODIFICATIONS TO CHAPTER VII OF THE TRANSFER PRICING GUIDELINES RELATING TO LOW VALUE-ADDING INTRA-GROUP SERVICES, 14 January, 2015.

Determining an arm's length charge

Direct charge methods

According to the direct-charge method, a specific charge is established for each service that can be readily identifiable. The present version of the OECD Guidelines states, «*An MNE group may be able to adopt direct charging arrangements, particularly where services similar to those rendered to associated enterprises are also rendered to independent parties. (...)*». The consequence of this statement is the general assumption according to which «*if specific services are provided not only to associated enterprises but also to independent enterprises in a comparable manner and as a significant part of its business, **it could be presumed***¹⁴ *that the MNE has the ability to demonstrate a separate basis for the charge (...)*».

According to our view, this general assumption does not reflect the reality of the vast majority of cases due to the following reasons:

- In few instances multinational groups provides similar services to independent parties *in a comparable manner*. In situations where these services are rendered, they are negligible and/or occasional.
- In practice, there are some kind of services that are provided only in a related-party context.
- Documenting each (direct) charge for each service will result in a burdensome activity, conflicting with the general principle stated by the OECD Guidelines according to which «*Taxpayers should not be expected to incur disproportionately high costs and burdens in producing documentation.(...)*».

Considering the above, we suggest reviewing the assumption provided by par. 7.22 and verify the viability of direct charging in the commercial and operating reality of multinational enterprises.

Indirect charge methods/Allocation keys

The first key matter with indirect charge methods is the appropriateness of the charge, due to the fact that «*when an indirect charge method is used, the relationship between the charge and the service provided may be obscured and it may become difficult to evaluate the benefit provided. (...)*». The root of the problem (probably) relies on the scarce guidance provided by the OECD. From our standpoint, the features provided in par. 7.23¹⁵ increase the level of subjectivity. In this respect, we believe that it could be beneficial to add some conditions that should be met in order to apply indirect charge methods. With reference to this matter we consider remarkable the criteria provided by the Canadian Tax Authority (CRA)¹⁶:

- The allocation must be produce an arm's length result
- The allocation must be based on a comprehensive review of the costs incurred at group level, before carrying out the allocation

¹⁴ Emphasis added.

¹⁵ «*(...) Any indirect charge method should be sensitive to the commercial features of the individual case (e.g. the allocation key makes sense under the circumstances), contain safeguards against manipulation and follow sound accounting principles, and be capable of producing charges or allocation of costs that are commensurate with the actual or reasonably expected benefits to the recipient of the service. (...)*».

¹⁶ CRA, TPM-15, par. 13-15 and 30-33.

- The cost base used must be explicit, definable and available in case of tax audit
- The allocation basis must result in costs being shared, considering the benefits received.

While discussing indirect charge method the second key matter is allocation keys. In this regard, it is possible to point out two related perspectives:

1. Features of the allocation keys: The guidance that can be found in the OECD, UN, EU JTPF and in domestic rules as well allows to highlight some common features for the allocation key(s) selected that must:
 - Be based on the nature and use of the services;
 - Provide for an allocation that reflects reasonably the expected benefit of the recipients; and
 - Lead to a result that is consistent with the arm's length principle.

We think that a feature that is not properly addressed is the consistency of the application of the selected allocation key(s). For instance, the consistency requirement is clearly stated in the UN TP Manual whereas *«An allocation key should be determined consistently for all associated enterprises concerned and should reasonably reflect each associated enterprise's share in the expected benefits from the intra-group services. An example of an inconsistent allocation key is one that uses different bases for allocating expenses for services to associated enterprises in different tax jurisdictions.»*¹⁷. The same principles are confirmed by the EU JTPF as well (*«It would, however, be inconsistent to apply a different allocation key to different recipients of the same services.»*¹⁸). Although this requirement should be obvious, in practice it is easy to find that consistency is not expected, causing a rising spiral of disputes in multiple jurisdictions.

We believe that the current guidance in Chapter VII might be improved considering an approach similar to those of the US Regulations. Indeed, the US TP Regulations¹⁹ consider some other potential indicators of a reliable allocation key:

- When the same allocation key is used to apportion costs in connection with statements and analyses for the use of management, creditors, minority shareholders, joint ventures, clients, customers, potential investors or other parties of interests; and
 - When the allocations are made to or from foreign members of the controlled group, practices employed by the domestic members in apportioning costs amongst themselves will also be considered if the relationships with foreign members are comparable to the relationships among the domestic members of the controlled group.
2. Type of allocation keys: When *«self-evident»* or *«standard»*²⁰ allocation keys are used and selected this is not questioned much. The real problem lies in allocation keys selected by taxpayers that deviate from those that are commonly used. It is not surprising that tax authorities are suspicious of charges based on *«uncommon»* allocation keys, because:

¹⁷ UN TP Manual, B.4.4.15.*

¹⁸ JTPF REPORT: GUIDELINES ON LOW VALUE ADDING INTRA-GROUP SERVICES. DOC: JTPF/020/REV3/2009/EN.

¹⁹ US Treas. Reg., Sec. 1.482-9(k)(2)(ii).

²⁰ With this term reference is made to the most common used allocation keys.

- The related charges are (probably) regarded as a means of transfer price manipulation and profit shifting; and
- These allocation keys are (probably) considered an index for transfer pricing risk assessment.

We deem opportune to underline that a strong reaffirmation of the general features set forth in par. 7.23-7.24 for all type of allocation keys (whether they are common or not) could prevent the increasing in litigation. Selecting an allocation key that is complex and not self-evident should not lead to the automatic conclusion that the taxpayer is not acting in *bona fide* and charges are not consistent with the arm's length principle.

Methods

The arm's length amount charged in a controlled services transaction must be determined according to the guidance provided in Chapter II. In this respect, the OECD states: «*Often, the application of these guidelines will lead to the use of the CUP or a cost-based method (cost plus method or cost-based TNMM) for pricing intra-group services. (...)*».

We support this recognition by the OECD. However, according to our knowledge the use of the CUP method is sporadic while the use of TNMM is widespread, due to the fact that information on gross margins are often unavailable for comparable service providers or because the cost base used for controlled and uncontrolled transactions is different.

With reference to the application of TNMM for services, one of the most challenged issue is the quality of comparables selected. In this regard, we consider noteworthy the outcome provided by the Finnish Supreme Administrative Court in case KHO: 2017:146. Based on our opinion, the fact of the case could represent the starting point for developing new guidance on the following matters:

- Comparability issues in benchmarking bundle vs. unbundle services
- Appropriateness of «*standard*» transfer pricing methods with reference to the provision of services in Global Value Chains (GCVs)
- Criteria for the determination of mark-up (safe harbor rules on low mark-up for services offered as a bundle).

We believe that a clarification on the use of the Transactional Profit Split Method (TPSM) should be given. Indeed, this method may in certain circumstances be used for services. Consistently with its features, («*(...) it can offer a solution for highly integrated operations for which a one-sided method would be not appropriate. (...)*»), the TPSM seems to be the most appropriate method with reference to services rendered in certain industries. According to our view, the examples (some of which are provided for your convenience in the following) set forth in the UN TP Manual are illustrative of the practical use of the method.

Example 15²¹

Air Express is engaged in the business of a logistics service provider offering a comprehensive portfolio of international, domestic and specified freight handling services. The group of entities is generally involved in international transactions involving freight services provided by associated enterprises. The business activities involve entering into contracts with third parties for moving their cargo from its source to destinations abroad. The execution of the job involves lifting cargo from the location of the customer in one country, sending it to the country of destination, collecting it from a port or airport and then supplying it to the ultimate buyer. All such activities are carried out by associated enterprises in various countries. The total expenses incurred in all countries are combined and then deducted from gross receipts and the residual amount is shared in the ratio of 50:50 between the entity of the origin country and the entity of the destination country, based on a Profit Split Method.

Example 16²²

An MNE group is operating in a few countries through its associated enterprises and providing agency services to various re-insurance companies and ceding companies, which place insurance risk by ceding it to re-insurance companies. Each entity in the group co-ordinates in giving technical guidance at the time of placement of the risk; handles premium collections over the period of cover and the subsequent period; handles claims arising out of the proposals placed; receives the payment from the re-insurer and pays it to the re-insured persons. An entity in one country acts as a procurement broker of re-insurance proposals and a second entity in the second country acts as a placement broker. For successful placement the consolidated brokerage is paid by the re-insurer, and this is shared equally say on a 50:50 basis using another Profit Split Method. Each party bears its own expenses.

We suggest providing some improvements to the description of the TPSM to be used for intra-group service purposes, with particular reference to cloud computing (even if, according to some scholars and practitioners, its characterization as service transaction depends largely on whether a transfer of property rights exists).

²¹ UN TP Manual, B.4.4.13.

²² UN TP Manual, B.4.4.13.

We remain at your disposal should you wish to discuss the issues we have raised in this paper in more detail.

Kind regards.

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SBA Submission: OECD Request for Public Comments on Scoping of the Future Revision of Chapter VII (Intra-Group Services) of the Transfer Pricing Guidelines

Dear Sir or Madam,

The Swiss Bankers Association ("SBA") would like to thank you for the opportunity to provide its comments on the new project of Working Party No. 6 ("WP6") to revise the guidance in Chapter VII: Special Considerations for Intra-Group Services of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD TPG").

Our views are based on the extensive experience of our members with respect to designing, implementing, operating, documenting and defending the intra-group services concept in Multinational Enterprises ("MNE") while concentrating its management and administrative services expertise in several regional or one global Shared Services Center ("SSC").

Please find below our comments on the following specific issues:

1. Comments on recent changes to Chapter VII: Special Considerations for Intra-Group Services of OECD TPG incorporating the simplified approach to determine the arm's length charges for low value-adding intra-group services ("LVAIGS") as a concept presented in OECD BEPS Action 10.

The SBA highly appreciates the simplified transfer pricing approach for LVAIGS developed by WP6 under the mandate of BEPS Action 10, which might lead to the revision of Chapter VII of

OECD TPG. It is of high practical relevance that a new guidance is presented on what type of commonly performed intra-group services can benefit from the simplified determination of arm's length charges.¹ Although we agree with the overall logic of the definition, we do not believe that all marketing services should be excluded from LVAIGS. In our view, there should be a distinction made between the group marketing promoting the existence of the whole MNE and product marketing that is closely connected with distribution. The former should be included in the LVAIGS group and benefit from the simplified remuneration approach. In addition, the SBA would welcome guidance on whether delegation of employees could be treated as LVAIGS or not.

The introduction of safe harbor rules for the profit mark-up of 5% on total costs incurred in connection with LVAIGS is for the SBA of the utmost importance. In practice, a high number of MNEs have been charging Cost+ 5% for LVAIGS for years. Therefore, the determination of the arm's length charge was not entirely new. However, the introduction of the Cost+5% as a safe harbor rule enables MNEs (incl. SBA members) not to undertake costly benchmarking studies substantiating that 5% is the arm's length profit mark-up on full costs. The benefit is even accentuated considering BEPS Action 13 requiring that benchmarking studies for at least routine functions should be yearly updated by presenting new financials of the final set of comparable companies.²

The SBA would appreciate, if the application of a simplified approach - with safe harbor rules for profit mark-ups – would be more frequent in the OECD TPG. We suggest that the WP6 would present a list of commonly performed routine services³ with indication of internationally accepted profit mark-ups on full costs. Such a step would significantly reduce the administrative burden for MNEs. Even if prices for benchmarking studies fell in the last five years, their preparation and update absorb resources of the in-house transfer pricing specialists. They spend a significant amount of time on each benchmarking study - if outsourced individually for each function - on:

- identifying the need for the study,
- drafting the request for proposal,
- selecting the most suitable provider (selection of objective criteria, evaluation of individual proposals and communication of results to applicants),
- coordination of benchmarking outputs with Master File ("MF") and Local File ("LF") filing deadlines,
- reviewing the quality of the benchmarking studies, and
- presenting the results of the studies to internal stakeholders.

¹ OECD TPG, Chapter VII, Art. 7.43 et seq.

² OECD TPG, Chapter V, Art. 5.38.

³ E.g. investment funds administration, structured products legal or any other middle-office type of routine functions.

In addition, the SBA would welcome, if additional safe harbor rules would apply for transaction volumes of business related intra-group services. We suggest that any intra-group transaction below USD 50'000 does not have to be documented in MF or LF. Alternatively, we would appreciate, if there would be a relief from benchmarking requirements for them in the new Chapter VII.

2. Comments on scoping of the future changes of Chapter VII: Special Considerations for Intra-Group Services of OECD TPG reflecting the rest of the findings presented in OECD BEPS Actions 8 to 10.

a. Interaction with Chapter I: The Arm's Length Principle

Overall, we believe that the Arm's Length Principle ("ALP") should prevail over formulary apportionment ("FA") when it comes to intra-group services. Our main concern with FA is the difficulty of implementing the system in a manner that would both protect against double taxation and ensure single taxation. To achieve this would require substantial international coordination and consensus on the predetermined formulae to be used and on the composition of the MNE in question.⁴

As the MNEs represented by the SBA exclusively provide financial services – acting in the fields of Asset Management, Investment Banking, Wealth Management and Retail Banking – the transfer pricing methods used for testing the arm's length character of intra-group services are limited to Comparable Uncontrolled Price ("CUP"), Cost Plus ("CPM"), Profit Split ("PSM") and Transactional Net Margin ("TNMM"). In our view, the most recent version of Chapter I presents more examples and guidance for MNEs manufacturing and selling goods than for MNEs providing exclusively services⁵. We would appreciate, if Section D of Chapter I would give more guidance for applying arm's length principles for entities providing only services. More specifically, we would welcome more guidance on the hierarchy of methods that could even be binding for the tax authorities. Furthermore, more examples and explanations on the choice between CPM, TNMM and PSM for intra-group services would be highly appreciated. In addition, the SBA is missing in the current version of OECD TPG any comments on transition issues related to the change of the method. We would welcome, if WP6 would explicitly mention that tax authorities should not change the method for transfer pricing adjustments typically by applying the new method on the previous years or the old method on the future years. Finally, we suggest that WP6 promotes the use of global benchmarking studies and restrict the – still widely spread – tax administration requirements for local or regional benchmarking studies.

⁴ OECD TPG, Chapter I, Art. 1.22.

⁵ OECD TPG, Art. 1.40 and 1.44.

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| b. Interaction with Chapter VI: Special Considerations for Intangibles |
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The SBA believes that there is an interaction between intra-group services and intangibles because of the OECD TPG rules determining who is entitled to the remuneration for the use of the intangible property ("IP"). According to Art. 6.32 OECD TPG, it is the group entity performing development, enhancement, maintenance, protection and exploitation ("DEMPE") of intangibles. In practice, the most common remuneration for the use of IP are royalties determined as a percentage of relevant revenues via application of the CUP method. At the same time, some of the DEMPE functions are intra-group services that are typically remunerated with the CPM, e.g. the legal activities connected with the protection of a brand or the marketing and communication activities related to development, enhancement and maintenance of a brand. The SBA would welcome, if WP6 would make a distinction between the marketing activities and could provide guidance on what are e.g. brand building marketing costs.

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| c. Interaction with Chapter VIII: Cost Contribution Arrangements |
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In the financial services business, Cost Contribution Arrangements ("CCA") are used for common cross-border development and maintenance of tools. The SBA believes that there is an interaction between intra-group services and CCA, when one of the participating parties provides intra-group services to other participants and the value of this contribution should be calculated.⁶ We would welcome, if the same rules for the determination of the arm's length price would be applied as mentioned in Chapter VII: Special Considerations for Intra-Group Services.

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| d. Interaction with the OECD work on the use of the PSM |
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The use of PSM is widely spread in the financial services business. This is because there are commonly used highly integrated business models⁷, in which more entities make unique and valuable contributions (i.e. perform non-routine functions, assume substantial risk or own/employ important assets).⁸ The SBA believes that LVAIGS do not present any unique and valuable contribution and as such should not trigger any need for the implementation of PSM. They can be remunerated via Cost+5% method according to the simplified determination. In contrary, non-routine and high-value-adding, business related intra-group services could require the application of PSM. The relevance of the distinction between routine and non-routine functions for PSM accentuates the importance of detailed knowledge of business models and their value chains.

⁶ OECD TPG, Art. 8.13.

⁷ OECD (2017), BEPS ACTION 10, Revised Guidance on Profit Splits, p. 7.

⁸ OECD (2017), BEPS ACTION 10, Revised Guidance on Profit Splits, p. 5.

e. Interaction with the OECD work on financial transactions

The OECD BEPS Action 4 focuses on limiting base erosion via interest deductions and other financial payments. The SBA believes that both provisions of intra-group credits and granting of guarantees are non-routine high value adding intra-group services. It would be highly appreciated, if WP6 would elaborate on the application of guarantee and e.g. the necessity to apply PSM because multiple parties make valuable contributions. In other words, there should be more guidance provided in the updated OECD TPG on, how the risk assumption is limited by the receipt of guarantee from another group entity.

3. Comments on the practical challenges - identified by many practitioners, academics and tax administrations - that require further analysis

a. Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient

In general for a MNE operating a global or a regional SSC, the rendering of intra-group management and administrative services for the benefit of group entities is the only activity performed by the specialists (e.g. Group Tax, Group Accounting and Group Treasury) located in the SSC. In most cases, a SSC concentrates a great level of know-how and experience that could be compared with external professional services providers. Many of the in-house experts used to work for external professional services providers (e.g. Big 4 or Law Firms) before going in-house. It tends to be less costly to hire an in-house specialist for e.g. international tax matters than to out-source the service to an external service provider. Simultaneously, the ultimate goal of any SSC is to support the main business lines (e.g. asset management, investment banking, wealth management and retail banking) as a back-office function. There is usually a pro-active collaboration between the front business lines and the SSC in terms of services needed.

All the above arguments demonstrate that - in practice - neither the evidence that service has been rendered nor the provision of benefits to the recipients present a significant issues that WP6 should further elaborate on in the envisaged update of Chapter VII.

b. Drawing a distinction between: (i) activities which do or do not benefit the local affiliates; (ii) benefits that purely arise from group membership and those that arise from a deliberate concerned action; and (iii) shareholder activities and stewardship activities

Ad (i): See our comments on 2 a) above and 2c) below.

Ad (ii): In our view, the distinction between the ways the intra-group services are ordered is not of a practical relevance. Ultimately, both groups have to be classified either as shareholder or as other services and the related costs should be directly or indirectly charged to the benefiting enti-

ties.

Ad (iii): The SBA believes that the distinction between shareholder activities and the rest of the intra-group services was sufficiently described in Art. 7.9 to 7.10 of Chapter VII. We would welcome, if WP6 would mention in the updated of Chapter VII, Art. 7.9 that the category stewardship activities should no longer be used by the tax authorities and the tax payers. Finally, it would be highly appreciated if WP6 would mention that even shareholder costs should be charged to the top holding company at Cost+5%, if performed by SSC.

c. Identifying in practice duplicated activities

In our view, there is such a high-pressure on costs in a MNE – maximizing the shareholder value – that there is no interest to incur costs unnecessarily or provide any intra-group services inefficiently. In a well-organized MNE the local CEOs / COOs regularly discuss the amount and quality of intra-group services provision with the Head of CSS. Therefore, we believe that the duplication of activities is not of practical relevance anymore.

d. Finding an appropriate allocation key for charging intra-group services

The SBA believes that the most suitable allocation key or keys should reflect the underlying need for the particular services.⁹ The major problem in practice is that the intra-group services receiving entities cannot usually identify the need for such a service on their own. This is because the recipients of LVAIGS are companies and branches employing business related specialists that do not have any expertise e.g. in accounting, group tax or group legal issues. In our view, the most pragmatic allocation key is the approximation of the time spent by the cost center (e.g. group tax) for individual entities.

e. Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises

In our view, full costs related to providing the service should be included in the cost base including both direct and indirect costs (e.g. allocations). However, neither the cost base nor the profit mark-up should include VAT/GST or WHT applicable to the service. The arm's length remuneration should present the basis for the determination of the output VAT/GST or the applicable WHT.

Due to the widely spread use of integrated business models, the cost base for intra-group services is frequently built by another intra-group charge remunerated with CPM as well. The SBA would highly appreciate, if WP6 would explicitly mention in the envisaged update of Chapter VII that all intra-group services influencing the cost base for another intra-group service should be remunerated at arm's length. In addition, it would be welcome to mention that netting of intra-group services charges is not allowed from the transfer pricing perspective.

⁹ OECD TPG, Chapter VII, Art. 7.59.

- f. Assessing the arm's length conditions for services provided in connection with the use of intangibles; services that are highly integrated with the value creation of the MNE group; and/or involve significant risk.

See the SBA's comments 2 a) to d) above.

We thank you for taking due consideration of our comments

Yours sincerely,
Swiss Bankers Association



Petrit Ismajli
Head of Tax department



Jean Brunisholz
Head of Tax Switzerland

June 20, 2018

Via E-Mail

TransferPricing@oecd.org

The OECD

To: Tax Treaties, Transfer Pricing and Financial Transactions Division, OECD/CTPA

Public Comments: Scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines

Dear Madam/Sir

The business federation SwissHoldings represents the interests of 61 Swiss-based multinational enterprises from the manufacturing and service sectors (excluding the financial sector).

SwissHoldings is pleased to provide comments on the planned revision of Chapter VII of the TP Guidelines (**in the following TPG**).

Our comments to the TPG are hereinafter provided.

1. We welcome and appreciate the OECD's effort to update and provide further practical guidance on Chapter VII of the TPG. We appreciate the update made with regard to the additional guidance and simplification measures for low value adding services.
2. A balance between the level of information requested and the compliance and extensive audit management burden for taxpayers needs to be maintained. We do not have the feeling that this is the case with current TPG and practical experience in tax audits. Hence, further simplification measures need to be considered. Moreover, a consistent (global) application of the revised TP rules needs to be ensured.
3. With regard to services we would like to highlight that it needs to be ensured that all (service) **costs are tax deductible** within a group and double taxation is avoided for taxpayers. In contrast to the assumptions in the general BEPS discussion, unfortunately double taxation, as opposed to non-taxation, is one of the main challenges in practice within the context of intragroup service transactions for MNEs. Hence, further clarification and mitigation measures needs to be considered.
4. Another critical area is the application of **withholding taxes** for intragroup services. Application of WHT often leads to double taxation (not fully recoverable) and a significant administrative burden for taxpayers and tax administrations. We appreciate the acknowledgement of the practical challenges with the new section D.4. (par. 7.65) of the revised TPG. However, the challenges still exist in practice. Therefore, we strongly recommend limiting in general the application of WHT for all type of service transactions. At a minimum, if WHT will apply, it should

be limited to the profit element (mark-up), and this should be applied to all types of services AND actually be implemented in local tax regulations.

5. In practice we face often also challenges in the area of **indirect tax customs**. Hence, we also recommend eliminating indirect tax impact such as non-recoverable VAT and/or import duties on services and/or similar local charges.
6. For the transfer pricing analysis (in particular during tax audits) tax administrations must also analyze and consider the **whole value chain and transfer pricing model** of the group and assess whether the service fee (input transaction) is eventually passed on – in a second step - by the service recipient/beneficiary to other members of the group (e.g., HQ) via other intercompany transactions (output transaction) and not only the services in isolation.

For instance, one group entity (service recipient/beneficiary) might receive “support services” (e.g. finance, accounting, HR or management) from other group members on a regular basis. The main function of this group entity (service recipient/beneficiary), for example, is to perform distribution activities or contract manufacturing services for another group entity and all costs - including the costs related to the “support services” - are indirectly (as a second step) passed on via other transfer prices for other transactions (e.g. contract manufacturing fee or fixed distribution margin) to another group entity. As the received “support services” represent from an economic perspective “pass-through costs” for the service recipient/beneficiary, **as a simplification measure** lower requirements and efforts should be applied to assess and document the arm’s length nature of the received “support services”. A tax deduction should always be ensured.

7. Moreover, we recommend considering **further simplification measures** and options to recharge (routine) shared service costs to one or limited key entities within the value chain (such as the key entrepreneur within the value chain of the group and the entity which receives and is entitled to the residual profit). This option would significantly minimize the compliance burden and tax audit management efforts and risks for centralized groups.
8. Further practical guidance and examples of the treatment of so called “**pass-through costs**” (or cost plus on local “value added costs”) would be appreciated. The clarifications in paragraph 7.34 and the new par. 7.61 for the treatment of “pass-through costs” is helpful. Further practical examples AND in particular actually acknowledgement/acceptance by tax authorities in practice would be appreciated.
9. In the current business reality, it is becoming increasingly difficult if not impossible to use the direct charge method for most of the centralized services. Current chapter B.2.2.2 seems to indicate that indirect charging methods are some sort of second-tier solution while in practice they are a worldwide standard. We believe that it should be stated that most MNEs use indirect charge methods for centralized services and that this is a globally accepted approach.
11. If the benefit test is still required at all in future, at least we strongly believe that the new **simplified benefit test** should be applied for all type of services.
12. In the current version of the TPG, the benefit test is applicable solely to service transactions. The aim of the benefit test is to assess whether an independent party would be willing to pay for particular services or bear costs to perform particular activities by itself. If so, there is a transaction, if not, there is none and therefore no remuneration is to be paid to the service provider. This analysis, in its core, is not different from the guidance provided in Chapter I of the TPG that addresses the issue of accurate delineation of the actual transactions between related parties which requires an analysis of the economically relevant characteristics of the

transaction and relevant circumstances in which the transaction takes place. Having accurately delineated provision of particular services as one of the actual transactions in line with the guidance from Chapter I of the TPG, should require no further analyses to reconfirm this fact.

13. From our perspective the focus should be to prove that the **activities exist** (costs incurred) and the cost base of the service provider is appropriate. A statement of the certified accountant (e.g., the statutory auditor) that the costs have been properly recorded in the books of the service provider should constitute a sufficient proof for the tax authorities who should not request any further accounting records from the foreign service provider. With regard to appropriate cost base we mean that costs for so called - shareholder activities - should be excluded from the cost base of a recharge. Shareholder costs needs to be borne by that parent company of the group. Again, key is to ensure that all (service) **costs are tax deductible** within a group. I.e. OECD should consider replacing the benefit-test with a “cost base test”.
14. In our global competitive environment, **multinationals cannot afford to perform non-value adding activities** (and/or duplicative activities); or probably the more correct economic term an “inefficient operating model/value chain”. Insofar, given the competitive environment there is no need to continue to perform a benefit-test for service transactions, i.e., except the costs for shareholder activities, all other service costs are performed for the benefit of one or several group members. Hence, again the focus of the analysis must be the right cost base, allocation keys and the mark-up to be applied on the right cost base (excluding pass-through cost, if relevant).
15. We appreciate the efforts to clarify the definition of shareholder activities. However, we would welcome a clarification that there exist only 2 categories:
 - *Shareholder activities*, where the cost should be borne by the parent company as the ultimate beneficiary); and
 - *Services*, where the costs should be borne by the respective recipients/ beneficiaries of the services within the group (or to HQ if the simplified method is selected, see comments above).

We also recommend avoiding reference to the old 1979 Report in paragraph 7.10 and the 1984 Report in paragraph 7.9. These references could give the impression that these old Reports are still applicable legal sources to interpret the arm’s length principle and/or “stewardship activities” is still a category taxpayers need to consider.

16. The examples mentioned in paragraph 7.9 are helpful to clarify the distinction. However, the examples need to be clear to avoid disputes in the future.
17. It would be helpful to provide guidance on characteristics and pricing of high-value services including a number of examples categorizing certain types of services as high or not high value. In practice, services can either attract relatively moderate remuneration if based on costs and, in some cases, incomparably higher remuneration if based on results. There is no clear guidance as regards factors which determines how particular service transactions should be assessed from a transfer pricing perspective, which can lead to disputes around the extent to which particular services are considered as high-value and what should be the basis for remuneration in return for the service.
18. TPG should acknowledge that depending on the service type and the functions and risks assumed by the involved entities cost based service charges may be based either on budgeted costs or on actual costs.
19. In case it is concluded that a service fee based on actual costs is an arm’s length consideration for the services provided, it should be acknowledged that in the business reality of a large MNE

it can be difficult to calculate such service fee in real-time. This may be specifically the case when one central entity is pooling costs of services performed by several sub-suppliers in order to provide a comprehensive service to its related service recipients. In such cases, the complete and accurate information about related costs can be only available after all the accounting records are booked, usually several weeks after year end. In such cases, MNEs usually agree that during the financial year the service fee is established based on budgeted or forecasted costs while after the year end, the full and accurate service fee is calculated. The difference between the amounts invoiced during the year and the service fee due based on actual costs is then either invoiced as a separate true-up/true-down invoice at the beginning of the next year or included in the service charge for the next period. TPG should acknowledge this practical challenge and the options to resolve it. The reconciliation of the difference between preliminary charges and the final service fee should be part of the documentation maintained by the service provider.

20. Similarly to the comment above, the allocation key used to calculate the service fee (e.g. revenues) may not always be available at the time the service invoices are issued. In such cases, MNEs may choose to use budgeted or historical values of the respective allocation key for preliminary invoices made during the year. Actual values of the allocation key should be then reflected in the computation of the final actual service fee as described above.

We kindly ask you to take our comments and proposals into due consideration.

Yours sincerely

SwissHoldings

Federation of Industrial and Service Groups in Switzerland



Dr. Gabriel Rumo
CEO



Martin Hess
Senior Policy Manager Taxation

cc - SwissHoldings Board

- Nicole Primmer, Senior Policy Manager, BIAC
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Comments on the scoping of future revisions of Chapter VII (intra-group services)

Dear Sir or Madame,

First of all, we would like to thank you for providing the opportunity to comment on the scoping of future revisions of Chapter VII (intra-group services). From our point of view, subjecting your work to public scrutiny constitutes an indispensable aspect of building and maintaining credibility with taxpayers and tax administrations.

Having said that, we would like you to consider the following comments as constructive criticism aimed at achieving better and generally accepted Transfer Pricing Guidelines.

I. Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient

The current OECD Transfer Pricing Guidelines 2017 (hereinafter: “OECD-TPG”) state that the questions of whether a service has been rendered “should depend on whether the activity provides a respective group member with economic or commercial value”. In addition, there is a reference to the arm’s length principle. Furthermore, there is the statement that “it is not possible in the abstract to set forth categorically the activities that do or do not constitute the rendering of intra-group services” but that “some intra-group services are performed [...] to meet an identified need [in which case] it is relatively straightforward to determine whether a services has been provided” (Sec. 7.6 et seq.). All in all, from our point of view these guidelines are far too general and brief to constitute practical, hands-on guidelines and help taxpayers and tax administrations to find agreement on the question of whether a service has been rendered.

Furthermore, it should be clearly stated that if a service has been rendered, the costs associated with this service provision to constitute deductible expenses from the point of view of the service recipient in principle. For this to be the case the central requirement that needs to be met is the demonstration of an expected benefit for the recipient. It should be noted that business decisions between unrelated parties may, and in fact, often do result in a loss. Consequently, the service recipient should only be requested to present the options realistically available at the time of entering into service transaction, thus meeting the “willing to pay” test.

As regards the scope of the benefits test, we believe that aspects which should be addressed include:

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- The taxpayer should solely need to demonstrate an *expected* benefit. This means that the benefit does not actually need to have been realized (even though often this will be the case). Instead, before or at the point in time the service is provided/the respective agreement concluded from the subjective point of view of the (potential) service recipient the realization of a benefit from receiving that service should have seemed to be more likely than not.
- The expected benefit may constitute cost savings but also (possibly and indirectly) increased income. Cost savings should take into account the concept of opportunity costs and the idea of alternative options for action.
- The benefit does not necessarily need to be expected to be realized in the same period the services are charged/costs are incurred. Instead, looking at the total period a benefit needs to be expected.
- The service recipient should not be required to quantify a benefit, even an expected benefit, from entering into the transaction, as long as the “willing to pay” test is satisfied.
- The taxpayer should not be required to demonstrate a direct link between the costs incurred and a specific revenue but only that a relationship between the costs and, in general terms, the overall activity of the company exists, even if such costs are only potentially able to increase revenues or taxable income.
- The fact that the costs are disproportionate to the revenues of the taxpayer should not constitute by itself conclusive evidence that the service has not been rendered.
- That a service has been rendered can i.a. be demonstrated by technical-accounting documents, i.e. reports drawn up by the parent company and certified by an international audit firm in which the nature and the composition of the services provided and their functionality in respect of the company’s activity receiving the services are highlighted. The fact that the reports are certified should be considered a sufficient proof that the service has been provided considering that the international audit firm carries out a public control function, is in a position of independence with respect to the person conferring the task and is exposed to civil and criminal responsibility when it attests untrue data. In turn, it should be the tax authority’s task to conclusively and convincingly demonstrate if – in contrast to the impression conveyed by such technical-accounting documents – a service has in fact not been rendered.
- The fact that the service recipient does not have the internal resources (know-how, capacity etc.) to provide these services internally (which is why the service is sourced externally) should be taken as indication that a service has been rendered.

II. Finding an appropriate allocation key

If intra-group services are not rendered directly (i.e. “bilaterally”) the costs (generally, including a mark-up) incurred by the service provider are allocated to all service recipients based on an allocation key. In this regard, we believe the guidelines regarding low value-adding services (Sec. 7.59 et seq.) to offer sensible guidance. This refers i.a. to the following aspects, to which we would like to comment as follows:

- The appropriateness of an allocation key will depend on the nature of the service. However, this does not imply that different services necessarily require different allocation keys; instead, a single allocation key (e.g. revenue-based) may also be appropriate to allocate the costs associated with various services.

- Allocation keys should be used consistently. However, we would like to point out that indeed there may be appropriate reasons to change and/or amend allocation keys. Thus, provided that there are sound reasons, a change/amendment of allocation keys should be accepted.
- An appropriate allocation key will reflect the benefit expected to be received by each recipient of the service. This means that – if all participants in e.g. a cost allocation agreement are viewed jointly – the allocation key should reasonably approximate the expected benefit of each recipient as compared to the expected benefit of any other recipient.
- When choosing an allocation key, a balance needs to be struck between theoretical sophistication and practical administration. If in doubt, the taxpayer should be allowed to choose the easier (although less precise) allocation key over the more sophisticated allocation key that is hard to handle.
- Guidance on which allocation keys should in principle be acceptable per type of service would assist in reducing the number of disputes between taxpayers and tax administrations on the matter. In this regard, e.g. a matrix with practical examples of which allocation keys might be usually acceptable for certain types of services would be useful.
- It should be clearly noted that amongst third parties it is highly unlikely that a service provider will share the calculation of its costs with regard to that service with the service recipient. In practice the service recipient will only receive the invoice to be paid, theoretically knowing the allocation key that is used but not knowing any details with regard to its application in practice.
- It should be acknowledged that allocation keys based on the time spent for the relevant service carry a significant administrative burden for MNEs and are less preferable compared to other allocation keys which refer to objective data (sales, assets, headcount etc.).
- An appropriate allocation key is not necessarily based on measures that concern the same period of time as the costs that are to be allocated. For instance, an allocation key might be determined based on revenues in $t=0$ and be used to allocate costs incurred in $t=1$.
- An appropriate allocation key may also be determined using average numbers over time. For instance, an allocation key might be determined based on average revenues in $t=-5$ to $t=0$ and be used to allocate costs incurred in $t=1$ etc.
- Regarding the expected benefit reflected by the allocation key, the benefit of doubt should lie with the taxpayer meaning that the taxpayer does not need to prove the allocation key's appropriateness. Instead, the taxpayer should merely need to explain the reasoning behind choosing a particular allocation key.
- Tax administrations must not assess an allocation key's appropriateness by looking at the actual/realized benefits. Instead, tax administrations should be required to – based on the information available at that time – try to understand the taxpayers reasoning behind choosing an allocation key.

III. Identifying in practice duplicated activities

The current OECD-TPG state that “no intra-group service should be found for activities undertaken by one group member that merely duplicate a service that another group member is performing for itself, or that is being performed for such other group member by a third party” (Sec. 7.11 et seq.).

In general, this assessment is fully appropriately and accurately reflects the behavior of an unrelated, independent company. However, in practice the difficulty is to identify such duplicated activities and to properly distinguish duplicated activities from activities that complement each other and/or constitute additional activities. In this regard we would like to comment as follows:

- Also regarding the question of duplicated activities, the benefit of doubt should lie with the taxpayer, i.e. as a general rule the taxpayer will be much better qualified to judge whether in fact a duplicated activity exists or whether there is a case of different, additional or complementary activities.
- As stated correctly in the OECD-TPG, an exception must exist for cases of temporary duplication. Thus, if the taxpayer can provide sound business reasons of why a duplication of activities was acceptable from a business perspective, this should also be actable from the point of view of tax authorities.
- Identifying duplicated activities must be the tax authority's task, i.e. they must conclusively and convincingly demonstrate that in fact a duplicated activity exists.
- Duplicated activities cannot be described in the abstract but rather can only be identified by analyzing the activity in question in detail, evaluating the expected benefit of such activity against the background of a company's economic activity and comparing/contrasting such activity with other activities undertaken on the company's behalf.
- The fact that the taxpayer lacks a structure suitable for carrying out the service received by another group member should constitute evidence that such service has effectively been provided and does not constitute duplicated activities.
- With regard to the taxpayer it is recommendable to describe the services received in detail, in order to help tax authorities understand each type of service, its nature, the counterparty and the corresponding amounts. As similar services are often received from both related and/or unrelated parties (i.e. between independent enterprises), including a detailed description of the intra-group services received will strengthen the taxpayers position.

IV. Determining the costs

When determining the relevant costs, tax authorities should be encouraged to apply more general approaches (e.g. the use of ledger accounts instead of separate invoices) when auditing a fiscal year more than e.g. three years ago. The benefit of such an approach lies in the fact that it may be extremely burdensome to identify all separate transactions for the year in scope of the tax audit. One should therefore be allowed to defend the transfer pricing system with a more general approach (in line with the overall idea of the OECD-TPG on Low-value-adding services).

We hope that these brief remarks will contribute to the further discussion of the topic.

Yours sincerely on behalf of Taxand,

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19 June 2018

Jefferson Vanderwolk
Head, Tax Treaties, Transfer Pricing and Financial
Transactions Division
Centre for Tax Policy and Administration
Organisation for Economic Co-Operation
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Paris, France

Via email: transferpricing@oecd.org

**RE: Potential Revisions to Chapters IV and VII of the OECD
Transfer Pricing Guidelines**

Dear Mr. Vanderwolk:

On 9 May 2018, the OECD issued two invitations for comment regarding potential future revisions to the OECD's Transfer Pricing Guidelines (the Guidelines). One request asks for comment on the scope of revisions to Chapter IV (administrative approaches) of the Guidelines (the Chapter IV Request). The Chapter IV Request seeks input regarding "how the guidance in Chapter IV could be revised or supplemented to reflect the latest developments on administrative procedures aimed at minimizing transfer pricing disputes and to help resolve them"

The second request asks for comment on the scope of future revisions to Chapter VII of the Guidelines regarding intra-group services (the Chapter VII Request). The Chapter VII Request notes it is concerned with the "practical application" of the guidance in Chapter VII, rather than its underlying principles.

On behalf of Tax Executives Institute, Inc. (TEI), I am pleased to respond to the OECD's requests for comments.

TEI Background

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organization has 57 chapters in Europe, North and South America, and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax policy, as well as the fair and efficient administration of the tax laws, at all



levels of government. Our nearly 7,000 individual members represent over 2,800 of the leading companies in the world.¹

Comments regarding the Chapter IV Request

General Comments

TEI commends the OECD for seeking comments regarding the scoping of potential revisions to Chapter IV of the Guidelines. In general, TEI prefers countries adopt a transparent cooperative approach to tax administration, which would help avoid disputes, including audits and arbitration. In this regard, TEI recommends the OECD improve current practices rather than introduce completely new mechanisms. New mechanisms present new complexities and compliance burdens, when the overall direction of administrative approaches to preventing transfer pricing disputes should be toward simplicity and shorter timelines.

Over the past several years the OECD has introduced several initiatives and new concepts that have increased taxpayers' compliance burden (most notably, country-by-country reporting). These initiatives have increased the incidence of double taxation. The OECD should thus aim to address how double taxation can be avoided or relieved in the new guidance. Finally, we note safe harbor guidelines can be very useful as long they are accepted by all countries/member states, but unilateral measures are not efficient. The OECD should thus aim to facilitate multilateral safe harbor measures.

Comments on Specific Questions

The Chapter IV Request asks "What additional aspects or mechanisms to minimise the risk of transfer pricing disputes should be included as part of the guidance on transfer pricing compliance practices (e.g. co-operative compliance, risk assessment tax examination practices)?" TEI suggests a number of elements should be included in future guidance to improve transfer pricing compliance practices. First, tax authorities should share their risk assessments with taxpayers so taxpayers can improve their compliance processes where appropriate, or engage in a discussion with tax authorities regarding their view of the taxpayer's compliance risk. Second, to avoid transfer pricing disputes, Chapter IV should urge tax authorities to focus audit activity on transactions that are more likely to be tax motivated (i.e., between high and low tax jurisdictions), rather than simple intercompany transactions where the taxpayer makes reasonable efforts to price the transactions and where the possibility of a tax motivation is remote. For example, head office cost allocations between countries with relatively comparable tax rates should be viewed as low risk. Finally, the OECD should encourage countries to consider halting interest and penalties if dispute resolution takes longer than two years and if the country does not have a mandatory arbitration procedure.

¹ TEI is a corporation organized in the United States under the Not-For-Profit Corporation Law of the State of New York. TEI is exempt from U.S. Federal Income Tax under section 501(c)(6) of the U.S. Internal Revenue Code of 1986 (as amended).



The Chapter IV Request also asks about relevant aspects of the minimum standards and best practices included in the OECD's final BEPS report on Action 14 regarding effective dispute resolution, including whether "there [is] any additional guidance that would be useful in relation to corresponding and/or secondary adjustments to minimize the risk of double taxation?" TEI recommends the OECD include information regarding the impact of transfer pricing adjustments on areas other than the corporate income tax, such as indirect taxes, withholding taxes, and customs duties. For example, on 20 December 2017, the Court of Justice of the European Union (CJEU) ruled that a customs transaction value may not be based on a transfer price that was subject to a retroactive adjustment. Customs values are established by the price actually paid or payable for the goods when they are sold for export, the CJEU held.

In addition, the Chapter IV Request asks what additional guidance could be provided regarding advance pricing arrangements. In TEI's view, the OECD should provide guidance on the consequences and potential taxpayer remedies if advance pricing arrangements or other transfer pricing rulings are overturned by a non-tax governmental body that is not a court (e.g., the circumstances present in the current EU state aid tax cases).

Finally, the Chapter IV Request invites comments about "[a]ny other mechanisms or issues relevant to the administration of transfer pricing and/or to prevention and resolution of transfer pricing disputes for which guidance should be developed . . . ?" The Guidelines should address how taxpayers can attend to tax legislation changes around the world. In many cases, new rules in one country may effectively result in double taxation. For example, the recent U.S. tax reform legislation includes a "base-erosion anti-abuse" tax that may apply to certain payments even if those payments taxable in another country. Such guidance would be particularly helpful where it is uncertain that double taxation relief is available under an applicable tax treaty, such as where the tax imposed may not qualify as a tax on income as defined under the treaty.

Comments regarding the Chapter VII Request

The Chapter VII Request identifies a number of practical challenges regarding the Chapter's application. One challenge is "[d]emonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient." In this area, multinational enterprises are moving toward using independent companies to provide the enterprise with "software as a service" (e.g., basic software, software infrastructure, unified communication via software, etc.). After contracting with the independent provider, the multinational enterprise shares the software among its affiliates. Under these circumstances, tax authorities often question how to characterize software as a service for tax purposes. Moreover, tax authorities' view of such characterization is inconsistent across jurisdictions. To help alleviate these inconsistent views, the OECD should provide uniform guidance on the characterization of software as a service. Also, guidance would be useful on what documentation is necessary to demonstrate that a service recipient received a benefit.



A second practical challenge identified in the Chapter VII Request is “finding an appropriate allocation key for charging intra-group services.” TEI recommends the Guidelines emphasize that a taxpayer should be allowed to select any allocation key that provides a reasonable approximation of relevant benefit for the related parties to the transaction and, to the extent possible, the allocation key selected should be simple and based on easily obtainable and verifiable data. The Guidelines should also recommend, but not require, reasonable allocation keys for defined types of intra-group transactions. Helpful allocation keys would be: (i) allocating human resources cost by relative headcount; (ii) allocating marketing expenses by relative revenue; and (iii) allocating information technology costs, including software licenses, by computer user count. Such guidance would effectively provide safe harbors and reduce potential disputes over head office cost allocations, which are mostly not tax motivated but simply an effort by taxpayers to be compliant and practical. Finally, guidance on what documentation is necessary to demonstrate that a particular allocation key is appropriate would also be helpful.

Conclusion

TEI appreciates the opportunity to comment on the requests regarding the scope of future revisions to Chapters IV and VII of the Guidelines. These comments were prepared under the aegis of TEI’s European Direct Tax Committee, whose Chair is Giles Parsons. If you have any questions about the submission, please contact Mr. Parsons at +44 1455 826561, parsons_giles@cat.com, or Benjamin R. Shreck of the Institute’s legal staff, at +1 202 464 8353, bshreck@tei.org.

Sincerely yours,
TAX EXECUTIVES INSTITUTE, INC.

Robert L. Howren
International President

Organisation for Economic Cooperation and Development

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15 June 2018

Via email: TransferPricing@oecd.org

Dear Sirs

Request for Comments on the scope of the future revision of Chapter VII of the Transfer Pricing Guidelines on Special Considerations for Intra-Group Services

We appreciate this opportunity to contribute some general thoughts on how to address issues related to the practical implementation of the TPG in the context of intra-group services. Specifically, we greatly appreciate that the OECD explicitly focusses this scoping exercise on the practical implementation rather than on the potential theoretical disagreements.

Considering that intra-group services constitute an important transaction class for most MNEs, practical guidance can greatly contribute to enhancing tax certainty as well as alleviating administrative burdens. We recognize that, in the context of BEPS, the guidance must be formulated in such a way that abusive transfer pricing practices are curtailed, i.e. safeguarding the ultimate objective of BEPS, namely aligning profits allocation with value contributions. In our opinion there is ample opportunity to alleviate the administrative burden for taxpayers without compromising the objective of BEPS – the classical tradeoff when designing tax policies.

In this context, we would also like to call attention to BEPS Action 11. Transfer (mis)pricing for services, including management services, was not identified among the main sources for BEPS. Instead, BEPS behavior related to services was discussed in connection with intangibles. Considering that intra-group services, at least where those of routine (low value-added) nature are concerned, do not pose a pervasive threat to national tax bases, it would seem prudent to put a strong emphasis on limiting the administrative burden for taxpayers when evaluating the aforementioned tradeoff. It would also appear sensible to integrate a cross-reference to the ‘The Role of Tax Risk Assessment in Tax Administration’ outlined in the ‘Country-by-Country Reporting - Handbook on Effective Tax Risk Assessment’.

In the following, we address the practical challenges highlighted in your Invitation for Comments:

1. Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient;

The general guidance on the Benefit Test is straight forward – to determine whether a service has been rendered, it must be considered whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in-house (paragraph 7.6.). Any revision of Chapter VII should be geared at further strengthening this rationale by providing more instructive examples and unambiguously emphasizing that formal considerations (documentation) are strictly secondary to the economic rationale.

The existing guidance provided in paragraph 7.8. thus remains far too vague and offers ample scope for revision. We would suggest discussing the following amendments:

- *Integrating more instructive examples:* The current (single) example for an intra-group services is rather ‘obvious’, i.e. “[...] an associated enterprise repairs equipment used in manufacturing by another member of the MNE group”. We suggest adding examples that are representative of services within centralized or integrated groups (such as those briefly addressed in paragraph 7.4.). The level of detail should match that for “shareholder costs” (paragraph 7.10 – see below).
- *Integrating a ‘no timesheet to be requested by default’ provision:* The current wording regarding the practical implementation is prone to be interpreted in a way that places a disproportionate burden of proof on the taxpayer, ‘It is essential, however, that reliable documentation is provided to the tax administrations to verify that the costs have been incurred by the service provider’. Many tax authorities (i.e. Germany and Romania) have adopted highly restrictive stance on formal requirements (e.g. a detailed contractual basis and the provision of timesheets per employee) as well as an aggressive overall stance in tax audits when it comes to services.
Transfer prices for intra-group services are frequently calculated by applying the cost-plus method and personnel costs tend to constitute a substantial share of the respective cost base. While the taxpayer should naturally be able to document the cost base, the OECD should clarify that the request made by tax authorities should observe the principle of proportionality. For the practical implementation this would imply that in the case of routine services, time sheets (on an employee-by-employee level) would likely be disproportionate, i.e. for most centralized departments (i.e. accounting, IT) providing low value-adding intra-group services (“LVAIGS”) to various business units, it must be sufficient to provide cost data on a cost center level and to select an appropriate allocation-key (see below). In other words, there should be a provision to effectively discourage the default request of timesheets by tax authorities, which often lead to transfer pricing adjustments on purely formalistic grounds - i.e. by further emphasizing that the documentation and reporting requirements stipulated in paragraph 7.64. should not be exceeded by tax authorities without reasonable cause.
- *Clarifying that existing internal data (cost accounting) will generally constitute sufficient reliable documentation.* To observe the principle of proportionality, cost allocations based on the cost center reporting should generally be sufficient for tax

authorities to determine whether the personnel costs as well as reasonable overheads have been included in the cost base. For centralized departments providing LVAIGS there should be no additional information (i.e. correspondence etc.) required to demonstrate that a respective service has been rendered.

Recognizing internal accounting data as sufficient proof for the fact that services have actually been rendered, would also address an issue raised by Mr. Andrew Hickman in his “targeted comments” (published on LinkedIn on 21st of May), namely that “centralized corporate overheads” consume a disproportionate amount of compliance effort relative to importance or value. While it is true that such an approach primarily considers the perspective of the Service Provider, there seems to be no serious downside, as the perspective of the Service Recipient is safeguarded by the existing provisions on the duplication of services and shareholder costs. Introducing a “global corporate overheads rule”, allowing group enterprises to deduct corporate overheads only up to the group ratio of overheads to EBIT, seems unlikely to alleviate the uncertainty or administrative burden for the taxpayers and should not be followed-up.

- Further guidance should be given on *allocating centralized corporate overheads to a limited number of value centers rather than to all group companies*. We agree with the view expressed by Mr. Hickman in his targeted comments (see above), that the allocation of the overhead costs to the value centers (i.e. non-routine entities sharing in the residual profits) would generally be commensurate with the arm’s length principle. The scope of the revised guidelines should be focused primarily on establishing the principle that an allocation to value centers is indeed permissible (in fact a similar logic can arguably be deduced from paragraph 7.32). A secondary focus should be put on the identification of appropriate allocation keys for these cases (see below). Core issues in this context would be to ensure adequate working definitions of value centers (aligned with the established terminology of the functional and risk analysis as well as amending the definition of a “beneficiary”) as well as outlining an acceptable approach to delineate the benefits derived by different value centers.
- As emphasized above, the extension of the scope of the guidelines should be to further strengthen the rationale of the Benefit Test, i.e. to determine whether the Service Recipient would have been willing to pay for these services. Opposed to the suggestion by Mr. Hickman in his targeted comments (see above), we maintain that removing the benefit test from Chapter VII would not be beneficial – especially as the redundancy to the principles of Chapter I is not completely clear. Especially when interpreted in the context of the more lenient approach outlined above, it should be sufficiently ensured that the scope for second-guessing the willingness or behavior of the transaction parties as well as the respective administrative burden can be reduced. Further the problems regarding valuations should be limited by making it more difficult for local tax authorities to challenge cost accounting data.

A more lenient practical implementation, as sketched in the above comments, would not trigger a negative tradeoff with the aim of BEPS, as the safeguards in respect to the ‘duplication of services’ as well as ‘shareholder’ costs will continue to apply and will prevent abusive behavior (see last bullet above). It should also be noted that the more lenient approach primarily relates to scaling down formalistic requirements for routine services (i.e. low risk service transactions from BEPS perspective), which can adequately be counterbalanced by

stricter requirements for high value-added services (i.e. services rendered by top management). The economic benefit of these high value-added services, including those related to intangibles, is sometimes of a more indirect nature and not as intuitive. Often the respective transfer prices are not based on the cost-plus method and will require a more refined analysis (i.e. application of a CUP). Further, as taxpayers will have to document that these services are not shareholder costs, there is no (or only a limited) “additional” administrative burden.

2. *Drawing a distinction between: (i) activities which do or do not benefit the local affiliates; (ii) benefits that purely arise from group membership and those that arise from a deliberate concerted action; and (iii) shareholder activities and stewardship activities.*

The existing guidance on shareholder activities can generally be considered sufficient. Revisions should be focused on further clarifying that shareholder activities are a (much) narrower concept compared to stewardship activities – as already stated in paragraph 7.9.

A substantial share of the questions regarding the benefit as well as the delineation between shareholder and stewardship activities will be resolved by analyzing the functions performed by the respective management personnel. For these high-value added services, it seems appropriate that the taxpayer should compile a refined analysis and documentation (see above), while the burden of proof should remain clearly with the tax authorities.

When looking at the benefits that purely arise from group membership it would be worthwhile to extend the existing guidance by specifically clarifying the implementation for financial services.

3. Identifying in practice duplicated activities;

The existing guidance on duplicative activities can generally be considered sufficient.

If the respective guidance is revised at all, we recommend relegating the guidance on duplicated activities to a sub-section of demonstrating that a service has been rendered. If there were genuine duplicated services, it would be in the self-interest of the taxpayer to eliminate these zero value-adding services as soon as possible, instead of subsidizing inefficient centralized structures. As is clearly recognized in the introduction of chapter VII (paragraph 7.2), “*It is not in the interest of a MNE group to incur costs unnecessarily, and it is in the interest of MNE groups to provide intra-group services efficiently.*”

In other words, duplicative activities do not seem to be a systemic transfer pricing issue from a BEPS perspective. Hence, there seems to be no reason to place an additional burden on the taxpayer (i.e. the general benefit test must be sufficient) or to equip tax authorities with additional powers (i.e. who must continue bear the burden of proof).

Naturally, the adequate delineation of transactions would continue to apply (paragraph 7.27). Here additional guidance in relation to the delineation and evaluation of high value-added

services in integrated value-chains would be sensible (see also below). In the spirit of practical application of the guidelines, we would recommend addressing the effectiveness of a comprehensive functional and risk analysis in determining that intra-group services are different, additional, or complementary as opposed to duplicate as well as for delineation of transactions.

4. Finding an appropriate allocation key for charging intra-group services;

The general provisions for the indirect charge method (paragraphs 7.23. et seqq.) seem to constitute an adequate basis, specifically that *“any indirect-charge method should be sensitive to the commercial features of the individual case (e.g. the allocation key makes sense under the circumstances), contain safeguards against manipulation and follow sound accounting principles, and be capable of producing charges or allocations of costs that are commensurate with the actual or reasonably expected benefits to the recipient of the service”*.

In case the revision of the guidance on determining whether a service has been provided includes an amendment of the definition of “beneficiaries” (see above, value centers sharing in the residual profits) it would be required to also provide guidance regarding the application of appropriate allocation keys.

5. Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises;

In section D (paragraphs 7.56. and 7.58 (pass-through costs)) on *low value-adding intra-group services* the costs to be included are much more clearly delineated than in the guidance relating to services not qualifying for the simplified approach for low value-adding intra-group services. We recognize that this is at least in part due to the fact that the *“simplified method is premised on the proposition that all low value-adding service costs incurred in supporting the business of MNE group members should be allocated to those members”*. However, it is our opinion that, an equably comprehensive clarification for non-low value-adding services would be beneficial.

We also strongly recommend that further clarification, including elaborating examples, be given in paragraph 7.33 with regard to adjustments to be made to the costs incurred by the group service provider to ensure reliability of the comparison of the controlled and uncontrolled transactions.

6. Assessing the arm’s length conditions for services provided in connection with the use of intangibles; services that are highly integrated with the value creation of the MNE group; and/or involve significant risks.

The most important aspect to address for high value-added services that are integrated with the value creation of the MNE, will be to provide guidance on how to evaluate the arm’s length nature of a respective service while still adequately accounting for the overall business model. A key question in this context will be whether it is helpful (required) to conduct a

separate (stand-alone) arm's length analysis, or whether the evaluation of the services should generally be embedded in a wider (aggregated) analysis, i.e. in case a profit-split (DEMPE) analysis is applied. The latter will often be a better match to the economic rationale; i.e. looking at one cohesive franchise agreement that is composed of valuable intangibles as well as complementary services rather than conducting separate evaluations for a license and a service agreement. This would also simplify the need for cost assessment and determining which costs to include in the cost base for remuneration (see above).

In addition to guidance on an appropriate delineation of the analysis, an intriguing supplementary issue to be discussed would be the identification of cases in which the valuation of these high value-added services in integrated value-chains could reasonably be based on other factors than the costs incurred by the service provider (cross-referencing paragraph 6.7.).

Closing Remarks

We hope that our above comments contain relevant input for the scoping exercise. Regarding the revision of Chapter VII, we hold it to be important to shift the focus away from restrictive anti-abuse considerations and towards enhancing the clarity of the guidance and minimizing the administrative burden for taxpayers. We have tried to indicate specific issues that can be targeted to realize a positive tradeoff. We will be happy to further elaborate on these issues in the course of the further consultation procedure.

Please do not hesitate to contact us if you have any questions.

Yours sincerely

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Submitted by e Mail to:

Reutte, 20.06.2018

Dear Sirs,

Transfer Pricing Baumgartner welcomes the opportunity to present comments regarding the future revision of Chapter IV, "Administrative Approaches to Avoiding and Resolving Transfer Pricing Disputes" of the Transfer Pricing Guidelines, and the future revision of Chapter VII "Special Considerations for Intra -Group Services", of the Transfer Pricing Guidelines.

In regard to the revision of Chapter IV:

- We welcome the initiative to revise Chapter IV. From our perspective the revised Chapter could include some basic definitions characteristics and differences between joint audits and simultaneous audits. We believe the Chapter and also the attitude of policy makers and tax administrations should be more focus on preventing disputes then solving them. It is understood, with Section D2 that simultaneous audits have a legal framework and that the implementation of simultaneous audits would not represent a conflict with local law. Unfortunately, simultaneous audits not necessarily avoid a future conflict. As referred in par. 4.91 Chapter IV of the OECD Transfer Pricing Guidelines 2017, even if no agreement between the tax administrations can be reached in the course of a simultaneous tax examination with respect to the associated enterprises transfer pricing policies, a Mutual Agreement Procedure can be requested by the associated enterprises. In the case of a Joint Audit the tax

- Administrations have to agree on the view they will take regarding associated enterprises transfer pricing. That is the corner stone for avoiding future conflicts. Therefore, even if the simultaneous audits are easier to implement they do not prevent in all cases a future conflict.
- In this order of ideas, we encourage the OECD to talk with the German and Netherland tax administration and ask them to explain how the joint audits have worked in their cases and how they have solved the legal limitations. The presented at the Joint Transfer Pricing Forum and they are quite active and successful with joint audits.
 - It would be welcome if the taxpayers would have the opportunity of requesting a joint audit, or simultaneous audit. In both processes the taxpayer should be able to at least (as already mentioned in the actual chapter IV) present its case in front of both tax administrations. The possibility of presenting a case once to both tax administrations would be a great opportunity to clarify doubts, understand the business and avoid uninformed conclusions.
 - We would like to see some future efforts to find room for a joint audits legal framework.
 - We would be interesting in having some statistics regarding simultaneous audits. In our experience most of the countries are still dealing with budget issues, lack of transfer pricing experienced personnel among other daily issues, that we doubt the simultaneous audits are highly being implemented in audit processes. Therefore, we think that the OECD should be more aggressive and not only provide recommendations or guidelines but provide tools to facilitate the implementation of measures that could (in the case of simultaneous audits) and would (in the case of joint audits) prevent double taxation conflicts.
 - The world is getting digitalized, and changing at a very fast pace, therefore the OECD ideally should be adapting itself to the new digital world. Recommendations and guidelines will soon not be enough. Additionally they need to be implemented but if the OECD proactively provides tools for the implementation the process should be much faster. We believe the OECD could provide digital tools for tax administrations to use and apply in preventing transfer pricing conflicts. For example, a platform where the tax payer and the tax administration would be able to exchange information in a secure way, have virtual meetings, access to local law from different countries and have even virtual visits to taxpayers facilities. In this context joint audits and simultaneous audits would be much faster and less expensive for everyone. We understand this requires a legal framework and a lot of work from an implementation and IT and (including security) perspective. It is our view that this job will have to be done sooner or later and countries in developing stages will have it harder in terms of implementation if the support and tools do not come from an organization like the OECD.
 - There is already a first step into this direction included in Action 14, the introduction of a platform where member states should describe the MAP process. Soon we will be running and attending audits from a totally different perspective, like the rest of our work, audits will also have to change.

- We encourage to avoid the administrative burden by setting minimum amounts in regard to transfer pricing conflicts. A taxpayer should be able to ask for a joint audit or simultaneous audit, only in the case where the transaction results relevant for the tax administrations involved.
- We admire the work of the OECD Centers outside of the central offices. They do perform a great job by training tax administrations, I know it because I used to work for the OECD Center in Mexico City. Unfortunately, this is not enough. We are constantly challenged with auditors that do not have a certain transfer pricing expertise level. In this, area the OECD could also provide virtual workshops free of charge for tax administrations and encourage the tax administrations to educate their auditors at all levels in at least basic transfer pricing issues. The higher the level of discussion between the tax administration and the taxpayer the less conflicts we will be facing in the future. We recommend the use of new technology to provide trainings and information to more auditors, regardless of where they are or what position they have.
- As a final comment we would like to see a more proactive guideline and not a description of the current state and practices of the tax administration. In a lot of paragraphs of the actual guidelines practices are described and from our perspective a best practice guideline should be developed.

Regarding Chapter VII

- We welcome the inclusion of the low value added markup threshold and would like to see more guidelines and probably thresholds for the services that are not low value services. For example, Intra group services could broadly be classified into low value added, technical services in different areas and core business services. It would be desirable to have like in the JTPF recommendation a range of mark up's on intra group services, a threshold where not only low value added services are included but also technical services with a range of possible mark ups that would make sense depending on the service. This would save MNE a lot of resources.
- We would like to express our concern regarding administrative burden in the case of documentation. For example in countries in some countries there are special rules for pro-rata expenses (monthly payments abroad), these countries establish a special regime for the acceptability of this deductions, the tax administration uses this rule to ask the tax payer for outrageous amount of information that is difficult for the taxpayer to provide in order to deny the deduction.
- Therefore we would like to see included in the guidelines what information the taxpayer should keep in its documentation to proof that the service was provided, that the service represented an economic benefit for the receiver and that the cost basis is adequate. Examples in this regard would be appreciated.

Kind Regards,

Brigitte Baumgartner

Tax Treaties, Transfer Pricing and Financial Transactions Division

OECD/Inclusive Framework

RE: Comments to “Scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines” by the Transfer Pricing Committee of the International Fiscal Association - Chapter Mexico

When reviewing our comments on “Scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines”, the following facts should be considered:

- (i) Chapter VII of the OECD Transfer Pricing Guidelines, titled “Special Considerations for Intra-Group Services”, published in July 2017.
- (ii) A large group of countries have agreed to endorse the elective simplified mechanism by 2018.
- (iii) Confirmation from other countries that the elective simplified mechanism will not lead to base-eroding payments.
- (iv) The elective simplified mechanism will entail further work in relation to a potential threshold above which said mechanism will not apply.

Consequently, our comments to the questions raised below, are limited to reflect our recommendations when analysing value added services only. It is generally understood that in the cases where low value services are analysed, taxpayers can opt for the simplified approach, thoroughly described in Chapter VII of the OECD Guidelines, and published in July 2017. Thus, no additional documentation shall be required.

With regards to value added services or high value/intangible related services please consider are comments below:

1. Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient;

The proof and evidence that the service has been effectively rendered as well as the benefits generated to the recipient, have always been two controversial points, really complicated to document. Although the simplified approach in the cases of low value services tackle those issues efficiently, in the cases of value added services these points are significantly more complicated to handle. It is our belief, that putting together an extensive information request or even a detailed checklist, the taxpayers need to consider when receiving value added services, might not be the most adequate way to document the provision of the service. Setting aside any tax aspects of the nature of the service, one must not disregard the reality of the business world taxpayers and multination operate. Digital advances, new technologies and

internet have established new ways to conduct business, according to which the physical presence of top management is not an absolute necessity any more. Top management, VPs or any personnel that provide high value services might be located in different countries, board meetings have been substituted by virtual conferences that create significant savings to the multinationals, since travelling expenses are reduced dramatically.

Consequently, any possible information list that might include copies of plane tickets, for example, is nowadays considered absolutely outdated. It is our belief that a way to demonstrate that the service has been effectively rendered is closely linked to the following two items:

- i. Each taxpayers' or multinational groups' policies to "track" the activities of their employees, including (but not limited to) the employer/employee agreement, whereby the nature of the services, scope of the employee's activities, as well as the geographies covered by the employee's role are specified.
- ii. The benefit received by the service rendered.

It is our belief that in the cases where a tangible benefit from the service can be documented, it is obvious and only logical to believe that the service has been effectively rendered. To present an example; a Mexican affiliate that received charges for high value marketing services rendered by its related party abroad, and related to the campaign of a new product, needs to prove that the service has been effectively rendered and that there was a benefit received. In best case scenario, the marketing campaign (videos, marketing material, TV ads among others) were produced abroad and were only translated in the local language; in which case, providing evidence that the service was rendered, might be as simple as providing evidence of the marketing materials received as well as the translation. Assuming that the campaign was successful, the benefit of those services is translated to sales of the new product and thus higher income for the taxpayer.

Nevertheless, not all cases in the business world follow this ideal path of success. There are quite a lot of marketing campaigns that have not been successful at all or that they might be a little bit successful. Consequently, the benefits of those services might be limited to cost savings and have not increased the income. The fact that there is no sales increase does not by any means suggest that the service was not rendered, nor that the service is not valuable. Marketing campaigns might fail and even if the taxpayer had hired a third party for this unsuccessful campaign, this does not mean that if the campaign does not generate the sales the taxpayer is expecting, the latter will request a refund of the marketing services it received from the third party. In this example, -of the failed marketing campaign-, there is no evidence whatsoever of the benefit of the service received; nevertheless, this does not mean that the service provider shall not charge the recipient for those services.

In summary, we feel that especially in the case of value added/intangible related services, there is no simplistic approach to follow, or a simple checklist of documents to use as guide, in order to document the fact that the service was effectively rendered and that there was a benefit related to it. If one attempted to put together said checklists, those would be easily and quickly outdated since the ways of doing business evolve constantly and the digital paperless era in which the multinationals operate is constantly thriving in trying to reduce costs related to documentation, traveling expenses, bureaucratic policies and paperwork.

Specifically in those cases, we would recommend to evaluate point 1 and 2 previously mentioned, jointly and reach a reasonable conclusion considering the nature of the taxpayer's operations, considering the fact that a benefit is not limited to incremental income, but also to cost reductions or simple cost reimbursements of the service.

2. Drawing a distinction between: (i) activities which do or do not benefit the local affiliates; (ii) benefits that purely arise from group membership and those that arise from a deliberate concerted action; and (iii) shareholder activities and stewardship activities;

We do not have additional comments to this point.

3. Identifying in practice duplicated activities;

When analysing the existence of duplicated activities/services rendered, one must first analyse two important items:

- i. The terms and conditions of the service agreements signed; and
- ii. The nature of the taxpayer's operation, the necessity of the service and the benefit generated by the service rendered.

In practice, identifying duplicated services might be quite challenging, but in light of the new BEPS obligations, whereby a DEMPE style functional analysis forms part of the Local File uploaded to the Tax Authority's systems, as well as the intercompany service agreements (in the case of Mexico), one has some solid information to initiate an analysis and evaluate whether or not duplicated activities exist within a group. Unfortunately, until today, there are no additional mechanisms in practice in order to address this issue.

4. Finding an appropriate allocation key for charging intra-group services;

We feel that when determining the appropriate allocation keys for charging intra-group services, certain flexibility should be granted, in order to capture the benefits generated by global procurement negotiations and global multinationals' strategies and initiatives. Similarly to our comments on question 1, we feel that generating a list of allocation keys for charging intra-group services, might not be the right approach to address the issue, since that list might be easily and quickly outdated considering the evolution of the digital era and the constant search of multinationals to reduce costs.

At this stage, considering that a single allocation key parameter for charging intra-group services might not be enough, we would recommend relying on the reasonableness of a combined allocation key that contemplates the following parameters:

- i. Time invested
 - ii. Benefit generated (cost reductions or incremental income)
 - iii. Rationale behind rendering a service of this nature
5. Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises;

We feel that all costs related to the provision of value added/intangible related services shall be charged out, nevertheless we understand that there are specific costs that occur only as part of delivering or supporting the provision of value added services that should not be included in the markup base. Luckily enough, those types of costs, specifically incurred when providing value added/intangible related services, are easily identified and usually relate to the actual act of delivering the service, such as, for example travelling expenses of management teams and third party expenses that might relate to worldwide launching events, among others. We feel that those types of expenses that, in a way, support the provision of value added services, but are not transformed or otherwise “modified” throughout the provision of the service, shall not be included in the cost base.

6. Assessing the arm’s length conditions for services provided in connection with the use of intangibles; services that are highly integrated with the value creation of the MNE group; and/or involve significant risks.

We feel that this point should be reviewed and thoroughly analysed along with the comments provided on Profit Splits, since in light of BEPS, the majority of those types of transactions are deemed to be analysed through the application of a Profit Split. Those services may include, -but are not limited to-, financial services transactions (including but not limited to brokerage institutions), highly integrated consumer product manufacturers that operate in specific geographies and luxury goods manufacturers among others.

June 20, 2018

VIA E-MAIL – TransferPricing@oecd.org

Mr. Pascal Saint-Amans, Director
Centre for Tax Policy and Administration
Organisation for International Co-operation and Development
2 rue André Pascal
75116 Paris
France

**Re: Treaty Policy Working Group Comments on Future Amendments to
Chapter VII of the OECD Transfer Pricing Guidelines**

Dear Mr. Saint-Amans,

We are writing to share the comments of the Treaty Policy Working Group (“TPWG”) on the OECD’s recent invitation for public comments regarding future revisions to Chapter VII of the Transfer Pricing Guidelines (“TPG”) pertaining to intra-group services, particularly comments related to the practical implementation of intra-group service charges.

The TPWG is an informal association of large global companies that represent a spectrum of industry sectors.¹ The TPWG has been working since 2005 with the OECD and since 2010 with the UN to analyze proposals and provide constructive comments on tax policy and administration concerns regarding transfer pricing and other issues. The development of a broad international consensus that minimizes tax uncertainty, prevents double taxation, avoids interpretive disputes, and reduces compliance burdens is critical to the ability of our member companies to create growth and employment through international trade and investment around the world.

With the globalization of business, the volume of intra-group services transactions has increased, elevating the importance of transfer pricing of these services for taxpayers and tax authorities alike. For many years, and continuing to the present day, taxpayers have experienced persistent challenges from tax authorities related

¹ The membership of the Treaty Policy Working Group is currently comprised of the following companies: Amazon.com, Inc.; BP plc; Cisco Systems, Inc.; Microsoft Corporation; Procter & Gamble Co.; Salesforce.com Inc.; and Tupperware Brands Corporation.

to intra-group service charges. The number and difficulty of these audits is disproportionately high, relative to the magnitude of the deductions at issue in any particular jurisdiction in any particular tax year. In particular, intra-group charges for centralized services that benefit many affiliates are under constant attack. In addition, the inconsistency of approaches applied by various tax authorities to this issue results in irreconcilable positions, denial of deductions, and double taxation. While MAPs and APAs are sometimes available to relieve double taxation, not all issues taxpayers encounter in this area are eligible, many of the issues are ultimately multijurisdictional in nature, and such proceedings place an undue burden on the treaty partners located in headquarters jurisdictions, which are the source of most intra-group service charges.

At one level, it is apparent that the tax community has heard these messages, because we see and appreciate the efforts that have been made by the OECD, the US Treasury, the EUJTPF, and others to try to provide more definition and guidance around intra-group services. However, on the ground in the local jurisdictions where the price for intra-group services must be paid, taxpayers find the available guidance provides little relief in practice. It is the experience of TPWG members that many tax authorities persist in challenging a wide range of intra-group service charges, questioning whether a service was rendered, whether the local affiliate benefited from the service, which costs should be included in the pool associated with the service, whether the costs were allocated appropriately, and what the level of mark-up, if any, should be. In addition, certain tax authorities, including OECD members, have issued domestic guidance that effectively conflicts with OECD guidance, creating and amplifying disputes.

As a result, even after all the work that has been done, intra-group services is an area that commonly results in contentious disputes and double taxation. Moreover, the available mechanisms to resolve disputes – principally MAPs and APAs – are often not effective channels for resolution, particularly for centralized services that benefit multiple affiliates in an MNE. In our view, it is not a lack of guidance, *per se*, that creates the level of dispute and controversy; instead, it is that tax authorities do not apply the existing guidance. We believe the issues arise at the country level, and given that the OECD has no legal ability to require consistent application of its guidance in practice, the TPWG recommends a different approach. The proposition we offer for consideration is to create a series of requirements that, if followed by taxpayers, would grant a presumption that the taxpayer's intra-group services charges are arm's length.

Taxpayer Experience

Taxpayers continue to face significant barriers in obtaining local country deductions for intra-group service charges. To provide further context for our comments, here are a few examples of situations taxpayers encounter on a regular basis:

- In Mexico, the SAT routinely disallows a deduction for intra-group service charges if they are derived based on allocating a portion of a cost pool to the Mexico affiliate. While official guidance issued by SAT provides a list of circumstances, evidence and documentation that is required to support the deductibility of these charges, taxpayers

rarely can produce all the evidence required, and the deduction is denied in nearly all cases.²

- Similarly, the Canada Revenue Agency has promulgated transfer pricing guidance that directs its examiners to exclude from the intra-group service cost base certain items that are treated as non-deductible under domestic law. This guidance acknowledges that when items are excluded under provisions of domestic law, MAP procedures do not apply, and taxpayers have no recourse to avoid double taxation of the disallowed amounts.³
- This practice, and others like it applied in other jurisdictions, departs dramatically from enforcing arm's length conditions. The transfer pricing question is whether the absolute amount of the fee charged is arm's length, regardless of how mechanically the service provider may have determined the amount of the charge. The obligation to pay the fee charged arises from the single commercial transaction of the provision of service; the service provided is not simply a series of pass-through costs which may or may not be deductible depending on their individual nature.
- Some tax authorities require the taxpayer to provide invoices for the costs included in the intra-group service charge. Not only are such invoices difficult to supply many years after the charge is made, but invoices may only exist for the subset of costs that are incurred with third parties. For costs generated internally – such as employee salaries and benefits – there are typically no invoices to produce.
- Some tax authorities deny intra-group charges on the basis that the salaries of people included in the cost pool are higher than market salaries in the local jurisdiction, arguing that the local affiliate would not be willing to pay more than local salaries for the services rendered. This line of argument essentially ignores the benefits and synergies created within MNEs, which is not a valid basis for disallowing an intra-group charge.
- Notwithstanding that the TPG provide that for low value-adding services “ . . . the MNE provider of services *shall* apply a profit mark-up to all costs in the pool . . . of 5% . . . The mark-up . . . does not need to be justified by a benchmarking study”⁴ (emphasis added), the Canada Revenue Agency routinely prohibits a deduction for this 5% mark-up, taking the position that low value-adding services should have no mark-up at all.

The Existing Guidance

Current OECD guidance contains the following provisions that are intended to confirm that MNEs may charge for centralized functions as follows:

² Rule 3.3.1.27. of the Miscellaneous Tax Resolution provides the requirements for a pro rate cost-based charge to be deductible in Mexico.

³ Canada Revenue Agency *Transfer Pricing Memorandum TPM-15*, January 29, 2015. See particularly paragraphs 42-44.

⁴ OECD Final Report on BEPS Actions 8-10, “Aligning Transfer Pricing Outcomes with Value Creation,” which amended Chapter VII of the OECD Guidelines, 2015, paragraph 7.61.

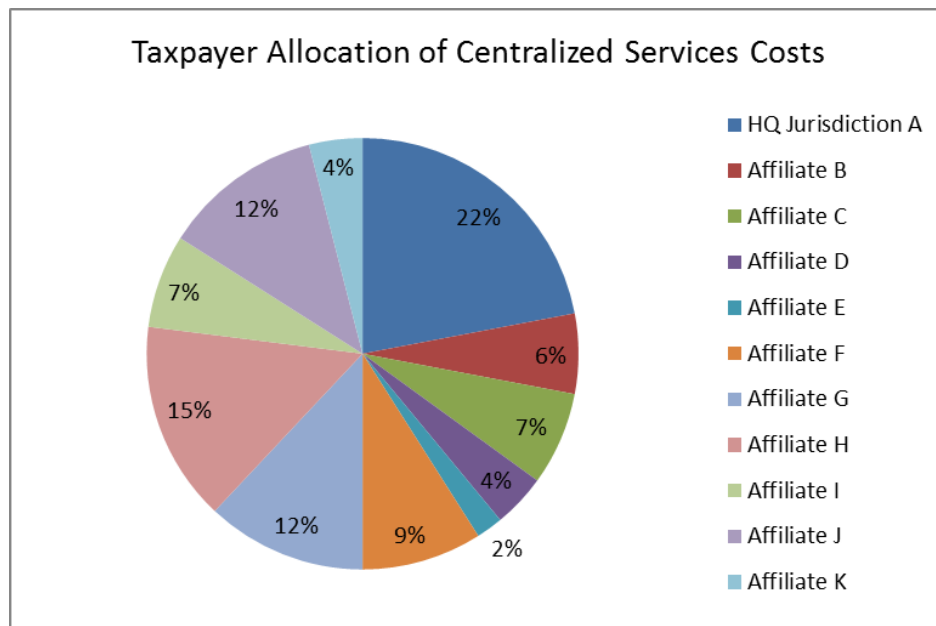
7.14 Other activities that may relate to the group as a whole are those centralized in the parent company or a group service centre (such as a regional headquarters company) and made available to the group (or multiple members thereof). The activities that are centralized depend on the kind of business and on the organizational structure of the group, but in general they may include administrative services such as planning, coordination, budgetary control, financial advice, accounting, auditing, legal, factoring, computer services; financial services such as supervision of cash flows and solvency, capital increases, loan contracts, management of interest and exchange rate risks, and refinancing; assistance in the fields of production, buying, distribution and marketing; and services in staff matters such as recruitment and training. Group service centres also often carry out order management, customer service and call centres, research and development or administer and protect intangible property for all or part of the MNE group. ***These type of activities ordinarily will be considered intra-group services because they are the type of activities that independent enterprises would have been willing to pay for or to perform for themselves.*** (emphasis added)⁵

Notwithstanding the direction that centralized functions *ordinarily* should be respected as services, taxpayers find that local country tax authorities do not ordinarily adopt this view.

A Typical Example

A classic example of intra-group services and associated charges, depicted below, relates to functions of a multinational group that are performed centrally in MNE Headquarters Country A, such as management oversight, legal, finance, treasury, and certain aspects of IT, which clearly fall within the types of services set out in TPG paragraph 7.14, and which ordinarily should be viewed as beneficial services. Corporate functions like these tend to develop and implement company-wide policies and systems that local affiliates deploy and follow. These central groups also assist local affiliates to address issues that have cross-border implications for the company. Because these functions are performed in the context of a multinational group, comparable services typically are not available in the marketplace, and/or are not easy to price based on market transactions. Thus, most companies employ a cost-based approach, whereby the Country A costs of rendering these services are measured, and these costs are awarded an arm's-length mark-up, if appropriate. The marked-up costs are then allocated across all affiliates in Countries B-K using one or more allocation factors. Commonly used factors include revenues, headcount, and square footage of occupancy, depending on the type of cost. The allocated amounts are invoiced to the 10 affiliates B-K as intra-group service charges. Typically, Country A retains some of the charges as allocable to its local operations, meaning that less than 100% of the costs are charged out to affiliates. In the illustration below, 22% of the cost pool is retained and deducted in the headquarters jurisdiction A, and 78% of the pool is charged out to affiliates around the world, according to the allocation factors applied.

⁵ OECD Final Report on BEPS Actions 8-10, "Aligning Transfer Pricing Outcomes with Value Creation," which amended Chapter VII of the OECD Guidelines, 2015.



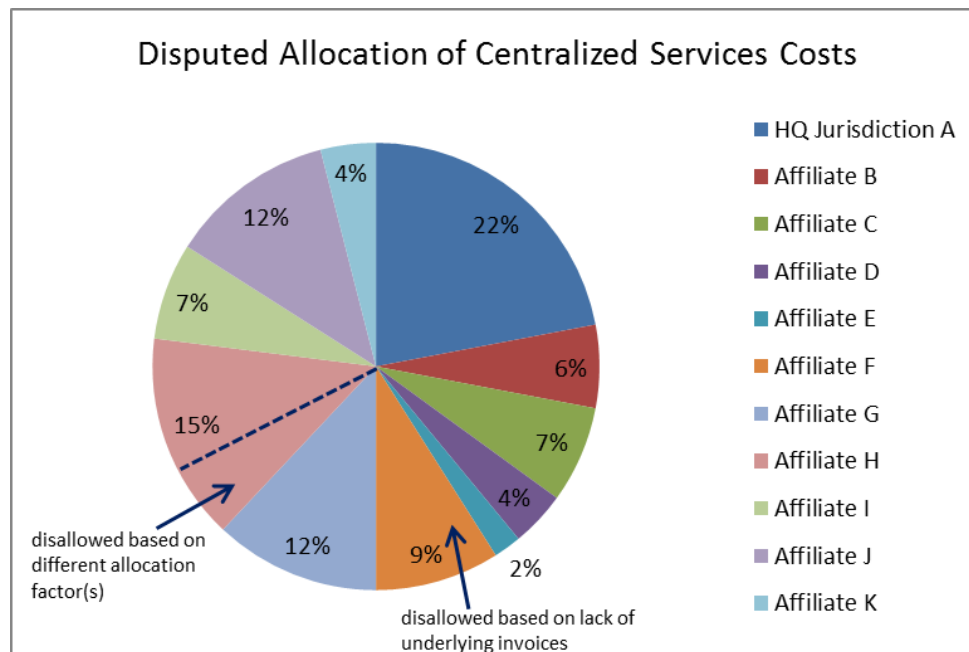
Assume that the Country F tax authority audited Affiliate F, and in the course of that audit requested the underlying invoices supporting the service charge. After an extensive search, the MNE is able to produce certain invoices that relate to third party costs, although the invoice amounts typically related to costs incurred that benefited the entire MNE, not only Affiliate F. Moreover, no invoices exist for the salaries of Country A employees who perform a wide range of services that benefit the entire MNE organization. After several years of work by the MNE to try to satisfy the Country F tax authorities, the authorities ultimately disallow the entire intra-group service charge.

At this point, the MNE faces two choices: accept the double taxation that results from the denial of the deduction, or attempt to resolve the dispute through a MAP. Of course, MAPs are limited to treaty partners, and depending on the jurisdiction, no treaty may exist between Country A and Country F. Even if a treaty exists, the MNE will have to invest more time and resources to pursue the case, in hope (but with no guarantee) of a resolution of the double taxation.

Imagine that for the same tax year, the tax authority in Country H audits the intra-group service charge and ultimately disallows a portion of the charge based on the application of a different allocation factor that results in a smaller allocation to Country H. After investing time and resources in this local dispute, the MNE then must choose among the following approaches:

- (1) consider whether a reallocation of the denied amount among Country A and all the other affiliates is appropriate, although a reallocation ordinarily will not be successful in practice because the tax authorities in the other jurisdictions will argue that the extra charge did not provide a benefit, and cannot be deducted;

- (2) pursue a MAP, if available between Country H and Country A; or
- (3) accept the double taxation arising from the denied deduction.



With numerous simultaneous challenges by different tax authorities in multiple tax years, it is clear that the level of investment MNEs must make in defending what “ordinarily” should be respected as a valid intra-group service charge is substantial. What is particularly frustrating is that these service charges normally are not as significant in magnitude as other intercompany transactions (involving tangible property, intangible property, etc.), and yet they consume a disproportionate amount of local and global resources to implement and defend. They also likely consume a disproportionate amount of tax authority resources that could be better spent on auditing and analyzing the more critical intercompany transactions.

The fact that some tax administrations apply different and more rigorous standards to support a deduction for intercompany service charges has a corrosive effect on the fair allocation of these costs among group companies. Uneven audit requirements create incentives (whether consciously expressed or not) for a group to tend to overallocate costs to jurisdictions which apply fairer and more transparent audit standards, in order to avoid the inevitable double taxation that arises when deductions for allocated costs are denied. This is not appropriate as an international tax policy matter, and is unfair to those jurisdictions which apply more reasonable audit practices. This discriminatory effect against the more reasonable jurisdictions can be alleviated through applying our proposals consistently across all jurisdictions.

The Inadequacy of Existing Mechanisms

With the examples above, it is also evident why MAPs and APAs are not mechanisms that are well-suited to resolving or preventing disputes. Most intra-group service charges for centralized functions are charged to multiple affiliates across the group, making the APA and MAP processes, which are typically bilateral exercises, inadequate to the task. Even if Country C and Country A can agree on the intra-group service charge through a MAP or APA, that agreement has no bearing on all the other affiliates. In a setting where three or more jurisdictions (and often dozens of legal entities in dozens of jurisdictions) are involved, unless all affiliate jurisdictions agree to the same cost pool and allocation regime, some portion of the services cost pool will fall through the cracks, and result in double taxation.

TPWG Proposal

TPWG members believe that controversy in the area of intra-group services would be substantially reduced if, in appropriate circumstances, taxpayers were afforded the presumption that benefits are provided to local affiliates by these kinds of centralized functions and that a charge based on an allocation of costs is an arm's-length charge. We believe that providing this presumption would merely clarify the position the OECD already has articulated in the TPG.

In order to secure this presumption, TPWG appreciates that tax authorities would require taxpayers to apply approaches that are well-documented, easily audited, and not easily manipulated. Accordingly, it might be appropriate to specify parameters, such as:

- Limit the services to those articulated in paragraph 7.14;
- Apply only specified allocation factors, demonstrate that these factors are consistently applied across all relevant affiliates, and document that 100% of costs in the pool are accounted for through this allocation process.
- Offer tax authorities transparency as to the composition of the cost pool, based on the existing accounting records, the application of the allocation factors, and the reconciliation of the intra-group charges to the total cost pool.
- Limit the mark-up applied to part or whole of the cost base to 10%, based on appropriate benchmarking support.

This approach would essentially create a “safe harbor” for the centralized services articulated in paragraph 7.14, which would build upon the framework created for low value-adding services. This safe harbor would be carefully defined, so as to avoid any opportunity for taxpayers to artificially increase the pool of services to be allocated under the safe harbor

* * * * *

The TPWG appreciates that this suggestion is one of many that Working Party 6 will receive during this comment period. We take very seriously the request for comments related to

practical implementation of the Guidelines, and believe that something needs to be done to strengthen implementation of the TPG, particularly with regard to intra-group charges for centralized functions.

We appreciate your consideration of this proposal and would be pleased to discuss it further.

Sincerely yours,

For the Treaty Policy Working Group



Holly E. Glenn

Baker & McKenzie Consulting LLC



Gary D. Sprague



Carol A. Dunahoo

Scoping of the future revision of Chapter VII of the Transfer Pricing Guidelines on "Special Considerations for Intra-Group Services".

With respect to the issues raised in the "Invitation for Public Comments", published on 9 May 2018, Tremonti Romagnoli Piccardi e Associati appreciates the opportunity to submit the following observations and comments on the scope of the future revision of Chapter VII of the Transfer Pricing Guidelines.

1. Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient.

The demonstration that a service is rendered for the benefit of a company is always a difficult and burdensome exercise, both for the taxpayer and the tax authorities.

In order to mitigate such an onerous exercise, we suggest the evaluation of the possibility to introduce a sort of (rebuttable) presumption according to which the benefit test should in principle be met when the service is duly described within the transfer pricing documentation and, therefore, supported by a comprehensive transfer pricing analysis.

Indeed, through a complete functional analysis pursuant to Chapter I of the 2017 OECD Transfer Pricing Guidelines (hereinafter, "**TPG**"), the taxpayer should (already) be able to prove that the service was indeed rendered for the benefit of the relevant subsidiary.

As a consequence, the failure to meet the benefit test should be challenged by the tax authorities only through the re-characterization of the functional analysis.

2. Drawing a distinction between: (i) activities which do or do not benefit the local affiliates; (ii) benefits that purely arise from group membership and those that arise from a deliberate concerted action; and (iii) shareholder activities and stewardship activities.

(i) According to the TPG (see paragraph "7.6" of TPG), an intra-group service is considered to meet the "benefit test" when a "two-step" test is satisfied:

- the "inherence test", that depends *"on whether the activity provides a respective group member with economic or commercial value to enhance or maintain its business position"*; and
- the "willing to pay test", that refers to *"whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in house for itself"*.

With reference to the "inherence test", we would like to point out that the presence of an "economic/commercial" interest constitutes a general widespread principle in domestic tax legislations when evaluating the legitimacy (and consequently) the deductibility of an intra-group cost.

However, since there may be differences among tax legislations on how to evaluate and ponder the various conditions/requirements to ascertain the existence of the "economic/commercial" interest, possible mismatches could arise.

We therefore suggest including in the TPG a

broader and more comprehensive definition of "inherence", which shall preferably lead to a less formalistic and more standardized approach from the local tax administrations.

For instance, the mere connection (even potential) of the intra-group service in question with the business purpose of the recipient could be *ex se* a reliable indicator.

To this end, the TPG should invite the local administrations to adequately consider the proposed criteria in order to resolve possible uncertainties when performing the "inherence" test.

To conclude, it is our expectation that the above could finally create a level playing field and grant greater certainty to taxpayers, discouraging - for instance - the position occasionally taken by the tax administrations which tend to disallow the deductibility of the full amount of the intra-group fee-charge, without performing a thorough quantitative analysis.

In fact, in our experience some MNEs perform intra-group re-charges centrally, and the deductibility is not uniformly acknowledged at the level of the local subsidiaries.

- (ii) We consider the presence of the "incidental benefit" test provided by paragraph "B.1.4" of the TPG as substantially correct and do appreciate the distinction made by the TPG between the "passive association" benefit and the "active association" benefit (i.e. the service is deemed to be rendered only when there is the

active involvement of the shareholder¹).

However, we would like to point out that there might be cases where, even in the presence of an "active association", an intra-group service is not identifiable, since it should be evaluated whether a sufficient/adequate underlying reason exists (e.g., commercial, financial, restructuring, etc.) to justify the peculiar treatment between the related parties (such as in a parent-subsidiary context).

In this respect, some guidelines can be found in the recent decision of the European Court of Justice, C-382/16, Hornbach-Baumarkt AG, which stated that *"in a situation where the expansion of the business operations of a subsidiary requires additional capital due to the fact that it lacks sufficient equity capital, there may be commercial reasons for a parent company to agree to provide capital on non-arm's length terms"*.

In practice, according to the cited case law, the non-remuneration of the parent company guarantee provided to its foreign subsidiary (which in principle could be seen as a form of "active association") has been considered by the ECJ fairly in line with the arm's length conditions. Given this context, it would be particularly welcome the introduction of some additional guidance aimed at addressing – even by means of examples – those cases in which "active or passive association" may (or may not) lead to qualify the underlying transaction as a service, which accordingly assume a full tax relevance.

(iii) Although we agree with the view that shareholder

¹ As pointed out under paragraph "7.13", TPG, *"passive association should be distinguished from active promotion of the MNE group's attributes that positively enhances the profit-making potential of particular members of the group"*.

activities are a part of the broader group of stewardship activities, we acknowledge that it is extremely difficult to demonstrate - in an objective manner - whether the cost related to a specific service has been sustained by the shareholder for its own interest or for the benefit of its subsidiaries.

Also here, the benefit test should be conducted in a way to evaluate whether the activity of the shareholder has been carried out with the aim to increase the profits of the subsidiary or of the same shareholder (e.g. in terms of higher dividends or capital gains).

From a different perspective, one could indeed wonder if - under the "willing to pay" test - the position of the minority shareholder could be enhanced (i.e. to which extent its position could be considered a reliable "benchmark"?).

Our recommendation would be to introduce some guidance specifically expanding on the topic. In doing so, once again, we also encourage the recourse to practical examples (dealing with cases in which directorship and coordinating activities can be qualified as stewardship activities).

3. Identifying in practice duplicated activities.

We appreciate the inclusion of the so-called "duplication test" - as stated by paragraph "B.1.3." of the TPG - and we of course agree with the general principle that no intra-group service should be deemed to exist when it merely duplicates a service that another group member (or a third party service provider) is already performing for the benefit of the company.

However, in our opinion, the "duplication test" should

be seen as part of the "benefit test", rather than as a stand-alone evaluation.

Such an approach should in essence broaden the number of exceptions according to which a service should be deemed to exist even in cases of duplicated activities².

In our experience, additional situations that may be seen as exceptions can be found in the R&D field.

Examples are "genuine" cases of (apparent) duplication of activities when one related-party performs basic research functions and the other related-party carries out the applied research duties on the same project or process.

In light of the above, the integration of the cited paragraph "7.11" of TPG could be particularly appreciated.

4. Finding an appropriate allocation key for charging intra-group services.

Given the current guidance provided in paragraphs "7.25" and "7.59" of TPG on allocation keys, we consider it appropriate to include a wider list of examples related to a more extensive number of services/activities.

At least, some allocation-key examples should be provided with respect to the already comprehensive list of low value adding services under paragraph "7.49" of TPG.

If we may, we would like to propose some possible practical examples (please find below a brief list of activities and the proposed allocation keys).

² According to by paragraph "7.11" of TPG, "An exception may be where the duplication of services is only temporary... [or] is undertaken to reduce the risk of a wrong business decision".

- Finance, treasury and administration management; human resources organization: Subsidiary's Revenue/Revenue of Group.
- Planning and control; group operations and business activities; legal affairs: Relevant Employees' Working Hours/Total.
- IT service: E-mail accounts/Total.
- HR administration: Relevant Personnel Pay-slip/Total.

5. Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises; and,

Please note that we are focusing here on low value adding services, although the same considerations may be extended to standard intra group services.

Particularly, with reference to the composition of the "cost pools" set under paragraph "7.56"³ of TPG, we would like to point out that, while the identification of the so-called "direct costs" appears to be reasonably straightforward, the determination of the "indirect costs" and the "operating costs" could result in a more difficult exercise, thus subject to more discretionary decisions.

In this scenario, therefore, we would consider it appropriate to exclude the computation of the "indirect costs" and the "operating expenses" from the cost pool on which the mark-up is levied (under the assumption

³ Under paragraph "7.56" of TPG, "the costs to be pooled are the direct and indirect cost of rendering the service as well as, where relevant, the appropriate part of operating expenses (e.g. supervisory, general and administrative)".

that the mere pass-through charge-out of these latter costs could in some circumstances be more in line with the arm's length conditions).

From a slightly different standpoint, the inclusion in paragraph "7.34", TPG of some additional clarification on cases for which the non-applicability of a mark-up is legitimate (given the "pass through" feature of the relevant expense) would also be welcome.

In this further regard, if we may, we suggest highlighting that no "mark-up" is to be levied for the re-charge of services whose original cost already includes the (arm's length) remuneration of the relevant third party provider. The increase of the number of examples would also be very much appreciated.

6. Assessing the arm's length conditions for services provided in connection with the use of intangibles; services that are highly integrated with the value creation of the MNE group; and/or involve significant risks.

In relation to the assessment of the arm's length conditions for services provided in connection with the use of intangibles, it must first of all be noted that such evaluation should always be performed through an analysis conducted according to the guidelines provided under Chapter I, as integrated under Chapter VI.

Having said that, given the strict connection between the service and the intangible in question and, as a consequence, the difficulties in separating (i) the return from the services themselves, and (ii) the return from the intangible, we believe it could be appropriate to introduce some "safe-harbours" for the evaluation of the arm's conditions.

If you have questions or you would like further clarification regarding any of the points discussed above, please contact milano@virtax.it.

Respectfully submitted,

Yours sincerely,

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Barcelona, June 19th 2018

Re: OECD scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines

Dear Sirs/Madams

The OECD is seeking public comments on how the guidance in Chapter VII of the Transfer Pricing Guidelines could be revised or supplemented in order to address issues related to the practical implementation of the Transfer Pricing Guidelines in the context of the provision of intra-group services.

These comments are presented by Universitat Pompeu Fabra, Business and Economy Department, Economic Taxation Task Force (Barcelona).

Executive summary

The supply of intra-group services is one of the most common transactions within MNE Groups. The main reason behind is the optimization of internal resources taking advantage at the same time of economies of scale. However, this area usually leads to controversies between tax administrations and taxpayers what implies long and costly audits and significant compliance efforts for taxpayers.

It would be desirable to find a common standard to rely on providing for legal certainty and reducing compliance and audit costs.

Comment

1. Introduction

It is within the nature of MNE Groups the setting up of closer relationships among the members of the group as well as the optimization of their own resources. It is well-known that MNE Groups generate within themselves relevant economies of scale which the members of the group try to benefit from as much as possible in order to achieve the maximum optimization of their businesses.

Globalization and development and generalization of digital resources have led in many cases to an increase of centralized structures, specially, in terms of corporate departments that provide support and assistance to the groups' core business. At the same time, the very same factors have determined a relevant degree of geographical dispersion of some aspects of the business. There has been a progressive growth of multinational groups which have become global and have production and commercial centers all over the world.

This geographical dispersion has at the same time contributed to increase centralization of support departments. For MNE Groups having a global scope, it may not be sustainable to replicate corporate and support structures for any and all business locations. It may be far more efficient, setting up global or regional centers providing coordination and ensuring a standard application of the group's policies. This does not imply however a generalized full absence of local resources but in many cases said local resources are minimized for efficiency sake.

All the above, implies an increasingly integration of some of the group's functions and a higher interdependence of the MNE Group's entities. In this framework, intra-group services become more and more relevant what implies, from a transfer pricing point of view, an area of concern for both MNE Groups and tax administrations.

The analysis of services in terms of real supply and effectiveness for the recipient as well as the valuation of the arm's length remuneration for the same implies high compliance costs for the taxpayers in order to justify those services and their valuation as well as high administrative costs when tax administrations have to review those aspects.

In this sense, it would be desirable to find a balance between: (i) an appropriate profit allocation key among the MNE Group's entities leading to an avoidance of Base Erosion and Profit Shifting practices thus ensuring a fair and appropriate alignment of value creation and taxation; and (ii) a reasonable level of compliance burden for MNE Groups to document and provide evidence of the reality and effectiveness of the services provided within the group on a continuous basis or in the framework of tax audits.

To put it in other words, an environment of legal certainty complemented with the pursuit of a simplified approach leading to time and costs savings for both taxpayers and tax administrations would contribute to the effectiveness and reliability of the system. The effects from the elimination of conflicts in this area, both in terms of interpretation and of elimination of double taxation, cannot be neglected.

As stated in paragraph 19 of the 2017 TP Guidelines, “properly designed safe harbours can help to relieve some compliance burdens and provide taxpayers with greater certainty”. However, most taxation systems are reluctant to include safe harbours due to the inefficiencies associated to fixing an inadequate level: if too low the safe harbor ends useless, if too high allow undue tax savings.

2. Scope

Our comments herewith included are specifically addressed in connection with so called backup services, typically provided by Finance and Treasury, Legal, Tax, HR and IT departments, among others. These services may typically fall under the category of low value-adding intra group services (as described by Chapter VII of the OECD 2017 TP Guidelines), which in practice are the most commonly and frequently supplied within MNE Groups. However, we would like to point out that in many occasions, there are service supplies more closely linked to the MNE Group business, which under the OECD TP Guidelines would not qualify as low value-adding services, but which usually meet the characteristics of being of a supportive nature and are not directly connected with the revenue-earning centers (i.e. supply chain services). In our view, those services should receive the same treatment as low value-adding services. Alternatively, the concept of low value-adding services should be reviewed to include other type of supportive services even though linked to the MNE Group business.

We cannot disregard that in practice we can also find complex and quantitatively relevant services involving valuable intangibles or leading to future profit earning activities but we must acknowledge that these are not the most common situations and consider that they may need a separate approach.

3. Simplification measures analysis

With regard to the intra-group services referred to above, it should be desirable to simplify the justification process for MNE Groups avoiding at the same time substantive compliance costs which contribute little value if any to the group, abuse situations which ensure a fair tax collection for the tax administrations involved without compelling them to complex and time-consuming investigations, for both the administration and the taxpayer.

Considering the TP Guidelines recommendations for a transfer pricing analysis, the functional analysis, when properly done, should provide sufficient evidence as to the actual supply of the service and to the need and effective use of said service by the recipients. This proves, however, insufficient in practice as in many cases it is difficult for the taxpayer to demonstrate the inexistence of duplicated services (in the event a minimum infrastructure is kept at the local service recipient entities) and generally does not satisfactorily provide evidence in connection with the incidental benefits test. This trend increases with the new technologies applied on the supply of these services which reduces traces and generates subtle efficiencies. Furthermore, a proper economic analysis should be additionally carried out in order to determine whether the service consideration has been agreed upon at arm's length conditions.

Therefore, the traditional transfer pricing approach to outline and value intra-group transactions does not seem to provide the pursued simplified approach.

Transfer pricing literature shows the same concern as to finding the balance between “available resources, compliance burden and potential level of adjustment” suggesting “alternative approaches that will achieve an appropriate level of confidence that the arm's length principle has been applied”.

Taking as starting point some critical assumptions, experts propose some mechanisms to simplify the analysis of intra-group service supplies in order to “maintain a balance between the level of information requested, the low risk nature of the services addressed and the potential compliance burden”. From the proposed mechanisms, the following could be outlined as they could help to build a simplified approach:

- ✓ Sanity checks providing for a contextualization of the provision of services with the MNE Group's activity, such as requesting indicative ratios: e.g. costs incurred for the intra-group services compared to overall operating expenses or the level of the intra-group service supply turnover over the total turnover). This proposal could be further analyzed in order to build safe harbour schemes considering the MNE Group's economic activity as well as the specific circumstances of the recipient entities (e.g. newly created entities may be in need of highly intensive services within the first years of activity even though their turnover keeps still at low levels).
- ✓ Explaining service provisions within the overall context of the MNE Group taking into account economies of scale and the degree of integration and centralization of the activities within the Group.

Based on a Guttman scale, we could try to find an overall indicator which could help us to achieve the desired simplification on the services analysis. This could be the application of the TNMM method to assess the valuation of the company's transactions. When a company determines the correct application of transfer prices of other main intra-group transactions through a net margin indicator, that would imply that any other type of cost item charged would have no relevancy as in the end, only compliance with the comparable net margin level will have to be considered.

This would be the case of single activity entities within the MNE Group exclusively or mainly dealing in their commercial relationships with other members of the Group. Risk isolation and geographical dispersion grounds may lead to have separate entities for a single economic activity. In this framework, we may commonly find within MNE Groups, members only dealing with production which clients are exclusively or mostly other MNE or commercial entities being procured by other group entities. In those cases, and when the entities concerned use a net margin indicator to value their core business transactions with the group, valuation of services would lose relevance.

In group structures presenting the features referred to above, the use of net margin indicators as main valuation method of the core business transactions could be a helpful method to achieve a simplified approach with regard to intra-group services scrutinization. (Depending on the circumstances and when other valuation methods apply, net margin indicators could also be used as sanity-check methods to evaluate the real impact of intra-group services in the entity's global activity).

A way to simplify this costly audit of intra-group services would relate to the application of variance analysis, which has been proved to be effective in many other public finance domains such as health or education. This analysis results from a systemic and comprehensive analysis of the information about a group of empirical researches results that analyze the same problem, to reach a synergic result -relevant knowledge- and generalizable conclusions, also to optimize the cognitive, investigative and making-decision processes through quantitative and qualitative methods.

OECD would in our view be in a position to promote identifying a set of indicators based on empirical researches results able to conclude whether good practices and reasonable processes have been put in place because meeting the indicator necessarily means that a reasonable intra-group service policy has been implemented by an MNE.

Thus both taxpayers and tax auditors would have a common standard to rely on, slightly more sophisticated than safe harbours, reducing compliance and audit costs. Those indicators if met (or not) would qualify the intra-group service as a reasonable (or unacceptable) standard. These indicators might require a specific industry segmentation, but not necessarily.



Please do not hesitate to contact us, should you wish to discuss any of the issues herewith addressed.

Yours sincerely,

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A handwritten signature in black ink, appearing to be 'Guillem López Casasnovas', written over a horizontal line.

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By email to: TransferPricing@oecd.org

Vienna, June 18, 2018

Subject: Comments on the Scoping of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines

Dear Mr. VanderWolk,

First of all, we would like to congratulate the OECD for work done on the transfer pricing matters under the OECD/G20 BEPS Project and the release of the 2017 OECD Transfer Pricing Guidelines.

We are happy that the OECD now takes a step forward seeking to further improve Chapter VII (intra-group services) of the Transfer Pricing Guidelines and we are grateful for the opportunity to provide comments. We hope that our suggestions can provide valuable inputs for the revision (or future revisions) of Chapter VII of the Transfer Pricing Guidelines.

1. Introduction

Overall, transfer pricing as one cohesive topic has presented remarkable progress after the development of the OECD/G20 BEPS Project. Concerning intra-group services, the highlight as a result of the OECD/G20 BEPS Project is the inclusion of an elective and simplified approach for low value-adding services (LVAS). Nevertheless, given the development in other transfer pricing aspects and the controversy this topic has presented for many years, there is still room for improvement and further alignment of this topic with the guidance under the BEPS Actions 8-10. Therefore, we would like to take this opportunity to provide our comments on Chapter VII of the Transfer Pricing Guidelines. Our comments to a great extent rely on our research on this topic and the debates we have during our regular seminars and conferences.¹

Our comments are of a general nature (see section 2, below), as well as referring to the specific aspects when dealing with the transfer pricing aspects of intra-group services (see section 3, below).

¹ Among many others, see Peng, X., "Chapter 9: Transfer Pricing and Intra-Group Services (including Safe Harbours)", in: Lang, M., Storck, A., Petrucci, R., Cottani, G., Fundamentals of Transfer Pricing, *forthcoming*.

2. General comments

This section contains general comments with respect to the structure and the scope of Chapter VII of intra-group services.

2.1. The structure of Chapter VII should reflect the new 4-step transfer pricing analysis

The latest version of the Transfer Pricing Guidelines has added substantial weight to the accurate delineation of the actual transactions before finally establishing a transfer price in a transfer pricing analysis. As a manifestation of the strong emphasis on the substance of an intra-group transaction, the application of the arm's length principle is to be exercised through the new 4-step transfer pricing analysis. The new 4-step transfer pricing analysis consists of: (1) identification of the commercial or financial relations,² (2) recognition of the accurately delineated transaction,³ (3) selection of the transfer pricing method,⁴ and (4) application of the transfer pricing method.⁵

In the context of an MNE a large variety of transactions exists within the group, such as services (in all variations), sales and purchases, business restructurings, intangibles, financing activities, etc. Nevertheless, the arm's length principle and the new 4-step transfer pricing analysis applies equally to all types of transactions. In recognition of the inherent nature of different types of intra-group transactions, the new 4-step transfer pricing analysis, however, needs a few adaptations in the practical application of the different types of transactions.

Therefore, it is first suggested that the structure of Chapter VII should at least expressly reflect the new 4-step transfer pricing analysis. This structural revision, in our opinion, is necessary in that it recognizes and underscores the add-on of the "substance over form" approach compared with the previous transfer pricing concept. Besides, by integrating the new 4-step transfer pricing analysis derived from Chapter I and II into the structure of Chapter VII, the Transfer Pricing Guidelines will be seen as a more consistent and cohesive piece of work.

In more detail, the OECD may consider amending the structure of "B. Main issues" of Chapter VII of the 2017 Transfer Pricing Guidelines by replacing it with a new structure consisting of the new 4-step transfer pricing analysis. On the other hand, the "B. Main issues" has identified two main issues in the transfer pricing aspect of intra-group services and they are: (1) whether intra-group services have in fact been provided; and (2) what the intra-group charge for such services for tax purposes should be in accordance with the arm's length principle.⁶ The two main issues remain their relevance and significance to the topic. Indeed, the new structure echoes these two main issues. Steps 1 and 2 in the 4-step transfer pricing analysis ultimately answers the first main issue, i.e. whether any compensation for the tested transaction can be chargeable/deductible, while steps 3 and 4 are aimed at the second main issue, i.e., the determination of the arm's length charge of the intra-group services.

2.2. The scope of Chapter VII should include the classification of "management and administrative services" (or LVAS) vs. "core services"

As rightly pointed out in the current OECD Transfer Pricing Guidelines, MNEs can arrange intra-group services in a very wide scope and variety.⁷ As a matter of fact, intra-group

² Section D.1. of Chapter I of the 2017 OECD Transfer Pricing Guidelines.

³ Section D.2. of Chapter I of the 2017 OECD Transfer Pricing Guidelines.

⁴ Part I of Chapter II of the 2017 OECD Transfer Pricing Guidelines.

⁵ Part II and III of Chapter II of the 2017 OECD Transfer Pricing Guidelines.

⁶ Para. 7.5 of the 2017 OECD Transfer Pricing Guidelines.

⁷ Para. 7.2 of the 2017 OECD Transfer Pricing Guidelines.

services could be classified in quite a few ways, for example based on the functionality of intra-group services, how intra-group services are structured, the link to the “core” activities, the availability of intra-group services in the external market and so on. However, it is suggested that the OECD officially recognize the classification of “management and administrative services” vis-à-vis “core services” for the direct interest of a transfer pricing analysis.

So far, there are no prescribed or official definitions available for “management and administrative services” and “core services” across the international and regional guidance. However, it is commonly understood in the field of transfer pricing that “management and administrative services” and “core services” are two opposite concepts. On the one hand, “management and administrative services” refer to those that by nature are routine and supportive but essential and important for a successful daily operation of an MNE. They normally include services of an administrative, technical, financial, and commercial nature. On the other hand, “core services” are usually associated with an MNE’s core business and are utilized to maintain or enhance the MNE’s profitability, viability, or market position. As a further observation, “management and administrative services” usually deserve a low profit margin while “core services” could provide a relative high margin in contrast. The OECD, while delineating the elective and simplified approach on LVAS provides very useful guidance, which can be used to draw the line between “management and administrative services” and “core services”. In practical terms, those services qualified as LVAS are typical “management and administrative services”.⁸ Likewise, those services that fall outside the scope of LVAS as they are outlined by the OECD are typically “core services” in practice, including research and development services; manufacturing and production services; sales, marketing and distribution activities; financial transactions; extraction, exploration, or processing of natural resources; insurance and reinsurance; and services of corporate senior management.⁹ In this regard, the requirements defined in para. 7.45 of the current guidance are of key relevance.

Moreover, it would be useful to explicitly specify in Chapter VII that, when a service does not fall into the category of, in our view broader defined LVAS, it does not necessary fall into the category of “core services” or requires higher returns.¹⁰

Furthermore, an explicit recognition of the classification between “management and administrative service” and “core service” in Chapter VII would be beneficial for a clear, logical and sound performance of an analysis on transfer pricing aspects of intra-group services. The reason is that the practical application of the arm’s length principle differentiates depending on which category the concerned service belongs to. It typically has a major influence on the content and exercise of the benefit test and the pricing determination, both of which are essential to the two abovementioned main issues of this topic.

For “core services” in a group, it is often not necessary to document the benefit test to confirm that such activities have conferred benefits to the group. Being part of the core activities of the group, the benefits appear obvious. However, for “management and administrative services”, the benefits to the group are often not immediately identifiable because such services are routine, auxiliary to the group as a whole and multiple services within the category are often provided through a single contract. For that reason, the benefit test is therefore of importance in order to defend their chargeability (and deductibility). Besides, “management and administrative services” are often suspicious with regard to the non-chargeable shareholder activities. As a result, it again requires a proper and detailed documentation regarding whether the recipient economically or commercially benefits from the concerned activities and whether an independent entity would be willing to pay for or perform such in-house activities.

⁸ For a full list of qualified service items, please see para. 7.49 of the 2017 OECD Transfer Pricing Guidelines.

⁹ Para. 7.47 of the 2017 OECD Transfer Pricing Guidelines.

¹⁰ Para. 7.48 of the 2017 OECD Transfer Pricing Guidelines.

For intra-group services, the transfer pricing method typically and most widely applied is the cost plus method or the transactional net margin method (on a net cost basis) when the comparable uncontrolled price method is not applicable. That would work when it comes to both the majority of “management and administrative services” and “core services”. However, the assessment of “core services” in the form of functions performed, risks assumed and assets used may justify higher margins or even the application of the profit split method, when the specific case requires the application of this method in practice. However, such pricing methodologies will never be used for “management and administrative services”.

As a further comment from a more structural perspective, the OECD may consider merging “management and administrative services” within the category of LVAS, since practically speaking they share the same scope. As a result, the OECD’s elective and simplified approach on LVAS would apply to “management and administrative services”, including *inter alia* a simplified benefit test based on categories and a fixed mark-up of 5% as rebuttable safe harbor. Moreover, “core services” themselves deserve a separate discussion in Chapter VII, distinguishing from “management and administrative services” (or LVAS). In particular, such separate discussion should establish a proper link with other relevant Chapters in the Transfer Pricing Guidelines, for example research and development services to Chapter VI (intangibles).

3. Specific comments

This section intends to deal with the practical challenges that have been outlined by the OECD.

3.1. Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient.

As explained in the previous section, the benefit test might be more difficult to assess for “management and administrative services” (or LVAS) than for “core services”. However, those “management and administrative services” are normally featured with low risks and low value-adding and therefore low profit margins (around 5% based on common practice). Hence, it is expected that resources that taxpayers and tax authorities employed to deal with those services should be deployed in an efficient and proportionate way. In other words, such benefit test has to be balanced and is supposed to give tax authorities sufficient confidence that the intra-group services were carried out in an arm’s length manner by conferring benefits to the recipient, but at the same time it should not be too burdensome for the taxpayers to prepare.

It is therefore suggested to use the simplified benefit test as a general consensus, also given the experience of the OECD’s approach on LVAS. Using the concept of the simplified benefit test, the services should be assessed on categories together with service descriptions that are necessarily detailed. In particular, the service description should clarify at what level and in what functional context the concerned services are provided, for example at global or regional level. When it comes to “management and administrative services” provided at the group or regional level for example, it is usually not possible to provide incontrovertible evidence establishing a direct link between the service recipient and the benefits that a specific service provides. In that case, an indirect charging method has to be used in practice. Hence taxpayers should not be challenged for using the indirect charging method, or they should not be required to apply with priority a direct charging method (based on time sheets for example). The direct charging method in such cases would not only be very burdensome and complex to implement, it does not reflect the very nature of the respective services (for example service by global management or group functional teams).

Furthermore, the benefit test should fairly consider two sides of the intra-group service. It should reflect not only that the service has been rendered from the perspective of the provider, but also that the service provides economic or commercial value to enhance its commercial position and the recipient would have paid for the activity or else performed the service itself from the perspective of the recipient. Accordingly, the supporting documents may include “acts of acceptance” from the service recipient confirming their acceptance and receipt of the concerned services, in addition to the existence of service agreements.

3.2. Drawing a distinction between: (i) activities which do or do not benefit the local affiliates; (ii) benefits that purely arise from group membership and those that arise from a deliberate concerted action; and (iii) shareholder activities and stewardship activities.

First of all, the three aspects listed call for clear distinctions, which would be very much appreciated and very relevant to the practice. As a general comment, the OECD is greatly encouraged to add more examples, especially on the last two topics, in the coming revision to provide more certainty and clarity. Below, we present our views on these specific topics.

Concerning whether certain activities benefit the local affiliates, it is rather easy to identify and confirm if such activities are exercised through direct contracts and being part of a measurable/controllable value chain, and it usually happens to “core services”. However, benefits to the local entities are usually less readily identifiable in the case of “management and administrative services” where multiple services in packages are provided through often one contract to multiple entities. However, the assessment of the benefits should not turn out to be an exhaustive test for taxpayers when those services are not priced with high margins and do not involve high risks. Instead, as long as the taxpayers properly delineate the service with certain descriptions and the scope of the services for the identification of beneficiaries in the simplified benefit test with no obviously absurd and incorrect information and appropriate costs are allocated consistently, the outcome should not be easily challenged by tax authorities (also see our comments in section 3.1.).

As has been rightly documented by the OECD, group synergies can be divided into two categories, i.e. the passive association or incidental benefits (passive group synergies) and synergies arising from deliberate concerted group actions (active group synergies). Depending on the type of synergies, the treatment in transfer pricing varies.¹¹ As an advancement to the OECD’s guidance, the two types of group synergies are distinct in certain ways. “*[Active group synergies] are derived from the additive effect of the group, while passive association comes from the spill-over effect of a ‘stronger’ group member. Furthermore, [active group synergies] are expected to bring surplus profits to the entire group, and one group member is to be remunerated for a share of [active group synergies] only if it performs deliberate concerted group actions. However, passive association describes non-excludable benefits at the entity level, and such benefits are always a result of a unilateral offer by third parties.*”¹²

Shareholder activities are non-chargeable. By referring to activities performed solely for the ownership interest, it is rather clear that they usually cover activities related to the juridical

¹¹ For more details, see section D.8. of Chapter I and para. 7.13 of the 2017 OECD Transfer Pricing Guidelines.

¹² Peng, X., *The Application of the Arm’s Length Principle to the Allocation of Joint Efficiencies within MNEs*, 23 International Transfer Pricing Journal 5 (2016), 382. For a more detailed comparison, see section 2.1. of this article; for a discussion of practical application, see section 3 of this article.

set up of the parent company, costs relating to the reporting, legal or regulatory requirements of the parent company, costs of raising funds for the parent company acquiring participation, managerial and control activities for senior management and protection of the investments and others related to the investor relations etc.¹³ However, some activities within those categories turn out to benefit subsidiaries also and those in broad terms are stewardship activities.¹⁴ For example, board members or senior executives with their statutory duties may in smaller MNE well perform activities beneficial to the operation of subsidiaries (e.g. making long-term business strategies, participating in day-to-day management of subsidiaries) so that only part of costs incurred are shareholder costs.¹⁵ Another example would be the use of group selected accounting standards (such as IFRS or USGAAP) and the consolidation of financial statement of the group, which may well help certain subsidiaries to fulfil their local filing requirements.¹⁶ In that sense, only a portion of the costs are related to shareholder activities. This would also apply if the whole operational management is based on such accounting rules. Therefore, it is highly recommended that the OECD should provide more examples to increase certainty and predictability in order to identify shareholder activities. In that context, the definition of “services of corporate senior management” also has to be made clear as these activities were excluded from LVAS.

3.3. Identifying in practice duplicated activities.

As a common understanding, duplicated activities (for example, activities that have already been performed by another party or in-house) are not chargeable because they will not create deductible business expenses. However, activities that are under the same service headings or that are seemingly the same should not be classified as duplicated activities by default. The OECD in the Transfer Pricing Guidelines has always properly underlined these points and also exceptions.¹⁷ An activity that is suspected of a duplication should be assessed based on whether additional value has been or is expected to be generated through the performance. If so, the chargeability of such activity is justified. To answer this question, it would be necessary to evaluate the nature of the activity and to what extent it benefits to enhance or maintain the commercial position of the recipient. This should be part of an accurate delineation of the actual transaction.

3.4. Finding an appropriate allocation key for charging intra-group services.

As a rule, the allocation key should be sensitive to the commercial nature of the service and should reasonably reflect the level of benefits expected to be received by the service recipient. It is also important that allocation keys are consistently applied group wide to the service recipients for the same type of services.

It is commonly acknowledged that services related to people, e.g. HR, health and safety, management development etc., should use headcount as key. Using the same logic, for IT services number of computers (or users) is relevant and for fleet management number of

¹³ Para. 7.10 of the 2017 OECD Transfer Pricing Guidelines.

¹⁴ Para. 7.9 of the 2017 OECD Transfer Pricing Guidelines.

¹⁵ EU Joint Transfer Pricing Forum, JTPF Report: Guidelines on Low Value Adding Intra-group Services (4th February 2010), DOC: JTPF/020/REV3/2009/EN, Columns 4 and 12 of Annex II.

¹⁶ EU Joint Transfer Pricing Forum, JTPF Report: Guidelines on Low Value Adding Intra-group Services (4th February 2010), DOC: JTPF/020/REV3/2009/EN, Column 8 of Annex II.

¹⁷ Para. 7.11 of the 2017 OECD Transfer Pricing Guidelines.

vehicles. In addition, turnover or value added (in terms of revenues minus purchases) are often used, e.g. for tax and accounting services etc. It would therefore be beneficial if the OECD could provide more examples of the use of allocation keys.

3.5. Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises.

In practice, for the calculation of the cost base, the actual costs that are incurred in full are often applied. This is also reflected in the OECD's approach on LVAS. However, it is still worth a discussion on whether actual costs or budgeted costs and whether a calculation based on full cost or based on operating cost is for certain activities more appropriate. For example, if a continuous stream of services exists and the difference between budgeted and actual cost is small, the budgeted cost could be used so as to avoid adjustment charges at year end. Furthermore, it would also be highly appreciated if the OECD would include additional guidance and clarifications on topics, such as which accounting standards (i.e., the group accounting or the group calculation rules), should apply when calculating the cost base, how to deal with costs related to sickness, holiday, trainings etc. and costs related to stock options, among others.

3.6. Assessing the arm's length conditions for services provided in connection with the use of intangibles; services that are highly integrated with the value creation of the MNE group; and/or involve significant risks.

As mentioned in previous comments, "management and administrative services" should be expressly distinguished from "core services" due to their different requirements on the benefit test and on the pricing issues. In particular, "core services" should be discussed in a separate subchapter in order to highlight the differences. For example, contract R&D and marketing services should each constitute an independent section, including the new guidance on transfer pricing aspects of intangibles (and the relevance of the DEMPE analysis). Moreover, topics like location savings (it may have a significant influence on the calculation of the cost basis) and highly integrated services (e.g. what services are highly integrated) and financial services (i.e. financial services and the risks), also deserve more detailed explanations given how controversial and practically relevant they are. Another question that is highly disputable in practice and that therefore calls for more clarification is how to appropriately price "core services": are the cost-plus method and TNMM with a relatively high markup enough? When should the transactional profit split method apply?

4. Conclusive remarks

In general, we welcome the remarkable work the OECD has done in developing the Transfer Pricing Guidelines under the OECD/G20 BEPS Project and the initiation of further revision on the topic of intra-group services. However, we would appreciate if the described topics in our comments could be clarified in the future work of the OECD.

Yours faithfully,

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