COMMENTS RECEIVED ON PUBLIC DISCUSSION DRAFT

BEPS ACTION 10: PROPOSED MODIFICATIONS TO CHAPTER VII OF THE TRANSFER PRICING GUIDELINES RELATING TO LOW VALUE-ADDING INTRA-GROUP SERVICES

/ - January 2015
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Vicenza, 14 January 2015

By e-mail: TransferPricing@oecd.org

OBJECT: BEPS ACTION 10 Comments to proposed modification to chapter VII of the Transfer pricing Guidelines relating to low value-adding intra-group services.

Dear Sir,

We refer to OECD’s request for input on Action BEPS 10: Proposed modifications to chapter VII of the transfer pricing guidelines relating to low value-adding intra-group (Draft) published on November 2014 on which public comments are expected by 14 January 2015.

We are pleased to bring to your attention our observations, comments and possible suggestions to the above-mentioned Draft. In the following pages we would like to offer some general remarks on the draft as well as our point of view on certain selected topics with specific reference to paragraph from 7.45 to 7.61.

ADACTA STUDIO ASSOCIATO is a tax legal consulting firm based in Veneto (Italy) one of the largest accounting associations in Italy outside the Big Four. Our focus is advising large family businesses and small to medium enterprises. We are interested in attending the public consultation to be hold on 19-20 March 2015.

Yours sincerely

dott. Paolo De Muri

The author wish to thank his colleagues Sonia Parolin for her contribution to the preparation of our comments and Laura Xausa for the valuable work of translation.

WWW. ADACTASTUDIO.COM
The paragraph summarizes the content related to low value-adding services, anticipating its conclusions. Some parts seem to be redundant, as the specific concepts are already deeply analyzed in section A and B above. In particular it does not seem useful to stress once again that “the simplified approach […], allocates the costs of providing each category of such services to those group companies which benefit from using those services”.

Moreover, in our opinion, the choice to force the use of the mark-up for all these costs seems not to be justified, considering that the application of differentiated mark ups can be hypothesized, even with a simplified approach.

In our opinion, the introductive paragraph should contain the fundamental base principle leading to the identification to such category of costs, basically linking it to the possibility of simplification of the managing of such costs both for taxpayers and tax administration, with the optimization of the sources needed for compliance in this matter.
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| **7.46** Low value-adding intra-group services are services performed by one member or more than one member of an MNE group on behalf of one or more other group members which
  - are of a supportive nature;
  - are not part of the core business 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 and do not give rise to the creation of significant risk.

The guidance in this section is not applicable to services that would ordinarily qualify as low value-adding intra-group services where such services are rendered to unrelated customers of the members of the MNE group. In such cases it can be expected that reliable internal comparables exist and can be used for determining the arm’s length price for the intra-group services.

The following criteria could be added for the definition of low value-adding services:

- amount of costs charged in respect to the structure of the costs for the beneficiary or from another point of view the materiality of the transactions for the subjects receiving the services;
- the frequency with which a service is rendered (a one-time service versus a continuous service)

In the next paragraphs there are no mentions regarding the use of unique and valuable intangibles and regarding the assumption or control of substantial or significant risks. An example related to the two elements could be useful to improve the comprehension.
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<td>The following activities would not be considered as qualifying for the simplified approach outlined in this section:</td>
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<td>- Services constituting the core business of the MNE group;</td>
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<td>- Research and development services;</td>
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<td>- Manufacturing and production services;</td>
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<td>- Sales, marketing and distribution activities;</td>
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<td>- Financial transactions;</td>
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<td>- Extraction, exploration, or processing of natural resources;</td>
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<td>- Insurance and reinsurance;</td>
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<td>- Services of corporate senior management.</td>
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<td>The paragraph defines some categories of services which, based on their nature, cannot be treated according to the simplified approach of this section.</td>
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<td>We understand that this list of activities are an exception to the general principles included in the previous paragraph 7.46, as such services are always considered “high value-adding services&quot;.</td>
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<td>In our opinion it should be specified that this is not an exhaustive list and that only a case by case analysis allows a service to be included or not in the low value-adding services category.</td>
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<tr>
<td>Actually, some of such services are normally rendered within a MNE group, but some could also fall within such category because they could meet the requirements for the simplified approach. For example, routine commercial or production activities, operative marketing services (an exhibition organization, the translation of advertising material in the subsidiary company language), assistance in specific and non recurring financial transactions are services that in many cases could be considered low value-adding services.</td>
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<td>Finally, we suggest a minimum requirement definition of “corporate senior management&quot; to be provided, as this is a residual category which could be used for every and each category of services where contribution by a senior manager is required. On the contrary, there can be services falling within the definition of paragraph 7.46 that are performed through the activity of highly qualified personnel.</td>
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The following bullet points provide examples of services that would likely meet the definition of low value-adding services provided in 7.48:

- Accounting and auditing, for example gathering and reviewing information for use in financial statements, maintenance of accounting records, preparation of financial statements, preparation or assistance in operational and financial audits, verifying authenticity and reliability of accounting records, and assistance in the preparation of budgets through compilation of data and information gathering;
- Processing and management of accounts receivable and accounts payable, for example compilation of customer or client billing information, and credit control checking and processing;
- Human resources activities, such as:
  - staffing and recruitment, for example hiring procedures, assistance in evaluating of applicants, and selection and appointment of personnel, onboarding new employees, performance evaluation and assistance in defining careers, assistance in procedures to dismiss personnel, assistance in programmes for redundant personnel;
- training and employee development, for example development of training needs, creation of internal training and development programmes, creation of management skills and career development programme;
- remuneration services, for example, providing advice and determining policies for employee compensation and benefits such as healthcare and life insurance, stock option plans, and pension schemes, verification of attendance and timekeeping, payroll services including processing and tax compliance;

Considerations opposite to the ones mentioned in paragraph 7.47 apply. Please consider that this is just an example which should be examined based on a case by case analysis, according to the situation.

Production or commercial support services are often rendered by seconded personnel. See what included in section D.7 “Assembled workforce” of the new Chapter I of the Guidelines as reviewed by Guidance on transfer pricing aspects of intangibles. In our opinion such services should be included in the list as per paragraph 7.48, with specific reference to paragraphs 1.93 – 1.97 of Chapter I.

We think that references to the main principles included in Section A and B above should be provided, in order to clarify whether or not such principles are to be considered in the case of low value-adding services (for example: duplication, shareholder costs, as included in the following paragraph 7.52)
7.48 (continue)

- developing and monitoring of staff health procedures, safety and environmental standards relating to employment matters;
- The monitoring and compilation of data relating to health, safety, environmental and other standards regulating the business;
- Information technology services where they are not part of the principal activity of the group, for example installing, maintaining and updating IT systems used in the business, information system support (may include the information system used in connections with accounting, production, client relations, human resources and payroll, and email system), training on the use of applications of information systems as well as on the associated equipment employed to collect, process and present information, developing IT guidelines, providing telecom services, organizing IT helpdesk, implementing and maintaining of IT security systems, supporting, maintaining and supervising of IT networks (local area network, wide area network, internet);
- Internal and external communications and public relations support (but excluding specific advertising or marketing activities as well as development of underlying strategies);
- Legal services, for example general legal services performed by in-house legal counsel such as drafting and reviewing contracts, agreements and other legal documents, legal consultation and opinions, representation of the company (judicial litigation, arbitration panels, administrative procedures), legal research and legal as well as administrative work for the registration and protection of intangible property;
- Activities with regard to tax obligations, for example information gathering and preparation of tax returns (income tax, sales tax, VAT, property tax, customs and excise), making tax payments, responding to tax administrations’ audits, and giving advice on tax matters;
- General services of an administrative or clerical nature.

The example concerning the "Internal and external communications and public relations support (but excluding specific advertising or marketing activities as well as development of underlying strategies)" potentially contrasts with the generic "marketing activities" included in paragraph 7.47, thus confirming that such examples should always be contextualized.

Some legal and tax services can require high level professional skills and be rendered in a continuous way. Their inclusion in the low value-adding services is surely significant but, in our opinion, it is anyway important to verify the meeting of the general requirements set forth in paragraph 7.46.

There is a significant difference between the services list in annex I of the Guidelines on low value adding intra-group services released by the EU Joint Transfer Pricing Forum on 28 January 2011 and the list included in paragraph 7.48. Maybe an effort could be performed in order to merge the activities mentioned in those documents.
### Public discussion draft

| 7.50 | The definition of low value-adding intra-group services refers to the supportive nature of such services, which are not part of the core business of the MNE group. The provision of low value-adding intra-group services may, in fact, be the principal business activity of the legal entity providing the service, e.g., a shared service centre, provided these services do not relate to the core business of the group. As an example, assume that an MNE is engaged in the development, production, sale and marketing of dairy products worldwide. The group established a shared services company, the only activity of which is to act as a global IT support service centre. From the perspective of the IT support service provider, the rendering of the IT services is the company’s principal business activity. However, from the perspective of the service recipients, and from the perspective of the MNE group as a whole, the service is not a core business activity and may therefore qualify as a low value-adding intra-group service. |
| 7.51 | This subsection sets out the elements of a simplified charge mechanism for low value-adding intra-group services. An MNE group electing to adopt this simplified method would apply it on a consistent, group-wide basis in all countries in which it operates. This simplified method is premised on the proposition that all low value-adding service costs incurred in supporting the business of the MNE group members should be allocated to those members. A possible alternative approach for dealing with the issues discussed in this subsection would be the use of Cost Contribution Arrangements, covered in Chapter VIII. |

### ADACTA comments

In many cases when a Group allocates some activities to a service company or “the best in class” company because of the quality and efficiency those activities are carried out, there could be the undertaking of growing risk and the development of unique know-how elements that make difficult the qualification of those services as low value-adding services.

It is not clear why the simplified approach mentioned in this section should be applied on a world-wide basis and in all the countries where the MNE Group operates.

The services are, based on their actual nature, heterogeneous and can be rendered or received in different ways, taking into account the different business models that MNE group adopts in the different geographic areas where it operates. That is the reason why we suggest such requirement to be cancelled, as it may lead to many operative difficulties without any crucial advantage.
### Public discussion draft

**7.52** The initial step in applying the simplified approach to low value-adding intra-group services is for the MNE group to calculate, on an annual basis, a pool of all costs incurred by all members of the group in performing low value-adding intra-group services. The costs should be pooled according to category of services, and should identify the accounting cost centres used in creating the pool. The cost pool should exclude costs that are attributable to an in-house activity that benefits solely the company performing the activity (including shareholder activities performed by the shareholding company).

There are many cases in which services are rendered exclusively by one member of the Group (for example the head office). The rules provided in this paragraph seem to refer only to the hypothesis of more than one service provider, which is not always the case.

### ADACTA comments

**7.56** The examples of allocation keys provided in the previous paragraph are not intended to be an exhaustive list. Depending on the facts and circumstances more sophisticated allocation keys might be used. However, 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. In this context, there may be no need to use multiple allocation keys if the taxpayer can explain the reasons for concluding that a single key provides a reasonable reflection of the respective benefits. For reasons of consistency, the same allocation key or keys should be applied in determining the allocation to all recipients within the group of the same type of low value-adding intra-group services, and it is expected that the same reasonable key will be used from year to year unless there is a justified reason to change. Tax administrations and taxpayers should also bear in mind that changing the reasonable allocation key can give rise to considerable complexities. It is expected that the taxpayer will describe in its documentation (see paragraph 7.61 below) the reasons for concluding that the allocation key produces outcomes which reasonably reflects the benefits likely to be derived by each service recipient.

The choice of the allocation keys should follow the main principles included in paragraph 7.25 above and we suggest that a cross-reference should be made.

In our opinion the documentation containing the reasons why a specific allocation key was selected, should not be requested, as it often leads to a generic adequacy statement, not differently justifiable.

Moreover, it is not clear why the allocation key should have to be justified based on benefits, while such request is not foreseen for the “high-value service” mentioned in Section A and B.
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<td><strong>7.57</strong> In determining the arm’s length charge for low value-adding intra-group services, the MNE provider of services shall apply a profit mark-up to all costs in the pool. The same mark-up shall be utilized for all low value-adding services irrespective of the categories of services. The mark-up selected by the taxpayer should be no less than 2% of the relevant cost and should be no greater than 5% of the relevant cost. It should be noted that these intra-group services mark-ups should not, without further justification and analysis, be used as benchmarks for the determination of the arm’s length price for services not within the definition of low value-adding services, nor for similar services not within the elective, simplified scheme.</td>
<td>There should be a link between the rules here included and the one included in Paragraphs 7.36-7.39 of section B) above. It is not clear whether the mark-up here included (2-5%) must be always applied or it can coexist with the hypothesis included in paragraphs 7.37 and 7.38, based on which it is not always necessary for the service provider to realize profits performing a inter-company service. In our opinion this topic should be deeply clarify; in case of low value-adding services, it could happen that the market value of the activities performed is greater than the cost incurred by the service provider.</td>
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<td><strong>7.58</strong> Subject to the provisions of paragraph 7.60, the charge for services to any member of the electing MNE group shall be the sum of (i) the costs incurred by another group member in providing services specifically to the member under the second step as detailed in paragraph 7.53, plus the selected profit mark-up, and (ii) the share of pooled costs allocated to the member under the third step as detailed in paragraph 7.55 using the selected allocation key, plus the selected profit mark-up. The charge is payable to the group member that incurred the costs in the pool, and where there is more than one group member incurring those costs, in proportion to each member’s share of the pooled costs.</td>
<td>The mark-up indication should be used with the adjective “potential”. We do not think that the clarification concerning the payment of the charge to the group member who incurred the costs is needed; in fact the flows of payment can follow different and variable rules and terms.</td>
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7.60 While low value-adding intra-group services may provide benefits to all recipients of those services, questions may arise about the extent of the benefits and whether independent parties would have been willing to pay for the service or perform it themselves. The documentation and reporting discussed in section D.3 below should provide sufficient evidence that the benefits test is met given the nature of low value-adding intra-group services. In evaluating the benefits test, tax administrations should consider benefits only by categories of services and not on a specific charge basis. Thus, the taxpayer need only demonstrate that assistance was provided with, for example, payroll processing, rather than being required to specify individual acts undertaken that give rise to the costs charged. Provided such information outlined in paragraph 7.61 is made available to the tax administration, a single annual invoice describing a category of services should suffice to support the charge, and correspondence or other evidence of individual acts should not be required. With regard to low value-adding intra-group services that benefit only one recipient entity in the MNE group, it is expected that the benefits to the service recipient will be capable of separate demonstration.

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<td>In our opinion, the simplified approach to the benefit test suggested in this paragraph conflicts with the content of the documentation suggested in paragraph 7.61. No paragraph in this Chapter VII states that, in case of services, the “individual acts undertaken” in performing them should be specified; therefore such requirement should not be due in case of low value-adding services. Finally, the benefit deriving from the simplified approach should not be hindered by the compliance of the information included in paragraph 7.61.</td>
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<td><strong>7.61</strong> An MNE group electing for application of this simplified methodology shall prepare the following information and documentation and make it available upon request to the tax administration of any entity within the group either making or receiving a payment for low value-adding intra-group services.</td>
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<td>• A description of the categories of low value-adding intra-group services provided; the reasons justifying that each category of services constitute low value-adding intra-group services within the definition set out in section D.1; the rationale for the provision of services within the context of the business of the MNE; a description of the benefits or expected benefits of each category of services; a description of the selected allocation keys and the reasons justifying that such allocation keys produce outcomes that reasonably reflect the benefits received, and confirmation of the mark-up applied;</td>
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<td>• Written contracts or agreements for the provision of services and any modifications to those contracts and agreements reflecting the agreement of the various members of the group to be bound by the allocation rules of this section;</td>
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<td>• Calculations showing the determination of the cost pool as described in D.2.1, in particular a detailed listing of all categories and amounts of relevant costs, including costs of any services provided solely to one group member;</td>
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<td>• Calculations showing the application of the specified allocation keys.</td>
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We believe the documentation requested for the low value adding services to be too analytical and not adequate to the simplified approach of section D).

In particular we do not agree with the requests related to:
• [...]the rationale for the provision of services within the context of the business of the MNE;
• a description of the benefits or expected benefits of each category of services;
• a description of the selected allocation keys and the reasons justifying that such allocation keys produce outcomes that reasonably reflect the benefits received[...]

In our opinion if a simplified approach is permitted, also the extent of the documentation must be lighter, otherwise intra-group management services will remain a challenging and troublesome topic for both tax administration and MNE.

In general we suggest that more cross-reference must be included in every paragraph of the revised Chapters of the Guidelines: many topics have strong connections each other and requiring the information linked in a more efficient way.
14 January 2015

By email to: TransferPricing@oecd.org

Andrew Hickman
Head of Transfer Pricing Unit
Centre for Tax Policy and Administration
OECD

Dear Andrew,

**BEPS Action 10: Proposed modifications to Chapter VII of the transfer pricing guidelines relating to low value-adding intra-group services**

AFME\(^1\) and the BBA\(^2\) welcome the opportunity to respond to the OECD’s discussion draft entitled “BEPS Action 10: Proposed modifications to Chapter VII of the transfer pricing guidelines relating to low value-adding intra-group services” (the **discussion draft**). We wish to make clear that while AFME and the BBA have separate and distinct memberships, for the purposes of the OECD discussion draft, both organisations have decided to submit a single, combined response since our respective members share the same concern with the OECD’s proposals in the discussion draft.

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\(^1\) The Association for Financial Markets in Europe (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.

\(^2\) The British Bankers’ Association (BBA) is the leading association for the UK banking and financial services sector, speaking for 180 banking members, headquartered in 50 jurisdictions and operating in over 180 territories worldwide jurisdictions, on the full range of UK or international banking issues. Collectively providing the full range of services, our member banks make up the world’s largest international banking centre.
We welcome that the OECD is consulting with business on its proposals. We believe that this approach is to the benefit of both policymakers and business and helps to avoid any unintended consequences arising from the OECD’s initial proposals. We believe that it is also valuable for the OECD to take account of the views of business on the practical aspects of operating the intended policy.

Given the relatively short time available to consider the discussion draft – and the large number of other OECD discussion drafts currently open for consultation - it has not been possible for us to consider the discussion draft in detail at this stage. We may decide to write to you again with further comments once we have had a chance to consider the proposals in greater detail.

However, we would like to take this opportunity to welcome the proposal in Paragraph 7.57 of the discussion draft – relating to profit mark-up – that multi-national enterprises (MNEs) can apply a standard mark-up to low value-adding intra-group services. If this proposal is taken forward by the OECD we believe that it is essential that (1) all tax authorities respect the mark up applied by a given MNE; and, (ii) MNEs should obtain a tax deduction for the costs of such services somewhere in the MNE group. This is in order to prevent double taxation. We believe that those principles should be set out in the proposed revisions to Chapter VII of the OECD Transfer Pricing Guidelines.

Yours sincerely,

Richard Middleton
Managing Director
Tax and Accounting Policy
AFME

Sarah Wulff-Cochrane
Director of Policy
Taxation
BBA
We respectfully submit comments on the Discussion Draft "Proposed modifications to Chapter VII of the transfer pricing guidelines relating to low value-adding intra-group services" (dated 3 November 2014) ("the Draft"). If there is any specific point from our comments that you would like to discuss further, please do not hesitate to contact us.

As a general comment, we welcome this draft as it is well written, clear and it adds some clarifications to the current Chapter 7 (2010 Guidelines).

Particularly useful is the new language on the "simplified benefit test" for low value adding services (pars. 7.50 to 7.61). Based on many years of experience, we do not know of any multinational that engages in base erosion and profit shifting using management fees or allocation of headquarters costs but we do know about many multinationals that spend too much management time trying to meet the requirements of current Chapter 7. In particular, trying to allocate low value-adding services directly and trying to demonstrate that the services meet the benefit test is very difficult.

On the other hand we wonder if the reference to a specific profit mark up (par. 7.57) would create more confusion and controversy than add value. They could also lead to double taxation. For example, the transfer pricing documentation requirements of some countries allows them to charge low value-adding intra group services without a mark up. Does the reference to "no less than 2% of the relevant cost" means that they would now need to charge a mark up on those costs? Also, even though the range proposed, 2% to 5% seems reasonable at first sight, there could be situations when it would not be appropriate. For example, it could be too high for a company whose overall consolidated profit never goes above 2-5%. Or it could be too low in a few years if interest rates increase significantly. It could even be too low for a hypothetical company whose margins are very high, say 40-50% profit before tax, and for whom the efficient provisions of low-value added services intragroup becomes a competitive advantage (we don’t know if that case exists but it could).

The reference to specific profit margins gives also raise to all sort of practical questions. For example, some other countries like US and Australia already use a different number, at cost or 7-8% depending of the type of service. The EU JTPF guidance on low value added services (Brussels, 25.1.2011) refers to 3% to 10%. The Netherlands also allows for the application of no mark up for low value added services if the cost of performing the analysis is too burdensome for the group, which is often the case for smaller companies. For all these reasons we would think that the reference in section D.2.3 should be to something along the lines of "no mark up or a reasonable low mark-up, without the need of performing a specific benchmark". The most important relief would be that companies do not need to perform a benchmark to justify the profit mark up applied to low value-adding services. That in itself would already be a big improvement as we have seen companies advised to perform up to 6 comparable searches to document these type of transactions.
It is also very difficult for companies to decide which share of the costs classifies as "shareholder" costs. The additional guidance provided in the Draft is useful. However, in practice, even with some examples, we know that it is very difficult to separate shareholder costs from other costs, especially when the multinational is very large and has several regional headquarters, several holding companies, several service centres. In practice we know that many companies can only take an overall number from the total, say 10%, and assume that those are shareholder costs.

We would also think that some section of the OECD Guidelines, maybe the revised Chapter VII but could also be Chapter I, need to recognize that some categories of intra group transactions, for example shareholder services or the concept of implicit support, apply only in an intragroup context. For this reason, it is important that these "special services" which require directly or indirectly that some costs are incurred are treated consistently with benefits that only arise due to the fact that the group is a group, for example synergies that cannot be allocable to any specific party. For example, if shareholder costs end up in company X of the group it would seem logical that also the benefit of synergies that cannot be allocable elsewhere would end up with company X. It is much more difficult in practice as any given multinational could have many "companies X". If we don’t do this the cost/disadvantage of being a multinational would be concentrated in one or two jurisdictions whereas the benefits of being one would be spread with all the group members and that does not seem logical nor fair.

We hope our comments above are useful. We would be happy to join the meetings 19-20 March to further discuss our comments above.

With kind regards

Ágata Uceda
Buenos Aires, January 13, 2015

Mr. Andrew Hickman  
Head of Transfer Pricing Unit, 
Centre for Tax Policy and Administration 
OECD  

E-mail Response: TransferPricing@oecd.org  

RE: ASOCIACION ARGENTINA DE ESTUDIOS FISCALES (AAEF or Argentine Association of Tax Studies)  
RESPONSE TO THE OECD REQUEST FOR COMMENTS ON THE PROPOSED MODIFICATIONS TO CHAPTER VII OF THE TRANSFER PRICING GUIDELINES RELATING TO LOW VALUE-ADDING INTRA-GROUP SERVICES  
BEPS ACTION 10  

The Transfer Pricing working group of Asociación Argentina de Estudios Fiscales welcomes the simplified approach to deal with low value-adding intra-group services and would like to thank the OECD for this opportunity to provide comments on the BEPS Action 10. 

The proposed approach will reduce the administrative burden for taxpayers, while improving efficiency in conducting audits by the tax authorities. The definition and characterization of low value-adding services is appropriate, and covers much of the centralized services carried out by most of the MNEs. The simplified way to determining the arm’s length consideration and the suggested mark-up ranges are in line with standard business practices. Also, the documentation requirements seem reasonable and consistent. 

General comments:  

We understand that while the proposed amendments to Chapter VII are mainly aimed at defining low value-adding intra-group services and suggesting a simplified approach to deal with them, a  

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1 Created in 1953, the Argentine Association of Tax Studies committed itself in its 61 years to promote research on Fiscal Law and related disciplines among its members, Law and Economic Sciences professionals graduated from any of the Argentine Universities.
review of the remaining sections of Chapter VII (which have no significant changes) should also be addressed.

We consider this relevant because:

1. The chapter is intended to provide Special Considerations.... Thus, we understand that services other than low-value adding ones should follow as closely as possible the General Principles, contained primarily in Chapters I to III).
2. Certain issues relating to services documentation remain to be addressed separately; and
3. There have been developments in other chapters of the Guidelines, in specific new Chapters I to III that made the current wording of Chapter VII inconsistent with these new provisions.

As a result, we believe that the following matters should be reviewed:

- Wording in Section B.2.3.1 in general, and in paragraph 7.33 in particular seem to continue being aligned with the previous wording of Chapters I to III, where a hierarchy of methods existed. We understand that preference for the CUP and Cost Plus Methods should be abandoned in favor of the general rule to choose the Best Method contained in the 9 Step Comparability Process of Chapter III paragraph 3.4.
- As many MNE’s might choose the new simplified methodology contained in Section D, regarding low value-adding intra-group services, it is in our opinion that the other sections of Chapter VII should provide more thorough guidelines specific to value-added services, which might require a different methodology to document their arm’s length nature, instead of the CUP or Cost Plus methods.
- Paragraph 7.60 of the new Section D provides that “tax administration should consider benefits only by categories of services and not on a specific charge basis. Provided such information outlined in paragraph 7.61 is made available to the tax administration, a single annual invoice describing a category of the services should suffice to support the charge, and correspondence or other evidence on individual acts should not be required. These Guidelines nonetheless are intended only for low value-adding services; while in our experience, many discussions with the tax authorities regarding intra-group services focus on how taxpayers would prove the actual rendering of services. In this sense, Section B.1 determining whether intra-group services have been rendered, focus more on whether the related entity has or has not benefited from the service, rather than proving that it has actually been rendered.
Even though one might argue that it would be impossible to benefit from a service that has not actually been rendered, many discussions never reach this stage, since tax authorities deny the deduction arguing that there is no proof that the services have been rendered. To this end, it would be desirable to have more precise guidelines on the nature of the evidence, sufficient for a taxpayer to support his position, while taking into consideration that gathering evidence is not a minor challenge, and often permeates the organization, and in many cases should rely upon evidence from the provider abroad.

Paragraph 7.4 recognizes that there might be a wide range of operating structures, from decentralized organizations to those more centralized or integrated, where “the directors and senior management of the parent company may make all important decisions considering the affairs of its subsidiaries, and...”. We consider that it would be desirable to review this sentence in light of the other BEPS Actions (in particular Action 7) and other previous work by the OECD (i.e. the Report On Attribution of Profits to Permanent Establishments) to avoid any future misunderstanding in the area of Permanent Establishment issues, in particular those relating to item a) of the second paragraph of Article 5 of the Model Tax Convention: A place of management.

The current version of Chapter III provides substantial guidance on segmentation, cost allocation and the treatment of different costs under a TNMM analysis. As an example, paragraph 7.36 deals with pass-through costs, while paragraphs 2.93 and 2.94 do so as well. We understand that the former should refer to the latter for the sake of consistency and as well that it is not only worthless to duplicate efforts, but it could create inconsistencies from one chapter to the other.

Specific comments to the new Section D:

- The wording “Services of corporate senior management” excluded from low value-adding services in paragraph 7.47 might be too broad and could potentially lead to disputes and double taxation issues.

- The general rule is that low value-adding services must not be part of the principal activity of the group. Being so, we do not see any need to emphasize this condition for IT services, in specific, while not doing so for the other services detailed in paragraph 7.48.
• Paragraph 7.52: clarification would be desirable, like what would be the accounting principles to consolidate the poll of costs. (HQs’ GAAP? Each service provider’s GAAP?). In addition, further clarification needs to be provided on how to deal with associated tax costs, i.e. non-creditable withholding taxes.

• Regarding indirect charge methods, guidelines need to be developed about the treatment of potential economies or diseconomies of scale that might arise and/or the treatment of potential exit costs.

• Let’s assume for a moment that an MNE decides to centralize certain functions in a subsidiary (e.g., the collection of accounts receivable) and that will perform these functions for all group members. Let’s also assume that fix costs are $100 while variable costs for each member of the group are another $100 (for the sake of simplicity let’s consider that they represent the same amount for each of the different entities of the group). If the plan is rolled-out over a period of time, and all the charges are recovered from the service recipients, the entities that enter at earlier stages of the plan will bear the start-up costs (the first will bear $200, plus mark-up), while the latter ones would not. Let’s assume that there are 10 entities, the last will bear $110, plus mark-up. On the other hand, if the start-up costs are borne by the service provider, should they be recovered through the mark-up? Another issue may arise where an entity only renders services to related entities. Who should bear the exit costs – e.g. severances – if the business is restructured? Would it be the service recipients? or is it Headquarters? or are they absorbed with retained earnings and equity?

• Paragraph 7.60 refers to a benefit test. Although, we welcome the simplified approach, nonetheless we consider that some wording should be included to take into account situations where the service charge (even through the mere cost) could put the recipient company into a loss-making situation. We have learnt from our experience that in some particular circumstances (e.g. a significant devaluation of the currency in the recipient country) the cost of the service in foreign currency could not only erode completely the recipient’s profit, but could put it into a loss making situation. Safeguards should be included to allow certain recipients to be excluded from the simplified method where abnormal circumstances take place.

• The reference to an annual invoicing could create not only financing issues for the service provider, even more so if it is the service provider’s only activity. It could also create indirect tax issues in countries where the accrual of such taxes should be made on a monthly basis.
We would be happy to discuss with the OECD any of the above in greater detail, and would as well be pleased to contribute further as the OECD’s work develops.

Yours faithfully,

Horacio R. Della Rocca: President
José María Segura: Transfer Pricing Working Group Co-coordinator
(Should you have any doubt please contact: segurajosemaria@yahoo.com.ar)
Comments on the OECD Discussion Draft on BEPS Action 10 “Proposed modifications to Chapter VII of the transfer pricing guidelines relating to low value-adding intra-group services”

Dear Mr. Hickman,

BASF welcomes the opportunity to provide comments on the Discussion Draft regarding BEPS Action 10.

BASF is a globally operating multinational with operations in over 80 countries and more than 400 production sites. Like many other MNEs, we have centralized certain activities in Shared Service Centres, R&D Hubs as well as other service platforms (e.g. for supply chain services or marketing services) in order to increase efficiency and effectiveness. These services are generally provided to all or to a large number of group companies.

Our experience in tax audits shows us that many countries are increasingly unwilling to accept a tax deduction for intra-group service fees and intensively question the benefit to the recipient. The issue is usually not the allocation key or the mark-up applied, but rather the proof of benefit, whereby the documentation requirements are sometimes disproportionally high. Even after providing relevant information, the benefit test is often considered to be insufficiently documented. BASF therefore welcomes modifications to the OECD transfer pricing guidelines whenever the aim is to enhance certainty and clarity on intercompany pricing aspects, both for taxpayers and tax administrations. Our main comments on the Discussion Draft are provided below.
1. **Costs are incurred for business reasons and not for the purpose of obtaining a tax deduction**

If a MNE incurs expenditures for a service project or an ongoing service activity, it should be generally assumed that this is based on a sound entrepreneurial decision and is for the benefit of the MNE. This should as such not be challenged by tax authorities. Based on a cost-plus methodology, such costs must – as far as they do not relate to shareholder activities - be allocated among the beneficiaries, as they would not be treated as tax deductible in the country of the service provider. Based on this principle, the threshold for the benefit test should be reasonably low. In allocating costs to group companies an allocation key must be used in the absence of directly allocable costs. In the choice of allocation key, the MNE is implicitly allocating a “benefit” portion to each group company in order to have a practicable approach. Hence, it should be generally assumed that intra-group services generate a benefit and therefore an extensive proof of benefit should not be necessary.

BASF agrees with the OECD’s statement that direct charging facilitates the determination of whether a charge is consistent with the arm’s length principle (paragraph 7.22). In the case of direct intra-group charging, a benefit is inherent for both the service provider and the service receiver as direct charging is often based on bilateral agreements and a specific order made by the receiving entity. Thus further proof of benefit should generally not be necessary in these cases (in accordance with paragraph 7.7). BASF would appreciate an explicit clarification that direct charging in such cases would not be subject to the proof of benefit rules.

2. **BASF welcomes the simplified approach for the determination of arm’s length charges and documentation of low value-adding intra-group services (paragraph 7.51ff). However, the same approach should also apply to non-low value-adding intra group services.**

As mentioned before, for low value-adding services as well as non-low value-adding services it should generally be assumed that in case a MNE had not rendered the intra-group service, either the receiving entity would have performed it by itself or it would have asked an external service provider to render the service. Hence, it can be assumed that all rendered intra-group services generate a benefit, although that anticipated benefit can only be generally described but not quantified in many cases.

An elucidatory example in this regard might be “marketing services”:

*Global marketing activities are performed in order to increase sales. Further, direct charging is not applicable as usually no work performance records per service recipient (i.e. “how many hours worked for whom / what”) are available because either the nature of the rendered function simply does not allow it (e.g. developing a global marketing strategy) or the effort in preparing records would be disproportionally high.*
Given the above, BASF does not see a pragmatic way to verify or even quantify an increase in sales attributed to the global marketing activities for single legal entities that are charged with global marketing costs according to e.g. a sales allocation key. In addition, there is often a time lag 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). That makes it even more difficult to prove benefits. In such case it is not possible to connect a specific and precise benefit to the single charge. Nevertheless as obviously not only the legal entity performing the global marketing function benefits from these activities, it only seems fair that the respective costs are charged out to the benefitting service recipients.

As for low value-adding intra-group services, the following documentation should provide sufficient evidence for all indirect services that the benefit test is met:

- a general description of the service including a general benefit description,
- the identification of the beneficiaries (e.g. for assistance in the fields of production rather manufacturing entities than pure agents would benefit and therefore only manufacturing entities shall be charged respectively),
- the determination of an appropriate allocation key,
- the description of the cost allocation mechanism,
- the contractual basis,
- calculations showing the determination of the cost pool and the application of the specified allocation keys.

Therefore BASF strongly recommends to apply the same proposed simplified approach (including simplified benefit test), that focuses on creating transparency on the service charging rather than on proving benefits for single charges, for all intra-group services – covering both, low value-adding and non-low value-adding services.

If it is considered necessary to differentiate between low value-adding and non-low value-adding services, this could be done by applying a different profit mark-up to the costs. In this regard, we would highly appreciate clear guidance by the OECD which profit mark-ups should be applicable to non-low value-adding services.

As the OECD further recognizes that the intra-group services listed in paragraph 7.15 are beneficial for the service recipient, it should be clarified that only the simplified benefit test is necessary in these cases as well.
3. **Comment on the arm’s length compensation and profit element (paragraph 7.31 – 7.39):**

   *When determining the arm’s length price in relation to intra-group services, the perspective of the services provider should be considered as well as that of the service recipient. In addition cost synergies must be taken into account.*

Paragraphs 7.31, 7.32 and 7.35 suggest that the charge for a service should not exceed the receiving entity’s costs if it had performed the activity itself or the cost of that service if provided by an external service provider. In addition, the service recipient’s circumstances shall be considered. It should be clarified by the OECD how this shall be done and if a cost analysis on receiver’s side would be necessary. If it should be the intention that MNEs shall apply individual mark-ups to the single service recipients or to establish individualized pricing to each service recipient, the handling of indirect charging will hardly be possible. In addition, the centralization of services very often leads to cost efficiencies, quality improvements as well as other synergies which would need to be factored in to such a test as efficiency gains are passed on when applying the cost plus method. A cost based remuneration and a uniform mark-up according to service categories should therefore be sufficient except if extreme circumstances imply a need to adjust the costs charged.

4. **Comment on new section D on low value-adding intra-group services (paragraph 7.45 - 7.61):**

   *BASF believes that the simplified approach to documenting services should apply to all intra-group services. However, should the criteria for low value-adding services be maintained, then certain changes are necessary.*

BASF very much welcomes the proposed simplified approach and believes that especially the simplified documentation obligation would be a huge reduction in efforts to comply with tax compliance obligations. However, in the case that such criteria should apply only to low value-adding intra-group services, there needs to be a clear definition in terms of criteria for a case by case evaluation whether a service can be considered as low value-adding or not.

BASF welcomes the attempt to establish a definition of low value-adding intra-group services according to the criteria as proposed in paragraph 7.46 for the most part, however “…and do not give rise to the creation of significant risk” (paragraph 7.46, 4th bullet point, second half sentence) should be deleted, as there might be services that are low value-adding from their nature but nevertheless might give rise to the creation of significant risk.

For example paragraph 7.48 mentions the preparation of tax returns or legal services as low value-adding. However, the preparation of tax returns / legal services might give rise to creation of significant risk in case of incorrect tax returns / legal advice.
The provision of lists of services that should (paragraph 7.48) or should not be (paragraph 7.47) considered as low value-adding might lead to a prejudged categorization of a service without properly considering the specific circumstances that might be crucial for an appropriate assessment as the example “marketing activities” illustrates:

*BASF agrees that marketing activities might not qualify as low value-adding service in cases of consumer brands. In such case marketing would not meet the criteria qualifying for low value-adding intra-group services as marketing might lead to unique and valuable intangibles. But marketing activities in B2B businesses like the chemical industry might not be such a value driver so that all the criteria as proposed in paragraph 7.46 might be met.*

If a list is deemed to be required we would like to encourage the OECD to align the statements regarding the definition of low value-adding services with the EU JTPF in order to avoid inconsistencies. For example OECD does consider marketing as non-low value-adding while the EU JTPF may or may consider marketing activities as low value-adding (EU JTPF, annex I).

5. **BASF recommends adjusting the proposed range for the remuneration of low value-adding intra-group services to 0 – 5% mark-up on costs.**

Paragraphs 7.37 - 7.39 describe situations in that it would be at arm’s length to charge at cost (i.e. 0% mark-up). In order to avoid inconsistencies, charging at cost, if appropriate, should also be possible for low value-adding intra-group services.

It seems that a 5% mark-up became more or less consensus for low value-adding intra-group services according to EU JTPF’s guidance. However, with the range of 2 - 5% as proposed by OECD (paragraph 7.57) all services that have been remunerated with a 5% mark-up would suddenly be remunerated at the upper end of the proposed range. This changed guidance might lead to discussions in future audits although neither the remuneration nor the nature of the services itself changed. In order to avoid such future discussions OECD should clearly state that each single point within the proposed range might be equally adequate.

Sincerely,

BASF SE
Central Department for Taxes and Duties

Anne Wenisch

Daniel Zech
Dear Mr. Hickman,

BDI\(^1\) refers to the OECD Discussion Draft “Proposed modifications to Chapter VII of the transfer pricing guidelines relating to low value-adding intra-group services” issued on 3 November 2014. We would like to thank you for the possibility to provide our comments that allow us to engage with you on these important issues and have limited our comments to some specific issues of the Draft.

We welcome the efforts made at OECD level to provide guidelines for the identification of low value-adding intra-group services, as well as for the determination of their remuneration.

We especially appreciate the explicit confirmation that

- such low value-adding intra-group services are treated as chargeable services and the cost incurred are deductible at the payor level,
- there are intra-group services where a direct-charge method is so difficult to apply that indirect-charge methods for calculating an arm’s length charge should be allowable and
- it is sufficient that the benefits to the recipient of the service need to be reasonably expected.

\(^{1}\) BDI (Federation of German Industries) is the umbrella organization of German industry and industry-related service providers. It speaks on behalf of 37 sector associations and represents over 100,000 large, medium-sized and small enterprises with more than eight million employees. A third of German gross domestic product (GDP) is generated by German industry and industry-related service.
B.1.1 Benefits test

With regard to the benefits test, it would be useful if the Draft would state more explicitly that the requirements needed have to be reasonable. It should be sufficient to validate the plausibility, especially because

- a number of services cannot be directly linked to the success of a business (e.g. accounting services which neither provide a rise in revenue nor in profit),
- even regarding a number of intra-group services that are more closely connected to operative business (such as marketing or distribution services) their effectiveness often is hard to quantify and
- businesses must be allowed the possibility of misjudgements.

D.1 Definition of low value-adding services

The Draft suggests that the qualification of a service as being a low value-adding intra group service should be conducted from the point of view of the MNE-group instead of the individual group member rendering the service. This seems hardly to be in line with the arm’s length principle, that compares intra-group charges to charges levied for goods and services between unrelated parties. If the service provided by the group member is core business for this member and the respective functions and risks are allocated respectively then this should be considered when setting the charge.

D.2 Simplified determination of arm’s length charges and profit mark-up

The simplified approach recognizes that the arm’s length price is closely related to costs and allocates the costs of providing each category of such services to the group companies that benefit from using the services, using consistent group-wide allocation keys with an associated consistent small mark-up.

We generally welcome the described simplification, since it would reduce the burden of both, taxpayers and Tax Administrations, with regard to routine and low value-adding intra-group services transactions and would contribute to resolve or reduce multilateral disputes with tax administrations over low value-added services.

However, for the benefits of a simplified approach to unfold a uniform adoption and implementation of the provisions provided within the Discussion Draft on a global level is key.

With regard to the suggested profit mark-up we understand that when services qualify for the simplified approach and the approach is elected by taxpayer following the requirements stated, a mark-up between 2% and 5% applies and no further functional and economic analysis is required.
Although we welcome the simplified approach we are concerned with the risk that tax administrations in the locations where services are provided from will assume the upper limit proposed while the tax administration of the payor country will assume the opposite. The difference in the interpretation by two countries might be much deeper in the case of developing vs developed country flows and/or European vs non-European country flows. However, businesses quite often are faced with tax administrations of certain countries from which intra-group services typically are provided which argue for unrealistically high profit mark-ups to be applied. With regard to this situation the suggested approach would be rather helpful, whether a range or a fixed mark-up percentage is agreed upon.

Please do not hesitate to contact us if you have any questions.

Sincerely,

Berthold Welling          Dr. Karoline Kampermann
Mr Andrew Hickman
Head of Transfer Pricing Unit
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2, rue Andre Pascal
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France

14 January 2015

Dear Mr Hickman,

Discussion draft of the proposed modifications to Chapter VII of the Transfer Pricing Guidelines

BDO welcomes the opportunity to comment on the OECD’s Discussion Draft on the proposed modifications to Chapter VII of the Transfer Pricing Guidelines (the “Discussion Draft”), including the addition of low value-adding intra-group services, and the OECD’s efforts to seek outside consultation.

We support the OECD’s efforts to simplify the requirements for multinational enterprises (‘MNEs’) under the Transfer Pricing Guidelines where the transactions in question are low risk and unlikely to give rise to controversy. Low value-adding intra-group services are one such area.

In preparing this letter we have received comments from BDO firms in our global transfer pricing network which we have incorporated into the letter, with the specific contributors listed.

General comments

It is hoped that this consultation will enable a treatment of low value-adding intra-group services which is practical to determine and apply for MNEs regardless of size and structure, and that fiscs may be provided with sufficient assurance from both the OECD and tax payers that the low value-adding services in question are low risk from a transfer pricing perspective.

To achieve an effective solution this discussion should be addressed in the context of challenges seen currently around the pricing of intra-group services, both low value-adding or otherwise. In our experience tax authority challenges primarily focus on requiring support for:

- The benefit resulting from the service provision
- The necessity of the services - i.e. whether a third party would seek and pay for the particular benefit provided
- The underlying cost of the services, especially when they are provided from a higher cost economy

Any simplification in respect of low value-adding intra-group services will need to address these issues to provide a genuine reduction of time spent on MNEs’ policy setting, testing and defence, and to provide fiscs with confidence in the charging arrangements employed.
In this context, our specific comments on the discussion draft are as follows.

**Determining the arm’s-length charge for services**

**Charging services into low relative cost environments**

An increasingly common challenge around service charging arises where the service recipient operates in a markedly lower cost environment than the service provider, which can lead to challenge on justifying the higher relative cost of the service provision from the recipient’s perspective.

There may be compelling commercial reasons for an MNE arranging its service provision in this way, e.g. charging into developing markets from established high cost locations as new territories are expanded into or a shared service centre (‘SSC’) being based in a relatively higher cost location than some of the operations it serves.

The guidance in paragraphs 7.31 and 7.35 can be used as a basis to assess an appropriate position but more clarity, perhaps by way of an example, may be helpful to draw out the main points for consideration in these circumstances.

**Use of ‘cost plus method’**

The current drafting of 7.33 sets out that ‘a cost plus method would likely be the most appropriate in the absence of a CUP where the nature of the activities involved, assets used and risks assumed are comparable to those undertaken by independent enterprises’.

We question whether this paragraph and specific references to cost plus method and the inference as its status as a ‘most appropriate’ method absent CUP remains helpful guidance. The overriding principles of selection of transfer pricing method in paragraphs 2.1 to 2.11, and 2.2 in particular, if not intended to be modified, should be given prominence and reinforced.

**‘Low value-adding’ services definition**

The definition of low value-adding intra-group services set out in paragraph 7.46 is helpful. The use of a principles-based approach should allow for a more practical application than a narrowly drafted list of qualifying activities.

All MNEs will have a requirement for activities such as HR, accounting and legal support and there are good reasons for providing these centrally as opposed to local provision or outsourcing. These reasons will be common across much of the MNE population and a default acceptance of the need and benefit of low value-adding intra-group services is required for simplification to be achieved successfully. This is important for questions around the evidencing of benefit as part of documentation, which we comment on below.

By expanding on its discussion of low value-adding intra-group services in paragraphs 7.45, 7.46 and 7.48 to include comments to this effect, the OECD could significantly reduce the potential for the challenges in principle to centrally provided services which are currently on the increase. Linking these comments explicitly to the Handbook on Transfer Pricing Risk Assessment would also strengthen the Discussion Draft. Without this support, simplification is unlikely to be effective in OECD Member territories where low value-adding intra-group services are not commonly viewed as low risk.
Interaction between ‘low value-adding’ and other services

Having set out the principles for a low value-adding intra-group service in paragraph 7.46, the OECD qualifies this with examples of services likely to fall inside or outside the definition. This clarity is helpful, although practical issues for achieving simplification arise from where the line between low value-adding and other services is drawn in the Discussion Draft.

Those low value-adding intra-group services set out in 7.48 are broadly consistent with what might be found in a typical SSC of an MNE. They are essential but ancillary services where cost and quality benefits can be achieved by co-location, often in a territory different from the head office. Many MNEs will have a SSC. However many more will not, particular smaller MNEs which do not possess the critical mass, and here central service activity is likely to centralised at the head office or with the largest or oldest of the trading companies in the group.

In these cases it is likely that some support services will also be provided by senior management that will neither be wholly shareholder in nature nor relate directly to a core business transaction that is subject to a different pricing policy (for example sales or manufacturing). Under the proposed definitions, these activities would fall under the earlier part of Chapter VII and would not comprise a low value-adding intra-group service. In many cases, the amounts involved in these management support services will be limited once low value-adding intra-group services are separately identified and the materiality of these amounts would not justify the expense of a ‘full’ study.

The OECD might add comments to the Discussion Draft to address instances where a low level of intra-group services remain once low value-adding intra-group services have been separately identified. The low value of these services and resulting low impact on tax at stake for fiscs is likely to result in a low level of transfer pricing risk. Simplification might be extended in these instances with reference made to the OECD’s Handbook on Transfer Pricing Risk Assessment.

Such a reference to the Handbook on Transfer Pricing Risk Assessment might be expanded upon to underline the low risk nature of these activities given the limited tax impact of the mark up applied when compared with core business transactions. A materiality threshold for detailed support of intra-group services might be considered to enable the simplification of documentation and benchmarking requirements where the size of the MNE’s business or service transactions and corresponding risks to treasuries is low.

In terms of profit expectation, the OECD has set out an acceptable range of mark-up for low value-adding intra-group services. Specific comment might be made on whether the 2%-5% range set out in paragraph 7.57 has any influence on services not considered to be low value-adding. Our expectation is that these services may attract a mark-up based on comparables analysis which could fall within the 2%-5% range if this is what the comparable data shows. If this expectation is shared by the OECD, this point might be made explicitly to avoid any assumption that services not characterised as low value-adding should automatically attract a mark-up in excess of 5%.

Similarly it would be useful to clarify the situation where no mark-up on costs might be acceptable in light of the low value-adding services guidance. Whilst B.3.2, and 7.39 in particular, provides guidance for identifying when tax administrations may forgo computing and taxing an arm’s-length price from performance of services, referencing low value-adding services as being a potential factor in that consideration in addition to the ones already listed would be helpful. A greater simplification still in this regard may be a specification of service types, but
we recognise this may be difficult to articulate and agree given the construction of what constitutes low value-adding services in the draft.

**Documentation**

The OECD sets out documentation requirements for low value-adding intra-group services in part D3 of the Discussion Draft, which we have read in the context of the recently revised Chapter V of the Transfer Pricing Guidelines. Clarification of an acceptable level of supporting documentation is helpful both to manage the expectations of tax authorities on transfer pricing risk review and to enable MNEs to meet these expectations consistently and effectively.

An important aspect of this clarification should be what consequence the requirements in paragraph 7.61 have for services other than low value-adding services, i.e. whether the guidance at 7.61 now forms the de-minimis requirement for all service charging documentation, and how that fits with Chapter V.

With specific regard to low value adding services, the documentation requirements appear broadly consistent with those required historically and for other intra-group services, with the exception that benchmarking is not required for low value-adding intra-group services. On this basis the proposed elective approach requirements offer a somewhat more limited simplification for MNEs than we think could be achievable.

Since it is difficult to determine the specific benefit of receiving a low value-adding intra-group service it is a reasonable approach to set out the categories of services received together with the respective invoice. This is in line with the target to avoid excessive documentation compliance burdens on the one hand and to provide tax authorities with adequate information on the other. However, it is important that there is effective simplification of the burden of proof of benefit that will be required by tax administrations.

In particular, we would question the need to set out a rationale for services and their benefits given the OECD’s comments in paragraphs 7.46-7.48. The OECD’s comment at the end of paragraph 7.59 appears to acknowledge this.

The question posed in paragraph 7.59 whether the amounts involved warrant detailed determination of the benefits received might usefully be expanded upon. Otherwise, the risk is either that simplification of filing requirements is not achieved or that a tax authority cannot perform an effective transfer pricing risk review, leading to audit work on both sides.

As discussed above, the OECD has the opportunity as part of this review to set out and endorse much of the underlying commercial rationale for the need for low value-adding intra-group services within an MNE. This might be summarised in part D3 in a way which would:

- Prevent the need for a similar analysis to be prepared by each MNE in its filing, leading to extensive duplication of activity both for preparers and tax authority reviewers; and
- Anticipate and offset many of the challenges around the necessity of service provision and its resulting benefit which may not be necessary in the context of low value-adding intra-group services.

This could provide meaningful simplification and increased certainty for both MNEs and tax authorities.
One way in which this may be achieved is by drawing further on one of the concepts that was put forward in the JTPF report: Guidelines on Low Value Adding Intra-Group Services, i.e. that ‘all costs are allocable’, to shift the focus away from evidencing of benefit per se and to focus the support on the allocation basis selected reasonably reflecting the level of benefit enjoyed. This presupposes that the services provide benefits to all recipients (and this is recognised in paragraph 7.60) but given the nature of the services in question, and that these have been identified using the guidance in 7.46–7.48, this seems reasonable and would offer greater simplification for MNEs.

It is acknowledged that the facts and circumstances of service provision may at times differ from a default model set out in the Guidelines. In these cases we would expect MNEs to address the position in detail. However this would be done by exception, enabling a clear focus on the more unusual or potentially higher risk fact patterns.

Similarly, the OECD might propose default allocation keys in respect of the low value-adding intra-group services listed. For example this might propose headcount for HR functions, users for IT etc. Again, where required by facts and circumstances an MNE might adopt a different approach, but the focus of documentation and support would be on exceptions, reinforcing simplification for ‘expected’ low risk models for the provision of low value-adding intra-group services.

**Interaction with other safe havens and charging regimes for intra-group services**

Other bodies have issued regulations or guidance on the charging of intra-group services, including the EU, US and UN. The potential for bilateral or multilateral agreements in respect of low risk transactions was also considered recently by the OECD in its consultation regarding safe havens.

The OECD might include a comment on how expectations of safe havens or comparable simplification might be best addressed by MNEs and tax authorities, either in the Guidelines or its Handbook on Transfer Pricing Risk Assessment.

**Implementation best practice**

Charging bases for intra-group services may incorporate terms observed at arm’s-length where possible. For example this might include setting a charge based on budget, with adjustment to actual amounts based solely on additional services required by the service recipient rather than the charging of overruns by the provider.

Where the OECD has an expectation of best practice in this area it might usefully include comments in the updated Draft, for example by expanding parts B.2.3 and D.2.1. This would be of assistance in clarifying expectations for both setting and reviewing pricing policies.

**Conclusion**

We support the OECD’s efforts to put in place a framework for the charging of intra-group services that is practical and effective, and which simplifies low risk transactions where possible.

We would support further consideration in the identified areas to ensure that additional compliance requirements placed on businesses are consistent and reasonable and that the OECD’s efforts towards simplification are practical and achieved throughout the MNE population.
We would like to thank the OECD again for this opportunity to comment and should be happy to expand on these points and contribute to further stages of this review if required.

For clarification of any aspects of this response please contact:

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Yours sincerely

Paul Daly
Transfer Pricing Partner
For and on behalf of BDO LLP
BEPS MONITORING GROUP

Response to Action 10 Discussion Draft on Low-Value-Added Intra-Group Services

This report is published by the BEPS Monitoring Group (BMG). The BMG is a group of experts on various aspects of international tax, set up by a number of civil society organizations 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. This paper has not been approved in advance by these organizations, 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.

We are grateful for this opportunity to comment on the proposals for dealing with deductions of charges for intra-group services within multinational corporations (MNCs). This forms part of one of the three actions in the BEPS project relating to transfer pricing, which is a key aspect of international corporate taxation.

This paper has been prepared by Sol Picciotto and Jeffery Kadet, with comments and input from Henrique Alencar, Veronica Grondona and Tom Balco.

1. GENERAL REMARKS

A. The Need for simplified transfer pricing methods

1. The OECD began to coordinate transfer pricing rules with its report of 1979, but by the late 1980s significant difficulties had been identified with the application of the arm’s length standard, due principally to the difficulty of identifying suitable comparables. The introduction by the US into its transfer pricing law of the ‘commensurate with income’ concept in the Tax Reform Act of 1986 created disagreements between the US and other OECD members. These disagreements eventually led to the introduction of the the transactional net margin method (TNMM) and the profit split method, described as transactional profit methods when they were formally included in the Transfer Pricing Guidelines of 1995. Despite the apparent consensus around the arm’s length principle, its application in practice has continued to be problematic, due to the lack of adequate comparables, so that even the most sophisticated microeconomic techniques can produce only a range of possible arm’s length prices that far too often is significantly broader than good tax policy could ever suggest. With such wide ranges, even small differences can have a significant effect on the attributable profit. Hence, re-evaluation of transfer pricing rules is long overdue.

2. Developing countries have generally introduced transfer pricing rules much more recently. Although some, such as Argentina, have long had provisions in domestic law allowing adjustment of accounts of local affiliates of foreign companies, they have only relatively recently adopted the OECD Guidelines. Others have done so even later, often as a result of ‘capacity building’ by the OECD and other organisations, which have regrettably sought to encourage them to adopt methods which the OECD countries have long known are defective.¹ Unsurprisingly, they have experienced even greater difficulty due to the lack of local or even regional comparables. Some have introduced methods which are easier to administer, such as Brazil’s legislatively fixed margins, and the so-called 6th method for commodities (using prices quoted by exchanges, at fixed dates and with adjustments) in Argentina and other Latin American countries. Some countries which have tried to apply the

¹ See our comments on the OECD report on Transfer Pricing Comparability Data and the Use of Comparables, April 2014.
full range of OECD-approved methods have found that they nevertheless generate
disagreements, conflicts, and a high number of legal disputes with taxpayers. India, with
some 3000 cases pending before its tax tribunals, is the most notable example of this. For the
large majority of developing countries the introduction of transfer pricing rules based on the
OECD Guidelines is much more recent; many have only begun implementing them very
recently, and some not yet.

3. Hence, in our view there should be a fundamental re-evaluation of the OECD approach to
transfer pricing, and not just a patch-up of the current rules. The wide variety of available
methods, and the need for detailed ‘facts and circumstances’ analysis, have created a system
which is difficult to administer and leaves considerable scope for subjective judgment. As all
countries around the world now begin to implement these rules with more rigorous audits,
they are therefore likely to lead to greater uncertainty and conflicts. At the same time, they
impose significant strains on especially the poorer countries, which can ill afford to waste
scarce human resources operating a dysfunctional system.

B. Legislating for the world

4. This discussion draft takes the form of a draft revised chapter VII of the OECD Transfer
Pricing Guidelines. Similarly, Action 8 on Intangibles mainly consists of a revised draft of
chapter VI, as well as parts of other chapters. Introducing changes by revising the Guidelines
is no doubt a convenient way to introduce changes quickly even on a global basis. However,
it is important to consider the implications of this procedure, and adopt appropriate
arrangements to mitigate its dangers. In principle, the Guidelines constitute only international
‘soft law’, since they are not formally binding on states. In practice, however, they are often
incorporated into domestic law, directly or indirectly. This means that once adopted they can
immediately create legally enforceable rights and obligations. For example, in the UK, the
Guidelines are given direct effect by statute, which also means that changes could become
immediately effective. 2 In other countries they may also be directly applied as ‘aids to
interpretation’. 3 This may be the case even in non-OECD developing countries. For example,
in Kenya the High Court allowed a company to use a transfer pricing method relying on the
Guidelines even though those Guidelines were at that time not mentioned anywhere in
Kenyan law. 4 Similarly, a Malaysian court has upheld a transfer pricing method based on the
Guidelines, rejecting an adjustment made by the tax authority under local law, which it held
to be invalid. 5 A tax tribunal in India has even recently referred to the discussion draft on

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2 The Taxation (International and Other Provisions) Act 2010 s.164 provides that UK treaty provisions based on
the OECD Model should be interpreted ‘in accordance with’ the Guidelines and with any documents published
by the OECD as part of the Guidelines prior to May 1998, and any documents designated in an Order made by
the Treasury after that date as comprised in the Guidelines.

3 For example the Tanzania Income Tax (Transfer Pricing) Regulations 2014 s.9 specifies that they shall be
construed in accordance with both the OECD Guidelines and the UN Manual ‘as supplemented and updated
from time to time’. Hence, although Tanzania is not represented in the working parties or other groups working
on BEPS, any revisions of the Guidelines which result from their work will have some direct effect in Tanzanian
law.

4 Allowing an appeal by Unilever against a transfer price adjustment by the Revenue Authority under the
Kenyan statute, the court accepted Unilever’s arguments that its pricing was based on methods accepted in the
Guidelines. ‘We live in what is now referred to as a “global village”. We cannot overlook or sideline what has
come out of the collective wisdom of tax payers and tax collectors in other countries. And especially because of
the absence of any such guidelines in Kenya, we must look elsewhere’. (Judge Alnashir Visram, Unilever Kenya
v. KRA 2005, 12).

5 MM Sdn Berhad v Ketua Pengarah Hasil Dalam Negeri Appeal No PKCP(R) 55/2009 (2013) MSTC ~10-046
(2013).
Intangibles issued under the BEPS project, although it has not yet been approved and incorporated into the Guidelines.\(^6\)

5. Thus, in effect by rewriting the Guidelines the OECD Committee on Fiscal Affairs may be creating new tax norms for the world. Yet, the procedures for adopting these global rules involve little if any democratic accountability. Failing this, it is important to adopt some minimum procedural safeguards. The issues addressed are inevitably technical and specialised, but this should be all the more reason to avoid using approaches of dialogue with the public that make it difficult for all but the hardened specialist to understand what is being proposed. Regrettably, this does not seem to have been attempted. The approach used here is that the public has been presented with a draft for a revised chapter VII, with only a brief summary of what is new in the draft. Additions to and deletions from the previous version have not been marked, so that only those who are already closely familiar with the text can fully appreciate the implications of the changes, absent a very time-consuming line-by-line side-by-side reading of the current Guidelines and the new draft.

6. Essentially, a new category of ‘low value-adding intra-group services’ has been created, and a new section D added to explain a simplified method which may be applied to such services. This is essentially an apportionment method, based on a different perspective from the transactional pricing methods. The significance of this change is obscured by putting it forward as a mere revision of the Guidelines. The change is taking place as a modification by accretion, with some relatively modest rewording of the existing chapter, plus addition of a new section.

7. This approach that discourages broad participation greatly adds to the opacity and lack of accountability surrounding transfer pricing. It creates major entry barriers tending to confine discussion of the issues to a closed group of persons with long familiarity with the texts. Yet the importance of the BEPS project, and the potentially immediate and very wide impact of revisions of the Guidelines, clearly requires a widespread and well-informed debate on the issues involved. While the OECD has made efforts to consult with the community of tax experts, little or nothing has been done to reach out beyond this closed group. Even well-informed and highly educated professionals with an interest in the broad question of international corporate tax reform are effectively excluded from participating in the debate by the approach adopted. This applies also to policy makers and senior tax officials in developing countries and elsewhere who are relatively new to transfer pricing.

8. We therefore call on the Committee on Fiscal Affairs to rethink the approach which has been adopted to the writing of reports, especially in relation to transfer pricing. They should begin by explaining clearly the issues involved, including a frank appraisal of the limitations of existing approaches. Changes and the reasons for them should be explained clearly, and alternatives should be presented and evaluated. Finally, both clean and red-lined versions of amended portions of the Guidelines or other applicable documents should be provided.

2. **Specific Comments**

9. We welcome the proposals for a simplified method based on apportionment of joint costs put forward in this discussion draft. This recognises the problems with existing approaches discussed in section 1A above, although only implicitly. This report deals with only one issue to be addressed under this Action point: allocation of costs for services provided centrally for the members of a corporate group. Such services are generally provided centrally because either (i) they benefit the group as a whole rather than only one or more specific members,

\(^6\) *Watson Pharma Pvt Ltd vs. DCIT* (9 January 2015) ITA No. 1565/Mum/2014, para. 61
and/or (ii) they can be provided more cheaply internally rather than by an independent
contractor, mainly due to economies of scale or scope. Hence, they essentially entail joint or
overhead costs, and the most appropriate and simplest approach should be to apportion them
among affiliates in the group on the basis of a suitable allocation factor. The simplified
method here proposed essentially adopts this approach, which entails treating a corporate
group as a single or unitary enterprise.

10. The existing chapter VII, however, is based on assumptions derived from the independent
entity principle. Thus, it begins by defining an intra-group service narrowly as one for which
an independent company would have been willing to pay, and attempting to draw a
distinction between ‘shareholder activities’ and services that benefit one or more other group
members. The examples and discussion of these have been helpfully amplified in this draft,
but the distinction continues to rely on subjective judgment, with the text repeatedly
mentioning the need for detailed analyses of facts and circumstances. For example, the draft
adds to the list of shareholder activities ‘compliance of the parent company with the relevant
tax laws’; but this leaves unclear whether it includes for example preparation of transfer
pricing documentation, and in particular the Country-by-Country reports and Master File now
proposed. This type of uncertainty will mean high compliance costs and a significant
potential for conflict. Hence, we suggest that the Commentaries should provide additional
concrete guidance as far as possible. For example on this point, it could be specified that the
costs of preparing Country-by-Country reports and the Master File will be treated as
‘shareholder activity’, but that any locally incurred expenses by a subsidiary to prepare the
Local File would be borne by that subsidiary.

11. The costs of services provided centrally for members of a corporate group reduce the tax
base of affiliates. Even though a service may potentially benefit a particular affiliate, there
may be no actual benefit or only an indirect benefit. For example, discussing in paragraphs
7.17 and 7.30 services provided ‘on call’, the draft notes: ‘A parent company or a group
service centre may be on hand to provide services such as financial, managerial, technical,
legal or tax advice and assistance to members of the group at any time’. In such cases, there
may be no clear or direct relationship between the costs incurred and the affiliate’s business.
We are concerned that this nebulous facts and circumstances determination will increase
uncertainty and conflicts.

12. We are also concerned about the ‘facts and circumstances’ approach regarding allocation
keys. This will similarly increase uncertainty and conflicts. There is also a justified concern
by some tax authorities, especially in developing countries, based on some MNCs’ past
practices, that charges for centrally provided services have been overstated, and sometimes
misstated, to siphon profits out of their countries. To both allay these concerns and reduce
conflicts, we recommend suitable concrete allocation keys for all common categories of
central group services. Such systematization and formalization can be based both on research
studies and examination of practical experience. As a simple example of this, paragraph 7.48
of the Discussion Draft lists a number of legal services that are considered to be low value-
adding services. One category of such costs is ‘legal as well as administrative work for the
registration and protection of intangible property’. A concrete allocation key for this category
of legal services could reasonably be the number of IP assets capable of being registered
owned by each group member. We should note also that in any case where a profit split
method is used, the costs of centrally provided services may be charged against the combined
revenues which are subject to the profit split, thus avoiding the need for deciding whether and
how to allocate such costs.
13. Further, particularly in the case of some private equity investments, there are concerns that inappropriate and inflated management fees have found their way into tax havens. Given these concerns and scepticism about such charges, we suggest that Working Party 6 consider whether there are any safeguards that would discourage MNCs and private equity investors from any inappropriate or fraudulent practices in applying the simplified method. With respect to private equity investors where private equity management companies might not have common controlling ownership with investee companies, guidance in the Guidelines should make clear that private equity management companies that exercise any degree of control or influence over the companies in which their managed funds invest will be considered to be related for purposes of applying transfer pricing rules.

14. The emphasis on ‘facts and circumstances’ in the current arm’s length standard creates significant problems for tax authorities around the world which are facing budget restrictions, and need to allocate scarce trained staff to areas which would be most cost-effective. Hence, we believe that concrete approaches to dealing with the vast majority of intra-group services will minimise the time, expense, and effort of both taxpayers and tax authorities. Only outlier situations should require a detailed ‘facts and circumstances’ analysis.

15. The subject of this discussion draft is ‘low value-adding intra-group services’. Especially in today’s world of centrally managed and directed multinationals, the location of performance and the structuring of which group members will perform joint services is a central organisational decision. The performance of such services is entirely internal to the group and not at all a part of the group’s earning profits from conducting a business that earns revenues from third-party customers, clients, etc. To suggest that there should be any profit element earned by any group member for such services is therefore entirely inappropriate. Frankly, including this profit element is insulting to the many developing countries where multinational group subsidiaries will be the predominate payers of such charges. We strongly recommend that the 2% to 5% profit mark-up be totally eliminated from Section D of Chapter VII so that charges only reflect actual costs incurred. (We accept the discussion in Section B.2.3.2. (‘Considerations on including a profit element’) regarding possible profit elements where the simplified approach is not being used.)

16. We strongly support the move towards simplified transfer pricing methodologies based on profit-splitting. Tax authorities are understandably reluctant to allow deductions of costs based on apportionment where direct benefits to the local affiliate are not clearly evident. An expanded use of the profit-split method side-steps difficult issues of expense apportionment since relevant costs, including those for low value-adding services, are charged against the combined profits that are split amongst the several group members. The theoretical and practical deficiencies of transactional transfer pricing methods, outlined above, are well known. They are particularly inappropriate for tax authorities in developing countries, because (i) suitable comparables are simply not available, and (ii) audits based on comparables require detailed ‘facts and circumstances’ analysis, and are therefore time-consuming, require skilled personnel, and involve subjective judgments.

17. While we recognise that the current system as represented by the entire Guidelines will not disappear immediately, it must be recognised that it is inherently a defective system. Hence, the current reform proposals should be formulated in a way which begins to establish more secure foundations for the system. For those reasons, we applaud this Chapter VII shift towards an apportionment method and all other efforts that would improve administration and cost-effectiveness. This includes the increasing recognition that the profit-split method will often be the only viable approach under the current Guidelines for many multinational situations. We suggest an expanded discussion in the Guidelines of these possibilities, as
proposed in our submission on the related Action 10 report on *The Use of Profit Splits in the Context of Global Value Chains*. Both businesses and governments would benefit from the adoption of simpler methods which are easier to administer and reflect business realities.
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January 14, 2015

Ref: OECD DISCUSSION DRAFT: BEPS ACTION 10, PROPOSED MODIFICATIONS TO CHAPTER VII OF THE TRANSFER PRICING GUIDELINES RELATING TO LOW VALUE-ADDING INTRA-GROUP SERVICES

Dear Andrew,

1. BIAC welcomes the opportunity to comment on the OECD’s Discussion Draft of the Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services (the “Discussion Draft”).

General comments

2. We support the recognition by the OECD, that there must be a balance between simplifying the deduction of legitimate management and head office expenses, that should be charged to affiliated companies under the Arm’s Length Principle (“ALP”), and addressing the concerns of certain tax administrations and other Stakeholders, that such recharges could potentially be used by Multinational Enterprises ("MNEs") to artificially reduce taxable profits in the payor country. We note that many such payor countries will not be OECD members and in order for the proposals in the Discussion Draft to be effective, we encourage the OECD to reflect on its recent commitment to increasing engagement with non-OECD countries, and to obtain a broader commitment to a solution that is implemented by more countries. This would greatly add to the attractiveness of the proposals from a taxpayer and tax administration perspective.

3. Although we agree in principle that a separate regime for lower value services could be an effective practical solution for certain services, we are concerned that the Discussion Draft does not substantially add guidance on the other, more valuable services, which are also provided to affiliates and for which the ALP requires that charges are made. Such high value-adding services have been identified as a BEPS concern by many governments, and are the cause of many disputes between MNEs and tax administrations. We believe that it would be helpful if more specific guidance on these services could be included in the Transfer Pricing
Guidelines. However, as no other proposals are expected on this specific issue as part of the BEPS project, we assume that the government concerns over other intercompany charges are intended to be addressed through other work on Actions 8-10 (including proposals on intangibles, risk recharacterisation, commodity transactions, profit splits and cost contribution arrangements).

**Achieving greater certainty**

4. A recent survey of BIAC members showed that most MNEs have experienced significant recent disputes with tax administrations, in both payor and payee countries relating to Management Fees. In addition, there was almost universal support for a simplified methodology to achieve certainty and clarity relating to the treatment of Management Fees. The objective of simplification behind the OECD’s proposals will therefore be welcomed by the majority of MNEs. These businesses are, however, very surprised that this Discussion Draft refers to the recharge of routine services under the ALP as being “base eroding”. In practice, such services are often provided from higher tax locations, and recharged at a profit in line with the ALP, typically creating an incremental tax liability in the location of the service provider.

5. While the focus of the BEPS review concerns double-non taxation, it is important to recognise that double taxation remains a significant and increasing problem. Businesses have experienced, on many occasions, tax administrations alleging that more of the costs incurred by MNEs in relation to management and administration activities should be recharged and at mark-ups that are often considered to be higher than the ALP should permit. At the same time, tax administrations in payor countries often argue that part or the entire recharged amount should be disallowed. Further, in some instances, even after a domestic disallowance, tax administrations in certain countries have sought to treat the payment for services as ‘other income’ and imposed WHT on the payment. In the absence of a concerted approach to the treatment of these services, it is likely that an increasing number of disputes will arise requiring resolution under Competent Authority or Mutual Agreement Procedures.

6. Specifically addressing issues associated with deductibility and WHT would be a very positive step in making the administration of intra-group recharges much more efficient and consistent for both tax payers and tax administrations.

7. In many cases the absolute amount of the charges are insignificant in relation to the enterprise revenues and profits. A disproportionate amount of effort and cost is therefore regularly dedicated to seeking agreement about relatively small amounts of tax.

8. Although business welcomes the principle of an elective simplified methodology to provide certainty of treatment for Management Fees, the benefit of such a regime will only be enjoyed by business and tax administrations if it is designed to be clear, simple to operate, without excessive documentation, and, most importantly, be respected by all or most tax administrations in both payor and payee locations. There would be no benefit to business in implementing an additional reporting regime, requiring administrative effort and cost, if the majority of payor locations did not implement or respect the regime.

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1 For the purposes of this letter, we will refer to the recharge costs related to ‘Low Value-Adding Intra-Group Services’ as “Management Fees.”
Proposed amendments to Sections A-C

Duplicative Services

9. New proposed paragraph 7.12 adds four sentences at the end to caution that activities are not necessarily “duplicative” merely because they are similar in nature. Although this text is a welcomed addition, we are concerned that further consideration may be required for certain industries. In this regard, paragraph 7.12 does not consider the fact that, in a regulated industry, such as banking, local regulatory requirements have a strong influence on how certain support functions are organized. Even where branches and subsidiaries are subject to consolidated supervision by the home regulator, local regulators will still expect to see controlling and reporting functions such as compliance, finance, risk and internal audit performed in country. This may result in some inevitable duplication of the control functions.

10. In addition, we believe that further guidance is required in relation to the exception noted where duplicative services “reduce the risk of a wrong business decision.” MNEs may have internal risk management processes that serve as an internal alternative to seeking costly legal second opinions. Similarly, we believe that further consideration should be given to services rendered by regional or functional centres, where such services may at first appear duplicative in nature, but may actually create valuable synergies for the group. We would welcome more clarity in this regard, which could be provided through the use of practical examples. See our suggestions below on complementary and supplementary services.

Benefit of services

11. BIAC welcomes the explanation in Paragraphs 7.7-7.15 of the tests that should be applied in determining whether affiliated companies within an MNE obtain benefits from services that are rendered intra-group, either directly or indirectly. We also welcome further clarification of the distinctions drawn between shareholder activities, stewardship activities and other direct and indirect services that are provided within an MNE.

12. In Paragraph 7.11, examples of shareholder activities are provided, including a reference in 7.11 (e) to “Costs which are ancillary to the corporate governance of the MNE as a whole”. BIAC encourages the OECD to expand on this definition as its intention seems unclear. For example, is this intended to include internal audit, internal controls and other, similar functions? 7.11(b) also refers to the costs of preparing consolidated financial statements. It should be noted that for some MNEs, local and regional consolidations are required, irrespective of the ultimate ownership of the company or local group. Such costs, which are an obligation to comply with local reporting or regulatory requirements, should not be treated as shareholder costs. We note in this regard that for many MNEs, the administrative and management costs incurred for the benefit of the group will not be incurred in one location, but increasingly in multiple locations. These will include shared service centres, regional headquarters and elsewhere within the group, either as a result of an increasingly mobile workforce, or in the pursuit of specialisation and economies of scale. The ALP rightly requires that these costs, relating to services of direct or indirect benefit to other group companies, should not all be borne by the entity that incurs them. So, it is a requirement that some, or even all of the costs, are recharged on an arm’s length basis to the affiliates that receive the corresponding benefit. It would be helpful if the OECD were to explicitly recognise the principle that, where these costs do not relate to “shareholder” activities, that the ALP should
apply to either charge costs directly attributable to the beneficiary, or, to allocate the costs to all the relevant affiliates benefiting indirectly from the services using an appropriate allocation key, and that all of those costs should be deductible, while shareholder costs should be deductible in the parent company location.

13. In Paragraph 7.20, the OECD recognises that if services have been rendered, charges should be made within the MNE group in accordance with the ALP and that the payment for such services should not be treated differently from third party payments simply because the transactions are between associated enterprises. It is the experience of many MNEs that this principle is not followed in many countries. BIAC would therefore welcome greater emphasis and clarification in the Discussion Draft that arbitrary limitations on deductibility of intra-group service charges should be avoided by tax administrations.

BIAC Example: Complementary and supplementary services

14. Set out below are examples of ‘complementary’ and ‘supplementary’ services that we believe should not be considered duplicative in nature. The costs of such services should be recharged and deductible in the payor jurisdiction.

Complementary activities

15. Complementary services are often provided to facilitate the operation of a Local Affiliate in-line with an MNE’s global goals and policies. These services provide various benefits and can contribute to improving the performance of Local Affiliates. Such services are often provided directly by the headquarters entity, but can also be provided by other affiliates in the group.

16. It is often the case that Local Affiliates are adequately staffed to undertake all of the basic functions that are required for them to operate (e.g. Legal, HR, administration, finance etc.). Although this may be the case, Local Affiliates also benefit, and rely on, industry/sector/functional expertise and experience provided by equivalent functions elsewhere in the group. The advice, assistance and support provided is intended to enhance the activities performed by the Local affiliate. The benefits received through the provision of complementary services might include:

- Ensuring consistency with global MNE policies to maximise performance (e.g. implementing a globally consistent approach to administrative tasks to achieve efficiencies)
- Aiding compliance with MNE/Industry best practices and standards (e.g. complying with latest internationally endorsed safety standards)
- Reviewing and providing feedback on local affiliate budgets, plans and forecasts identifying potential opportunities and/or shortcomings
- Providing feedback/validation in relation to the employment of new staff
- Reviewing and providing feedback in relation to business succession planning
- Developing and implementing a common IT platform/strategy for affiliates

Example:

17. Local Affiliate B located in Country B employs a qualified Local Lawyer to provide general advice and guidance in relation to the local business. The Local Lawyer is responsible for
compliance with local laws and provides input into local legal disputes. Although the Local Lawyer has adequate knowledge of local law and appropriate experience, they also rely on input from a more senior qualified International Lawyer employed by Headquarter Company A in Country A. The Local Lawyer will discuss local issues with the International Lawyer to determine whether proposed decisions are consistent with the MNEs best practices and guidance. The International Lawyer will also provide a second technical opinion over the validity of arguments made/decisions proposed by the Local Lawyer.

18. The oversight and support provided by the International Lawyer is just one example of the indirect benefits provided through affiliation with an MNE, and is one of the mechanism through which the many advantages of MNEs are translated to local jurisdictions. The provision of such services should be considered to confer a benefit to the Local Affiliate and should not be considered duplicative in nature. The Local Affiliate should be permitted a tax deduction in relation to any arm’s length recharges made for the services of the International Lawyer.

19. Complementary services may differ in their nature in some ways, either in their substance, or in the way they are delivered, to similar services that may be procured from third parties. In some cases, it may be challenging to categorically prove that exactly the same services would always be sought from a third party. However, minor differences in the way that services are provided should not preclude a tax deduction for the cost of such services.

**Supplementary activities**

20. Supplementary services are often provided to directly improve the performance and maximise the potential of a Local Affiliate. Once again, such services are often provided directly by the headquarters entity, but can also be provided by other affiliates in the group.

21. Such services may form part of broad functions that are also undertaken by the Local Affiliate, but the specific service itself will not be performed locally.

**Example:**

22. A Local Affiliate may have its own marketing function, responsible for the printing and distribution of advertising literature. However, the headquarters entity may employ a team of marketing personnel which is responsible for the coordination of the global marketing strategy, campaigns and advertising literature, tailored to each market (which is physically delivered by the local marketing team). In this case, there is a substantial difference in the role of each marketing team.

23. In addition to the example noted above, supplementary services might also include activities that seek to expand the local market through undertaking market research, reviewing competition, identification of opportunities, identifying potential customers and understanding their future needs, providing details of multi-point products to potential customers from different businesses within the MNE that may not be able to be undertaken locally, but which ultimately could provide a current or future benefit to the local MNE affiliate from these efforts.

24. A local tax deduction should always be permitted in relation to arm’s length recharges for supplementary services.
Direct vs. Indirect recharge methods

25. The Discussion Draft at paragraphs 7.22-7.27 considers direct and indirect charging methods for intra-group services, and suggests that the direct charging method should be the default that MNEs adopt. The ‘indirect charge method’ is identified as the less favoured alternative.

26. MNEs operate and are structured in many different ways, with different types of services being provided across different business lines using different financial/management reporting tools. Given the extremely broad spectrum of fact patterns existing across MNEs, it may not be helpful to make assumptions as to the general ability of taxpayers to accurately implement a direct charging method in most situations.

27. Some MNEs will be better placed to adopt direct charge methods than others, but it should be understood that taxpayers themselves are best placed to understand which method is most appropriate for different services based on their understanding of their businesses and their capability to implement most efficiently and effectively. That assessment would also take into account the relative burden of implementing more complicated methods when taking into consideration cost volumes and risk.

28. We also note that for some taxpayers, there will be relatively few instances where similar services are provided to independent parties at all, or even under broadly comparable terms and conditions. The limitations of internal accounting and other processes can also prevent the separate identification or recording of work done and all related costs. It would therefore be more reflective of the reality of intra-group charging, if the Discussion Draft were to recognise that some MNEs will be less or more able to operate direct charge methods. It may, therefore be of considerable practical benefit to provide further guidance on the operation of indirect charge methods and cost allocations.

Research and Development Services

29. Paragraph 7.43 addresses the intra-group provision of Research and Development (“R&D”) services and proposes to substitute two new sentences (and an ending citation) in place of the final three sentences in the current guidelines. We do not disagree with the proposed new text, but would encourage the OECD to retain the existing text, which makes accurate and important points that should not be lost. It should be recognised that contract R&D is a common feature of commercial relationships between third parties operating at arm’s length, even though it may result in creation or enhancement of an intangible owned by the IP owner who contracts out the R&D.

A simplified method

30. Section D2 of the draft sets out the process that is recommended for computing charges that would fall within the proposed simplified method. BIAC welcomes the proposal for such a method and urges the OECD to make the method as simple to apply as possible to encourage participation by MNEs, and to avoid additional or disproportional administrative costs in complying with the requirements.

31. The full detail of the method would require additional objective commentary and examples, but care must be taken to provide a balance so that the ‘simplified method’ does not become complicated and unwieldy. We believe that the overly-brief explanation provided in the draft
is not yet sufficient for businesses to determine whether the method would be practical or beneficial. In particular, further clarity and certainty is needed on the:

- application of the benefits test to the costs incurred and recharged;
- method of calculation of cost pools;
- selection and justification of allocation keys in a variety of different business models;
- appropriateness of global allocation keys rather than testing against local comparables, and
- mark-up to be applied to costs in different categories, if a range of mark-up percentages is expected.

32. That being said, such additional commentary will only be a worthwhile investment if a critical mass of tax administrations make a clear commitment to adopt the proposals. From a tax administrations perspective, more practical guidance on implementation of the proposals would also be helpful, to ensure consistent application of the rules.

**Mark-up on costs**

33. The suggestion of recharging using a mark-up within the range of 2-5% is not explained or justified, and there is no guidance on how the range should be applied. There seems to be a clear risk here that tax administrations in the locations where services are provided from will assume that the upper limit proposed is the default mark up to be used, and that payor country tax administrations will assume the opposite. This will create unwelcome uncertainty where services are provided to many jurisdictions, or where a mark-up must be established on a multilateral basis to include all payor jurisdictions. Questions may be raised about whether the same mark-up should be applied by two different service providers within the same MNE group covering different regions (e.g., one provider for Europe and America regions, and the other one for Asia Pacific regions), which would add complexity and reduce the benefit of a consistent “safe harbour” to tax administrations and businesses alike.

34. BIAC recognises that in developing a simplified method, a balance needs to be struck between a simple method with very broad application, and a more complex method that would apply in a different way in different circumstances. There is no clear consensus among BIAC members on whether the most appropriate and useful approach would be to have an extremely simplified method that provides certainty, but that does not fit well with all business models, or to have a more complex and nuanced method that acknowledges that “low value-adding services” are not all similar and that a 2-5% mark-up would not be consistent with the ALP for all such services.

35. To simplify the application of the proposed method, a single mark-up percentage could be proposed. Such simplicity would provide benefits for businesses and governments alike, addressing one element that is likely to cause dispute. If that were not possible, the guidance could, as an alternative, clearly state that a single point within the range of mark-ups should be applied consistently by an MNE, globally, and for all low value-added services. An alternative approach that would be favoured by some MNEs would be to distinguish between categories of services that are not high value-adding and propose a mark-up range for each category, with the overall range of mark-up percentages expanded to, say, 0-10%. This
approach would be more consistent with existing practice for the recharging of services, and would mean that MNEs would not have to choose between complying with accepted practice from the tax administration of their head office and electing for the simplified method on a global basis. It is also a concern that the use of a narrow range of 2-5% for mark-up on low value adding services may prevent some countries from adopting the simplified method.

36. It is of concern to business that the proposed method appears to mandate (at paragraph 7.57) that a mark-up in the range of 2-5% would be required for all low value-added services across an MNE, while paragraphs 7.37-7.39 refer to circumstances where it would be within the ALP for services to be recharged at cost only. Is it the intention, to make it a condition of participation in the elective method, that services that would ordinarily fall within the meaning of paragraphs 7.37-7.39, that would otherwise require no mark-up to be applied, should in-fact be charged with a mark-up if the MNE decides to elect for the simplified method?

37. It is also not clear from the Discussion Draft on whether the 2-5% range is intended to provide a safe-harbour, or whether tax payers are required to evidence their point in that range using comparables. We assume that the intention is the former.

38. We do recognise that the simplified approach in Section D makes an important contribution by recognizing that a cost-plus method, which allows a taxpayer to recover the full cost of providing a service, is a reasonable tax administration approach. Recovery of costs is not abusive; taxpayers adopt this method to be tax compliant, not to gain a tax advantage. However, BIAC is aware that some tax examiners challenge the recovery of costs, arguing that the service recipient could and should have obtained alternative services at a lower cost through other means, e.g., by hiring a local service provider. The argument, in these cases, is not whether a service was provided, or a benefit received; it is an argument whether the taxpayer provided the service in a cost efficient way. We urge that the guidelines adopt language to make clear that it is not appropriate for tax examiners to substitute their business judgment for the business judgment of the taxpayer, and that nothing in the guidelines, e.g., in 7.35, 7.37, or 7.38, supports a tax examiner to take upon themselves to question whether an alternative transaction would have been more reasonable than the transaction actually entered into.

39. There is also a concern that by making a distinction between low and high value-adding services, the revised guidance may also be used as a means of arguing that a TNMM method is only suitable for low value services, and that a profit split or other disproportionately complex method should be used more generally for higher value services. We believe that the revised chapter should clearly indicate that the TNMM is still appropriate for many services, and that it should be used when it is the most appropriate method.

40. From a practical perspective, it would seem to reduce some of the practical barriers of the proposals if the requirement for a mark-up in all circumstances was removed altogether as this would be in line with the Service Cost Method permitted in the US for low value-adding services.
Definition of services

41. The Discussion Draft defines services that should be excluded from the proposed method and lists examples of services that are to be treated as “low value-adding” in paragraph 7.48. BIAC encourages the OECD to explicitly state whether its list is intended to be exclusive, or merely illustrative. We note that the length of the list is likely to encourage some countries to treat it as exclusive.

42. Low value-adding services are defined in a restrictive way in the draft (paragraphs 7.46 and 7.47); appearing to exclude any service that should be compensated using a higher mark-up or through a participation in enterprise profits that is not linked to costs. We believe it is unhelpful that the services of senior management would not qualify, as the costs associated with such are typically a small percentage of overall costs and do not involve the use of hard to value intangibles.

43. In paragraph 7.47 reference is made to activities which would not be considered as qualifying for the simplified approach. We believe it would be helpful to further clarify what is included within these services described, as it is the experience of business that services related to the implementation, running, maintenance and back office activities regarding the categories of services described should not be excluded for the simplified approach, given they are supportive in nature and would meet the general definition of low value-adding intra-group services. Similarly, reference is made to section E of Chapter IV of the Guidelines and its Annex I (from 16 May 2013) which describes Memoranda of Understanding on low risk manufacturing, distribution and R&D services, and we feel that these activities should not be excluded from the simplified approach.

44. The Discussion Draft suggests in paragraph 7.46 that the low value-added services guidance would not apply where services are provided by MNEs to unrelated customers. While this is appropriate where such services are core to the group, there are situations where a MNE will provide services to unrelated parties that are ancillary to its core activities. Those activities may fall within the definition of low value-added services (e.g. accounting and indirect tax compliance services to hotel owners as an ancillary service to the provision of hotel management). Such activities may be performed by an entity that provides the same or very similar services to both related and unrelated parties. In this situation, the fact that similar services are provided on an ancillary basis to third parties does not change the nature of the services provided, and therefore, we consider should not necessarily preclude an MNE from applying the election for the simplified method.

Interaction with withholding taxes

45. As these low value-adding services are recognised as generating a low profit under ALP, the application of high withholding taxes on a gross revenue basis would clearly exceed the profit arising on the service provision. Consequently, unless there is an interaction between the adoption of this method and the imposition of withholding taxes on a gross basis on services, there would be little or no benefit to MNEs in adoption of the method.

Group-wide adoption

46. Paragraph 7.51 states that “An MNE group electing to adopt this simplified method would apply it on a consistent, group wide basis in all countries in which it operates.” We believe that
the guidance should make it clear that an MNE group would not be disqualified from using the simplified method simply because it complies with the transfer pricing ("TP") rules of jurisdictions that do not endorse or follow the OECD’s simplified method. The addition of a qualifier to the sentence, such as “where practicable” may help.

47. It is important to note in this respect, that services falling within the 'low value-added' category may be provided as part of broader package of services, and that not all of the bundled services will fall within the 'low value-added' category. In such circumstances, BIAC believes that a cost plus (or rather, a cost based TNMM) approach for the combined services may still be suitable and appropriate. Within the same group there will often be centres that purely provide 'low value-added' services, and others that combine both activities within and outside the definition. Because of the global election requirement, it seems that groups will either have to adopt more complex requirements to segregate activities, or, they will be prevented from using the simplified method anywhere in the group. Further clarification on this point would be welcomed.

Documentation

48. Paragraph 7.61 refers to a requirement for “written contracts or agreements.” We agree that it is important to have contemporaneous documentation setting forth the terms on which services are provided, and that such documentation provides clarity to taxpayers and tax administrations alike. However, in large MNE groups, there may be many hundreds of entities receiving services, and it is a needless burden to require formal, signed agreements among all parties for each individual service. The commentary should expressly recognize that the requirement for written contracts or agreements is satisfied by a contemporaneous document that properly identifies the entities involved and the terms on which services are provided without the need for formal bi-party or multi-party contracts or agreements.

49. While not specifically addressed in paragraph 7.61, it is assumed that the documentation requirements proposed for the elective method are an alternative to documentation required under the TPG as amended by the proposals in Action 13. The exemption from normal TP documentation should be clarified, together with the interaction of these documentation requirements and the TPG in the event of a dispute with a tax authority and confirmation that penalties would not be incurred where reasonable efforts have been made to comply with the proposed method.

A pool of costs

50. The proposed guidance sets out the initial step in applying the simplified approach in paragraph 7.52. This would require MNE groups to calculate “a pool of all costs incurred by all members . . . in performing low value-adding intra-group services.” The sentence following provides that the “costs should be pooled according to category of services” and the text elsewhere, including paragraph 7.55, signals a clear preference that costs be pooled and allocated by category. For many MNEs, it would be a needless and burdensome complexity to aggregate all costs, then to split them by category. The commentary should allow taxpayers, in appropriate cases, to focus directly on the aggregation of costs on a category-by-category basis without the initial cross-category aggregation.

51. Paragraphs 7.52 and 7.53 provide that the taxpayers should remove from the general cost pool, any costs that are attributable to activities performed only for itself (7.52) or for another
single member (7.53). This proposal signals that charges that are specifically allocable to an entity should be handled in that manner. This principle should extend to any pool of costs that relates to a discrete population of service recipients. So, for example, if a taxpayer has two service-providing entities, one providing a category of services to certain entities (e.g., in the Asia-Pacific region) and one providing the same category of services to other entities (e.g., in the Americas), the taxpayer should be permitted to keep those costs in separate cost centres for separate allocations, for the same reasons that costs attributable to a single service recipient are required in 7.52 and 7.53 to be maintained separately.

52. Furthermore, paragraph 7.57 indicates that the mark-up should be applied to all costs in the pool, but it does not mention pass-through costs. In aggregating all costs, the treatment of some “pass through costs” (as introduced in Paragraph 7.36) should be clarified, i.e., whether such “pass through” costs should be removed from the cost pools and only recharged at cost.

53. The pooling of costs would require a recharge of all service cost to a pooling entity. In general, these recharges are subject to VAT reverse charge, and to ensure input VAT recovery by the pooling entity would increase the administrative burden substantially. In addition, the local TP documentation efforts would be doubled, since all recharges from the service provider to the pooling entity, and subsequently to the service recipient, would have to be documented. To avoid the additional administrative burden, MNEs should be permitted to apply the simplified method without the need to pool cost. The service provider should be permitted to invoice service recipients without the need for an intermediary.

Divestments

54. In case of divestments or restructuring, it may take some time to reduce a group’s full cost of low value-adding services, e.g., due to legal restraints of reducing headcount, etc. Based on the proposed guidance, it seems that there is potential for differing interpretations as to whether such costs should be retained in the pool and recharged. We believe it is important for an MNE to be able to deduct such costs once, and we would welcome clarity in the guidance as to how they should be dealt with to avoid double taxation.

Operation of the simplified method

55. While many businesses welcome the principle behind the proposed simplified method, there are currently significant reservations about the practical benefits and potential administrative costs that would be involved. Only when businesses can make a more objective assessment as to the practicality of the method or the benefits it might bring will it be possible to state whether we generally support the proposal or that MNEs will likely adopt it. We therefore encourage the OECD to provide additional practical guidance on how the regime would operate, including on

- How would the method be implemented? (i.e. through amendment to Chapter VII of the guidelines and domestic ratification or through any another mechanism?)
- Whether the method would apply to all entities within an MNE or if it could apply to separate business lines etc.?
- How the election would be made and for how long it would be effective - including how the election would legally bind an MNE’s entities in different jurisdictions and to which tax administration(s) the election(s) would be made?
Where the MNE has multiple locations providing low value-added services, would the method be applied to all costs incurred in all locations and charged anywhere within the MNE group?

Whether benefit tests should be undertaken only in relation to the provider jurisdiction, or by multiple jurisdictions, with the opportunity for different conclusions?

How would the existence of the election be recorded and communicated to other tax jurisdictions?

Would there be any compulsion or expectation that payor locations would be required or recommended to accept the existence of the election? What procedure would be followed where payor countries do not accept the approach?

How would an MNE gain any comfort or certainty that the use of the elective method would avoid or reduce audit issues or disputes in any or all payor locations?

What would be the expected level and detail of documentation required to support the method?

Which tax administration would have the responsibility to audit the integrity of the cost pool calculation and allocation key application (we would prefer this to be the service provider location, which could share the results with relevant jurisdictions)? MNEs would be concerned about having to deal with multiple audits or enquiries relating to the method from different tax administrations.

Would additional streamlined tools be available to address dispute situations, and resulting double taxation?

Where a taxpayer has an APA for low-value added services, how would the operation of the APA be affected if this new guidance is adopted, particularly in respect of countries that do not have APA processes or where they do not recognise other APAs. What transition arrangements would be in place to go from the method agreed in existing APAs to the new simplified system? Would MNEs be permitted to elect so that the existing agreed methodologies transition into the simplified method automatically at the end of the APA term?

If the MNE is an investor in one or more Joint Ventures or subsidiaries that are not wholly owned, and where the other shareholder has some control over operations and costs, there may be commercial difficulties in recharging all relevant costs within the cost pool as defined. In these circumstances, how should the cost pool be adjusted, or recharges to other recipients be adjusted to make allowance for the costs that cannot be recharged?

56. BIAC supports the principle of a simplified method to resolve or reduce multilateral disputes with tax administrations over low value-added services, and is ready to work with the OECD to develop the practical guidance that is needed on the operation and implementation of the method. The guidance should provide clarity and certainty to business and tax administrations on the:

- deduction of all reasonable costs incurred in the management of the group, excluding shareholder costs;
- determination of cost pools and allocation keys;
• mark-up rates to be applied and which services should be charged at cost; and
• mechanics of the election, the supporting documentation and the commitment of tax administrations to recognise the use of the method.

Interaction with other BEPS actions

57. The OECD’s recent proposals under Action 7 (PE Status) seem to suggest that, in the future, MNEs may have to declare an increasing number of PEs where certain low value-adding services are being undertaken. We also note that the Action 7 Discussion Draft notes that the OECD does not expect to undertake substantial work on profit attribution. When further developing its guidance on low value-added services, BIAC would encourage further consideration of how the electable method (and other provisions of Chapter VII) will interact with the output under Action 7.

We hope that you find our comments useful. We look forward to participating in the public consultation in March, and would also be happy to help in any other way that we can.

Sincerely,

Will Morris, Chair
BIAC Tax Committee
We are pleased to accept the invitation to comment on the Public Discussion Draft, BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services, published by the OECD on 3 November 2015 (hereafter the “Discussion Draft”)

As a fairly new professional services firm that tries to bridge the gap between a sound theory and practical implementation of transfer pricing policies, through the mix of its competencies (know-how) built through working exclusively with professionals with over 10 years consulting experience in large, international consulting firms, the development and deployment of relevant capabilities (processes), as well as making the capacity available that is required by business in the field of transfer pricing policy design and implementation. As such bMoxie focuses on providing transfer pricing services in the fields of financial transactions and restructurings and valuations, as well as interim management services for the design, enhancement, maintenance and protection of transfer pricing control frameworks for the benefit of and complementary to the in-house capacity of multinational businesses. It is in the latter aspect that we feel obliged to provide our comments in respect of the Discussion Draft.

Indeed, having experienced acting as designers and systems integrators of (amongst others) transfer pricing policies for global intra-group services in the last few months of 2014 (to be applicable 2015 onwards), we had the privilege to help navigate our clients in the evolving landscape of the subject matter. Notwithstanding the Discussion Draft - as the name suggests - is still in a conceptual phase, given the likelihood that there will be substantial changes implemented in Chapter VII the OECD Transfer Pricing Guidelines, and given our understanding that the arm’s principle remains the standard whereas plenty of the new wording proposed is to be considered as supplementary guidance rather than deviating from aforementioned standard, we took the opportunity to stress-test the design under the currently formally applicable guidance (as per the 2010 Transfer Pricing Guidelines) translated to implementation requirements and possibilities against what is proposed in the Discussion Draft in order to ensure our clients have invested in a transfer pricing framework needed today, but that also is future-proof or at least adaptable to the final guidance resulting from this public consultation round.

Today, we wish to share our experiences from the above in-the-field exercise in the light of a few selected practical issues that we came across on our journey of the last few months.

Undoubtedly, you will receive numerous, valuable comments from other professional services firms (and other stakeholders) that will aim to comment on all (theoretic and perhaps also some practice) issues concerning the Discussion Draft, whereas from an overall perspective we limit ourselves to the following synopsis in that respect:
bMoxie welcomes the extended guidance on shareholder activities, and duplication.

Despite some experience in the field of transfer pricing for services (in European settings mainly), bMoxie cannot relate to the statement in paragraph 7.33 as if the CUP method and Cost Plus Method (CPLM) in practice would often be the most appropriate methods. Rather in the light of absence of available, reliable transactional data, and considering the CPLM in practice in our experience is considered to be applying gross profit mark-ups rather than net profit mark-ups, it seems to us that the Transactional Net Margin Method (TNMM) often is deemed the most appropriate method – even by the tax administrations where the service provider is located to ensure at least the coverage of its full (operating) costs. Whereas this may be a semantic discussion, paragraph 7.33 concludes with suggesting that not applying the CUP method or CPLM may only occur in exceptional cases. In the light of the above, it is suggested to erase the suggestion of exceptionality linked to the TNMM, or to reconsider rewriting the full paragraph 7.33 to reflect actual (reasonable) practice.

Also, bMoxie welcomes as such the introduction of separate guidance on low value-adding services, however we would consider them still as necessary costs incurred to enable the development of operating income (via the support they render to the higher value-adding functions), rather then calling them base eroding.

Nevertheless, bMoxie has concerns that the required proposed application of a group-wide (global) approach in connection to low value-adding services, when certain countries (most notably in emerging markets, but also other OECD countries have different approaches) are involved, may be very challenging for many MNEs. Therefore, a suggestion may be to explicitly allow for exceptions in case a group faces the challenge to overcome local compliance issues, without jeopardizing the validity and reasonableness of its overall approach.

In respect of the practical issues we came across in testing most notably the new guidance on low value-adding services, but within the design of an overall corporate services policy (i.e. including those that would not be considered low value-adding services), bMoxie would like to highlight the following:

1. **Activities that would not be considered low value-adding services as per paragraph 7.48**

We have had to deal with the following practical issues in the field, on which further guidance seems to be useful for effectively implementing the guidance in order to avoid discussions or even where alterations are suggested to sustain compliance with the definition of low value-adding services in paragraph 7.46 as well as to sustain practical applicability:

   - The scope of activities mentioned that would not be considered low value-adding services are described in a very broad manner, whereas within these areas mentioned there may be activities that would fit the definition of low value-adding services:

     o Example ‘financial transactions’

        - It is unclear what is meant with financial transactions. We tend to strictly define this as the exchange of (financial) assets, and accordingly not be as broad as the full spectrum of financial services or services that relate to the financial position of companies. Indeed many multinational groups organize their financial services or treasury departments centrally to enable an efficient and effective service to the group members, which may include the execution of
financial transactions, but also certain financial services. These services in turn may be fitting or not fitting the definition of low value-adding services. It is not uncommon that group treasury centers also provide auxiliary services that fit the examples of what is provided in paragraph 7.48 – i.e. that are merely of an accounting or administrative nature, and that do entail processing and managing of accounts receivable and account payable. In other words, the scope of a treasury department typically includes investment and funding activities, and may include other financial services that do require the assumption or control of substantial or significant risk, but may very well include services that could be considered low value-adding services, in the view of bMoxie.

- Taking it one step further, even for instance in the light of a cash pool, that entails the exchange of assets, it may well be that the cash pool manager is only to be considered economically to be performing a pure clerical function when it contractually vis-à-vis the cash pool bank and the participants does not assume any risk, however in practice this would not unlikely be the case that the cash pool manager. We just wanted to make the point that even in the light of services auxiliary to financial transactions, there may be a certain division of activities amongst stakeholders that could lead one of the service providers rendering services that could technically qualify as low value-adding services.

- A similar example could be ‘sales, marketing and distribution activities’

- These are also very broad concepts. Particularly in the field of marketing, there are plenty activities that could fall under the definition of low value-adding services, depending on what is considered to fall under the concept of what constitutes marketing. There are many definitions of marketing, and the scope of it can be widely interpreted. It is not so hard, however, to think of many activities a company performs that are customer-oriented and hence could be considered marketing (related) but that clearly could fit the definition of low value-adding services, such as (non limitative): creating sales presentations and copywriting for promotional materials and other content production, exploratory and descriptive market research.

- For other activities it may be industry dependent whether a certain market activity is low value-adding or not. For instance, a customer call center is not often considered as requiring unique and valuable intangibles and may well be considered supportive of nature in certain industries and depending on what is actually (trying to be) achieved – from sales soliciting, making an appointment for sales executives in the B2B-market to executing cold call sales as often seen in the B2C market. Even the latter perspective, the question still could be raised whether making the call is core to the business in our view, taking it one step further again.

- Another popular way of thinking we observed in our experience is to treat anything that has to do with the pricing process as directly valuable for the sales process. In for instance the energy industry pricing can be rather formulistic, depending on prevailing, independent market indicators for raw material pricing for instance, whereas the formula and margin has been negotiated under a framework agreement negotiated by the sales staff, and the actual pricing to be applied under the aforementioned agreement takes up the work of a centralized team calculating effective pricing for the transactions to be executed. Notwithstanding pricing is core to the business, it would be difficult to substantiate that the effective price calculations would not fit the low value-adding services definition.
By giving the above concrete (simplified) examples, we hope to have surfaced the undesired area for debate that may be created by what is stated in paragraph 7.47, given our assumption that it would not be the intention of the OECD to simply overrule its own definition given in paragraph 7.46 by excluding ‘any activity that has (remotely) pertain to’ the broadly defined activities stated. Therefore, bMoxie has the following suggestions:

- Or, define the activities stated in paragraph 7.47 – However, as shown whereas we may apply a strict definition on financial transactions this may not be as easy for marketing;
- Or, preferably, clearly state that the definition of paragraph 7.46 remains the overarching principle, and that depending on the case at hand and the actual specific activities performed the stated broad activities are examples.

- Treating the ‘services of corporate senior management’ as an example of activities that would not be considered low value-adding services at least gives rise to 2 practical issues:
  - First of all, what is the meaning of corporate senior management?
    - As to our knowledge there does not seem to be a clear and universal definition of corporate senior management, this may give rise to various debates with tax administrations.
    - One option would be to draw the line based on function titles given to persons in an organization, but then again not all enterprises do not apply the same management ranking system, and others in our experience, have honestly created well sounding titles to accommodate career advancement through seniority, however not necessarily in parallel with in increase in accountability.
    - However, in a rather constant manner, we observe that companies tend to consider senior management as those people that are the highest level of organizational management – i.e. those who report to board of directors of the (parent) company. This often includes those people that report directly to the board of directors that appoints them (C-level in most companies), but may also include those that collectively with the aforementioned report indirectly to the board of directors as part of the ‘executive management’ (which may also include non-C-level titles, such as VPs). The key distinction made by companies in our experience is that ‘corporate senior management’ is strictly limited to those that have been granted specific executive powers by the board of directors or the shareholders for managing the day-to-day operations of the business.

  - Secondly, is it true that a member of corporate senior management would not be partially able to provide services to group members that could be considered low value-adding services?
Applying the strict definition of the above, one can easily deduct that the decisions made by corporate senior management and services provided by them generally entail strategic matters, and hence may lead to the creation of unique and valuable intangibles and/or may involve the assumption or control of substantial or significant risk, insofar that their services would not need to be considered (for certain parts) as shareholder activities related. The question, however, arises whether the above excludes them from being partially, effectively occupied with services for the benefit of group members that would technically fit the definition of low value-adding services in paragraph 7.46.

In practice it seems to be the case, certainly when corporate senior management and corporate service departments tend to be centralized that the people that act as the corporate senior management also may have a more departmental lead role affiliated with their field of expertise. For instance, the CFO next to being accountable vis-à-vis the board of directors for the overall financial position of the group, may also be the functional lead of the centralized service group responsible for accounting and controlling. A VP that is part of the executive committee may be the functional leader of the HR department as well. Hence, both of them may be functionally responsible for organizing those particular corporate services, aided by functional directors.

Furthermore, the real issue from a practical perspective is that for management reporting / cost accounting purposes, the costs of senior executive management insofar they also take the functional lead over particular corporate service departments, are allocated between the cost center that relate to the group executive management activities and the cost centers that relate to the functional corporate service departments. The linking between the various processes the senior management executive is accountable for with the various cost centers is essential for instance for enabling required approval procedures, thereby acknowledging in our view that also senior management executives may have dual roles (perhaps more applicable in the smaller MNEs, but still we have observer this in larger companies as well for particular roles). As a consequence, with reference to our second example, the costs of the VP in charge of the HR department is reported in the executive management costs center as well as in the HR cost center (one of the services that typically could be considered as low value-adding services in accordance with the examples in paragraph 7.48). Considering this allocation actually reflects the time spent of the VP, it would in our view be onerous to treat the cost of the VP contained in the HR cost center differently from the (bulk of) other HR departmental costs, and in our view even would be contradicting the definition of low value-adding services in paragraph 7.46.

By giving the above concrete (simplified) examples, we hope to have surfaced the undesired area for debate that may be created by what is stated in paragraph 7.47, given our assumption that it would not be the intention of the OECD to simply overrule its own definition given in paragraph 7.46 by excluding ‘any activity that has (remotely) pertain to’ the broadly defined activities stated. Therefore, bMoxie has the following suggestions:
2. Direct charging under low value-adding services

In respect of the determination of cost pools, paragraphs 7.52 to 7.54, describe various adjustments to the cost centers taking into account as low value-adding services, such as the removal of costs relating to shareholder activity, the cost related to in-house activities that solely benefit the company performing the activity, and the costs related to the service provision for the benefit of one specific service recipient.

It is with respect to the latter there may be a misunderstanding. Whereas it rightfully should be excluded from the pool for indirect allocation, and given our understanding that nevertheless they should be added to charge as described in paragraph 7.58 (i), we would prefer making it more clear from the beginning that also direct charging is part of the low value-adding approach.

⇒ bMoxie makes the following proposition in that sense:

- add to paragraph 7.53 that costs relating to low value-adding services, but that are incurred solely for the purpose of a specific service recipient are indeed excluded from the cost pool and from the indirect cost allocation mechanism described in paragraphs 7.55-7.56, are treated further in paragraphs 7.57 and 7.58; and

- add to paragraph 7.57 that the same profit mark-up provisions apply to costs relating to low value-adding services, but that are incurred solely for the purpose of a specific service recipient.

3. Pass-through costs and low value-adding services

Whereas in paragraphs 7.36 it is acknowledged that in the case of mere agency or intermediation in respect of externally incurred costs that would otherwise be incurred directly by the beneficiary as well (hence, without the alteration of the externally provided services or own value added), it may be appropriate to pass on these costs to the group recipients without a mark-up (and to apply a mark-up on the costs incurred for the agency or intermediary function). These are in practice often referred to as pass-trough costs or disbursements.
In section D on low value-adding services there is no reference to pass-through costs. Rather paragraph 7.57 states that “In determining an arm’s length charge for low value-adding intra-group services, the MNE provider of services shall apply a profit mark-up to all costs in the pool. The same mark-up shall be utilised for all low value-adding services irrespective if the categories of the services. The mark-up selected by the taxpayer should be no less than 2% of the relevant cost and should be no greater than 5% of the relevant cost. It should be noted that these intra-group services mark-ups should not, without further justification and analysis, be used as benchmarks for the determination of the arm’s length price for services not within the definition of low value-adding services, nor for similar services not within the elective, simplified scheme.”

➔ bMoxie makes the following observations:

- Again, if it is the intention of the OECD to not apply the principle of pass-through costs in the same manner as it would apply on services that would not be considered low value-adding services it should clearly state this intention and should organize further debate whether this would be an appropriate action (which we firmly believe not to be, since it will only stimulate the search for workarounds – which to be clear and honest are available in our view but which do not contribute to the benefit of any party concerned.

- Otherwise, bMoxie proposes to add to paragraph 7.57 at the end of the first sentence [… a profit mark-up to all costs in the pool], insofar these do not constitute for which the service provider acted as a mere agent or intermediary and no mark-up should apply in accordance with paragraph 7.36.

4. Other (not related to low value-adding services)

- Paragraph 7.8 introduces the opportunity to neglect the fact a service has been rendered in certain cases where there has been no utilization of the service. In IT, for instance, it is not unusual to conclude break/fix service contracts, where it may well be that the large infrastructure breakdowns intended to be covered, are not incurred. Nevertheless, the service provider still charges (rightfully) a service fee for being standby and to invest in developing, enhancing and maintaining the know-how required to adequately fix the problem, when and if the problem occurs. Hence, we propose to make the point clear in the specific paragraph that ‘even in case where the service has not been utilized over a longer period of time, there should not be an automatic presumption that no service has been rendered’.

We hope that our comments may contribute to the important discussions that you will organize in the light of further finalizing this transfer pricing guidance. In case you would have further questions, or feel the need to have a sounding board, please do not hesitate to contact us.

Sincerely,

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BUSINESSEUROPE

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BUSINESSEUROPE represents through its members 20 million small, medium and large European companies. Active in European affairs since 1958, BUSINESSEUROPE's members consist in 41 leading industrial and employers' federations from 35 European countries, cooperating in a joint effort to achieve growth and competitiveness in Europe.

BUSINESSEUROPE is pleased to provide comments prepared by the members of its Tax Policy Group, chaired by Krister Andersson, on the OECD Discussion Draft entitled “BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-group Services” (hereinafter referred to as the “Discussion Draft”).

General Comments

Globalization of multinational enterprises has led to an increase of a wide range of intra-group services. Resources to ensure compliance to the arm's length principle are needed.

The approach adopted by most countries to accurately determine the price of transactions involving intra-group services is that based on the arm's length principle. This refers to a comparison between the conditions applied by associated enterprises and the ones that would have been applied between independent enterprises.

The interpretation and application of the arm's length principle differ among Tax Authorities and among Tax Authorities and businesses. The foregoing circumstance
might be conducive to increased uncertainty and costs for all multinational enterprises, as well as to potential double taxation or even double non-taxation.

Chapter 7 of the OECD Transfer Pricing Guidelines outlines specific issues pertaining to the supply of intra-group services, in connection with the following two areas:

• Determination of whether an intra-group service has been provided;
• Calculation of the price to be applied to service-related transactions in compliance with the arm's length principle, taking into consideration the perspectives of both, provider and recipient of a given service.

When determining the arm's length price, although provider ought to primarily take into account the cost for providing the relevant services, all facts and circumstances must be duly considered.

The remuneration of a specific category of intra-group services, so-called "low value-adding intra-group services", may be crucial when compliance with the arm's length principle is at stake. A major issue concerns the potential for excessive resources to be devoted by multinational enterprises when they have to provide documentary evidence of the supply of this particular type of services. Moreover, there is awareness that some types of service provision entail a lower risk for multinationals than others.

Chapter VII of the OECD Transfer Pricing Guidelines (2010 version) does not deal with so-called "low value-adding intra-group services". Therefore, BUSINESSEUROPE welcomes the efforts made at OECD level to provide guidelines for the identification of those services, as well as for the determination of their remuneration.

BUSINESSEUROPE encourages Member States to reach consensus on the Discussion Draft in order for all States to follow the same guidelines which would reduce the possibility of double taxation on the topics described.

With the aim to ensure both, certainty and efficiency, breadth and depth of the evaluation to be effected with regard to the above mentioned category of intra-group services should be preliminarily addressed. Subsequently, specific/technical guidance on how the evaluation ought to be carried out should be provided.

A few principles play a key role when the supply of "low value-adding intra-group services" has to be fully proven. Those principles include:

• the fact that complete data and information should be made available to Tax Authorities;
• the fact that a flexible approach should be applied when reviewing low value adding intra-group services.

A flexible approach, however, should address some critical issues such as (i) the analysis of cost pools, (ii) the definition of shareholder costs, (iii) the definition of costs associated to incidental benefits (iv) the remuneration in compliance with the arm's length principle, (v) documentation obligations and related penalties.
Some clarity should be provided by the OECD on how to characterize activities that should be considered as creating an incidental benefit. Should the incidental benefit category include all activities not characterized as shareholder and that does not pass the "would be willing to pay" test?

Moreover, a sensitive area for intra-group services, including "low value-adding intra-group services", concerns the resolution of double tax disputes.

BUSINESSEUROPE welcomes the guidance provided on "low value-adding intra-group services", which represents a further step towards a balanced approach to managing BEPS' concerns adopting a needed simplification on appropriate charges for these kinds of services.

Specific Comments

Chapter VII of the OECD Transfer Pricing Guidelines discusses issues that arise in determining – for transfer pricing purposes – whether services have been provided by one member of a multinational group to other members of that group and, if so, in establishing arm’s length pricing for those intra-group services.

The proposed new section D, which will be reflected in a revised version of Chapter VII of the OECD Transfer Pricing Guidelines, related to "low value-adding intra-group services" aims at identifying a simplified approach for the treatment of this particular category of intra-group services, in order to achieve the necessary balance between appropriate charges for low value-adding services and head office expenses, and the need to reduce the erosion of taxable income and protect payer countries' tax bases.

Benefit test

With regards to the benefit test, we consider it relevant to clarify that the analysis of the economic or commercial value that enhances or maintains the commercial position should be made on the recipient of the services and not on the provider. The services are required to produce an economic or commercial value that enhances or maintains the commercial position of the recipient. The analysis performed in order to verify this requirement should be an analysis made from the perspective of the recipient of the services and should take into account its circumstances.

According to it we propose to amend paragraph 7.8 as follows (the changes included are marked in yellow):

"7.8 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 intra-group services. However, some guidance may be given to elucidate how the analysis would be applied for some common types of services undertaken in MNE groups". The analysis performed in
order to verify that the services produce an economic or commercial value that enhances or maintains the commercial position of the recipient should be an analysis made from the perspective of the recipient of the services and should take into account its specific circumstances.

Shareholders activities and duplication

In the first instance, compared to the current Chapter VII of the Transfer Pricing Guidelines, BUSINESSEUROPE welcomes the additional examples provided by the Discussion Draft with reference to the shareholder activities (including costs related to stock exchange listings of the parent company; costs related to financial reporting and audit costs carried out in the interest of the parent company or related to consolidated financial statements; costs related to investor relations such as communication strategy; costs related to compliance of the parent company with tax laws and costs ancillary to the corporate governance of the multinational group as a whole).

However, in order to complete the current definition of shareholder costs of Chapter VII, it would be desirable to include more examples of shareholder activities and costs. In particular, specific examples should be provided to assist in determining the "cost which are ancillary to the corporate governance of the MNE as a whole".

Based on the lists published by some EU member countries (such as The Netherlands) and the EU Joint Transfer Pricing Forum, a non-exhaustive list of activities and costs that can be considered as incurred for the benefit of the parent company (shareholder costs) is included in order to complete the current list of paragraph 7.11:

1. All Presidential costs, including costs of the President's Cabinet.
2. Costs related to the study and implementation of the capitalization structure of the subsidiaries.
3. Costs for the increase of the share capital of the subsidiary.
4. Costs of supervision, managerial and control (monitoring) activities related to the management and protection of the investments in participations. Ideally, some examples could be provided. For instance, should we consider that the costs incurred by the business unit’s headquarters in charge of implementing the strategy defined by the Management, as well as supervising, managing and monitoring the BU’s legal entities should not be recharged?
5. Costs of internal audit activities within the group, as long as the conclusions derived from the activities are primarily reported to the parent and not to the subsidiary/ies audited.
6. Costs to reorganize the group, to acquire new members or to terminate a division, when the objective aimed is to benefit the group as a whole (increase its financial ratios, reduce costs, etc.) and it does not directly benefit one or several subsidiaries.

7. Activities relating to the establishment of group policies (financial policies, tax policies, human resources policies, insurance policies, etc.).

8. Activities related to the definition, measurement and promotion of the strategic principles in terms of groups’ reputation.

Nevertheless, it should be highlighted that determining which costs should be considered as shareholder costs is not a straightforward issue; it is necessary to perform a case-by-case analysis in order to reach to a conclusion on whether the costs incurred (i) benefit the whole group, (ii) benefit only the parent company or (iii) benefit certain subsidiaries and, consequently, a service is being rendered.

Example: a MNE might decide to incur training costs to maintain a know-how within the Group even if the related business activities are temporarily suspended for various reasons such as regulatory.

Example: a MNE might decide to place an employee in secondment with a subsidiary for which the costs appear to be disproportionate with the costs of an equivalent local employee.

Example: a MNE might decide to perform some prospective (very long-term view) and transversal (multi business units) R&D activities that would not necessarily be performed by the subsidiaries but is useful to define a competitive long-term strategy.

In the classification of the activities as group services or shareholder activities, certain activities may qualify as mixed activities. Mixed activities are activities conducted by a department within the group which partly qualify as group services and partly as shareholder activities.

It would be very useful to have some guidance to allocate the costs that benefit both the parent company and subsidiaries.

According to the above inclusion of the costs of supervision, managerial and control (monitoring) activities related to the management and protection of the investments in participations within the shareholder activities’ list, we propose to eliminate the following paragraph and modify the last sentence as follows (the changes included are marked in yellow):

The 1984 Report also mentioned "costs of managerial and control (monitoring) activities related to the management and protection of the investments as such in
whether these activities fall within the definition of shareholder activities as defined in these Guidelines would be determined according to whether under comparable facts and circumstances the activity is one that an independent enterprise would have been willing to pay for or to perform for itself.

Where the activities such as those described above are performed by a group company other than solely because of an ownership interest in other group members, then that group company is not performing shareholder activities but should be regarded as providing a service to the parent or holding company to which the guidance in this chapter applies. The costs of those services will be considered as shareholder costs by the holding company recipient of the services.

See above comment.

In addition to the above changes, we propose to amend paragraph 7.10 as follows in order to include companies that are not the parent company of a group, but a holding company of a specific business within the group (the changes included are marked in yellow):

"7.10 A more complex analysis is necessary where an associated enterprise undertakes activities that relate to more than one member of the group or to the group as a whole. In a narrow range of such cases, an intra-group activity may be performed relating to group members even though those group members do not need the activity (and would not be willing to pay for it were they independent enterprises). Such an activity would be one that a group member (usually the parent company or a regional or business holding company) performs solely because of its ownership interest in one or more other group members, i.e. in its capacity as shareholder (...)."

Would it be acceptable for a regional headquarter that is not directly shareholder (no dividend) to incur recurrent losses because not all costs are chargeable?

BUSINESSEUROPE welcomes the further clarifications on the duplicative costs as well, since, in most cases, Tax Authorities deny the deductibility of services charged based on the criterion that services have been duplicated.

BUSINESSEUROPE agrees that any consideration as to the possible duplication of services needs to examine the nature of the services in detail and the benefits deriving from the services received.

The OECD states in para 7.12 that an exception could be made to the duplication test when the duplication is undertaken to reduce the risk. Such costs could be significant for capital intensive MNEs. Is this exception subject to the "would be willing to pay" test at the level of the subsidiary?

The Discussion Draft provides an example, according to which the fact that a company carries out in-house marketing services and is also charged for marketing services
from a group company, would not – in and of itself – determine duplication, since marketing is a broad term covering many levels of activity.

The above example appears to be appropriate since the legal entity providing the services could be involved in various marketing activities from those performed by the recipient of the service, which could be considered complementary or additional.

Despite of the above, it should be clarified by establishing some rules or additional examples, in which specific cases a company could receive a charge from its parent or another group entity and, additionally, either perform the same type of services internally or subcontract with third parties the performance of that kind of services, as, in general, it should not be the case.

Low value-adding services

BUSINESSEUROPE welcomes the introduction of the new category of low value-adding services as well as the OECD’s effort to provide examples of services that may be suitably defined as low value-adding services. For the sake of clarity, BUSINESSEUROPE encourages the OECD to specifically refer to the list provided under paragraph 7.48 of the Discussion Draft as non-exclusive (the list includes some examples).

Paragraph 7.47 of the Discussion Draft provides that “The following activities would not be considered as qualifying for the simplified approach outlined in this section”. BUSINESSEUROPE suggests reviewing the wording by adding the underlined expression “the following activities, would not in principle, be considered as…”.

The definition of low value-adding intra-group services includes services performed by one or more members of a multinational group which:

- are supportive in nature,
- are not part of the core business of the multinational group (even if these services represent the core activities of the legal entity providing the service);
- do not require the use of unique and valuable intangibles and do not lead to the creation of such intangibles; and
- do not involve the assumption or control of substantial or significant risk and do not give rise to the creation of significant risk.

For the above mentioned category of intra-group services, the Discussion Draft provides a simplified approach (elective by the multinational groups) for determining the arm’s length remuneration to be paid by members of a multinational group, recipients of such services.

In paragraph 7.47 reference is made to activities which would not be considered as qualifying for the simplified approach. BUSINESSEUROPE suggests to clarify what is meant with these services described, as BUSINESSEUROPE feels application, implementation, run & maintain and back office activities regarding the services described would not qualify to be excluded for the simplified approach, given they are
supportive in nature and would meet the general definition of low value-adding intra-group services.

Similarly, BUSINESSEUROPE makes reference to section E of Chapter IV of the Guidelines and its Annex I (from 16 May 2013) which describes Memoranda of Understanding on low risk manufacturing, distribution and R&D services, and feels that these activities would not qualify to be excluded from the simplified approach.

The simplified approach recognizes that the arm’s length price is closely related to costs and allocates the costs of providing each category of such services to the group companies that benefit from using the services, using consistent group-wide allocation keys with an associated consistent small mark-up.

The above mentioned simplified approach consists of five main steps:
- determination of cost pools on an annual basis;
- appropriate cost allocation of low value-adding services by means of specific allocation keys consistent with the nature of services (i.e., headcount for services involving HRs, number of users for IT services, etc.);
- mark-up determination that ranges between 2% and 5%;
- computation of charges for low value-adding intra-group services;
- application of a simplified benefit test to low value-adding intra-group services by drawing up the relevant documentation, increasing the transparency through specific reporting requirements.

BUSINESSEUROPE welcomes the above described simplification, since it reduces the burden of both, taxpayers and Tax Administrations, with regard to routine and low value-adding intra-group services transactions.

The proposed simplified method for low value-adding intra-group services could significantly mitigate compliance costs of the multinational groups, since some Tax Authorities currently request detailed documentation of services received in order to provide sufficient evidence to substantiate deductions.

At the same time, the simplified approach will benefit Tax Authorities with limited resources in performing transfer pricing audits to verify the arm’s length charge of the intra-group services.

Consequently, the application of such a simplified method could reduce controversies with Tax Authorities related to the deductibility of low value-adding intra-group services. On many occasions, tax administrations in payor countries often argue that part or the entire recharged amount should be disallowed. Further, there have been experiences whereby, even after domestic disallowance, some countries have sought to treat the payment for services as “other income” and therefore have imposed WHT on the payment. In many cases the absolute amount of the charges are insignificant in relation to the enterprise revenues and profits. A disproportionate amount of effort and cost is therefore regularly dedicated to seeking agreement about relatively small amounts of tax.
Tax authorities challenge the small mark-up arguing that the cost plus method eliminates the capacity risk (i.e. costs are recharged even if activity is slowing down) and that the activities performed are risk-free.

In light of the above, the next step is to ensure a uniform adoption and implementation of the provisions provided within the Discussion Draft worldwide. Indeed, Paragraph 7.51 of the Discussion Draft specifies that such simplified approach would be applied by the multinational group on a consistent basis in all countries in which it operates. Furthermore, effective guidance and examples should be provided, so as to ensure a consistent application of the new provisions.

BUSINESSEUROPE stresses the need for the OECD to recommend and suggest that the new provisions be applied at a global level in all countries, emphasizing the benefits for both, taxpayers and Tax Authorities that would derive from a uniform implementation.

For OECD countries it could be sufficient to implement proposals by means of amended OECD Transfer Pricing Guidelines; for non-OECD countries (especially developing countries), it is necessary to ascertain whether such provisions are in line with domestic transfer pricing systems and the extent to which non OECD countries are able, in terms of resources and timing, to comply with them.

**Profit mark-up determination**

With reference to the determination of arm’s length charges for low value-adding intra-group services, Paragraph 7.57 of the Discussion Draft proposes a mark-up on low value-adding services ranging between 2% and 5% of the relevant costs.

The Discussion Draft specifies that the same mark-up should be used for all low value-adding services, irrespective of the categories of services.

BUSINESSEUROPE understands that when services qualify for the simplified approach and the approach is elected by taxpayer following the requirements in this Section D, a mark-up between 2% and 5% applies and no further functional and economic analysis (benchmarking) is required.

Further guidance on how the above range was determined should, in BUSINESSEUROPE’s view, be provided. BUSINESSEUROPE although welcomes the simplified approach, is still concerned with the risk that tax administrations in the locations where services are provided from will assume that the upper limit proposed while the tax administration of the payor country will assume the opposite. The difference in the interpretation by two countries might be much deeper in the case of developing vs developed country flows and/or European vs non-European country flows. In order to avoid the latter situation, a better approach could be to provide one fixed mark-up percentage.
Furthermore, it is necessary to coordinate Paragraph 7.57 with Paragraphs 7.33-7.36 which set forth cases with intra-group charges without any mark-up.

**Calculation of the cost base**

With reference to the costs on which the mark-up should be applied (cost base), the Discussion Draft refers generically to all costs incurred in the supply of the low value-adding intra-group services, without providing further guidance on their determination.

BUSINESSEUROPE suggests providing further guidance on the costs that should be considered for the calculation of the charge involving low value-adding intra-group services.

For example, the Dutch Decree, published by the Dutch State Secretary for Finance in November 2013, specifies which costs ought to be included in the cost base: “the relevant actual costs to be charged include the direct cost and indirect cost associated with the respective supporting services as well as the overheads. Therefore the relevant costs also include financing costs and non-operating expenses (...) which costs are relevant ensues from the functional analysis forming the basis of the transfer pricing system of the taxpayer”.

**Documentation requirements**

Paragraph 7.61 of the Discussion Draft refers to the documentation that multinational groups are required to prepare and make available to the Tax Administration of any entity within the group, which either makes or receives payment for low value-adding intra-group services.

With regards to the information that should be available to the Tax Administrations of the countries where the entities of the group are resident, it is necessary to specify that not all the documentation should be available to all the Tax Administrations, but only the information that specifically affects the provider or the recipient of the services in question. Accordingly, we propose the following wording for paragraph 7.61 (the changes included are marked in yellow):

"An MNE group electing for application of this simplified methodology shall prepare the following information and documentation and make it available upon request to the tax administration of any entity within the group either making or receiving a payment for low value-adding intra-group services. However, each tax administration shall only have access to the documentation that specifically affects its taxpayer (provider or recipient of the services)."

Where the above described simplified methodology is chosen, a multinational group would need to prepare the following information and documentation and make it available upon request to the Tax Authorities:
- description of the categories of low value-adding intra-group services provided, the (expected) benefits of such services and the reasons substantiating that such services constitute low value-adding services; the rationale for the supply of services within the context of multinational enterprises; a description of the selected allocation keys and the reasons substantiating that such allocation keys result in outcomes that reasonably reflect the benefits received; and the profit mark-up used;
- written contracts or agreements for the supply of services and any modifications to those contracts and agreements; and
- calculations presenting the determination of the cost pool and the application of the specified allocation keys.

BUSINESSEUROPE welcomes the clarification on such information that is required to support the charge of intra-group services, which would eliminate the current requests for detailed documentation pertaining to the services received. With regards to the requirement of providing written contracts or agreements for the supply of services and any modifications to those contracts or agreements, it is the BUSINESSEUROPE's understanding that there is no expressed formal requirement that such contracts/agreements be expressly signed by the Parties (from a legal point of view) but rather that they cannot be verbal agreements. Specific mention to this point should be included within the commentary which should expressly recognize that the requirement for written contracts or agreements is satisfied by a proper exchange of documentation that clearly identifies the entities involved and the terms on which services are agreed on/provided without the need for formal vest of the agreements.

However, there appears to be some inconsistency between this approach and the one outlined in the Discussion Draft on Action 13. Indeed, the Discussion Draft "Guidance on Transfer Pricing Documentation and Country-by-Country Reporting", published by the OECD on 16th September 2014, in its “three-tiered approach”, establishes that specific information related to intra-group services in the transfer pricing documentation be included. BUSINESSEUROPE suggests that this be re-examined in the interests of consistency and legal certainty.

To conclude, the Discussion Draft does not address the possible impact of the new guidance on low value-adding intra-group services on other BEPS Actions concerning transfer pricing.

BUSINESSEUROPE believes that a joint effort should be made to coordinate the work on the new Chapter VII of the OECD Transfer Pricing Guidelines and the work on transfer pricing within the BEPS project. Consequently, we urge the OECD to carefully consider these aspects in the process ahead.

BUSINESSEUROPE would be willing to engage in a constructive dialogue with the OECD on Low Value-Adding Intra-group Services.
On behalf of the BUSINESSEUROPE Tax Policy Group

Yours sincerely,

James Watson
Director
Economics Department
CBI RESPONSE TO THE OECD PUBLIC DISCUSSION DRAFT ON BEPS ACTION 10: PROPOSED MODIFICATIONS TO CHAPTER VII OF THE TRANSFER PRICING GUIDELINES RELATING TO LOW VALUE-ADDED INTRA-GROUP SERVICES

- The CBI is pleased to comment on the OECD’s Public Discussion Draft on Action 10: Proposed modifications to Chapter VII of the transfer pricing guidelines relating to Low Value-Adding Intra-Group Services, published on 3 November 2014.

- As the UK’s leading business organisation, the CBI speaks for some 190,000 businesses that together employ around a third of the private sector workforce, covering the full spectrum of business interests both by sector and by size.

- The CBI continues to support the BEPS programme to update international tax rules to reflect modern business practice, tackle abusive tax structures and target the incidence of double non-taxation. However, we are concerned that if complexity and uncertainty are not avoided, the outcome will be an increase of double taxation and resulting legal disputes, which could have a substantial and negative impact on cross border trade and investment, but also on tax administrations with limited resources.

Overview

- The CBI welcomes the opportunity to provide comments on the Discussion Draft regarding BEPS Action 10 to modify the transfer pricing guidelines relating to low value-adding intra-group services. The CBI welcomes modifications to the transfer pricing guidelines where this will enhance certainty and clarity for taxpayers and tax administrations alike as well as raising the possibility of reducing disputes and cutting down on compliance costs. Many MNEs choose to centralise or regionalise activities for reasons of commercial efficiency, and this inevitably leads to a need to recover costs cross border.

- It should be made clear that that classification as a low value service should not be used as a back-door means of arguing that the transactional net margin method (TNMM) is only suitable for low value services and that a profit split or other disproportionately complex method should be used more generally for higher value services. The draft also implies that if TNMM could be an appropriate method for non-low value services that the mark up should be in excess of the range for low value services - again this is without any supporting economic/functional analysis and thus appears to move away from the ALP.

- Our approach to this topic was to agree some fundamental principles which should be recognised by taxpayers and tax authorities alike. These key principles are:
• Companies do not deliberately go out to duplicate costs to achieve a tax deduction

• Shareholder costs should be defined and be tax deductible somewhere (e.g. either in the parent or pushed down)

• It should be explicitly agreed where a mark-up is appropriate and where costs should be recharged without a mark-up.

• If a range is agreed, then where in that range should be the choice of the group and as long as it is applied consistently across the group, it should be respected by all tax authorities.

• In respect of each of the above, we would make these further comments:

  • No commercial business incurs an expense solely for the purpose of obtaining a tax deduction, as it is a poor strategy returning less than the amount of the initial outlay. Most multinational businesses need to remain competitive, and are therefore very focussed on reducing costs in real terms year on year through productivity improvements in their supply chain and support costs. For these reasons we believe that the risk that an activity would be undertaken that is not needed is also low, with a corresponding impact on the risk that benefits have not been provided.

  • There are many practical challenges facing a taxpayer to ensure that the costs are properly recharged to the operating businesses that have benefitted overall from the business expenditure. If the expense is a valid business expense, in principle it seems fair that all of such costs should be able to be recharged and should be able to be deducted somewhere either at the shareholder level, or in individual subsidiaries. Taxpayers are usually in the situation of having both to defend an expense charged out, whilst at the same time satisfying the country where the costs were incurred that all costs have been recharged that should have been. These often end up not being aligned and taxpayers have faced significant double taxation.

  • Provided that the business expense is not a shareholder cost, we think that the most efficient practical approach should be to focus on ensuring that the allocation method is reasonable and that it is applied in a consistent way across the multinational group for each operating business. Both tax authorities and taxpayers have limited resources so there is a mutual benefit in ensuring that tax compliance responsibilities are met as efficiently as possible.

  • It is recognised that in some industries (such as extractives) it is currently considered to be arm’s length to recharge costs at no mark-up. A similar question arises in respect of pass through costs. It is our view that if a range approach is adopted, the lower end of the range should be lowered to nil to allow for industry specific norms.

  • However, overall, we are concerned at the range approach which will inevitably end up with some tax authorities in parent companies insisting on charging the upper end, and tax authorities for the subsidiaries only allowing deductions for the lower limit. This could lead to double taxation for the width of the range. Therefore where in the range should be the taxpayers choice, and the OECD should specifically state that as long as it is applied consistently, it must be respected by tax authorities.

  • If the consistent application of a rate at the taxpayers choice within a range is not adopted, an alternative approach would be to provide a specific fixed mark-up rather than a range.
• Payment for services outlined in this paper often attract withholding tax, especially when charged to the developed world. With a proposed mark up of 2-5%, any withholding tax based on the gross payment will often be in excess of the profit margin. We would therefore request that the OECD review the withholding tax in this area and recommend it is charged on a deemed profit amount rather than gross payment.

• We would welcome specific commentary that would allow payments falling within this regime to be subject to bi/multi-lateral APA’s to ensure a consistent approach amongst global tax authorities in their approach to a MNE.

**Detailed Comments**

• CBI believes that it would be helpful at the beginning of section B. to explicitly recognise that a business will not generally incur an expense unless it is necessary, and that due to competition the majority of businesses operate continuous business improvement programmes in order to become more efficient. This is important context in which the benefits test should be evaluated and whether the services being provided are duplicative.

• Also at the start of Section B, it should be recognised that the principle that is being achieved with this paper is to move away on a practical level from measuring the arm’s length price to accepting of an answer either fixed or in a range. Chapter V deals with the three tiered approach to documentation. A specific statement should be included in Chapter V that a lower level of documentation is required to support charges for low value services compared to non low-value services.

• With respect to the shareholder services outlined in 7.10 and 7.11, this seems to be expanding the current definition. We would like it to be made clear what the objective of highlighting these shareholder costs are e.g. is it to broaden the definition, but make it clear that it should be deductible at the parent company level, or should we be narrowing the definition to make it clear what should be passed on to group companies and achieve a tax deduction in those jurisdictions?

• In 7.10 and 7.11, we strongly recommend including a statement that shareholder costs should be deductible somewhere. These are a genuine business expense.

• In 7.12, the CBI welcomes the acknowledgement that when considering duplication the nature of the services in question need to be examined in detail and that expenditure can arise at different levels within an organisation and not be duplicative in nature.

• In 7.15, we would recommend that the wording is changed from “a group service centre” to “one or more group service centres”. Multi-national groups no longer operate in a hierarchical structure as they operate in an ever increasing digital economy, and often will have centralised services performed in different locations. This paragraph should reflect that there will often be charges between 2 or more companies at different levels in the organisation structure.

• A further example in relation to on call services in paragraph 7.17 are commission based procurement activities. It is the experience of our members that this type of arrangement is being increasingly challenged. The wording in the paragraph is helpful in this regard and maybe could be augmented with further specific examples such as procurement.

• In paragraph 7.20, it may be useful to clarify what type of abuse can be seen in relation to the recharge of management expenses. It is unclear why this topic should be within the BEPS programme when the primary issue is just trying to get one deduction somewhere for a genuine business expense.
• We welcome the acknowledgement in 7.24 that MNEs may have few alternatives but to use cost allocation and apportionment methods. In practice some tax authorities still expect to audit to the level of individual 3\textsuperscript{rd} party invoices based on the idea of a direct one to one service relationship. We recommend that paragraph 7.27 is strengthened to make it clear that the indirect nature of the service provision should not be a reason by itself for a tax deduction for the expense to be denied.

• We welcome the discussion in paragraph 7.32 regarding the range of prices. We would welcome an explicit statement in this section confirming “the lowest price is not the only acceptable price”.

• The new wording in paragraph 7.35 seems to move away from the arm’s length principle. It suggests that in some cases when pricing the transaction ‘the costs that would hypothetically be incurred by the recipient were it to perform the service for itself’ should be taken into account. In many instances it is simply not possible even to hypothesise what such costs might be, as the entity in question is not in a position to provide such services. Furthermore there may be no local external market for this type of service, so it is not possible to ascertain local comparable costs. As noted elsewhere in the guidance, MNEs choose to centralise certain services in the group for reasons of efficiency and control. Were services to be provided by each individual local entity neither of these criteria would be met and costs for the MNE would increase substantially. Therefore the decision to centralise services should be respected and the actual costs incurred should be taken into account when pricing.

• We thought it might be useful to outline an example from business such as the one below as to why it is not practical to always be able to allocate direct costs. We recommend that such examples are included in the guidance to highlight where a cost allocation method should be used in practice, and a tax deduction becomes available:

\textit{Example 1 Global IT Costs}

A group undertakes expenditure in a central service centre to work on an IT system which improves the efficiency and costs of all group companies. There is just one single invoice from the IT consulting firm for the global project as all the work was carried out in one location. It is a clear business expense for which each group company has benefited, however there is no direct cost that can be attributed to any of the countries. It is our view that the costs should be shared by all group companies as they have received a clear benefit, but the only practical way of doing so would be to use an allocation method.

• The summary in paragraph 7.45 at the start of section D is helpful in recognising that the arm’s length price for low value-adding services is closely related to costs. Implementation of this principle will bring more alignment between OECD countries and other participants which should help reduce the compliance burden and disputes for both business and tax administrations. We welcome making the simplified approach elective, rather than imposing a ‘one size fits all approach, as’ taxpayers’ circumstances differ. We would welcome further guidance on the election process and we would also welcome clarification on the treatment of pass through costs. If a mark-up is to be passed on, this should be limited to just one mark up (and not a second one by the intermediary).

• In relation to paragraph 7.46, it is noted that these rules should not be in point when rendered to unrelated customers of the members of the MNE. We would however question this where some non-core services are provided to unrelated companies. An example of this could be a franchise business which helps its non-group franchisees with administration or accounting support.

• Whilst we welcome the list of services outlined in 7.47 that would not qualify, we would recommend this is not a definitive list and would depend on the facts and circumstances of each group. For example, whilst the provision of insurance would not qualify, the administration services should do – we would recommend this is changed to exclude the administration of policies.

• In defining core activities it is important to differentiate between the core activities of the MNE group
and the principal activities of a particular legal entity, whose primary objective may simply be to provide support services and thus should be rewarded on a low value add basis. Paragraph 7.50 is therefore most welcome in making this distinction. We welcome the opportunity provided by the simplified charge mechanism set out in D.2 to reduce the tax compliance burden for both taxpayers and tax administrations for what should be a low risk area in tax audits. In particular we welcome the comments at D.2.5 which make clear how the benefits test is to be applied in connection with low value-adding services, as this is often one of the most difficult problems experienced by taxpayers in practice seeking to recover costs incurred and to avoid double taxation.

- However, we are concerned that services falling within the 'low value' category will often be provided as part of broader services which may not fall within that category but where a cost plus (or rather cost based TNMM) approach for the combined services may still be a suitable and proportionate approach. Within the same group there will thus often be some centres which are purely involved in 'low value' activities and some which combine both activities within that category and those not. Because of the global election requirement (7.51), groups will thus either have to adopt more complex requirements to segregate activities or they will be prevented from using a simplified and appropriate method anywhere in the group.

- The recognition in paragraph 7.56 that there is a balance to be struck between theory and practicality/resource/cost when identifying and using allocation keys is particularly welcome. MNEs information systems are designed to include certain data and parameters to meet business needs; for reasons of cost and efficiency they do not capture all possible data points or combinations thereof. It is therefore important that this paragraph acknowledges the need to be practical, reasonable and consistent when choosing allocation keys.

- The suggested mark-up range of 2% - 5% in paragraph 7.57 is more in line with the appropriate arm’s length range and reflects the mark-ups already applied in practice by many MNEs. This guidance is therefore most welcome. However, there are concerns around implementation; if some tax administrations do not accept this safe harbour range the potential for disputes remains.

- However there are still two common scenarios where double taxation is incurred and which will not be helped by the discussion paper:

  o There are a number of countries that impose absolute limits on the amount of services recharged by foreign affiliates – whether low value-adding or not - generally by reference to a percentage of sales. Clearly, this penalises MNE taxpayers that operate a highly centralised business model compared with other MNE taxpayers and compared with domestic taxpayers.

  o High withholding taxes (where the services are sourced outside of the country levying the withholding taxes) or irrecoverable indirect taxes levied on the gross amount of services recharged by foreign affiliates may mean that in the case of low value-adding services with a mark-up on costs in the range of 2 – 5% there may be a net cost to the taxpayer for making the recharge.

- In the case of a mark-up on costs of 2 – 5% it is clear that eroding the tax base to take advantage of differences in corporate income tax rates is not the primary motivation.

- The detailed guidance around the simplified benefits test, particularly the direction in paragraph 7.60 to look at the generality of the service provided, rather than requiring evidence of individual acts, is
pragmatic and will be helpful in reducing the compliance burden for taxpayers.

- The CBI believes that permitting businesses to centralise low value-adding services in the location where it makes most commercial sense (without worrying about double taxation) would make an even more positive contribution to global economic growth.

We trust that you will find the above comments helpful in understanding the potential impact of the proposals outlined in your paper. We remain committed to ensuring that each BEPS Action achieves its stated goals whilst ensuring that genuine business arrangements are not unduly impacted to which this Action forms a key part. We remain at your disposal should you wish to discuss the issues we have raised in this paper in more detail. Please contact neil.anthony@cbi.org.uk for more information
Mr Andrew Hickman  
Head of the Transfer Pricing Unit  
Centre for Tax Policy and Administration  
Organisation for Economic Cooperation and Development  
2 rue André-Pascal  
75775, Paris Cedex 16  
France  

8 January 2015  

Dear Mr Hickman,

Re: PUBLIC DISCUSSION DRAFT: BEPS ACTION 10: PROPOSED MODIFICATIONS TO CHAPTER VII OF THE TRANSFER PRICING GUIDELINES RELATING TO LOW VALUE-ADDING SERVICES

We welcome the opportunity to comment on the above document issued on the 3rd November 2014.

The introduction of a simplified methodology for Multinational Enterprises ("MNE’s") in the area of low value-adding services should bring more certainty and clarity. This is an issue that tends to result in a significant investment of resources by MNE's and taxing authorities. However, failure to achieve a consensus approach would result in missing the current opportunity for simplification.

Any simplification measure should be one that is easy to understand and administer and bring certainty of treatment. It should mitigate the need for dispute or the need for resolution.
mechanisms. While we acknowledge a clear intention to move in this direction by the OECD with this current discussion draft, we believe that the approach could be further improved with relatively minimal changes and have outlined a number of suggestions:

- **Introduction of some flexibility for MNE’s to apply a common simplified approach to something less than all entities and all costs.** The guidance should make clear that an MNE group is not disqualified from using the simplified method simply because it complies with the transfer pricing rules of jurisdictions that do not accept the OECD endorsed simplified method, or because some portion of otherwise eligible services are handled for transfer pricing purposes in a different manner, e.g., through an APA. The key is to apply the simplified method in a reasonable manner, to a reasonable population of entities and to a reasonable population of costs. Imposing a flat-footed requirement for all entities and all costs will severely restrict the application and usefulness of the simplified method. Making the application of a mark-up (Paragraph 7.57) elective in most cases to ensure a consistent approach across an MNE’s affiliates globally which may also be more acceptable to tax authorities in payor countries by reducing the level of charges made to affiliates there. It is not suggested that a nil mark-up or cost recovery approach should apply in circumstances where the sole business of an in-house service provider is the provision of low value-adding services.

- In circumstances where, in accordance with the guidelines, an allocation has been applied for low value-adding services, the guidelines should suggest that requests to ‘look’ through to the underlying expenses of the service provider by a tax authority in the jurisdiction of the recipient are not warranted. This aligns with the proposed objective of the guidelines which is to frame guidelines for pricing services with a view to treating them in like manner to services provided by an independent party. It may also be relevant to point out here that MNE’s do not incur costs unnecessarily or unintentionally. Costs incurred by MNE’s should be deductible, whether at the HQ country level or at the receiving country level.

- Further guidance would be welcome to address transitional matters likely to arise upon implementation in the case of first time adoption of the simplified approach e.g. the move to adoption of single annual invoice suggested at para 6.70.

We acknowledge that there will be overlap with other Actions under the BEPS Plan. In particular, we suggest there should be:

- Confirmation that the proposal for Action 10 would override the Transfer Pricing requirements of the local file in BEPS Action 13.

- Expectation that the interaction of Guidelines on Transfer pricing of Intangibles under Action 9 would be explored especially in the pricing of high value-adding services.

- Consideration given to framing a Memorandum of Understanding (MOU) encompassing low value-adding services for use and adoption by states in accordance with Section E on Safe Harbours in Chapter IV of the Transfer Pricing Guidelines. The provision of such
a framework for a safe harbour for low value-adding services could provide certainty for taxpayers in those states that adopt the MOU.

Furthermore, we believe that specific guidance incorporating examples would be useful to all parties, and could clarify how the proposed approach outlined is to be implemented at the country level. This would include further clarification on the election mechanism in 7.45, the interaction with Action 13 and at the MNE by citing examples such as in terms of shareholder activities in 7.11.

Especially in the case of SMEs, it might be appropriate to suggest that they could somewhat modify the approach of applying a single factor to a bundle of services rather than being required to identify and apply a factor for each service.

In conclusion, there is merit in simplifying the approach to determine and document the area of Low-Value-Adding Services. With minor changes and additional guidance, the approach could be more beneficial to MNE’s, practitioners and taxing authorities alike. Current practices by tax authorities with regard to assessing the benefit of such services may from time to time currently exceed the proposed simplified standard set out in D3 in the Draft.

You may wish to note that this response is from a representative body. The Consultative Committee of Accountancy Bodies – Ireland is the representative committee for the main accountancy bodies in Ireland. It comprises Chartered Accountants Ireland, the Association of Chartered Certified Accountants, the Institute of Certified Public Accountants in Ireland, and the Chartered Institute of Management Accountants, which represent a combined membership of some 40,000 accountants. Brian Keegan, Director of Taxation at Chartered Accountants Ireland (brian.keegan@charteredaccountants.ie, +353 1 6377 347) may be contacted if any further details in relation to this letter are required.

Yours sincerely

Paul Dillon, Chairman, CCAB-I Tax Committee
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Warsaw, 14 January 2015

For the attention of
Mr Andrew Hickman
Head of Transfer Pricing Unit
OECD/CTPA
TransferPricing@oecd.org
sent by e-mail

Subject: COMMENTS ON THE DISCUSSION DRAFT ON THE PROPOSED MODIFICATIONS TO CHAPTER VII OF THE TRANSFER PRICING GUIDELINES RELATING TO LOW VALUE-ADDING INTRA-GROUP SERVICES (Action 10 of the BEPS Action Plan)

Dear Sir,

“Transfer Pricing Centre” Association (“TPCA”) welcomes the opportunity to provide comments on the discussion draft on the proposed modifications to chapter VII of the Transfer Pricing Guidelines relating to low value-adding intra-group services.

“Transfer Pricing Centre” Association (“TPCA”) is a non-profit organization aimed at promoting transfer pricing knowledge in Poland, founded by specialists working for capital groups in Poland, mainly in energy and industry sector. Hence we hereby present the comments as representatives of business. However, since the Association is a legal person, we present the comments only on behalf of the Association. The comments expressed in the letter should be interpreted as opinion of the Association and not particular members of the Association.

We would like to confirm that have no objections with posting our comments on the OECD website.

We are at your disposal to discuss any aspect of our comments. We look forward to developments and further discussions on the topic.

Yours faithfully,

Sylwia Rzymkowska
Chairman of TPCA

sylwia.rzymkowska@cct.org.pl
Subject: COMMENTS ON THE DISCUSSION DRAFT ON THE PROPOSED MODIFICATIONS TO CHAPTER VII OF THE TRANSFER PRICING GUIDELINES RELATING TO LOW VALUE-ADDIN G INTRA-GROUP SERVICES (Action 10 of the BEPS Action Plan)

Incidental benefits (Section B.1.4 of chapter VII)
We see need to expand description of incidental benefits attributable solely to participation in a MNEs group. In our opinion some guidance should be given on the issue of requiring group companies to follow a corporate governance system imposed by a parent company. In many situations, imposition of corporate governance system on subsidiaries relates mainly to restrictions at the level of subsidiaries and is not related to an active promotion of the local companies. In many cases it is very difficult to state that common corporate governance system enhances the profit potential of particular members of the group. Therefore, we would welcome some additional language on organisational restrictions imposed by a parent or a holding company with regard to incidental benefits that should not be recognised as an intra-group service.

Considerations on including a profit element (Section B.2.3.2. of chapter VII)
There are common situations where intra-group service includes some external costs related to services purchased from third parties (e.g. advisory services, travel costs, IT expenses). Since those expenditures include a profit element at the level of the service provider, it should be clear from the Guidelines that such costs should be re-charged only at costs with no mark-up. Since the BEPS Action should address the issue of eroding the tax base through excessive management fees and head office expenses, we would welcome some restrictions on charging all external costs incurred by a parent company to the group companies. Some of these costs relate specifically to a parent company and should not be included in the cost base and should not be enhanced by a mark-up. We fear that excessive management fees are in practice due to fully-loaded cost base of a service provider and imposing a mark-up on external costs. Therefore, we would opt for expanding argumentation found in section 7.38 of chapter VII to address the issue of excessive management fees and head office charges in more detail.

The above comments are also applicable to section D.2.1 – Determination of a cost pools for the purpose of low value adding services.

Simplified determination of arm’s length charges for low value-adding intra-group service (Section D.2 of chapter VII)
The assumption that the simplified approach should be adopted on a consistent, group wide basis in all countries in which and MNE group operates, is a very difficult to be applied in practice. There may be several units that are involved in providing supportive services (not part of the core business of the MNE group). Application of a simplified method consistently among the group companies may be very difficult taking into account various account standards, potential differences in the structure of costs, specific risks or local circumstances that need to be taken into account.
More practical guidance should be given on the calculation of the cost pool. Currently, it is stated that a pool of all costs should be calculated on an annual basis. It is not clear whether this should be understood that costs of year X should be applied to services provided in the year X+1 or whether the costs incurred in year X will only be charged at the end of the year and so the service charge will be calculated at the year end.

It is stated that the same mark-up (in the range 2%-5%) shall be utilised for all low value-adding services irrespective of the categories of services. We understand that there is no requirement to verify the mark-up in the range between 2%-5% through benchmarking analysis. We would welcome a clear statement with this regard and a clear statement that a group is free to choose a point in the range.
Dear Mr. Hickman,

Chiomenti Studio Legale (Italy), Cuatrecasas, Gonçalves Pereira (Spain), Gleiss Lutz (Germany) and Gide (France) appreciate the opportunity to provide comments on the OECD Discussion Draft on Action 10 – Discussion Draft of the Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services published on 3rd November 2014 ('the Draft').

Chiomenti Studio Legale has accompanied the growth of the major Italian businesses and the continuing increase in incoming and outgoing foreign investments from the post Second World War economic recovery to the recent market integration reforms. The firm’s success is based on the combination of its international outlook, recognised quality and reputation of its professionals. The firm today has approximately 270 attorneys and tax advisers and has offices in Rome, Milan, London, Brussels, New York, Beijing, Shanghai and Hong Kong. Chiomenti Studio Legale is the exclusive member firm in Italy for Lex Mundi - the world’s leading network of independent law firms with in-depth experience in 100+ countries worldwide.
Cuatrecasas, Gonçalves Pereira is a leading law firm in Spain and Portugal. It represents most of the largest listed Spanish and Portuguese companies, and advises on strategic transactions and foreign investments in the Iberian market. With 25 offices worldwide, the firm’s headquarters are located in Barcelona, Madrid and Lisbon. Cuatrecasas, Gonçalves Pereira has international offices in the largest financial centers, Latin America, Asia and Africa. The firm has relationships and experience with the best law firms worldwide, so it can meet clients’ legal needs anywhere. The firm advises on all areas of business law, including 18 practice areas and 15 industry-specific knowledge groups.

Gleiss Lutz is one of Germany’s leading full service law firms. With over 300 lawyers, including 86 partners, and offices in Berlin, Düsseldorf, Frankfurt, Hamburg, Munich, Stuttgart and Brussels, the firm’s practice covers all areas of commercial law. As full service firm, Gleiss Lutz provides lawyers recognised as true experts in their chosen field. The clients include leading German and international businesses, including numerous DAX listed and Fortune 500 companies, major privately held companies and public authorities.

Gide is a premier international law firm and the first to have originated in France. Founded in Paris in 1920, the firm now operates from 17 offices worldwide. With 600 lawyers, drawn from 35 different nationalities, Gide offers some of the most respected specialists in all sectors of national and international finance and business law. In each of its offices in Europe, Asia, North America and Africa, the firm provides its clients with comprehensive knowledge of local markets, regional expertise, and the resources of an international law firm. Gide offers legal advice and assistance across a broad spectrum of disciplines to businesses, public and private sector institutions, investment funds and governments.

We appreciate the draft on charges concerning low value-adding intra-group services as it lowers the compliance burden for the group, especially with respect to the documentation of the beneficial nature of these services for other group members and the adequacy of the profit margin.
Due to time constraints we will provide only our preliminary non-exhaustive view as follows:

**Section B.1 Determining whether intra-group services have been rendered**

**B.1.2 Shareholders Activities**

(...)

**7.11**

Regarding the final sentence added before paragraph B.1.3 (i.e., last sentence of new paragraph 7.11) stating: "Where activities such as those described above are performed by a group company other than solely because of an ownership interest in other group members, then that group company is not performing shareholder activities but should be regarded as providing a service to the parent or holding company to which the guidance in this chapter applies."

From our point of view, the scope of this addition is not entirely clear. The situation addressed might refer to the case in which certain activities are carried out by a group company that is not the parent company or a regional holding company (the focus of the current wording of paragraph 7.9 is primarily on the holding or parent company providing activities to the benefit of other group companies), and/or it might refer to the case in which a group company is, in fact, such parent or regional holding company, but the reason why it performs the services is not only based on its interest in another group company that also benefits from the services performed.

We recommend, explicitly clarifying which situation is supposed to be addressed.

Due to our opinion, in both situations the group company should not be regarded as performing shareholder activities, but only in the first situation the group company should be regarded as rendering the respective services to its parent or holding company.

In general, such addition is welcome as on the basis of the plain wording of the guidelines which are currently in force this situation would not be
expressly covered (this interpretation would also be consistent with last sentence of new paragraph 7.52).

It should also be mentioned that, from an Italian tax law perspective, this addition could support certain arguments put forward by the Italian tax authorities regarding LBO structures. In these structures an Italian Newco is considered as having provided a service to the foreign parent company upon the completion of the acquisition of the Italian target.

B.1.4 Incidental benefits

7.13
We support in particular the addition of the new last sentences of paragraph B.1.3, referring to service duplication according to which "Any consideration of possible duplication of services needs to examine the nature of the services in detail. 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."

This is a case that often happens in practice, and the reference to adequate documentation supporting the charge should grant that no undue benefits can be achieved.

Section D.1 definition of low value-adding intra-group services

7.46, last paragraph

To exclude services which are provided to unrelated parties from the simplified approach of pricing is, in principle, acceptable, because, as stated, CUP would be the preferred method to identify the arm’s length price. However,
the way the sentence is drafted may lead to situations in which services provided to related parties are excluded even if these services are provided to third parties only at a very limited scale, or for unforeseen circumstances (i.e. a company leaves the group but still receives services for a limited period of time).

Therefore, we suggest limiting the scope of the exception so that the exclusion of the simplified approach for low value-adding intra-group services is restricted to situations in which such services are rendered to third parties, but only if and to the extent that reliable internal comparables exist and can be used for the determination of the arm’s length price. In order to reflect such premises, we suggest a changed wording of 7.46 to the OECD that reads as follows:

"The guidance in this section is not applicable to services that would ordinarily qualify as low value-adding intra-group services where such services are rendered to unrelated customers of the members of the MNE group. In such cases it can be expected provided that reliable internal comparables exist and can be used for determining the arm’s length price for the intra-group services."

7.48

While marketing activities seem to be expressly excluded from the scope of application of the simplified approach (cf. para. 7.47), the following paragraph 7.48 - when making reference to "specific advertising or marketing activities" - seems to suggest that certain marketing activities are included. According to our view, it would be advisable to include a few examples to guide the reader in a difficult choice as to which marketing activities are regarded as low-value added and which are not.

Although the list under paragraph 7.48 is not exhaustive, it could be considered to add, for instance, the provision of logistics services (under the obvious assumption that the provision of such services is not the enterprise's main activity).
Section D.2 Simplified determination of arm’s length charges for low value-adding intra-group services

D.2.3 Profit Mark-up

7.57
The OECD suggests applying the same mark-up to all low value-adding services within the same MNE. We do not see a reason why different categories of services would not be eligible for different mark-ups as long as they fit within the suggested range. We would thus recommend deleting the second sentence of the paragraph.

Concerning the range, however, it may serve the intended simplification if the guidelines would explicitly allow the taxpayer to select any point within the prescribed range. To avoid any misunderstandings in so far, section D.3, 7.61, first bullet point, last part (“and confirmation of the mark-up applied”) would have to be deleted.

As regards the bounds of the range, from our point of view, the lower bound should be zero, i.e. pricing at cost should be possible. Otherwise, a conflict to B.2.3.1, 7.36 may arise as this section allows for certain costs as pass-through costs on which no profit mark-up needs to be applied. As an alternative to a zero bound, the guidelines should explicitly clarify in 7.57 that regarding low value-adding intra-group services a mark-up is also applicable to pass-through payments.

Section D.3 Documentation and reporting

7.61
It should be coordinated with the action taken under the revised TP documentation discussion draft.
We hope you will take our comments into consideration in further developing this Action point. Of course, we are available to elaborate on these comments should this be helpful and we look forward to further discussion on this important issue.

Yours sincerely,

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Chiomenti Studio Legale

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1 Introduction

1.1 The Chartered Institute of Taxation (CIOT) is pleased to submit this response to the public discussion draft issued on 3 November 2014 by the OECD which looks at BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines relating to Low Value-Adding Intra-group services.

2 General

2.1 The revised text of Chapter VII of the OECD Transfer Pricing Guidelines set out in the discussion draft includes an ‘elective’ simplified approach for low value-adding intra-group services in Part D.

2.2 We welcome the concept of an elective regime as this will benefit groups which are either new to operating transfer pricing across the group or which do not have established or coherent transfer pricing methodology. However, it is important that groups which do have an established method for dealing with the costs for intra-group services or which would not benefit from the simplified approach can continue to use their established methods for transfer pricing without being inadvertently penalised.

2.3 In this regard, we would like to explore the implications for multi-national enterprises (MNEs) of electing or not electing to use the simplified approach. At paragraph 7.45 the discussion draft says that ‘taxpayers not electing to apply the simplified approach set out in this section should address transfer pricing issues … under the provisions of section A and B above.’. We hope that taxpayers will be given this option in practice, and that MNEs which elect not to use the simplified approach will not be penalised in some way by tax authorities; for example, by being considered a higher risk as a result of not using the simplified approach,
resulting in TP enquiries.

2.4 For some MNEs the suggested methodology and the compliance requirements of the simplified approach may present an additional compliance burden, particularly in relation to splitting out and identifying the low value-adding services from other intra-group services. We would be grateful if the guidance could confirm that for any MNE not using the new simplified approach, their transfer pricing methodology will be looked at on its merits.

2.5 Notwithstanding this general point, the simplified approach does give rise to some practical questions as to how transfer pricing will be viewed by tax authorities going forward. For example, does the setting of a profit mark-up rate (in paragraph 7.57) mean that any intra-group charges which are higher than the rate of 5% will be challenged on the basis that there may be some low value-adding services within the intra-group services that are being charged for, which should be charged at a lower rate?

2.6 Does this mean that the simplified approach in Section D will, in effect, become mandatory because it will become necessary for MNEs to separate out the services and identify low value-adding services in any event in order to justify charging structures?

2.7 Are the OECD’s TP Guidelines the appropriate place to seek to implement this change? Although these are incorporated into law in the UK, this is not the case in all jurisdictions. Also, how is it expected/intended that low value-adding services will be treated between non-OECD and OECD jurisdictions?

2.8 We would also like to explore circumstances where it may not be practical, possible and/or beneficial to apply the simplified approach across the whole group. For example, assume that most of the entities in a multinational group wish to operate the simplified approach, but some of the services are provided by a company in a non-OECD country (which does not apply OECD transfer pricing principles) to a company in an OECD country. The non-OECD company could choose a mark-up for low value-adding services of, say, 7%. It is not clear from the discussion draft if the outcome for the OECD company would be a denial of deduction for the uplift between the safe harbour and the 7%.

2.9 Alternatively is it intended that MNEs should operate the simplified approach on a group wide basis or not at all? Therefore in the situation mentioned above, the group may decide not to apply the simplified approach. It would then seek a deduction for the 7% mark up in the OECD country in the usual way.

3 A. Introduction and B. Main Issues

3.1 There is some discussion (at paragraph B.1.2) of the difference in treatment to be applied in relation to ‘shareholder activities’ and ‘stewardship activities’. We would welcome some additional clarification and guidance in this area as there are a number of grey areas which it would be helpful to clarify to avoid disputes. Additionally, the discussion draft does not actually specify that stewardship activities can/should be treated as low value-adding services, but we assume that this must be what is intended.
4 D.1 Definition of low value-adding intra-group services

4.1 The list of services in paragraph 7.48 is fairly broad and lists only examples of services that would be 'likely' to be considered low value-adding. On the one hand it is welcome that the discussion draft is not too prescriptive of precise services, because there are so many different types of businesses, it would be very difficult to specify what would be a low value-adding service for every business. On the other hand this will result in a greater number of transfer pricing disputes between taxpayers and tax authorities. What will be required of businesses in order to 'prove' and/or 'document' that services are low value-adding services?

4.2 As mentioned above, please confirm that stewardship activities are within the concept of low value-adding services.

4.3 Please could you clarify the position regarding 'pass through' third party costs? We assume, but please confirm that these costs would not be included as low value-adding intra-group services. For example, if a service company buys in payroll services from a third party (such service would be considered a low value-adding service if provided in house) then when the costs are shared around the group companies using that service, there should be no mark-up as the service is already provided to the group at an arms-length price.

5 D.2 Simplified determination of arm’s length charges for low value-adding intra-group services

5.1 The methodology suggested is, we understand from our members, similar to that used in many multi-national groups already, and will therefore be welcomed by many businesses. We note that D7.55 suggests that more than one allocation key should be used to allocate out cost pools. Whilst we accept that this is a logical approach, in practice the number of allocation keys will need to be kept to a small number, or the allocation calculations will become disproportionately complex, and prone to errors.

5.2 It is helpful to note that in relation to the proposed methodology with steps 1, 2 and 3 outlined at D2 to determine the cost pools there is an expectation that the methodology, once set, would not need to be proved year on year if the business model remains broadly steady. This approach is helpful and we welcome it.

5.3 Is there any particular reason or justification behind the figure of 2 to 5% in the discussion document?

5.4 The discussion draft suggests that no benchmarking is required to prove or justify the mark up chosen between 2-5% for low value-adding intra group services. However, what would be the position for a group which has elected to adopt the simplified approach if, say, Company A (which is resident in Germany) considers that the correct mark-up on the services it provides to Company B (resident in the UK) should be 5%, and this is accepted by the German tax authorities, but the UK tax authorities think it should be 2%. How would this be resolved? In principle, there could still be a dispute even though the group as a whole has elected into the regime. The OECD could make it clear that it is up to the company making the recharge to set the percentage and provided it is within the range (which should then be referred to as a ‘safe harbour’), then the fiscal authority of each company should accept it.

5.5 However, this could result in, for example, a German company recharging the UK company for something with a 5% mark up and the UK charging Germany something
with a 2% mark up. In order to pre-empt that, we suggest that a single percentage of, say, 3% is chosen to apply to all low value-adding intra-group services for MNEs using the simplified approach.

6 D.3 Documentation and reporting

6.1 Please could guidance be given as to whether the method adopted for cost pool allocation should be outlined as part of the Master File and/or Local File requirements of Action 13. Or, is it intended that would this need to be submitted separately or only ‘on request’ as seems to be suggested at D3? It would be helpful for these practical aspects to be addressed at the earliest possible stage, and a format agreed to ensure that there is not an increase in the amount of queries/audits raised by fiscal authorities as a result of too much/too little information provided in respect of low value-adding intra-group services.

7 The Chartered Institute of Taxation

7.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT’s work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members’ experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT’s comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT’s 17,000 members have the practising title of ‘Chartered Tax Adviser’ and the designatory letters ‘CTA’, to represent the leading tax qualification.

The Chartered Institute of Taxation
19 January 2015
REPLY TO THE OECD’S REQUEST FOR COMMENTS ON THE
“PROPOSED MODIFICATIONS TO CHAPTER VII OF THE TRANSFER PRICING
GUIDELINES RELATING TO LOW VALUE-ADDING SERVICES”
FROM CMS

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

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Do you authorize the OECD to publish your contribution on the OECD website? Yes
Introduction

1. We would like to welcome the OECD initiative to consult companies and practitioners in the framework of the update of Chapter VII of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (further referred to as “the OECD Guidelines”). We were very interested in reviewing, in the light of Action 10 of the Action Plan on Base Erosion and Profit Shifting, the “Proposed modifications to Chapter VII of the transfer pricing guidelines relating to low value-adding services” dated 3 November 2014 (further referred to as the “Discussion Draft”).

2. Since the OECD is considering to reorganize / slightly modify the general guidelines on intra-group services (and though paragraphs 7.1 to 7.44 of the Discussion Draft propose limited changes to the current Chapter VII of the OECD Guidelines), we have made some comments on these general considerations. To our knowledge, the general principles defined by the OECD do not per se raise theoretical issues; it is merely their practical application and documentation that may raise difficulties for taxpayers.

3. As was already the case at European level\(^1\), we encourage the proposal of the OECD to rely on simplified approaches for the determination of transfer prices for low value-adding services (paragraphs 7.45 to 7.61). Generally, we consider that, for these services, additional simplifications – in particular as regards the benefit test and documentation - could be envisaged by the OECD.

Definition of the services that must be invoiced or not

Benefits test

4. Under paragraph 7.7 of the Discussion Draft, focus is made on whether the activity provides a group member with economic or commercial value to enhance or maintain its commercial position. The expression “commercial position” may be misleading. It may be interpreted as referring only to services that have a direct and/or strict relation with sales and marketing functions. It could perhaps be replaced by the expression “business position”.

5. Paragraphs 7.7 to 7.9 seem to draw a sort of distinction between “effectiveness” (i.e. a service has actually been rendered by one entity) and “inherence” (i.e. the said service was actually valuable for the other entity / the recipient). The Discussion Draft should clarify that the focus should be on whether a service has been effectively rendered (and such service does not duplicate other services rendered by another service provider or an internal activity of the recipient) and that, to the extent the price charged can be viewed as complying with the arm’s

\(^1\) Guidelines on low value adding intra-group services prepared by the European Union Joint Transfer Pricing Forum; these guidelines were adopted by the Council on 17 May 2011.
length principle, the question of the value of such service for the recipient would not need to be addressed.

Shareholder costs

6. The fact that the list of shareholder activities (paragraph 7.11 of the Discussion Draft) be more detailed that under the current OECD Guidelines is a good initiative and we generally agree with the additions made.

7. It is proposed that shareholder costs include “costs relating to reporting requirements (including financial reporting and audit) of the parent company including the consolidation of reports, costs relating to the parent company’s audit of the subsidiary’s accounts carried out exclusively in the interest of the parent company” (paragraph 7.11-b) of the Discussion Draft). The key notion here is “carried out exclusively in the interest of the parent company”. It should be emphasized that only the exclusivity of the parent company interest leads to the qualification of shareholder costs and that, in many cases, financial audits and controls performed by one entity regarding the activity of another entity is valuable for the latter as part of a broader internal control system. Furthermore, it should be recognized that financial audits performed by one entity and aiming at assessing the level of compliance of another entity with group’s procedures can benefit to the latter and characterize a service.

Form of remuneration

8. Paragraph 7.18 of the Discussion Draft on “on call” services seems to conclude that the benefit conferred by an “on call” arrangement should be assessed a posteriori (“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.”). If our understanding is correct, such approach could in practice not be applied by taxpayers and could result in “hindsight analyses” by tax authorities. It should therefore be recalled that a benefit test should also be based on the information available to the taxpayer at the time such taxpayer has to make a decision (for services provided on call, even if during a given period of time (e.g. a fiscal year) the service provider has never been actually called does not mean that there was no need for the potential service recipient to enter into an agreement (and pay a fee)).

9. Though we agree that taxpayers should generally try to formalise the rendering of intragroup services in written agreements, we welcome paragraph 7.19 of the Discussion Draft which states that “the absence of […] contractual agreements does not automatically lead to the conclusion that no intra-group services have been rendered.”
Transfer pricing method

10. Even if the Discussion Draft states that “MNE group should often be able to adopt direct charging arrangements, particularly where services similar to those rendered to associated enterprises are also rendered to independent parties”, our experience is that it is rare in practice to have similar / comparable services rendered to independent parties; this makes the Comparable Uncontrolled Price Method as well as direct-charge methods difficult to implement. A statement indicating (i) such practical difficulty and that (ii) in practice the indirect charge mechanism and cost plus method are often used, could perhaps be inserted under paragraph 7.23 of the Discussion Draft.

11. For the same reasons, rejecting indirect-charge methods “where specific services that form a main business activity of the enterprise are provided not only to associated enterprises but also to independent parties” cannot be a general rule. Paragraph 7.25 of the Discussion Draft could therefore include a statement recalling that the implementation of the Comparable Uncontrolled Price Method depends on whether comparability criteria are met.

Definition of low value-adding intra-group services

12. We generally agree with the definition and approach described under paragraphs 7.46 to 7.50 subject to the following comments:

- Though we agree that, in a majority of situations, low value-added services will not be the heart of the group’s activity (namely “services constituting the core business of the MNE group” within the draft), considering that low value-adding intra-group services cannot, by essence, form the core business of the MNE group may not be an accurate statement in all situations. For example, toll manufacturing services – irrespective of whether they constitute or not the core activity of a MNE group – could qualify as low value adding services. We are therefore wondering whether the criterion according to which “services constituting the core business of the MNE group” would not qualify as low value-adding intra-group services is appropriate.

- Looking at the lists under paragraphs 7.47 and 7.48, it should probably be clarified that the question as to whether a service qualifies or not as low value-adding should be considered in view of the nature of the service but also in view of its importance within the value chain of the MNE group and the functional analysis. For example, when excluding insurance and reinsurance from the scope of low value-adding services, further explanation about the scope of services concerned should be inserted. A priori, a company providing insurance or reinsurance services performs value-added functions. Management of group insurances or allocation of insurance costs between group entities are displaying less value added and could perhaps be assimilated to low value-adding services. Another example could be given with a legal or tax function: it could characterize a low value-adding function within an industrial group but could not be seen as such within a law or tax firm.
The exclusion of services of corporate senior management from the scope of low value-adding services raises an important practical issue: based on the Discussion Draft, assuming such services would be invoiced according to a cost plus method, taxpayers would need to perform a benchmarking analysis to determine the mark-up applicable. It is at this stage unclear which comparable service providers could be searched / found by taxpayers. Such exclusion therefore raises a difficulty / an additional burden for taxpayers whereas for years many taxpayers have invoiced such services within their management fees by using a cost plus (generally) 5%-methodology and, for many years, this approach has been generally accepted by tax authorities. We therefore question the necessity to exclude services of corporate senior management from the scope of low value-adding services.

**Simplified determination of arm’s length charges for low value-adding intra-group services**

13. Paragraph 7.51 could be redrafted to clarify that the simplified method can be applied to charge low value-adding services to associated enterprises which benefited from low value-adding services (given its current drafting, the paragraph gives the impression that, irrespective of whether low value-adding services were rendered or not, such services should be invoiced to all associated enterprises).

**Profit mark-up**

14. Another important concern, at least from a European standpoint, is the discrepancy between the Discussion Draft and the Guidelines on low value adding intra-group services prepared by the European Union Joint Transfer Pricing Forum. Indeed, the Discussion Draft envisages mark-up rates ranging from 2% to 5% whereas the European Union Guidelines state that “in cases where it is appropriate to use a mark-up, this will normally be modest and experience shows that typically agreed mark ups fall within a range of 3-10%, often around 5%”. As a result, European MNEs applying a mark-up between 5% and 10% would benefit from a safe harbor for transactions between European associated enterprises but would be at risk for transactions with associated enterprises established outside of the European Union. Since both Guidelines aim at the same type of services, we would encourage that the Discussion Draft retain a similar range of mark-ups.

15. Since the entity invoicing the services to the recipients could act as a “cost pooler”, i.e. invoice costs that it incurred itself to render the services but also the compensation of other entities that rendered services (and for which the cost pooler acted only as an intermediary), it could be specified that, in line with the principle explained under paragraph 7.36, the cost pooler can add a mark-up on the costs borne to act as a cost pooler but, to the extent feasible in practice, not on the compensation of the other entities that rendered services.
Benefits test for low value-adding intra-group services

16. The simplification envisaged by the Discussion Draft on this point is not clear to us. Indeed, paragraph 7.61 provides that the documentation to prepare by the taxpayer should include “a description of the benefits or expected benefits of each category of services”. Given the type of services involved, could it be envisaged that taxpayers would only need to show that low value-adding services were effectively rendered to them (which is the approach that seems to be suggested under paragraph 7.60)?

17. On the same line, it is not clear to us what is expected from taxpayers when paragraph 7.60 states at the end “With regard to low value-adding intra-group services that benefit only one recipient entity in the MNE group, it is expected that the benefits to the service recipient will be capable of separate demonstration”. Additional guidance on this point should be provided.

*
On the letter head of CII

Date: January 14, 2015

To

Mr Andrew Hickman
Head of Transfer Pricing Unit,
Centre for Tax Policy and Administration
Organization for Economic Cooperation and Development (OECD)

Dear Sir

Sub: Comments on – BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value Adding Intra Group Services (Discussion Draft on Low Value Adding Services)

We are pleased to submit our comments on the Discussion Draft on Low Value Adding Services. We appreciate this opportunity to share our views on this issue and hope that you will find them useful for discussion.

We look forward to continued collaboration with OECD on this and other important aspects of Transfer Pricing.

Yours Sincerely,
Our Specific Recommendations in response to your request for comments on various topics are as follows:

On November 3, 2014, the OECD issued a Discussion Draft on Low Value Adding Services (Discussion Draft) for public consultation. This is one of the 15 action plans recognized by OECD for mitigating the Base Erosion and Profit Shifting (BEPS) practices adopted by Multinational Enterprises (MNEs). The concern regarding BEPS was first highlighted by G20 lead of nations in 2011 and India being a part of G20 nations supports the OECD work on BEPS.

The Discussion Draft has been issued with the objective of providing a simplified transfer pricing approach for certain intra group services which may be categorized as low value adding services. The aim of the Discussion Draft is to reduce base erosion through excessive management fees particularly in developing countries. The Discussion Draft introduces a simplified approach, which Multinational national enterprises (MNEs) may elect to adopt for the transfer pricing of low value added intra group services. The simplified approach defines low valued adding services, recognises that the arm’s length price of such intra group services is closely related to costs and provide mechanism to allocate the costs of providing each category of such services to those group companies which benefit from such services using consistent group-wide allocation keys with an associated consistent small mark-up.

In general, we recognize the efforts of G20 along with the OECD towards providing simplified approach to transfer pricing of intra group services. However, in view of the existing Indian tax system and the legal and economic environment in India, we foresee certain practical challenges in the implementation of the recommendations of the Discussion Draft in its present form for companies operating in India.

Firstly, we would like to highlight that the Indian tax authorities have been challenging the payments for intragroup services made by Indian entities to overseas Associated enterprises (AEs) on grounds of commercial benefits test for each service, cost benefit analysis for individual services, lack of proper documentation, etc. In this regard, the proposed simplified approach to low-value adding services will be helpful for some MNE groups. It needs to be seen if Indian tax authorities would be willing to accept these suggestions given that they are not a part of OECD; but are supportive of the BEPS action plan.

Additionally, we wish to humbly put forth the following challenges and recommendations for your kind consideration.

1. Determination of arm’s length markup

Concerns

Due to various reasons (such as lower cost, availability of quality resources, wide spread use of English) developing countries like India have been the hub of many shared service centres/back offices. The mark-up required to be earned by such service providers has been a continuous matter of dispute between the taxpayers and the tax authorities.

The Discussion Draft provides that the proposed provisions shall be applicable even in cases where the low value-adding services may be the core business activity of the legal entity providing the service (e.g. a shared service centre); as long as the same is not the core activity from the perspective of the operations of the MNE group. Accordingly, from a service provider point of view, many of such services provided by the shared service centres/captive back offices may classify as low value adding intra-group services and therefore, may qualify for the simplified approach and a suggested mark-up of 2% to 5% for such provision of services.

However, in such cases where the low value adding services provided by a group entity forms the core business activity of this entity, the arm’s length markup required to be earned by such service provider entity (based on the benchmarking analysis of the local independent comparable companies in its jurisdiction) may be higher than the suggested low mark up of 2% to 5%. Accordingly, the tax authorities in the jurisdiction of such service provider entities would challenge the arm’s length nature of the service fee earned by these entities. In such a scenario, it would become practically difficult for the MNE to implement such simplified approach as a group policy. The
simplified approach can be adopted by an MNE in its entire group only if all the countries where its group companies are operating agree to adopt such approach without qualification. Accordingly, while framing these provisions, it is important to keep in mind the perspective of both the service provider and service recipient.

**Recommendations**

It is recommended that where provision of low value added services forms core business activity of a group entity, OECD may consider adopting mark ups on a jurisdiction wise basis.

2. **Determination of cost base**

**Concern**

The Discussion draft provides guidance on identification of the cost of providing low value adding services and creating a pool of common cost for allocating it to the beneficiary entities based on the appropriate allocation keys. However, the tax authorities may challenge the authenticity of the cost base sought to be allocated to disallow the charge for such low value intra group services in the hands of the beneficiary entity. Further, the Discussion Draft provides uniform allocation of the cost pool to all the beneficiary entities of the group. However, the Discussion draft does not provide considerations of certain exceptional circumstances, for example moratorium period support for start-up entities of the group etc.

Additionally, the Discussion Draft does not discuss a common key issue, which is the disparity in the costs incurred in high-cost developed countries where services are provided to low-cost developing countries, where comparable services cannot be obtained locally, and this is likely to remain a source of disputes.

**Recommendation**

a) It has been observed in many disputes relating to intra group services that the tax authorities challenge the veracity of the cost pool as well as the detailed computation of allocation keys and also require substantive backup documentation to verify the sanctity of the cost pool and allocation keys. The OECD should provide some guidance relating to backup documentation that may be maintained by the MNE groups which can be regarded as authentic base by tax authorities to accept the authenticity of the cost pool and allocation keys. This may require some additional cost for the MNE but would assure them about the acceptability of the cost base by tax authorities. An independent auditor’s certificate regarding the verification of common cost pool and computation of the allocation keys could be recommended to bring in more sanctity to the process.

b) The OECD may provide certain exceptional circumstances where the cost of low value adding services may not be charged to beneficiary entities based on economic rationale for non-charging or delayed charging of such costs to such beneficiary entities under arm’s length scenario.

c) The OECD may also provide guidance relating to the transfer pricing of the costs incurred in high-cost developed countries for providing services to low-cost developing countries. Some of the circumstances for availing services in such cases could be where similar services cannot be obtained locally. Group synergies from these centralized services, quality of these services as per the group standard, common tools, techniques and procedures of the group can be taken as the guiding factors for such costs.

Yours Sincerely,

On Behalf of
Confederation of Indian Industry
Andrew Hickman  
Head of Transfer Pricing Unit  
OECD Centre for Tax Policy and Administration  
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France

Submitted by email: TransferPricing@oecd.org


The Confederation of Swedish Enterprise is Sweden’s largest business federation representing 49 member organizations and 60 000 member companies in Sweden, equivalent to more than 90 per cent of the private sector.

The Confederation of Swedish Enterprise is pleased to provide comments on the OECD Discussion Draft entitled "BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services" 3 November 2014 - 14 January 2015 (hereinafter referred to as the Draft).

General Comments

The globalization has led to an increase of intra-group services. For commercial reasons and cost efficiency Multinational Enterprises (MNEs) often choose to centralize services. Chapter VII of the OECD Transfer Pricing Guidelines provides guidance on determining if an intra-group service has been provided and how the price of such a service is to be calculated.

The interpretation of the Arm’s Length Principle (ALP) differs among States, making the interpretation subject to disputes leading to costs for both companies and States. The Confederation of Swedish Enterprise therefore welcomes the initiative to simplify the interpretation of the ALP in relation to low value-adding intra-group services. The area of low value-adding services relates only to a small proportion of an enterprise’s revenues and profits, making the cost and effort dedicated to seeking agreement regarding the taxation of this area disproportionate, relative to the small amounts of tax it concerns. In order for the new guidelines to facilitate for less administration and cost for companies and tax authorities, they need to be clear and simple to operate with limited documentation requirements.
To be effective, it is naturally important that any amendment to the OECD Transfer Pricing Guidelines gains recognition and is implemented widely, and not just by tax administrations in OECD countries. Consequently, the new guidelines need to be attractive also for non-OECD members.

The aim of the proposal should be to give MNEs the opportunity to centralize low value-adding intra-group services, where from a business perspective it is most profitable, without concerns of double taxation. It needs to be acknowledged that it is highly unlikely that a company would incur a cost solely for the purpose of obtaining a tax deduction. Consequently, the focus should be to find a suitable allocation method, not to evaluate if the cost is valid from a business perspective.

Specific Comments

Shareholder activities and duplicative costs

The Draft proposes amendments to section B paragraph 7.11 which provides examples of shareholder activities. The Confederation of Swedish Enterprise welcomes the additional examples provided in the Draft which clarifies the scope of shareholder activities.

The Draft also provides additional clarification on the duplicative costs set out in paragraph 7.12. We welcome the clarification that any consideration of possible duplication of services needs to examine the nature of services in detail. The fact that a company both performs services in-house and also is charged for services that are similar in nature is not, as stated in the Draft, by itself enough to conclude duplication. Since companies often are denied deductibility for services charged on the grounds that services have been duplicated, it is an important amendment to the Transfer Pricing Guidelines that there must be an examination in detail of the nature of the services before it is established that a service is indeed duplicated.

Low value-adding intra-group services

Section D of the Draft introduces a new simplified method for services falling within the category of low value-adding intra-group services. If the simplified method for low value-adding services indeed is simple to operate, it should have good prospects in lowering the administrative burden for tax payers as well as for tax authorities. In order for the simplified method to be effective, it is essential to ensure a uniform adoption and implementation. The OECD should therefore recommend all countries to apply the new provisions in order to ascertain a uniform adoption.

The Confederation of Swedish Enterprise shares the view that, if possible, a MNE should apply the simplified method in all countries. However, paragraph 7.51 seems to imply that a MNE is disqualified from applying the simplified method if the MNE
does not use the simplified method in all countries in which it operates. Such a requirement seems unnecessarily harsh. The fact that a tax payer might be unable to apply the simplified method in a country that does not accept the OECD transfer pricing guidelines should not disqualify the tax payer from using the method in other countries. We therefore urge the OECD to clarify or reconsider this aspect.

Low value-adding intra-group services are defined in paragraph 7.46 of the Draft, outlining four requisites that together constitute such a service. Paragraph 7.48 contains a list of bullet points which provides examples of services that would likely meet the definition of low value-adding services. We encourage the OECD to specify if the list provided in paragraph 7.48 is exclusive or illustrative, in order to clarify which services fall within the category of low value-adding intra-group services.

When a tax payer has found that services rendered are indeed falling within the low value-adding category, the initial step in applying the simplified approach is for the MNE to calculate, on an annual basis, a pool of all costs incurred by all members of the group in performing low value-adding intra-group services. The cost should be pooled according to category of service. In our view additional guidance on the costs that should be considered when calculating the cost pool is necessary, as the guidance in this area is limited.

The Confederation of Swedish Enterprise welcomes the opportunity laid down in paragraph 7.52 to keep costs for in-house activity, only benefiting the company performing the activity, outside the cost pool. However we encourage OECD to further extend the possibility to keep costs outside the cost pool. Paragraph 7.53 outlines a procedure where a cost attributed to a service performed by one group member solely on behalf of one other group member in a first step is allocated to a cost pool, and then in a second step be removed from the cost pool. This two-step procedure seems excessive. The cost should be allowed to be kept outside the cost pool already in step one, treating it the same way as an in-house activity. It should also be possible to keep costs outside the cost pool when only a small number of members of a MNE are receiving a service.

According to paragraph 7.57 of the Draft, the MNE provider of services shall, in determining the arm’s length charge for low value-adding services, apply a profit mark-up to all costs in the pool. The same mark-up shall be utilized for all low value-adding services irrespective of the categories of services. The mark-up should be between 2 % and 5 % of the relevant cost.

There is a clear risk of double-taxation due to the fact that tax administrations may make different interpretations of which mark-up that should be used. If a mark-up range is to be kept, additional guidance is needed. To eliminate the risk of double-taxation and to create a safe harbor, a single mark-up percentage would be preferable.
Is it a requirement to apply a mark-up in order to be able to use the simplified method? If so, how does this relate to paragraphs 7.37-7.39? The said paragraphs refer to services where it would be within the arm’s length principle to recharge the services at cost only. If a mark-up is mandatory for the use of the simplified method, this would mean that services normally recharged at cost only must be charged with a mark-up if the simplified method is applied. The Confederation of Swedish Enterprise suggests that paragraphs 7.57 and 7.37-7.39 are coordinated to adjust the above-mentioned problem.

We note that the mark-up percentage proposed in the Draft is different to the mark-up proposed by the EU Joint Transfer Pricing Forum’s guidance for similar low value-adding services, which suggest a mark-up between 3-10 %.

We welcome the clarification in paragraph 7.61 on documentation required when a MNE elects application of the simplified method. We would however also welcome a statement that electing the simplified method means an exemption from the normal requirements on transfer pricing documentation. The Draft should also address the impact of other BEPS actions concerning transfer pricing, especially action 13 on country-by-country reporting.

The requirement for a MNE using the simplified method to document all provision of services through written contracts seems unnecessary. It should be enough to provide one document that identifies the entities involved and the terms under which services are provided, rather than requiring formally signed agreements for each service. This would lower the administrative burden for MNEs while at the same time not affect tax authorities’ possibility to acquire necessary information. The needed information is still provided, just not in the formalized nature of an agreement.

On behalf of the Confederation of Swedish Enterprise

January 14, 2015

Krister Andersson
Head of the Tax Policy Department
Dear Andrew

Discussion Draft on BEPS Action 10: Proposed modifications to Chapter VII of the Transfer Pricing guidelines relating to low value-adding intra-group services

Thank you for the opportunity to comment on the Discussion Draft – ‘Proposed modifications to Chapter VII of the Transfer Pricing guidelines relating to low value-adding intra-group services’ released on 3 November 2014 (the ‘Discussion Draft’).

As a matter of principle, multinational businesses should obtain a tax deduction for commercial costs incurred in relation to their trading and business activities, including for support costs related to low-value ‘back-office’ functions, where these are available to domestic businesses. Multinational businesses may incur such costs centrally for reasons of efficiency (e.g. shared service centres) or in one or more entities for commercial or historical reasons. The OECD’s current approach to such costs is to determine the ‘service’ that is being provided intra-group and apply the arm’s length principle to price the services. We agree that the most appropriate transfer pricing method to apply to such services is the cost plus method. We also agree that, depending on the facts and circumstances, in many cases the services being provided are ‘low value’ relative to the profit-generating activities of the business.

However, in practice many issues arise in the application of the associated enterprises article of bilateral tax treaties (Article 9 in the OECD Model Treaty) to such services. It is commonplace for businesses to be challenged over low-value intra-group services charged to a number of different countries, where the burden of providing information and demonstrating the benefit to each of them through an audit (or mutual agreement procedure) process may be disproportionate to the tax deduction concerned in each country. Collectively, however, and over a period of years, this may lead to significant double taxation for a multinational group. The question is primarily one of allocation of costs incurred.

By email: TransferPricing@oecd.org

14 January 2015
Our ref: WJID/AL
The ‘simplified approach’ proposed in the Discussion Draft could be helpful for businesses and tax authorities, particularly where there are many small amounts being charged for intra-group services across a wide number of countries. Consistency of application (global consistency by each multinational business and consistency in implementation by tax authorities) will be key to making this an appropriate and practical method. In particular, we welcome the proposal that benefits should be considered by category of services and that a single annual invoice describing a category of services would be sufficient to support the charge. This will remove the significant administrative burden in providing evidence of multiple small individual services performed.

To minimise potential for inconsistencies or disputes, a fixed mark-up (e.g. cost plus 4%) should be substituted for the 2%-5% mark-up range proposed for the simplified approach. (Businesses that wish to operate a mark-up outside of this range would have the opportunity to do so by not electing to apply the simplified approach, requiring a benchmarked range for the services provided).

The simplified approach will only be of benefit where it is widely adopted by countries, including those outside of the membership of the OECD. It would be useful for countries to publish their positions on acceptance of the simplified approach, and suggest that the work of the OECD’s Forum on Tax Administration would be helpful in ensuring it is applied successfully. For example, consideration should be given to the procedure when one country challenges an allocation and the consequences for other entities, including shared service centres. Mutual agreement procedures (MAP) must be available in the event of any dispute.

The Discussion Draft states that the mark-up should be applied to ‘all costs’ in the cost pool, so that this appears to include ‘pass through’ third party costs incurred on behalf of other group companies, which are, under the general transfer pricing principles in Chapter VII, not considered part of the service being provided and therefore not subject to a mark-up. Depending on the types of service being considered such costs could be considerable. Pass through costs should be allocated under the simplified approach but should not attract a mark-up. This will require that they are separately identified.

A common source of dispute is the disparity in costs incurred in high-cost developed countries in cases where services (not necessarily low-value adding services) are provided to low-cost developing countries, where comparable services cannot be obtained locally. This has not been addressed in the Discussion Draft, and is likely to remain a challenging area for businesses and tax authorities.

Detailed comments are set out in the attached appendices, but as a final general observation the proposals are broadly helpful and well-drafted, and if implemented successfully will be of benefit to businesses and tax authorities alike.
If you would like to discuss any of the points raised in this letter, please do not hesitate to contact either me (bdodwell@deloitte.co.uk) or Alison Lobb (alobb@deloitte.co.uk). We would be happy to speak on this topic at the Public Consultation meetings on 19-20 March 2015.

Yours sincerely

W J I Dodwell
Deloitte LLP
Appendix 1: Comments on Section D of the Discussion Draft

References are to paragraph numbers included in the Discussion Draft.

D.  Low value – adding intra-group services

7.45 The Discussion Draft recognises that the arm’s length price for low value-adding intra-group services is closely related to costs and we agree that this is the right starting point for the simplified approach. The simplified approach will only be effective if it is widely adopted by tax authorities.

D. 1 Definition of low value-adding intra-group services

7.46 We agree with the definition and note that it is in line with the EU Joint Transfer Pricing Forum recommendations.

7.47 The list of activities that would not qualify for the simplified approach is helpful, although the general exclusions for insurance and services of corporate senior management seem to be unduly narrow. Provided the services meet the four conditions in paragraph 7.46, then these services should be included in the simplified approach. For example, procuring global buildings insurance policies on a centralised basis and handling claims may be low value-adding services. A definition of ‘corporate senior management’ would be helpful, and examples (similar to that in paragraph 7.49) would be beneficial.

7.48 The list of services that would be likely to meet the definition of low value-adding provided in paragraph 7.46 is helpful and its scope is in line with that of the recommendations made by the EU Joint Transfer Pricing Forum.

7.49 The Discussion Draft correctly highlights that the same type of service may be low value-adding for one business but not for another, depending on the facts and circumstances of their value creation. The credit risk analysis example provided illustrates the point well.

7.50 This paragraph is helpful, and illustrates the point that shared services centres can be used to centralise the provision of common low-value adding intra-group services, and are typically clustered in countries that provide cost benefits (e.g. the Czech Republic, India). By fixing the margin for the simplified approach at a consistent low rate, the income of these entities will also be fixed.

D. 2 Simplified determination of arm’s length charges for low value-adding intra-group services

7.51 We agree - all low value-adding service costs incurred in supporting the business of the group should be allocated to group entities.

D.2.1 Determination of cost pools

7.52 Examples would be helpful indicating the level of detail that will be appropriate for categories of services – for example, a category of service may be ‘accounting services’ or ‘statutory accounting services’ or ‘accounts payable/receivable’.

D.2.2 Allocation of low value-adding service costs
7.55 Whilst the examples given are helpful, turnover may be an appropriate allocation key (e.g. for accounting support services). The final sentence could be interpreted as saying that turnover would only be applicable to other cases (see also comments below).

7.56 We agree that allocation keys should be based on facts and circumstances, and that there is a balance between theoretical accuracy and practicality. The key point is that an allocation key or keys provide a reasonable reflection of the respective benefits.

The reasonableness of the keys chosen will be tempered by the requirements for the approach to be applied consistently across all businesses in the group and from year to year in the absence of a justified reason for change. This is an important facet of the proposals.

D.2.3 Profit mark-up

7.57 The Discussion Draft states that the profit mark-up shall be applied to ‘all’ costs in the pool. This implies that this would include pass-through costs, (third party expenses incurred by one group entity on behalf of other(s)) which are allocated but attract no mark-up under the general principles in Chapter VII. Such costs may be significant, do not form part of the ‘service’ being provided, and so would appear to be better allocated but not marked-up. Clarification of the simplified approach in relation to pass-through costs would be helpful to ensure consistent interpretation.

As an observation, the mark-up range is lower than the range in the EU Joint Transfer Pricing Forum’s guidance for similar low-value services (endorsed by the European Commission), which suggests a typical mark-up of 3-10%. Many European businesses may therefore need to revise down the level of mark-up in order to apply the simplified approach.

In the absence of benchmarking studies supporting a range for an arm’s length level of mark-up and with the intention of simplification a single mark-up, for example 3% or 4% should be chosen by the OECD for the simplified approach. It is not in the interest of business nor tax authorities to have discussions around why the mark-up is 2% and not 5%.

D.2.5 Application of the benefits test to low value-adding intra-group services

7.59 The acknowledgement that it may be difficult (and may require greater effort than the amount of the charge warrants) to meet the usual benefits test for low value-adding services is important, and one of the key difficulties in this area.

7.60 We agree with the simplified benefits test. The concession that a single annual invoice describing a category of services should suffice to support the charge and evidence of individual acts should not be required is welcomed. It is important that countries that agree to implement the simplified approach ensure that in practice their tax inspectors apply this – the OECD’s Forum on Tax Administration may be able to assist here.

D. 3 Documentation and reporting

7.61 Consideration should be given to businesses that already have an established methodology for allocating intra-group service charges, perhaps on a regional basis. Moving to the simplified approach may require changes to the existing allocation keys, mark-up and documentation standards, but would only be possible if all countries adopt the proposals. It is essential that countries do not attempt to apply the proposals in the simplified approach absent an election from the taxpayer.
Appendix 2: Comments on Sections A, B, C of the Discussion Draft

7.11 The examples of ‘shareholder activities’ included in the Discussion Draft are welcome. As a general comment, additional examples aid clarity, particularly where they are used to illustrate differences of outcome based on factual circumstances.

7.12 The revisions and examples in relation to what is, and is not, a duplicative cost are helpful. In our experience businesses do not incur costs (apart from the occasional mishap) unless they need to for commercial, legal or regulatory reasons.

7.31 The arm’s length price should be considered from both the perspective of the service provider and from the recipient of the service, but this should be tempered with the need for practical application of the arm’s length principle and the need to balance businesses’ costs, particularly in relation to low value-added services. A particular concern here is that if sufficient number of countries do not accept the simplified approach for low-value adding services this requirement could become onerous for businesses attempting to price low value-adding services under general principles.

7.34 Similar to the point made above, the requirement for a full functional analysis of the various members of the group (a change to ‘necessary’ rather than ‘helpful’) should be applied only to intra-group services that are not low-value added.
Appendix 3: Charging for intra-group services

There are a number of circumstances (some commercial, some tax-related) that may arise where businesses may not actually charge in full for intra-group services. In these situations businesses either impute income at the service provider company level or disallow third party costs that are not recharged, depending on the circumstances.

- Some companies operating under joint venture arrangements (which may be Associated Enterprises and therefore within transfer pricing) may not be able to recharge service costs, unless the charge is specifically agreed to by other joint venture parties. Typically, where agreement is given it will be for recharge at cost with no mark-up.
- Some countries may levy a withholding tax on the gross amount of payments for services. This, combined with the often low margin return on low-value intra-group services, means that charging for some services may be uneconomic. (See Appendix 4 for further illustration and discussion of this point).
- Some companies in the energy and resources sector may not recharge services to countries which have a revenue based tax for oil and gas (such that there is no tax deduction).
- For some countries, charging for services may be problematic because currency controls make extracting money from the jurisdiction difficult.

It would be helpful if there could be acknowledgement in the revisions to Chapter VII that whilst allocation of intra-group services to specific countries under either general principles or a simplified approach may be appropriate, it is not necessary for businesses to actually make the recharges (albeit that this will preclude a local tax deduction for them and will lead to double taxation).
Appendix 4: Interaction with withholding tax on payments for services

Withholding tax issues are not within the direct scope of this Discussion Draft, but the simplified approach may highlight and, due to the low mark-up, intensify the problems that can occur. The issue derives from (i) the withholding tax some countries levy at source in relation to payments for services calculated on a gross basis and (ii) the rules and limitations pursuant to which the recipient can claim a foreign tax credit to alleviate double tax calculated by reference to net profits.

In such circumstances, the source country deducts a withholding tax on the gross payment (which may or may not include third party ‘pass through’ costs as well); while the amount of the foreign tax credit the recipient can claim in its country of residence is typically limited to the amount of its income tax liability on the foreign source income, generally calculated based on the net profit arising from the services provided, after deduction of costs.

In practice, situations arise where the effective tax rate borne on low value-adding intra-group services may be higher than 100%. Between third parties, this is unlikely to be accepted as an arm’s length transaction (gross-up clauses may be contractually negotiated in such circumstances to help provide a more equitable outcome).

The following example illustrates this:

- Cost incurred in the provision of a low value-adding intra-group service: 100
- Mark-up: 5%
- Gross payment made by the service recipient: 105
- Profit before tax for the service provider: 5
- Withholding tax suffered at source (10%): 10.5
- Corporate tax rate on service provider at residence: 30%
- Corporate tax liability in country of residence: 0 (5*30% less foreign tax credit limited to 5*30%)
- Overall tax borne: 10.5 (solely the withholding tax)
- Profit/(loss) after tax: (5.5)
- Effective tax rate: +200%

The simplified approach is designed to work with all countries, including developing ones that are most likely to have a withholding tax on services, and whilst we agree that a low margin is appropriate at arm’s length, a withholding tax that creates an uneconomic return is clearly not arm’s length. Tax authorities are often reluctant to accept gross-up clauses in intra-group situations as being arm’s length. It would be helpful if consideration could be given to the interaction between low gross margin returns and high withholding taxes.

It is of course possible that some countries will prefer to keep their withholding tax levy on payments for services rather than participate in the simplified approach, or try to operate both models, and this may be a limiting factor for the success of the simplified approach.
Appendix 5: Services provided from different locations via a shared service centre

Businesses may operate a ‘virtual’ shared service centre alongside an actual one. It would be helpful if an additional example could be provided in relation to the simplified approach in this regard, albeit the outcome would be consistent with the overall principle. The example below illustrates this.

Modern business may set up a central shared service centre in a centralised location, for example in the Czech Republic. The same group may also have a few employees located in other countries for various reasons (often personal) providing services in the same categories as those provided by the shared service centre. Typically these employees are employed by the local operating entity, and are on the local payroll, but are providing low value-adding services to the shared service centre rather than on secondment to the local entity. The costs of these employees should be recharged by the local entity with the appropriate mark-up to the shared service centre before the allocation of low-value added services to other group companies. This will mean that the profit in respect of these employees not physically based in the jurisdiction of the shared service centre will be in the local company rather than the shared services centre entity.

The shared service centre should then mark-up its own costs for recharge and aggregate these with the recharged costs, including the mark-up from the local country but with no additional mark-up. The shared service centre should then use the allocation key to allocate the costs as before under the simplified approach. The key points are that there should be consistency of mark-up and no duplication of mark-up within the group.
Berlin, 9 January 2015

Mr. Andrew Hickman  
Head of Transfer Pricing Unit  
Transfer Pricing and Financial Transactions  
Division  
OECD/CTPA  

Via email: transferpricing@oecd.org

Comments on Discussion Draft BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines relating to Low-Value Adding Intra-Group Services

Dear Mr. Hickman,

We welcome the opportunity to comment on the discussion draft on BEPS Action 10 “Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines relating to Low-Value Adding Intra-Group Services” published on 3 November 2014.

The German business association The Family Entrepreneurs – ASU represents almost 5,000 family businesses in various sectors. Founded in 1949, it speaks on behalf of 180,000 family entrepreneurs with more than 8 million employees. They reflect a wide range of businesses from small, medium sized and international corporations.

Our members constitute a substantial part of the nation’s GDP. They are significant drivers of the German economy and export industry as well as internationally well connected. We therefore welcome the OECD/G20 initiative and its aim to create a single set of consensus based international tax rules to address Base Erosion and Profit Shifting by simultaneously encouraging non-harmful tax competition among states.

The Family Entrepreneurs – ASU has closely monitored the BEPS Project from its beginnings and applaud the fast pace of work at the OECD. Nonetheless, we have become increasingly concerned that the initial objectives of the project are lost in technical details. With a rising number of countries proposing unilateral measures to counter BEPS and to increase domestic tax revenues the risk of uncertainty, complexity and double taxation for taxpayers is once again growing.

Moreover, the fast pace of the project and the public attention on very few international tax avoidance cases suggests that an objective, comprehensive analysis and assessment of the effects of the proposed
rules is overlooked. The proposed measures may indeed effectively target abusive tax arrangements by multinational corporations. Nevertheless, due to their broad reach they also heavily affect small, mediums sized and even large companies with international business activity. This holds especially true for German family businesses competing internationally. These companies will need to adhere to stricter tax laws and compliance responsibilities without having the same resources as multinationals.

In this context, we welcome the proposed simplified approach for low-value adding services, useful examples of shareholder activities and addressing the subject of duplication. The simplified approach may serve as a useful technique to reduce compliance costs and burdensome paperwork. Nonetheless practical issues remain. For example, disputes may arise in cases where comparable services cannot be obtained locally for costs incurred in high-cost developed countries where services are provided to low-cost developing countries. This disparity needs to be addressed.

Moreover, although the requirement to adopt the approach on a consistent group wide basis may have its benefits for taxpayers, the situation needs to be addressed when a country does not allow or accept the simplified approach. In this context, scenarios should be addressed where countries may apply withholding tax rates to value-adding services with low mark-ups instead of accepting the proposed simplified approach.

Finally the discussion draft fails to clarify how the proposed changes will interact with other BEPS actions. This holds especially true for the proposed documentation package of Action 13 since the discussion draft seems to indicate that no separate local files would be needed in case the elective approach is opted for.

It is evident that the usefulness will depend on the application of the simplified approach especially by non-OECD countries. Should this not be the case, the work on Action 14 is even more essential to ensure effective dispute resolution mechanisms.

Should you have any questions, please do not hesitate to contact us.

Kind regards,

Dr. Peer-Robin Paulus

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OECD
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Tuesday, Jan 12th 2015

Discussion Draft on BEPS Action 10: Proposed modifications to chapter VII of the Transfer pricing guidelines relating to low value-adding intra-group services - issued November, 3rd 2014

Dear Sir or Madam,

I am pleased to respond to the OECD’s request for comments. This comment was prepared with my very best intentions to help with this process and is submitted today on my own capacity.

For a couple of years, I was Head of the Global Operational Transfer Price Management of the Merck Group, a large German-based Pharmaceuticals & Chemicals Company. My organization - being part of the Finance, Accounting and Controlling organization - managing all operational transfer pricing aspects in terms of implementation, monitoring, data reporting and supervision of IC transactions within the group.

In comparison to comments by tax experts, I would like to highlight my views and comments from Finance and Accounting practice point of view in particular with regards to timing questions.

I provide my comments on the draft to contribute useful thoughts from my experience in industry.

Please contact me in case you would like to discuss them in further detail or in any consultation.

Sincerely,

Dr Frank Schoeneborn

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I. General comments

In my view, the provided discussion draft provides an excellent and comprehensive overview on intra-group service charges from transfer pricing perspective. The given examples of potential services are relevant for the vast majority of MNEs and describe cases help to understand the intentions on how to deal with intra-group service charges. Such charges usually create a lot of practical issue and require quite some administrative work in processing them through the MNEs organization which is usually out of scope of tax experts. The discussion draft addresses a lot challenges and provides very good guidance for industry practice and the proposed simplified approach will help many MNEs to manage these charges in an acceptable and efficient way to meet tax and compliance requirements without excessive administrative burden.

With my comments, I would like to provide some proposals for slight modifications to get an even more precise and complete chapter on intra-group-services with high practical relevance for taxpayers and tax administrations.

I also provide a text proposal for an additional paragraph which provides a guidance on timing issues. The frequent question for taxpayers is when to execute these charges and how to deal with the year-end and the potential need for a true-up. The current public discussion draft does not reflect these challenges yet. I assume such a paragraph would make the updated chapter VII of the OECD Transfer Pricing guidelines even more complete.

II. Minor modifications for additional clarity

The following underlined modifications should be applied the text:

7.4 Intra-group services may ……………………………….such as treasury management, marketing, global key account management and supply chain management.

7.15 Other activities that may ………………. 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 centers, research and development or administer and protect intangible property for all or part of the MNE group…..

7.28 The search and identification for a reasonable allocation key is often challenging. The allocation might be based on turnover, or staff employed, or some other basis. Whether the allocation method is appropriate may depend on the nature and usage of the service. For example, the usage or provision of payroll services may be more related to the number of staff than to turnover, while the allocation of the stand-by costs of priority computer back-up could
be allocated in proportion to relative expenditure on computer equipment by the group members. The selected allocation key should be based on a substantial and transparent key figure which is easy to verify. Besides substantial data like headcount or turnover, sometimes an activity-based key could be even more comprehensive, e.g. number of invoices or order lines processed, number of customer calls taken etc. The allocation key should not consider any profit related components as these could result in unacceptable allocations when consistently applying the allocation key e.g. calculation of values $>100\%$ or $<0\%$ when profits of single MNEs companies might turn into losses.

7.55 The third step in this ……………… might employ the share of total relevant transactions or the share of total assets. In other cases, the share of total turnover may be the most relevant key. Special attention must be given whether the group’s 3rd party revenues and the related share or the revenues to other MNE group companies are more appropriate and reasonable depending on the provided service.

7.56 The examples of …………………………………………………………………. the reasons for concluding that a single master (or “generals”) key provides a reasonable reflection of the respective benefits. …………………………………. Tax administrations and taxpayers should also bear in mind that inadequate definition or changing the reasonable allocation key can give rise to considerable complexities (see also paragraph 7.28 for avoidance of potential results $>100\%$ or $<0\%$). It is expected that the taxpayer will describe in its documentation (see paragraph 7.61 below) the reasons for concluding that the allocation key produces outcomes which reasonably reflects the benefits likely to be derived by each service recipient.

III. Additional paragraph on “timing issues”
Intra-group services are expected to be charged in the fiscal year where the service was rendered. Usually it is expected that an invoice is issued right after the completion of the service. This can be observed between third parties. Is a service continuously rendered, monthly (or a least quarterly) invoices will be issued by the service provider. Independent companies as well as MNEs face the challenge to deal with local accruals / provisions for any outstanding charges. Dedicated accounting rules require these procedures.
Dr Frank Schoeneborn, Heidelberg, Germany

From tax and in particular transfer pricing point of view, one invoice per year might be reasonable (see also paragraph 7.60) but MNEs should not be encouraged to do so. At least on a quarterly basis, an invoice should be issued for various reasons (profit transparency, liquidity etc., VAT declarations etc.).

In absence of CUP, MNEs often apply the cost-plus transfer pricing method to determine the transfer pricing for their intra-group services. It is assumed and natural, that these charges are based on actual cost. But this is not expressively mentioned. In practice, the service-providing MNEs group companies have to wait until each month’s closing is completed before there are able to analyze the actual cost occurred and, if necessary, to perform the allocation key calculation, and to finally come up with the appropriate amount and markup to issue the invoice to other group companies. Remarkably, this issue applies for direct as well as indirect charge methods. Due to this fact, the actual service charge from one MNE group company to another one is usually processed with one month delay, no matter if the sequence is monthly or quarterly. The industry practice shows that many MNEs also charge budget amounts e.g. monthly 1/12 of the annual budget during the year and try to apply a true up in December to reflect actual cost. Others start actual charging e.g. in February with one month delay but face issue in how to post December cost still in December without knowing accurate actual cost. Sometimes forecast are applied as base for the charge. But the final service provider’s actual cost will always differ from any budgeted or forecasted amount. The following graphics illustrate the various patterns.

![Figure 1 Service charges based on budgets during the year](image)

Comment on Proposed modifications to chapter VII of the Transfer pricing guidelines relating to low value-adding intra-group services - issued November, 3rd 2014 by OECD.
Comment on Proposed modifications to chapter VII of the Transfer pricing guidelines relating to low value-adding intra-group services - issued November, 3rd 2014 by OECD.

Figure 2  Service charges based on actuals with one month delay

Figure 3  Service charges based on budget and actuals illustrating the true-up issue
In order to give comprehensive guidance on these challenges as well, I propose to add a paragraph “E” to the chapter VII of the OECD guidelines with the content as follows:

**E. Timing of Intra-group service charges**

7.62 Special attention should be paid on timing issues related to intra-group service charges. Intra-group services are expected to be charged in the fiscal year where the service was rendered. One annual invoice might be reasonable (see also paragraph 7.60) but MNEs should not be encouraged to do so. MNEs should prepare and process intra-group invoices close to the completion of the service or at least in a regular timely manner (monthly or at least quarterly).

7.63 Independent parties as well as MNEs face the challenge with local accruals and provisions for any outstanding charges. General accounting rules require these procedures. In absence of CUP, MNEs applying the cost-plus transfer pricing method should calculate charges based on actual cost occurred. As service-providing MNE group companies have final costs available after each months-end closing only, the appropriate invoice with amount incl. the markup is usually processed with one month delay. Some MNEs charge budget amounts e.g. monthly 1/12 of the annual budget during the year and do apply a true up at the year-end to finally reflect actual cost. Such simplified approach should be accepted.

7.64 At year-end closing, once 11 months with actual figures are processed, questions regularly appear concerning the determination of actual cost for the 12th month. A charge of a forecasted (or budgeted) amount should be accepted. A true-up to adjust the charge to actuals for a single month should not be mandatory but limited to material deviations only. The ratio vs. the annual service charge can serve to define materiality.

**Conclusion**

Intra-group services in particular those with low value-adding do create administrative burden. I appreciate the OECDs approach to prove practical guidance on how to consistently judge these services from a transfer pricing perspective a how treat these charges in a transparent way.

I provided my comments in order to bring some more additional clarity on practical cases which are relevant for many MNEs and provided a proposal for an additional paragraph to be included in the Chapter VII on how to deal with the timing issues for processing intra-group service charges.

I appreciate if these comments and proposals for modification could be considered in the process of updating Chapter VII of the OECD Transfer Pricing guidelines.
COMMENTS TO PUBLIC DISCUSSION DRAFT REGARDING PROPOSED MODIFICATIONS TO CHAPTER VII OF THE TRANSFER PRICING GUIDELINES RELATING TO LOW VALUE-ADDING INTRA-GROUP SERVICES

1. INTRODUCTION

We refer to the discussion draft published by the OECD 3 November 2014 regarding proposed modifications to Chapter VII of the Transfer Pricing Guidelines relating to low value-adding intra-group services (the "Discussion Draft").

The following are our comments to the proposed modifications. Our comments are, inter alia, based on our experiences from assisting major multinational companies and the challenges these companies are facing when they allocate costs created by technical and managerial services provided by a parent company to the subsidiaries.

2. MAIN CONCERN

Our main concern is that the Discussion Draft has not sufficiently addressed the practical problems and administrative burden often associated with composing a workable methodology for allocating indirectly charged costs, especially for large multinational enterprises ("MNEs"), often consisting of many subsidiaries and divisions (product lines). Such activities call for a number of different services to many group companies.

The problems facing these MNEs are caused (i) by difficulties in setting up a fair methodology for allocating costs to the subsidiaries, leading to arm's-length prices for the subsidiaries, and (ii) by tax authorities in some countries that do not accept to cover their share of these costs under that methodology because they feel that the value of the benefits have not been documented properly, although benefits have been proved.

As a consequence, the parent company is not able to recover its costs over the years, not to mention a profit element. An independent service provider would require over the years to have its costs recovered. If the costs are not recovered, the country of residence of the parent company will have to accept a deduction for a disproportionate share of the costs.

Clearly, this does not facilitate international business and is not the aim of the BEPS process.

Hence, the main issue for many MNEs in practice is to be able to provide sufficient proof of the value of the benefits. This is addressed in paragraph 7.27 in the Discussion Draft, where the following is said:
When an indirect-charge method is used, the relationship between the charge and the services provided may be obscured and it may become difficult to evaluate the benefit provided.

In our view, the value of the services for each subsidiary can only be estimated, not documented, and the way this estimation is to be done is to find the appropriate allocation key. Thus, the valuation of the services that meet the benefits test has to be determined – "documented" – by means of the allocation key. We think that this should be expressed clearer in the Discussion Draft, for example in section B.2.2.2.

We suggest that the proposed modifications to the Guidelines address in more detail this practical issue, and also make clearer how the allocation key may properly document the value of the benefits.

In order to illustrate our views, we will in the following describe a case which addresses the challenges facing many MNEs.

References to the discussion draft are included.

3. THE CASE

3.1 The facts

Company A, resident in Country X, is the parent company of a large MNE consisting of 120 subsidiaries in 75 countries. The subsidiaries are grouped in four divisions; (a), (b), (c), and (d). The group engages in business lines which require use of technology and large capital investments.

Company A has 3,000 employees at its head office in Country X and does not perform any other business than managing the business of the subsidiaries and providing services to the subsidiaries in the group. We assume that Company A provides the following services in each of the divisions (a) through (d) to the subsidiaries in those divisions: (i) Technical support, (ii) research and development, (iii) human resources, (iv) health, safety and security, (v) legal services, (vi) crisis management, (vii) public relations, (viii) long term planning, and (ix) finance.

Company A's services can be split into Direct Services, which can be allocated based on a direct-charge method and Indirect Services which have to be allocated based on an indirect-charge method.

The employees of Company A possess the highest technological and managerial skills in the group and Company A owns all intangibles used by the subsidiaries. Company A controls the finances of the group and all major capital investments in the group have to be approved by Company A.

On a yearly basis Company A incurs costs in the amount of MEUR 1,000. The only income of Company A is dividends from the subsidiaries and amounts to MEUR 1,250.

Company A is listed on the stock exchanges in Country X and Country Z and subject to extensive control and regulations in those countries.

3.2 The benefits test – section B.1.1.

In reality a substantial part of the business of Company A in each service category supports and facilitates the business of the subsidiaries. The group benefits from economy of scale by centralising the performance of these services. Of course, it could under the circumstances be so that one or several of the subsidiaries do not need for example research and development in their business, and that would have to be taken into account when allocating costs. Nevertheless, each subsidiary would either have to staff up locally to perform the relevant activities themselves, which would likely be expensive for the
subsidiary and more costly for the group as a whole, or the subsidiary would be willing to pay for another company's supply of the services to them.

Under any circumstances, the benefits test as described in the Discussion Draft is therefore met.

In practice, however, to determine whether benefits have been obtained by the subsidiaries is the easy part. The controversies with the tax authorities arise when the figures are to be determined.

### 3.3 Determining the deductible figures

#### 3.3.1 Introduction

It is necessary to split the costs of Company A three times: The own costs of Company A ("Own Costs") often called shareholder costs, and costs incurred on behalf of the subsidiaries which should be allocated to the various subsidiaries ("Subsidiary Costs"). The Subsidiary Costs should then be split into costs for Direct Services and costs for Indirect Services.

Subsequent to carving out the Own Costs, the Subsidiary Costs have to be split into Direct and Indirect Services. The Indirect Services should then be split among the four divisions, and ultimately allocated to each of the subsidiaries in the divisions.

The challenge for Company A is to establish a fair methodology for cost allocation among the divisions and subsequently the subsidiaries, and a method which would be accepted by the tax authorities.

#### 3.3.2 Carving out the Own Costs – section B.1.2

The first step would be to carve out the shareholder costs which shall not be charged to the subsidiaries (B.1.2). In our view the Discussion Draft does not adequately address what should be considered an appropriate practical method, acceptable to the tax authorities, for carving out such Own Costs.

Company A has appointed one of the four major auditing companies, to set up a methodology for carving the Own Costs out of the MEUR 1,000. The conclusion of the auditing firm is that MEUR 50 should be carved out as Own Costs.

The tax authorities receive the report from the auditor, including a description of the methodology for carving out the Own Costs, and an extract of the accounts for Company A showing the nature of the costs that have been carved out as Own Costs.

Provided that the tax authorities after having examined the report from the auditor, and reviewed the accounts in light of the methodology, have not been able to identify any inconsistencies in the methodology or the application of the methodology of the auditor, it is our opinion that the tax authorities normally should accept the MEUR 50 as the correct Own Costs of Company A.

We propose that the OECD improves section B.1.2. in the Discussion Draft to include examples of methods – like the one described above - to carve out shareholder costs, which, if applied by a company, should normally be accepted by the tax authorities.

#### 3.3.3 Carving out Direct Costs

Direct Costs incurred for Direct Services provided by Company A have to be carved out of the amount remaining when Own Costs have been taken out. Normally this is fairly easy, since these are directly charged costs. Transfer pricing issues may occur, however, related to finding the correct hourly rate for the personnel employed by Company A.
In case of controversies, a similar approach as mentioned for Own Costs could be applied. Company A could appoint an auditing firm to set up a methodology for carving the Direct Costs.

In our case MEUR 250 are costs coming from Direct Services.

3.3.4 Calculating the arm's-length consideration relating to indirect-charged services – sections B.2.2.2, B.2.2.3 and B.2.3

In our case we assume that MEUR 50 is considered to constitute Own Costs, and MEUR 250 is Indirect Costs. Hence, MEUR 700 relates to Indirect Services.

The remaining MEUR 700 should be allocated to each of the four divisions, (a), (b), (c), and (d), and the question is what methodology could be applied in order to allocate these costs to each division. An allocation key should be used based on the circumstances in the group.

Company A has chosen to use invested capital in each of the divisions as the key, since the business in the group is capital intensive. In other MNEs the number of employees could be an allocation key, or gross sales. It is possible also to blend two or more keys to find an appropriate allocation key. The choice of allocation key would depend on the elements that create the need for Indirect Services.

Company A has calculated division (a)'s share of the MEUR 700 to MEUR 375. Division (a) is the biggest division in the group with the largest investments. Division (a) has 35 of the subsidiaries in the group. All the subsidiaries receive all categories of services, but it is impossible to quantify how much support each subsidiary gets in each service category, and how much that would be worth. The only reasonably certain figures are the total cost incurred by Company A for Indirect Services (MEUR 700), the number of subsidiaries (35) and the accounts of the subsidiaries, number of employees etc.

The administrative burden if Company A were required to document the scope of the services and the value of the benefits for each subsidiary would be too big to be acceptable, as stated in paragraph 7.24 in the Discussion Draft.

As already mentioned, the value of the services for each subsidiary can only be estimated by means of an appropriate allocation key. A main task is thus to determine the relevant allocation key. This is a major challenge in practice, and it would be beneficial if the Guidelines gave advice on this issue. Invested capital, gross turnover, operational costs, number of employees, units produced, units sold, etc. are alternatives.

The aim when picking the allocation key should not be perfection, which is impossible under the indirect-charge method, but to choose the most reasonable alternative available. Again, it is possible to blend allocation keys if this is likely to express the value better.

The following quote from the Discussion Draft paragraph 7.56 is important:

*However, a balance should be struck between theoretical sophistication and practical administration, bearing in mind that the cost involved are not generating high value for the group. In this context, there may be no need to use multiple allocation keys if the taxpayer can explain the reasons for concluding that a single key provides a reasonable reflection of the respective benefits.*

In practical cases, acceptance of one allocation key for a package of services is essential to reduce the administrative burden of the MNEs. For many MNEs the number of service categories is so big that a requirement of different allocation keys for each category and the corresponding accounting work will be very burdensome, and requirements from the tax authorities may lead to economic double taxation. If the same key is used for all subsidiaries in division (a) and all services categories, and accepted by all the tax offices involved, Company A will be able to recover its costs related to this division within a reasonable work load.
In practice, some MNEs apply indirect-charge methods that are not consistent with the arm's-length principle, technically speaking. The result in numbers from using these methods may, however, be consistent with the results from using a method that is recommended by the OECD. Of course, such a "non-OECD method" used by an MNE should be accepted by the tax authorities, provided the results are consistent with the methods recommended by the OECD. We think this should be expressed clearer.

It is the result that should be subject to the arm's-length test, not the method itself.
Re: Comments pertaining to the Discussion Draft on Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services from Christopher Desmond, Rod Koborsi, Michael Berbari and Walker Wood, Duff & Phelps, LLC

Dear Madame / Sir:

This letter is in response to the OECD’s request for comments on its most recent Discussion Draft on its Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services issued November 3, 2014, hereinafter referred to as the “Discussion Draft.”

We believe the OECD’s proposed modifications to Chapter VII of the Transfer Pricing Guidelines relating specifically to “Low Value-Adding” Intra-Group Services is a necessary and positive step in providing further clarity on how taxpayer activities that provide a benefit yet do not add significant value to a related beneficiary can be analyzed. We focus the remainder of our response on the areas that we believe may hinder the OECD’s objective of achieving the “…necessary balance between appropriate charges for low value added services and head office expenses and the need to protect the tax base of payor countries.”

We have segmented our key observations / comments concerning the Discussion Draft into five areas: i) shareholder activities and duplicative expenses; ii) classification of low value-adding services; iii) application of the simplified approach; iv) documentation and reporting of low value-adding services; and v) approval from non-OECD countries.

Shareholder Activities and Duplicative Expenses

While we generally support the expanded language related to shareholder activities and duplicative expenses, we are under the belief that taxpayers will still face challenges in conflicting definitions across tax jurisdictions in this area.

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1 The thoughts expressed in this paper are those of the authors and do not necessarily reflect the views of Duff & Phelps as a whole or its clients.

2 OECD, Discussion Draft, Page 3.
Related to shareholder activities, ¶7.10 should address the treatment of activities related to corporate reorganizations. Given how highly this activity is contested in many tax administrations, it is important that the Discussion Draft mention that there are instances in which a direct benefit (or expected benefit) to the group members can be identified and should be charged accordingly. Whether a corporate reorganization is to be classified as a shareholder activity should be determined on a case-by-case basis.

Additionally, further clarification is necessary in ¶7.12 when describing duplicate services. Specifically, the Guidelines should be revised to recognize that duplicate services may render an additional benefit depending on the facts and circumstance. In other words, the mere duplication of services or activities does not imply avoidance of benefit. The Discussion Draft uses the example of a group member that performs marketing services in-house but is also charged marketing services by another group member. It goes on to state that this in itself does not determine a duplicative service since marketing may comprise many levels of activity. However, this seems to imply that a service would be considered duplicative if the same activity is performed by the group member in-house and is also charged by another group member. There are instances whereby an MNE may maintain personnel at local offices and at a central office who work jointly on the same activities to ensure smooth operations. For example, marketing personnel at a central office may work with marketing personnel at local offices to jointly create and customize marketing materials such as brochures or direct mailings for the local market. In this example, the activities performed by the central office provide an added benefit to the operations of the local offices even though the activities are very similar to those executed by the local office.

**Classification of Low Value-Adding Services**

In defining low value-adding intragroup services, the Discussion Draft should provide guidance as to which stakeholders are best suited to determine the low value nature of the services analyzed. It is our opinion that MNEs, as opposed to tax administrations, are best suited to make this determination related to their business. Any revisions to the Guidelines should include a statement to this effect in order to prevent arbitrary interpretation of the definition for low value-adding services.

¶7.47 of the Discussion Draft lists marketing activities within the definitive list of activities that would not qualify under the simplified approach. Depending on business-specific circumstances, marketing activities can be considered an intangible generating activity (e.g., global branding), a mid-to-high value service (e.g., creating advertising copy), or a low value-adding service (e.g., printing marketing brochures). Therefore, we believe marketing activities should be further defined in the Discussion Draft. Alternatively, the authors can consider removing marketing activities from ¶7.47. Along these lines, the OECD should go a step further and recognize that certain service groups, similar to marketing, (e.g., information technology and legal) may consist of varying activities ranging from intangible-generating to low value-adding. For example, 'Legal Services' could include IP management and
protection, which could be both ‘Core’ and/or ‘IP-Generating’. In addition to acknowledging this reality, the OECD should give tax authorities and taxpayers latitude in this respect by requiring that an analysis be conducted to identify these differences within service categories where appropriate along with the fact that different activities under a single service heading may be charged for using more than one method.

The Discussion Draft should consider adding “Value-Added Engineering” to the list of activities in ¶7.47 that do not qualify under the simplified approach. Doing so will add further clarity and prevent the risk that taxpayers classify these services as low value-adding.

Lastly, we recommend removing “services of corporate senior management” from ¶7.47. While we generally agree that these types of services are unlikely to meet the definition for low value-adding services as currently proposed, we believe the service category is too broad to exclude explicitly. In many instances service group heads such as the head of the legal group may reasonably be considered “corporate senior management”. However, it may be likely that much of the services that he or she provides will meet the proposed definition for low value-adding services. Thus significant confusion may arise as to whether or not the costs of this individual can be allocated under the simplified approach. Removing this inherently subjective category will allow for the determination to be made on a case-by-case basis.

**Application of the Simplified Approach**

We note that the Discussion Draft leaves some ambiguity as to whether or not the use of the elective, simplified approach for low value-adding services meets the arm’s length principle. In order to eliminate any uncertainty, the simplified approach should be paired with language explicitly stating that taxpayers electing and implementing this method properly are in compliance with the arm’s length principle as stated in paragraph 1 of Article 9 of the OECD Model Tax Convention.

While we are in support of the simplified approach to low value-adding services being an elective method for MNEs, clarification is needed to determine whether an MNE can elect to apply the simplified method to a selective group of activities categorized as a low value-adding service under ¶7.48 but also select the transactional net margin method (“TNMM”) for other activities categorized as a low value-adding service even if they meet all of the requirements for the simplified approach to be used. It is our opinion that the simplified approach should be treated as a true elective method that would not require the taxpayer to apply it to all services categorized as low value-adding.

In addition, we believe the following statement in ¶7.46 should be removed from the Discussion Draft:

“The guidance in this section is not applicable to services that would ordinarily qualify as low value-adding intra-group services where such services are rendered to
unrelated customers of the members of the MNE group. In such cases it can be expected that reliable internal comparables exist and can be used for determining the arm’s length price for the intra-group services."

If the service being performed is identified as a low value-adding service, the taxpayer should be able to elect to apply the simplified method without exception.

We also recommend the following clarifications and considerations below relating to the application of the simplified method.

**Determination of Cost Pools** – In discussing how an MNE is to arrive at a pool of costs associated with categories of low value-adding services, Section D.2.1 does not provide sufficient guidance on the steps to be undertaken when determining the cost pool to be charged to group members. First, language should be added in ¶7.52 to ensure indirect expenses, such as overhead, are added to the cost pool. Next, the Discussion Draft does mention that costs associated with in-house activity be excluded. However, given the material importance of this step, the Discussion Draft should provide additional guidance on the type of costs that are commonly removed from the cost pool to be charged to other group members. In practice, the removal of “in-house” costs or costs associated with activities that do not provide a benefit to foreign affiliates is an inherently subjective process. The OECD should acknowledge this reality and provide guidance requiring a reasonable approach be used for estimating these costs, including examples of acceptable methods for making this estimate.

The Discussion Draft should also consider addressing the issue of stock-based compensation, which should cover if these expenses are to be included as part of the cost pool, how they are to be attributed to the appropriate cost center, and appropriate methods by which these expenses are to be valued.

In addition, ¶7.53, which emphasizes the removal of services performed solely for the benefit of only one group member, seems to be an unnecessary addition to the application of the simplified method. Instead, the process of allocating low value-adding service costs (Section D.2.2) should simply mention that an allocation key is not necessary for services that are provided to only one group member.

**Profit Mark-up** – We understand the Discussion Draft has introduced a mark-up to be applied to the entire pool of low value-adding services that is between two percent and five percent. The same mark-up is applied to all low value-adding services and no benchmarking analysis is necessary. The fixed mark-up applied to group members across the globe does not account for disparities that exist between developed countries and developing countries. We believe taxpayers should have the option to apply the simplified approach to low value-adding services or alternatively not elect to use the simplified approach and utilize another arm’s length methodology (e.g., the TNMM). For example, developing (or low-cost) countries may argue a higher mark-up and refer to a local country or regional comparable set that
supports its position. In this scenario, the taxpayer may address the argument of a high mark-up if it utilizes the simplified approach with a profit mark-up that is supported with a benchmarking analysis. The Discussion Draft should also recognize that certain industries, such as retail, commonly have low system-wide profit margins. In this instance, the taxpayer should have the option to either utilize the simplified approach for low value-adding services or apply another arm’s length methodology that may illustrate a margin for that industry that may be below the two percent floor that is mentioned under the simplified approach.

In addition, ¶7.39 recommends that tax authorities consider the materiality of the differences between what they may consider an arm’s length mark-up and an at-cost service charge. The Discussion Draft should consider adding this language in ¶7.57, where the profit mark-up is further defined.

**Simplified Benefits Test** – Section D.2.5 discusses the application of the simplified benefits test, whereby taxpayers need to only specify the benefits by low value service category rather than detailing the individual acts performed related to each service charge. We are in support of the intentions in introducing this simplified benefits test. However, we note that the Discussion Draft leaves much open to discussion by requiring that “the taxpayer need only demonstrate that assistance was provided”. This seems to imply that taxpayers must prove that the service recipient country not maintain duplicate services locally. However, as already noted, the mere fact that services are duplicated in both locations does not necessarily indicate the absence of a benefit. If the intention is that taxpayers should maintain and be able to provide evidence of services having been delivered (e.g., contracts drafted, accounts prepared, new hires processed) then that should be clear.

**Documentation and Reporting of Low Value-Adding Services**

We believe the Discussion Draft needs to clarify where the documentation for Low Value-Adding services falls within the OECD’s guidance for Transfer Pricing Documentation and Country-by-Country (“CbC”) Reporting. Under the current guidance, it is unclear whether taxpayers are recommended to maintain and possibly provide separate documentation related to Low Value-Adding services in addition to a Global Masterfile, Local Country documentation and a Country-by-Country (“CbC”) reporting document or if this detail is to be included within these documents.

**Approval from non-OECD Countries**

We understand that the Discussion Draft is not a consensus document. We have a concern that certain jurisdictions in which many MNEs operate will not accept that the services being performed locally on behalf of the beneficiary can be categorized as low-value, even though they meet the definitions listed in ¶7.48 of this Discussion Draft. For example, we understand the tax authorities of some countries have historically argued for profit mark-ups that far exceed five percent for activities listed in ¶7.48. As stated in page four, we believe taxpayers should still be able to utilize the benefits of the simplified approach to low value-adding
services, but have the option of applying a TNMM (or another methodology) to determine a profit mark-up. Furthermore, we believe MNEs will face difficulty in the current environment from certain non-OECD countries in applying the guidance in ¶7.50, which mentions that while a service may be a principal business activity to the legal entity performing the service, the activity may not be core to the MNE as a whole and therefore can be considered a low value service. The OECD should continue its plans to seek to establish support from these jurisdictions to meet its goals of providing a simplified and generally-applicable approach to analyzing low value-adding intra-group services.

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We sincerely hope that these suggestions and comments are of assistance in this initiative. Please let us know if we can be of any further assistance.

Sincerely,

Christopher Desmond, Rod Koborsi, Michael Berbari, and Walker Wood
Duff & Phelps, LLC
Dear Mr. Hickman,

The European Banking Federation (EBF) welcomes the opportunity to comment on the OECD’s current work on the transfer pricing guidelines relating to low value-adding intra-group services as part of the Base Erosion and Profit Shifting (BEPS) project.

The EBF is committed to contributing constructively to the BEPS project, in the expectation that the final outcome will deliver fair, certain, sustainable and principled rules.

We consider this revision of Chapter VII of the OECD Transfer Pricing Guidelines as very instructive. We believe that once the recommendations set out in the report are refined, they will certainly ease the compliance burden on the taxpayers. We therefore support the OECD work on this and encourage the Committee on Fiscal Affairs (CFA) to reach consensus view in order to adopt the proposed recommendations.

Further to the above general comment, we would like to provide comments on the following three specific points:

1. **Chapter D.1.** provides for a definition of low value-adding intra-group services. In the current discussion draft, Information Technology Services are described as ‘likely to meet the definition of low value-adding services’. However, our understanding is that IT development services would not be eligible to qualify as low value-adding services to the extent that such services give rise to the creation of valuable and unique intangibles.

   This would imply that it would be impossible to include the cost related to the development of such intangibles in cost pools. In our view, this does not sufficiently reflect the fact that certain of these intangibles, which might involve significant development efforts and costs, are often only developed and designed within the context of a multinational group in order to ensure compliance with legal, accounting, regulatory requirements in a more standardized or efficient manner, but do not really add to the commercial activities of such group (e.g. group-wide standardized data capturing and reporting tools which are developed in order to ensure...
compliance with specific requirements imposed by financial regulators; e.g. development of a
group-wide accounting platform).

In these circumstances, such intangibles only support low value-adding support activities and it
should basically be possible to include the cost of such intangibles in cost pools. In this regard, it
would be helpful to include a definition of the concept ‘unique and valuable intangibles’, which
ensures that high development cost intangibles which are only supportive for low value-adding
activities could be included in cost pools.

2. **Chapter D.2.1.** describes the first step of the simplified approach i.e. use of cost pools. We very
much welcome this pragmatic approach towards intra-group service charging. The discussion draft
however does not clearly indicate how to deal with costs in general and cost pools in specific (e.g.
which costs should be in the cost base? Which ones are out? Which correction of charges are
needed at year end? pass through costs?). In this regard, we would very much welcome a clear
position on the conditions and circumstances in which cost pool charges could be based on
budgets, without a further requirement to effect any year-end correction of charges based on
actuals. This would allow multinational groups to ensure stable pricing of intragroup services for
internal clients and reduce significant administrative efforts and costs caused by year-end
correction mechanisms.

3. Under **chapter D.2.3.** a mark-up range for low value-adding services has been proposed, i.e. 2-5%.
However we note that the 2011 ‘EU Joint Transfer Pricing Forum (JTPF) report on low value-
adding intra-group services’ mentions an arm’s length range between 3 % and 10 %. We suggest
that the proposed range be reconsidered taking into account the EU JTPF findings, as the use of
this broader range would decrease the necessity to make adjustments due to year-end
reconciliations and would contribute to a simplified approach.

We appreciate your consideration of our comments and suggestions and remain at your disposal to
contribute further as the work develops.

Yours sincerely,

Wim Mijs
European Business Initiative on Taxation (EBIT)

Comments on the OECD's Discussion Draft on

BEPS ACTION 10: PROPOSED MODIFICATIONS TO CHAPTER VII OF THE TRANSFER PRICING GUIDELINES RELATING TO LOW VALUE-ADDIN 错 INTRAGROUP SERVICES
EBIT Comments on BEPS ACTION 10: Proposed modifications to Chapter VII of the Transfer Pricing Guidelines relating to low value-adding intra-group services

Andrew Hickman
Head of Transfer Pricing Unit
Centre for Tax Policy and Administration
OECD

Submitted by email to: TransferPricing@oecd.org

Brussels, 14 January 2015

Dear Andrew,

EBIT is grateful for this opportunity to provide comments on the OECD Public Discussion Draft entitled BEPS ACTION 10: Proposed modifications to Chapter VII of the Transfer Pricing Guidelines relating to low value-adding intra-group services (hereinafter “the Discussion Draft”).

General comments

EBIT welcomes this overall rather well-written, even-handed and nuanced Discussion Draft as a very good basis for revision of Chapter VII of the Transfer Pricing Guidelines in respect of low value-adding intra-group services, and in our view the OECD is on the right track here.

We also support in principle the proposed elective simplified transfer pricing methodology for low value-adding intra-group services but there are some practical issues.

EBIT Members believe that for this approach to really work, it is essential that all BEPS-44 will implement this elective approach for companies and in a consistent manner.

Specific comments

B.1.2 Shareholder activities

7.10-7.11: EBIT welcomes further clarification of the distinctions drawn between shareholder activities, stewardship activities and other direct and indirect services that are provided within a group.

B.1.3. Duplication

7.12: EBIT generally supports the OECD’s proposed additions regarding the possible duplication of services.

B.1.6 Form of remuneration

7.19: The OECD should preferably clarify the seeming contradiction between paragraphs 7.19 and 7.61: the latter requires “written contracts or agreements for the provision of services” whereas in paragraph 7.19 it is mentioned that “the absence of payments or contractual...
agreements does not automatically lead to the conclusion that no intra-group services have
been rendered”.

B.2.1. Determining an arm’s length charge in general

7.20: EBIT urges the OECD to add a specific reference that random limitations on
deductibility of intra-group service charges should be avoided by tax administrations.

B.2.2.1 Direct-charge versus indirect charge methods

7.22-7.27: EBIT does not necessarily agree with the OECD’s assertion in the Discussion Draft
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 MNCs 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 MNCs.

C. Examples of intra-group services – R&D

7.43: From our practical experience, contract R&D is part and parcel of commercial
relationships between third parties operating at arm’s length, even though it may result in the
value creation of an intangible owned by the IP owner who contracts out the R&D.

D2 Simplified determination of arm’s length charges for low value-adding intra-group services

7.51-7.54: EBIT in principle supports the proposed elective simplified transfer pricing
methodology for low value-adding intra-group services, but at this stage of the Discussion
Draft it is hard to determine whether it would be practical and beneficial. We understand that
there is no consensus on this proposed methodology apparently for the moment. It is however
extremely important for companies to know whether all or most tax authorities will actually
implement it and whether this will be done in a consistent manner because otherwise it would
defeat its purpose. EBIT is of course willing to assist the OECD in making the methodology
beneficial for both business and tax administrations.

EBIT Members are concerned based on their experience that payee tax administrations
sometimes allege that more of the costs incurred by MNCs in relation to management fees in
the top company location(s) should be recharged to affiliates, and at higher margins, whereas
their counterparts in payer jurisdictions sometimes contend that part or the entire recharged
amount should be disallowed.

In addition, some of our Members have experienced that even after domestic disallowance,
tax authorities in some jurisdictions have tried to brand the payment for services as ‘other
income’ and therefore have imposed withholding tax on the payment. We would argue that if
the expense in question is a valid business expense, in principle it seems fair that all of such
costs should be able to be recharged and should be able to be deducted somewhere either at
the shareholder level, or in individual subsidiaries. Further, withholding tax should be limited
to the tax deductible amount.
From our experience most of these charges are insignificant in relation to the total revenues and profits of groups yet still a huge amount of effort and cost is very often wasted to seeking agreement between payer and payee jurisdictions about relatively small amounts of tax, which should not be. EBIT would welcome more guidance by the OECD to limit the costs of compliance for companies related to this approach. There is in our view at this embryonic stage of the Discussion Draft still a big risk that companies would still have to justify their costs to tax authorities in detail even after having submitted all documentation in line with the simplified approach.

D.2.2. Allocation of low value-adding services

7.55 and 7.56: EBIT believes that the number of allocation keys needs to be small. Allocation keys are closely aligned to services, which is not satisfactory for practical purposes.

D.2.3 Profit mark-up

7.57: EBIT generally welcomes the OECD’s apparent intention to provide a clear safe-harbour with a profit mark-up to all costs in the pool of 2-5%. There might be a risk that payee tax jurisdictions will assume that the upper limit proposed is the default mark-up to be used, and the payer country tax administrations will assume the opposite. This might create unwelcome uncertainty where services are provided to many jurisdictions, or for establishing a mark-up that includes all payer jurisdictions.

Guidance is therefore needed for showing that the agreed margin is consistently applied by a MNC to all low value-added services and that tax authorities do not seek to unreasonably challenge the 2-5% mark-up.

Pass-through costs should have no mark-up in our view.

EBIT members trust that the above comments are helpful and will be taken into account by the OECD in finalising its work in this area. EBIT is committed to a constructive dialogue with the OECD.

Yours sincerely,

European Business Initiative on Taxation – January 2015

For further information on EBIT, please contact its Secretariat via Bob van der Made, Tel: +31 6 130 96 296; Email: bob.van.der.made@nl.pwc.com.

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13 January 2015

Dear Dr. Hickman,

By means of this letter, we would like to take the opportunity to provide comments on the discussion draft regarding BEPS Action 10: “Proposed modifications to Chapter VII of the transfer pricing guidelines relating to low value-adding intra-group services” (the Discussion Draft) as released by the OECD on 3 November 2014. This letter presents the collective view of EY’s global transfer pricing network. We agree to have our comments posted on the OECD website.

General remarks

While there is a great variety of transactional models applied by multinational enterprises (MNEs) across the world, virtually all of them to some degree will be engaged in the provision of intra-group services. Therefore the availability of specific guidance with respect to intra-group services is very valuable for MNEs, tax administrations and other transfer pricing professionals. In many cases, the lack of guidance with respect to low value-adding services may have created a disproportional administrative burden for taxpayers to comply with relevant transfer pricing rules and regulations. Against this background, we are very pleased with the OECD’s proposed modifications to Chapter VII of the transfer pricing guidelines and in particular the introduction of specific sections regarding low value-adding services.

The Discussion Draft explains that the proposed modifications seek to “achieve the necessary balance between appropriate charges for low value added services and head office expenses and the need to protect the tax base of payor countries.” We believe it is equally important to make sure that the proposed modifications also provide taxpayers with certainty and reduce the administrative burden with respect to intra-group services. As you will see in the detailed comments below, the issue of clarity and administrative burden is one of the main themes of our comments.

This proposed guidance is introduced as part of the work in connection with BEPS Action 10 (“Other high-risk transactions”) and the aforementioned goal of protecting the tax base of payor countries seems to imply that low value-adding services are high-risk transactions from a BEPS perspective. The qualification of low value-adding services as high risk transactions from a base erosion perspective seems debatable based on the very nature of the services. The introduction of this guidance in connection with Action 10 - without providing an explanation or context - may
even encourage tax administrations to put disproportionate emphasis on the analysis of charges made in connection with low value-adding services. This would not be aligned with the goal of reducing the administrative burden for taxpayers. Therefore we recommend adding an explicit statement that low value-adding services are typically not high risk transactions.

Key comments
Most of the newly proposed elements of the Discussion Draft relate to low value services. Given the importance of the topic, we also provide comments on sections and paragraphs that are not proposed to be changed as compared to the guidance currently available.

Our key comments with respect to the Discussion Draft, as further elaborated upon in the “detailed comments” section of this letter, can be summarized as follows:

- We believe the introduction of the proposed guidance with respect to low value-adding services is not intended to imply that an approach for other services may not have elements similar to the simplified approach. More specifically, it should not be concluded that the mark-up for other services should be higher than 5% per se.
- The benefit test is an important element of the analysis of intra-group services. In many cases it is possible to identify which benefits are provided but difficult or impossible to measure these benefits. We recommend emphasizing that the benefit test should be focused on the quality of the benefit and not so much on the quantum of the benefit.
- Intra-group services very often are unique in nature. Often independent parties are not able to provide services of the same nature and/or quality a related party does. Because of this unique nature, a comparison between the charges for intra-group services with the price level in a service recipient’s market in general will not be appropriate.
- According to the Discussion Draft, an MNE group electing to adopt the simplified charge mechanism should apply it on a consistent, group wide basis in all countries in which it operates. This “all-in” or “all-out” approach likely will create problems, for example because some countries may allow a charge-out of costs without a mark-up for certain activities or when countries in which the MNE is doing business do not allow the application of the simplified approach for low value-adding services (e.g., non-OECD member states).
- The need to pool the costs incurred by various members – the initial step in the simplified approach - seems to increase the complexity and the administrative burden of the charge mechanism.

More detailed comments with respect to the Discussion Draft are presented below. If you have any comments or questions, please feel free to contact any of the following:

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Yours Sincerely,
On behalf of EY

John Hobster/Ronald van den Brekel
Detailed comments

The Discussion Draft mentions it is preferred that comments be provided with references to paragraph numbers. In light hereof, we have structured our comments in accordance with the structure of the Discussion Draft itself and included references to specific paragraphs where considered helpful. While our focus is on the wording proposed to be added as compared to the current Chapter VII of the guidelines, we also provide comments on sections and paragraphs that are not proposed to be changed as compared to the guidance currently available.

Benefit test

The general rule as described in paragraph 7.7 is conceptually clear: an intra-group service is provided if the activity performed provides the service recipient with economic or commercial value to enhance or maintain its commercial position and this can be determined by considering whether an independent enterprise would have been willing to pay for the activity or would have performed the activity in-house for itself. In many cases it is possible to identify (or qualify) which benefits are provided but difficult or impossible to measure (or quantify) these benefits. To avoid intra-group charges being challenged merely because of the difficulties with respect to the measurability of the benefit, we recommend emphasising that the benefit test should be focused on the quality of the benefit and not so much on the quantum of the benefit. Moreover, for completeness it would be helpful to add a statement acknowledging that some activities will never actually produce the benefits that were reasonably expected when they were performed (reference is made to the wording used in paragraph 7.34).

Another point of attention with respect to the benefit test is the often unique nature of intra-group services. Sometimes services provided by a related party may appear to be available in the local market or could be performed in-house at a lower price, but in practice they are often so specific and tailored to the business of the MNE that no other company than the related party would be able to provide the exact same service or with the exact same quality. This should be recognised when applying the benefit test to intra-group services. It would be helpful to explicitly mention this in the section with respect to the benefit test.

Shareholder activities

Paragraph 7.10 defines a shareholder activity as “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.” This means that activities partly performed because of ownership in one or more other group members do not qualify as shareholder activities and therefore not all costs related to these activities should be disqualified for purposes of being charged out to the respective group members. It would be helpful to provide further clarifications in this regard.

The introduction of specific examples of shareholder activities (paragraph 7.11) is very helpful and will likely reduce the divergence between the interpretation by taxpayers and the interpretation by tax administrations. A minor comment in this regard is that the first sentence of paragraph 7.11 speaks of shareholder activities, whereas the examples concern shareholder costs.

Duplication

The wording added to paragraph 7.12 addresses the main point of discussion with respect to the issue of (possible) duplication, i.e., the fact that if similar functions are performed at different levels
within an MNE, this does not necessarily mean they are duplicative in nature. The proposed wording clearly addresses this issue by stating there are many levels of activity. In practice, we often see that the main levels of activities are the strategic level (e.g., long term decisions made at the head office level), the tactical level (e.g., translation of the strategy into an action plan by a regional head office) and the operational level (e.g., the actual implementation and execution by operating companies at the local level). As many MNEs are organised like this, it may be helpful to add some additional wording to the example of marketing services in paragraph 7.12.

Paragraph 7.14 assumes the so-called “halo effect.” We assume this will be further discussed in the context of BEPS Action 4 (“Limit base erosion via interest deductions and other financial payments”) or the related financial services transfer pricing project. We believe it would be very helpful if the OECD would provide concrete guidance and examples with regard to this topic. We would be happy to provide you with more detailed comments in this respect.

**Determining an arm’s length range**

The wording in paragraph 7.23 that MNEs should often be able to adopt a direct charge arrangement seems to contradict the statement made in paragraph 7.24 that a direct charge arrangement is difficult to apply in practice. Based on our experience, adopting a direct charge arrangement in many cases is only feasible (taking the administrative burden into account) with respect to certain expenses such as travel expenses and insurance premiums, fees incurred with third parties on behalf of member(s) of the group, or costs in relation to projects undertaken for a specific entity. It also requires that such costs are captured by the MNE’s financial systems in such a manner that they can be easily allocated. While this is recognised in paragraph 7.24, we believe it would be helpful if the wording in paragraph 7.23 is amended in such a way that it does not suggest a direct charge arrangement is often feasible.

The acceptability of an indirect charge method is invaluable for many MNEs, among other reasons because of practical challenges and the disproportionately heavy administrative burden of direct charge arrangements. Because of the great practical value and importance of indirect charge methods, some modifications to paragraph 7.25 could be considered to make sure taxpayers are not confronted with unreasonable requirements. For example, paragraph 7.25 indicates that indirect charge methods should be allowable provided sufficient regard has been given to the value of the services to recipients. It may be more appropriate to require taxpayers to give sufficient regard to the “expected” benefit of the services. Also the statement that “every attempt should be made to charge fairly for the service provided” may impose a disproportionate (administrative) burden on taxpayers. In light of the context, it seems more appropriate to require taxpayers to make a “reasonable effort” instead.

Furthermore, the guidance with respect to the use of an indirect charge mechanism and allocation keys suggest that any charging “must lead to a result that is consistent with what comparable independent enterprises would have been prepared to accept” (paragraph 7.26). In practice it is often impossible to establish what independent parties would have been willing to accept, for reasons as simple as the lack of sufficiently detailed comparability data. Also in this respect we believe the focus should be on the reasonable efforts made by taxpayers.

From practical experience, we believe paragraph 7.27 rightly raises the point that there is an increased risk of double taxation for various reasons when indirect charge methods are applied. In this context, we would recommend encouraging tax administrations to apply a pragmatic approach and, for example, to focus on the quality of the link of the allocation key with the expected benefit,
the unique nature (and therefore lack of alternatives) of the intra-group services and whether the charge mechanism is applied consistently throughout the group.

**Form of the compensation**

Paragraph 7.28 elaborates on various allocation keys and when they might be appropriate. This paragraph might therefore be better placed under section B.2.2.2 on indirect-charge methods.

**Calculating the arm's length compensation**

The emphasis on the value of the service and on how much an independent enterprise would be prepared to pay for that service (paragraph 7.31) may create issues for a number of reasons addressed in some of our comments above. For example, it is often not possible to accurately quantify the expected benefit of the service for the service recipient. In such cases, a mathematical comparison between the value of the service and the cost of the service is not feasible. Furthermore, it is often not possible to accurately assess how much an independent enterprise would be prepared to pay, e.g., because of the unique nature of the intra-group service and due to a lack of reliable comparability data.

Paragraph 7.32 mentions that “from the perspective of an independent enterprise seeking a service, the service providers in that market may or may not be willing or able to supply the service at a price that the independent enterprise is prepared to pay.” This section may cause tax administrations to compare the charge for the intra-group service provided with the cost of “similar” services in the local market or, more generally, to compare the price level in the service recipient's market with the price level in the service provider’s market. Such a comparison is often flawed when it concerns services for which no substitute is available in the local market, e.g., because the service is tailored to the MNE’s business (in terms of IT systems used, knowledge of the company, etc.) to a degree that cannot be offered by independent service providers. Also paragraph 7.35 may be interpreted as suggesting that a comparison of the price level in the service recipient's market and the price level in the service provider’s market is needed. We believe that in general this would not be appropriate. It would be helpful to add explicit wording to clarify the above.

With respect to the need for comparability adjustments to account for differences in the level of costs incurred by the group service provider and the costs that would hypothetically be incurred by the recipient were it to perform the service itself, we refer to our comments on the section on low value-adding services further below.

In cases where the transfer pricing policy adopted entails the (direct or indirect) charge-out of costs incurred by the service provider, tax administrations should not be allowed to ‘sit in management's chair’ and determine whether the cost base is appropriate; the presumption should be that the cost base is appropriate as management has decided to bear these costs. The only question should be whether the allocation of costs (directly or indirectly) and the mark-up can be considered appropriate. We recommend emphasising the importance of acknowledging the business considerations underlying the decision to have a service provided by a group member in a certain jurisdiction and the company-specific nature of the services involved.

Some of the issues mentioned above (e.g., the difference in price levels and lack of sufficient comparability data) may be particularly true for developing countries. Further clarifications as suggested above would therefore be helpful for taxpayers and tax administrations in developing countries.
Paragraph 7.36 effectively concerns the issue of pass-through costs, as introduced in paragraph 2.93 of the guidelines. Paragraph 2.93 states that the answer to the question whether costs can be treated as pass-through costs “depends on the extent to which an independent party in comparable circumstances would agree not to earn a mark-up on part of the costs it incurs.” As mentioned in paragraph 2.94, comparability issues may arise in practice where limited information is available on the breakdown of the costs of the comparables. In practice, this is very often the case and alternative approaches have to be adopted. Paragraph 7.36 is helpful where it mentions that “for example, an associated enterprise may incur the costs of renting advertising space on behalf of group members, costs that the group members would have incurred directly had they been independent. In such a case, it may well be appropriate to pass on these costs to the group recipients without a mark-up, and to apply a mark-up only to the costs incurred by the intermediary in performing its agency function.” It would be helpful if more general guidance would be provided along these lines; for example, by explaining that a relevant question is whether an independent party would have been able to incur certain costs directly. In the absence of reliable comparability data, this question could be answered by applying existing guidance and transfer pricing principles, e.g., by applying economic principles governing relationships between independent enterprises, as mentioned in paragraph 1.52 (in the context of the absence of written agreements).

Low value-adding services

In many cases, the lack of guidance with respect to low value-adding services may have created a disproportional administrative burden for taxpayers to comply with relevant transfer pricing rules and regulations. Against this background, we are very pleased with the proposed introduction of specific sections regarding low value-adding services. Our comments with respect to the proposed sections regarding low value-adding services are presented below.

Definition of low value-adding intra-group services

The definition of low value-adding intra-group services seems to strike a proper balance between being specific on the one hand and flexibility on the other hand. We are pleased that the OECD did not choose to provide an exclusive list of services and that it explicitly mentions that the supportive nature of the services should be determined by comparison with the activities of the MNE, and not on a legal entity basis. With respect to the criteria mentioned in paragraph 7.46, issues may arise about the definition of “supportive” and the definition of “core business.” The OECD should consider adding some further clarifications in this regard, e.g., in paragraph 7.50.

The examples of activities that would not qualify as low value-adding services (paragraph 7.47) and the examples of services that would likely qualify as low value-adding services (paragraph 7.48) are helpful. We can imagine that in some industries the activities mentioned in paragraph 7.48 are not low value-adding in nature, even in cases where they are not core business activities. For instance, monitoring and compilation of data relating to health, safety, environmental and other regulatory standards may be more important in some industries than in others. We recommend that the OECD clarify this, e.g., in the first sentence of this paragraph and emphasize that the lists in paragraph 7.47 and 7.48 are indicative. More generally, we believe the introduction of the proposed guidance with respect to low value-adding services is not intended to imply that an approach for other services may not have elements similar to the simplified approach. More specifically, it should not be concluded that the mark-up for other services should be per se higher than 5%.
Some of the activities that would likely meet the definition of low value-adding service might entail activities that can be qualified as shareholder activities (as defined in section B.1.2) for which no charge would be justified. For clarity’s sake, it would be helpful to add a statement in this respect to section D.1 or D.2.

As an aside, we note that based on the wording in paragraph 7.46 it is not clear whether all services that meet the criteria would automatically qualify as “low value-adding services” in the terms of section D. This may be a relevant question in light of the elective or mandatory nature of the suggested mechanism for low-value-adding services.

**Simplified determination of arm’s length charges for low value-adding intra-group services**

As per paragraph 7.51, an MNE group electing to adopt the simplified charge mechanism should apply it on a consistent, group-wide basis in all countries in which it operates. This seems to imply an “all-in” or “all-out” approach with respect to services involved and countries/group members involved.

The all-in/all-out nature across countries may create problems, for example because some countries may allow a charge-out of costs without a mark-up for certain activities (e.g., the Netherlands or the United States). While such an approach is not detrimental from the service recipient’s perspective, the all-in/all-out approach would force MNEs to adopt this approach globally. Similarly, it would create a problem if one (e.g., non-OECD) country in which the MNE is doing business does not allow for the simplified approach for low value-adding services.

**Determination of cost pools**

Paragraph 7.52 mentions that the initial step in applying the simplified approach to low value-adding intra-group services is for the MNE group to calculate, on an annual basis, a pool of all costs incurred by all members of the group in performing low value-adding intra-group services. This implies that the simplified approach cannot be applied by one legal entity just for the low value-adding services it provides to other group members. The need to pool the costs incurred by various members seems to increase the complexity and the administrative burden in of the charge mechanism, e.g., in terms of collecting data, reconciling data, and calculating and implementing the various charges. In light of the purpose of simplification we recommend allowing the application on a legal entity basis whereby the respective legal entity charges out the relevant costs to the service recipients in accordance with the simplified approach.

In addition, we recommend that the OECD further specify or provide further guidance with respect to the costs included in the cost pool (or cost base). For example, it could be helpful to clarify whether overhead and extraordinary expenses should be included in the cost base. Specifically, guidance should be provided as to the definition of cost that is included and could be applied consistently.

Paragraph 7.53 mentions that, as a second step, the taxpayer should identify and remove from the pool those costs that are attributable to services performed by one group member solely on behalf of one other group member. This rule, as well as the example provided, imply that if one group member provides low value-adding services to more than one other group member, a direct allocation mechanism (as a first step) cannot be applied. While there may be difficulties with respect to direct charge mechanisms, we struggle to understand why a direct charge of some costs (as a first step) would not be allowed.
In the context of assessing the appropriateness of the cost pool / cost base, we recommend adding further clarifications to make clear that for low value-adding services, it will not be required to examine whether comparability adjustments are needed with respect to the costs incurred by the group service provider and that a reference to the costs that would hypothetically be incurred by the recipient were it to perform the service for itself is not required either. It should be presumed that business reasons are underlying the MNE’s decision to provide intra-group services in a certain (e.g., centralized) manner and from a specific location.

**Allocation of low value-adding service costs**

The comment in paragraph 7.55 that “as a general rule, the allocation key should reflect the underlying need for the particular services” seems superfluous, given the relative nature of the benefit test for low value-adding services. In addition, it can be expected to be interpreted by tax administrations to require a more detailed benefit test than what appears to be intended in the simplified approach. More generally, by definition a simplified approach will result in a less thorough application of the arm’s length principle and will therefore not always align with the more rigorous application of the general guidance on intra-group services (i.e., sections A through C).

Paragraph 7.56 mentions that “there may be no need to use multiple allocation keys if the taxpayer can explain the reasons for concluding that a single key provides a reasonable reflection of the respective benefits.” If the taxpayer is able to provide such an explanation, we would say there “is” or “will be” no need to use multiple allocation keys.

**Profit mark-up**

The introduction of a clear rule with respect to the application of a profit mark-up, as in paragraph 7.57, will create certainty for taxpayers, which is generally helpful. However, the proposed range (2% to 5%) may be perceived as being rather narrow and it may force a large number of MNEs to change their existing transfer pricing policies which may include mark-ups ranging somewhere between 3% and 10% (e.g., based on the guidance provided by the EU Joint Transfer Pricing Forum or based on US regulations with respect to intra-group services). Moreover, for some taxpayers it may not be possible to adopt a transfer pricing policy that complies with the OECD guidance on low value-adding services and with domestic regulations. In this regard, the OECD should consider applying a wider range of mark-ups.

**Charge for low value-adding services**

With reference to our comment with respect to the definition of the cost pool, we note that the implementation of the proposed charge mechanism may be complex if it requires a multitude of cross-charges to be made. It seems that an application of the simplified approach on a legal entity basis would result in a simpler mechanism and to a similar extent would meet the objectives of achieving the necessary balance between appropriate charges for low value-adding services and head office expenses and the need to protect the tax base of payer countries.

It might be helpful to elaborate on how to apply the simplified approach when a central charge entity is used (i.e., one group member collecting / aggregating the costs and on-charging these costs to the relevant group members). To avoid duplication of mark-ups, it would be helpful to explain that no mark-up should be applied by the central charge entity on costs that were already subject to a mark-up by the group member performing the activity. It seems appropriate for the
central charge entity to only apply a mark-up on the costs it incurs in performing its (pooling) function.

**Application of the benefit test to low value-adding services**

The wording in paragraph 7.60 implies that the benefit test under the simplified approach does not apply to the quantum of the benefit. As this is an important factor for the practical value of the simplified approach, it would be helpful if this was explicitly mentioned.

Paragraph 7.60 indicates that a single annual invoice can be used if the information as mentioned in paragraph 7.61 is made available to tax administrations. For the sake of consistency with the requirements as mentioned in paragraph 7.61, it seems more appropriate to require taxpayers to prepare such information and to require them to make it available upon request. The statement that correspondence or other evidence of individual acts should not be required may be of great practical value for taxpayers and could reduce the administrative burden compared to the current situation. It may be helpful to add examples of such “other evidence” to make clear that asking for flight tickets, hotel bookings, meeting notes, etc. in many cases creates a disproportional administrative burden for taxpayers.

In light of the aim to have a simplified benefit test for low value-adding services, we recommend that the OECD reconsider the wording used in paragraph 7.61, first bullet. In particular the request for a description of the benefits or expected benefits, as well as the request for a description of the reasons justifying that the allocation keys used produce outcomes that reasonably reflect the benefits received, could be used by tax administrations to effectively require a benefit test that is not materially different from the benefit test for other intra-group services. We believe the benefit test for low value-adding services should be applied on an MNE basis (i.e., describing the benefit for the group) rather than on a legal entity / service recipient basis.
COMMENTS ON OECD DISCUSSION DRAFT

BEPS ACTION 10: PROPOSED MODIFICATIONS TO CHAPTER VII OF THE TRANSFER PRICING GUIDELINES RELATING TO LOW VALUE-ADDNG INTRA-GROUP SERVICES

5 DECEMBER 2014

Fidal is pleased to present its comments on the above OECD Discussion Draft. As recommended by the OECD, the comments below reference the paragraph numbers of the Discussion Draft.

Paragraphs 7.13-7.14: Incidental benefits

The question of incidental benefits is more complex than is presented in these paragraphs (examples include implicit support, the use of company name without payment of royalties, etc.). There is a risk that such simplification in these rules might constitute a departure from the arm’s length principle.

One such example is if a parent company (Parentco) is providing an explicit guarantee to a subsidiary (Subco). The fee charged by Parentco to Subco for the guarantee could be reduced by reason of implicit support because Subco is part of the group. However, such a result arguably disregards Parentco’s point of view in the application of the arm’s length principle. Indeed, the implicit support is only part of the conditions made or imposed between Parentco and Subco because they are not dealing at arm’s length. In other words, if they were dealing at arm’s length as independent enterprises, there would be no implicit support provided by Parentco to Subco. Consequently, in applying the arm’s length principle, the profits which would have accrued to Parentco, but, by reason of the non-arm’s length relationship, have not so accrued, should be included in the profits of Parentco.

Paragraphs 7.18 and 7.30: On call services

We note that between third parties on-call services are made available for which periodic retainers are paid. Such services may or may not be used. If they are not used over a period of time, the recipient may decide to terminate the arrangement within the terms of the agreed contract. If this does not take place, then the recipient is still contractually bound to pay the retainer.

Thus, unless such termination has taken place in an inter-company situation, it does not seem to us to be arm’s length behavior to evaluate past use of on-call services in determining whether they have been provided as a service. All that is relevant is that they are available.

The relevant fact in such charging between group companies for such arrangements is whether there is agreement between them for a retainer or not. Use of the on-call services is not a relevant fact by virtue of the very nature of such arrangements.
Paragraph 7.34: Methods

The suggestion that a functional analysis may not be necessary may be overstated. Perhaps the Guidelines should indicate that only a functional analysis of the service provider is required.

In a third party situation companies may embark on marketing and other campaigns and activities, which may or may not be successful. Not all business decisions result in benefits. Thus it seems to us that it is not correct at arm’s length to limit the payment for inter-group services only to situations where they result in the successful accretion to profits.

What is relevant is whether the management of the recipient entity engaged or otherwise agreed to the service or campaign or costs, not whether with hindsight they appear to be ‘heavy’.

Paragraph 7.39: Methods

It would be helpful in this paragraph if OECD could add a sentence to confirm that Tax Administrations should not routinely challenge the addition of a mark up to service costs. Absent this, the guidance here may allow such.

Paragraph 7.41: Example

We agree that it might be possible to use a CUP, but presumably this is predicated on the availability of market data on debt factoring rates. In practice this can be difficult to source reliably and OECD may like to acknowledge this.

Paragraph 7.42: Example

It would be helpful in this example to also cite toll manufacturing as a contracting model, the difference usually being that the toller does not own the inventory being worked upon.

Paragraph 7.43: Example

We are concerned about recharacterization creeping into the OECD Guidelines in various places without falling within the ambit of paragraphs 1.64-1.69. One such guise is the concept of “options realistically available”: some tax authorities have already started using it to price certain transactions as if they were entirely different transactions allegedly pursuant to the application of the concept of options realistically available in respect of transactions that do not meet the criteria of paragraph 1.65. For instance, as
presently worded, that concept might be invoked to treat a contract manufacturer as an entrepreneur (with “economic” ownership in the results of the R&D it performs, even if there is a proper legal agreement in place and the R&D is fully funded by the legal owner of the resulting intellectual property).

Thus, we recommend specifying that the concept of “options realistically available” cannot be used to recharacterize a transaction outside the parameters of paragraphs 1.64-1.69.

**Paragraph 7.47: Activities not qualifying for the simplified approach**

We note the exclusion of corporate senior management, but would point out that some of their roles and activities may fall into the services envisaged for the simplified approach. It would be helpful if OECD could acknowledge this.

**Paragraph 7.48: Activities qualifying for the simplified approach**

It is not obvious to us that drafting legal contracts, responding to tax administrations’ audits, and giving advice on tax matters represent low value-adding services. Given the amounts at stake in international tax matters and transfer pricing, the opposite may be the case. Similarly, communications and PR might have greater value-added than projected here.

It should be noted that the distinction between qualifying and non-qualifying costs here (as well as in other places) can in practice be very hard to determine. The OECD might like to draw attention to this difficulty and suggest a compromise position.

**Paragraph 7.57: Profit mark-up**

The OECD might like to note that many tax authorities, and the French tax authority is no exception, consider that 5% is the minimum mark up for such services. Thus it would be helpful if the OECD could add a comment that in its view any mark up in the 2-5% range, provided correctly applied to the relevant services, ought not to be routinely challenged by tax authorities. We would be interested to learn to what extent the OECD member tax authorities have undertaken to issue internal instructions to this effect.

**Paragraph 7.60: Application of the benefits test to low value-adding intra-group services**

The suggestion that benefits be considered by categories of services rather than on a specific charge basis is a welcome recommendation from the OECD and seems to simplify both tax administrations’ and taxpayers’ burdens in the administration of transfer pricing for low value-adding services.
Centre for Tax Policy and Administration
OECD - Organisation for Economic Co-operation and Development
2, rue André Pascal
75775 Paris Cedex 16

Via e-mail TransferPricing@oecd.org

Milan, January 13, 2015

Dear Sirs,

on November 3, 2014, the Committee on Fiscal Affairs of the OECD released a discussion draft (the “DD”) in relation to Action 10, proposing a simplified transfer pricing approach for low-value-adding intragroup services that will ultimately lead to revisions in Chapter VII of the OECD’s Transfer Pricing Guidelines for Multinational Enterprises and Tax, asking to interested parties to provide written comments.

Altagamma Foundation (“Altagamma”) is pleased to respond to the OECD’s request for comments on the DD.
1 Altagamma

Altagamma is the Foundation created in 1992 by the Italian high-end and luxury companies, and has the mission to strengthen the international presence of its member companies, support them in their growth and promote top-quality Italian industry and culture.¹

Today Altagamma represents the interests of more than 80 Italian high-end & creative companies; its members express the Italian culture and style in their industrial products and services as well as in their business approach.²

Although diverse, the sub-sectors represented by the Altagamma Foundation all boast highly symbolic contents, whether in the fields of design, fashion, food and wines, jewelry, hospitality, automobiles and yachts.

All Altagamma member companies successfully interpret the competitive advantage of the “Italian Style and Culture” the world over: a synthesis of excellent entrepreneurship and the idealistic, cultural, historical and natural legacy of our country.

Altagamma is a founding member of ECCIA – *European Cultural and Creative Industries Alliance*, based in Brussels, together with Circulo Fortuny of Spain, Comité Colbert of France, Meisterkreis of Germany and Walpole of the United Kingdom.

ECCIA represents the interests of about 500 European the high-end and luxury companies. These companies in the year 2013 achieved altogether sales of 547 Billions Euro equal to 4% of nominal EU GDP, 70% of Worldwide market share, 1.7 million Direct and Indirect employment, 17% share of the EU merchandise export. ³

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¹ Altagamma is active in the following areas:
- Institutional Relations
- Entrepreneurial Business Culture
- International Promotion and Development
- Protection of Intellectual Property
- Studies and Research
- Education
- Communications

² [http://www.altagamma.it/sezione2.php?id=10&Lingua=ing](http://www.altagamma.it/sezione2.php?id=10&Lingua=ing)

2 The DD and its proposal of a new Chapter VII of the OECD Transfer Pricing Guidelines (the "Guidelines")

The six key features of the new section (the "Section") to Chapter VII may be summarized as follow:

1. Definition: a standard definition of low value-adding intra-group services
2. Shareholder activities and Duplicative costs: clarifications of their meaning specifically in the context of low value-adding intra-group services
3. Mark up: determination of appropriate mark-ups for low value-adding intra-group services
4. Cost allocation: determination of appropriate cost allocation methodologies
5. Benefit Test: guidance on the satisfaction of a simplified benefit test with regard to low value-adding intra-group services; and
6. Documentation: a description of documentation that should be prepared by a multinational enterprise group to qualify for the simplified approach

Altagamma generally agrees with the approach and the position drafted by the OECD in the DD, but it considers that it would be highly recommendable to explain and clarify the main differences with a document previously issued on the same matter by the EU Joint Transfer Pricing Forum (the "JTPF Report").

More details and explanations will be drawn in the following paragraphs.

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3 Comments

3.1 Definition

3.1.1 Services which are not part of the core business of the MNE group

The new paragraph 7.46 defines the low value-adding intra-group services (the “Services”), specifying at the second bullet point that they are those services which “are not part of the core business of the MNE group”. The following paragraph 7.47 states that some activities (the excluded services) “would not be considered as qualifying for the simplified approach outlined in this section”.

Altagamma would suggest a clarification if the listed services under paragraph 7.47 may still be considered as low value-adding intra-group services, but without the opportunity to be treated according to the simplified approach further described, or if they are excluded from the definition of low value-adding intra-group services.

In the latter case, which seems to be the most rationale interpretation, Altagamma would like to highlight some remarks:
- the list under paragraph 7.48 is not fully parallel with the JTPF Report (for example Annex I of the JTPF Report does include a minimal but detailed list of marketing services, while the DD explicitly leaves out such services);
- the description used to identify the excluded services under paragraph 7.47 is quite broad and general, in particular if compared (again) to Annex I of the JTPF Report; such approach may substantially limit the application of the new Section. In this regard it would be recommendable to adopt a more detailed list of services, considering that between the last seven categories under the bullet points of paragraph 7.47 (i.e. from Research and development services to Services of corporate senior management) there may be services still classifiable as low value-adding intra-group services.
3.1.2 “Pass through” services

It is not fully clear if the services listed under the paragraph 7.47 should be always excluded from the simplifies approach or only whether those services are not characterized as “pass through” costs.

In Altagamma’s opinion, being such the “pass through” costs not incurred in the interest of the same company but on behalf of other group companies, it should be clearly stated or exampled that the “pass through” costs do not fall within the meaning of new Section of Chapter VII of the Guidelines and therefore they are not subject to any additional burden.

3.2 Mark-up

3.2.1 Mark-up vs CUP

With regard to the new Section, Altagamma would recommend that the Guidelines clearly state the determination method of the arm’s length charges to be recognized to the Services may always be based on a suitable CUP, if this can readily be found.

Consequently in such a case, the CUP adoption should not be challenged by any third party via the application of the new guidance (i.e. through a mark-up method).

For example, the CUP method can rely not only on similar Services supplied by the company to independent third parties, but also to similar Services received by the company from a third party.
3.2.2 Mark-up on “pass through” services

The DD suggests that the mark-up should be applied to all costs in the cost pool, and it is unclear whether this includes or not the so called “pass through” costs. Again, as previously stated, in Altagamma’s opinion it should be clearly stated or exemplified that under the new Guidelines the “pass through” costs do not fall within the new Section of Chapter VII of the Guidelines and therefore not subject to any mark-up.

3.2.2 Safe Harbour

With regard to the new proposed range between 2% and 5% of the relevant costs.

According to Altagamma members the established mark-up range seems to be appropriate when considering low value-adding intragroup services, however it may be beneficial to clarify that such range should be considered as “a safe harbour rule”, as already foreseen in different jurisdiction with regard to the low value adding intra-group services.

3.2.3 Determination of cost pools

Finally, Altagamma suggests to better specify if the costs pools to be considered are only direct costs or the full cost basis.

According to the reference in paragraph 7.52 (“... should identify the accounting cost centers ...”) Altagamma believes a full cost basis should be used, which would be also a more consistent approach.

3.3 Documentation

The proposed simplified approach to the Services will be for sure beneficial for some multinational groups, but it will be still costly when preparing the supporting documentation, in particular when a various and wide amount of minor charges would be present among different jurisdictions.

For this main reason Altagamma believes some additional simplification should be considered in section D3.

3.3.1 Threshold

Focusing on the documentation compliance requested by the simplified approach proposed in the Section of the DD, it is clear that that will
anyway imply an additional compliance and additional costs for multinational groups, not only in the year of adoption but also later on, due to the continues coordination to be requested on a global basis in order to follow and implement consistently the perimeter of the costs pooling and the allocation keys.

Therefore it would be absolutely important that the OCED would recommend an effective and immediate simplification measure, i.e. that the documentation compliance would not be required for small transactions, typically those valued at approximately less than a predefined threshold amount per annum.
In this respect Altagamma may recall that beside the fact that already various country have adopted such kind of threshold, this kind of guidance may be beneficial both for the taxpayers and for the tax authorities.

3.3.2 Penalty protection
Still with regard to the documentation feature, OCED should foresee to encourage the adoption of such kind of simplified approach also by means of the non-application of penalties in case the group companies have substantially followed the new guidance of the OECD Guidelines.

Again, this kind of simplification would represent a substantial incentive in particular where local tax regulations may foreshadow very high penalties in case of transfer pricing challenges and consequent transfer pricing adjustments.

3.3.3 Written agreements
Paragraph 7.61 D.3 provides a list of documentation that taxpayers, electing for a simplified approach, should keep at hand and provide to the relevant Tax Authorities upon request.
In particular a MNE should prepare and make available the “Written contracts or agreements for the provision of services and any modifications to those contracts and agreements reflecting the agreement of the various members of the group to be bound by the allocation rules of this section”.

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Altagamma would highlight that in many jurisdictions written agreements are not always compulsory, depending on the nature of the service provided. For instance, one off advisory services (e.g. legal, tax or HR intercompany advice services) may not need a written arrangement. Altagamma suggests that the DD takes into consideration also this option.

3.3.4 Coordination with Action 13 ("Guidance on Transfer Pricing Documentation and Country-by-Country Reporting")

On 16th September 2014 the OECD released the "Guidance on Transfer Pricing Documentation and Country-by-Country Reporting", wherewith the "three-tiered approach"\textsuperscript{5} was introduced.

In view of this, it might be necessary to address the impact of the new guidance on low value-adding intra-group service and of the proposed simplified approach to the Services on other BEPS Actions concerning transfer pricing, particularly on the OECD Action 13.

Conclusion

As a general comment, and as recently remarked by many commentators, the Section guidance has both similarities and differences relative to the report on low value adding intra-group services issued by the EU Joint Transfer Pricing Forum and to existing regulations in certain countries.\textsuperscript{6}

Ultimately, Altagamma believes the DD should seek wider coordination (e.g. with the JTPF and the European Commission) in order not create any area of uncertainty and risk with regard to the mark-up range and to the definition/perimeter of low-value adding intra-group services.

Furthermore, in Altagamma's opinion it would be appropriate to coordinate this DD with the other BEPS Actions in the field of transfer pricing (Action 8, 9, 13).

\textsuperscript{5} The report released on Action 13 contains revised standards for transfer pricing documentation (\textit{id est}, (i) Masterfile; (ii) Local File) and a template for country-by-country (CbC) reporting.

Altagamma strongly appreciates this opportunity to provide its view on OECD Discussion Draft on low value adding intra-group services.

Should you have any questions relating to our comments in this letter, we would be pleased to be of further assistance.

We will welcome the opportunity to participate in the subsequent public consultations and related discussions to be held by the OECD.

Respectfully yours,

[Signature]

Armando Branchini
Vice Chairman, Fondazione Altagamma
FONDAZIONE ALTAGAMMA MEMBERS LIST

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To: Andrew Hickman, Head of Transfer Pricing Unit, Centre for Tax Policy and Administration

General introduction

The OECD released its latest draft of the proposed revision to Chapter VII of the Transfer Pricing Guidelines on Monday 3 November 2014 (“the Draft”). Comments are invited by Wednesday 14 January 2015. A public consultation at the Paris headquarters of OECD is planned to take place on 19-20 March 2015.

The comments provided below are prepared by the author as representative of Gazprom Marketing & Trading Ltd.

Sections B and D – determining whether intra-group services have been rendered and determining an arm’s length charge.

Despite the title of the discussion document much of the document is dedicated to a general discussion around intra-group services (see sections B and C). Overall we feel that this is helpful. The various issues discussed: benefits test, shareholder activities, duplication, incidental benefits, centralised services and the form and amount of the remuneration are all areas that are frequently disputed between NMEs and tax authorities.

We generally agree with most of the comments made. We would however prefer to see more examples included in the paper to help common understanding of the issues. For example in section 7.12 the additional comments on duplication of services provide further confirmation using the example of a company which has a marketing team in-house and pays for marketing services from a group company. We find this example potentially very useful however we feel that it could be developed to really analyse the causes of the underlying “flash points” between MNEs and tax authorities.

Section D - Low value adding services

Generally we believe that introduction of the concept of low value adding services is a positive step made by OECD towards simplification of transfer pricing compliance for multinationals in the area of intra-group services.

However on the less positive side it would appear that the overall approach is to re-characterise the transactions concerned and to also cause a departure from the arm’s length standard. For example in the real world consulting firms certainly do not charge at cost or even near cost. In fact they make
very healthy margins and fat profits. Also services such as IT, finance, tax and HR are increasingly being seen as integral to the operations of a modern day multi-national and these are the very services which the consulting firms provide. Indeed it is a dubious proposition that any MNE regards these services as “low value adding”. This means that an MNE member paying a group service company for accounting advice might pay cost plus 5% whereas the same advice from a Big 4 firm will be significantly higher. If the OECD wished to continue down this path then it needs to be able to resolve this inherent contradiction and fully reconcile its approach with the overall commitment to the arm’s length standard. We discuss the special case of IT services later in our paper.

The success of these new rules will depend on consistency of implementation by various tax authorities around the world. At the moment, there are regional special provisions for such services (EU Joint Transfer Pricing Forum, “EUJTPF”) as well as local safe harbour rules (Australia, New Zealand, Japan and other countries), but inconsistent approach in countries of recipient and service provider reduces the positive effect of such provisions. These new rules should encourage consistent application.

**Remuneration for low value adding services**

The use of a simplified charging mechanism (section 7.55) is in theory tempting. However the necessary second step of using allocation keys is more troubling. Allocation keys are fraught with difficulty. They are difficult to agree with tax authorities mainly because it is very difficult when using them to pass the benefits test set out in section B.1. Most of the problems can be seen in the area of cost sharing activities. In those arrangements a service recipient can see its share of costs going up and down because of external factors (such as a division being sold) and its share of costs going up even though it uses the same level of services year on year. The draft does not go far enough in dealing with these difficult practical issues and it consequently offers no practical solutions.

We consider that external costs incurred by the service provider should be able to be passed on to the service recipient on a “pass through” basis at cost.

We support the range of mark-up suggested by OECD between 2% and 5%. This level of mark-up is consistent with the level that we have seen when benchmarking our existing mark ups for similar services. On the other hand, the range of the mark-up may be not consistent with local and regional rules currently in place (such as EUJTPF which provides a wider range between 3% and 10%). We hope that the final version of the range will represent a consensus between OECD countries and will be applied by all the participants in short time after that. Otherwise, discrepancies in approaches used by various countries will create significant risks of double taxation for MNEs around the world. The issue is even more important when services are provided between companies inside and outside of the OECD.

Recognising the risks described above, we still support the single mark-up approach with a clearly established range of mark-ups. We hope that once this approach is finalised by the OECD it will be consistently applied around the world.
Documenting and reporting

Another positive aspect of the new concept is the absence of the necessity to support the mark-up with a benchmarking study. Based on our experience, the outcome of benchmarking studies for low-value adding services does not vary significantly year on year and updating them creates additional cost for MNEs with limited benefit.

Other simplifications of the transfer pricing documentation requirements should also allow both MNEs and tax authorities to free up their time and resources. However it remains to be seen whether this simplified documentation will satisfy tax authorities in developing countries where excessive service fees are a constant worry for the tax authorities.

We would also like to note that the current wording of the Chapter is not clear on how often the required documentation for low value adding services should be updated. Obviously, calculations of the services will be updated every year, but it is not clear if the allocation criteria applied and benefits received should be tested and updated annually as well. We recommend that the OECD addresses this point in the next draft to ensure consistency of requirement across the countries.

IT services

In the modern world of technologies IT services change and develop at a fast pace. Also, more MNEs rely on their IT departments not just as a support functions, but also as an integral part of their business which drives core processes efficiency, effectiveness and therefore value.

This is relevant not just for companies focussed on internet trade, we are talking about contemporary retail and wholesale companies, commodity trading businesses, downstream divisions of natural resources and energy MNEs.

In such cases, in-house IT teams often develop bespoke software that can be a valuable intangible asset for a business. On an arm’s length basis, companies would be willing to pay substantial fees to external IT companies that provide equivalent services.

Therefore, we would suggest that the next Draft of the Chapter VII should include special examples of when IT services are not treated as a low value adding services, similar to the credit check services currently present in Section 7.49 of the Draft.

One of the potential criteria, how the low-value adding services could be distinguished from a high value adding services is to follow the accounting treatment of such costs. If an in-house IT team is involved in development internal software that meets the IFRS criteria for recognition as an intangible asset, the costs are capitalised on the balance sheet of the entity which bears such costs and then subsequently amortised. In this case, this is likely to be an indication of a high value-adding service and principles described for low-value adding services may not apply.

On the other hand, the costs, associated with day-to-day operations of certain IT activities (e.g. helpdesk) are treated as operational expenses (i.e. not capitalised). In this case, in a non-IT company this would probably mean that this activity is a routine support function and the services provided are likely to be low value adding.
Such a distinction would be relatively simple for MNEs to implement as it aligns the various different approaches in treatment of IT costs.

**Single approach across a MNE**

According to the section 7.51 of the Draft, a MNE should elect to apply the low value adding service provisions consistently across all the countries in which it operates. The principle is most easily applied in a vertically integrated company with a single global tax function that is responsible for setting tax strategy and policy across all its subsidiaries globally.

However, many MNEs nowadays apply different management structures. An MNE can be split into several independent lines of business that have a common parent company but little else in common. In such instances subgroups may have their own tax function that set their own tax strategy and policy. Another example is the existence of regional subgroups managed by a regional head office that may be interacting with the main shareholder, but have a high level of independence. More than that, such a regional subgroup would not have visibility or power to coordinate tax strategies and approaches in other subgroups of the MNE. In both cases, election of an approach at the main head office level and then application of consistent approach across the whole group may be very hard to achieve in practice.

The issue is even more critical if a head office company is located in a country which is not a member of OECD but which has subsidiaries in member states. In this case, the head office may prefer to choose an approach that is consistent with local rules, even though most of the intercompany low value service providers and recipients are located in OECD countries.

This issue is relevant not only for this draft. The documentation and country by country reporting document issued by the OECD in September 2014 also relies on a central management of a company and application of the OECD rules at the main head office level, which can be very inconvenient for an MNE with a parent company in a non-OECD country.

We suggest making the approach more flexible and allowing MNEs to elect to adopt this simplified method at the level of a sub-holding company for a subgroup or a regional holding company which would then make sure that the elected method is applied consistently across their subsidiaries.

**Conclusion**

The Draft contains helpful clarifications of the existing provisions in the Guidelines but it could benefit from the inclusion of more examples. It introduces the concept of low-value added services. On the one hand we consider this as positive step towards simplification of transfer pricing requirements for intercompany services. On the other hand however we are troubled by the re-characterisation of the underlying services and the departure from the arm’s length standard. We also foresee practical problems with the application of the polling and allocation key approach for costs.

In addition, there are other practical issues that need to be addressed such as treatment of different kinds of IT functions and the administration of the new approach in an MNE with several independently managed sub-groups or an MNE with a parent company in a non-OECD country.
Andrew Hickman  
Head of Transfer Pricing Unit  
OECD Centre for Tax Policy & Administration  
Paris  
France  

13 December 2014  

Dear Andrew,  

**OECD Discussion Draft BEPS Action 10: Proposed modifications to Chapter VII of the transfer pricing guidelines relating to low value-adding intra-group services**  

Grant Thornton International Ltd, with input from certain of its member firms, welcomes the opportunity to comment on the revised draft Chapter VII of the OECD Guidelines issued on 3 November 2014. We appreciate the work that the OECD has undertaken on the wider BEPS project and would like to make the following comments on the proposed modifications to chapter VII.  

Unfortunately we do not agree that the guidance as drafted is balanced between allowing 'appropriate charges' and 'the need to protect the tax base of payor countries' (emphasis added). In our experience, most head office locations struggle to charge out enough of the costs necessarily incurred by them for the benefit of their groups and often suffer tax losses as a result. The reasons for this range from: some very large payee countries refusing a deduction for anything described as 'management services', many countries repeatedly challenging the nexus between each cost and the specific benefit to them (eg asking for evidence of specific local visits), to others applying onerous withholding taxes which can be far in excess of the markups being charged in.  

A very helpful clarification at the outset of the new chapter VII would be to specify that this guidance is to be applied to all cases equally, inbound and outbound. We would also very much welcome additional clarification that:  

i. recharged costs, using a reasonable allocation key and following the principles in the chapter, should prima facie be deductible locally  
ii. where costs are not allowed as intragroup services because they are shareholder costs, they should be deductible at head office level.  

**Revisions to existing chapter**  

We note that there have been some minor changes to the existing chapter including the addition of new headings. This additional readability is welcomed.  

The commentary on 'incidental benefits' in 7.13 and 7.14 adds much-needed clarity. Furthermore, the clarification that services are not necessarily duplicative just because similar types of costs may be incurred locally (7.12) is also useful.
We note that there is a proposed change to para. 7.43 (which updates para 7.41 of the 2010 Guidelines) referring to contract research carried out by service providers. We welcome the retention in the services chapter of the acknowledgement that 'research is … an example of an activity that may involve intra-group services'. However, the proposed change to this paragraph removes the sentence: 'In such a case a cost plus method may be appropriate'. We disagree with the removal of this sentence given that third party contract research organisations can, and often do, build up their pricing from costs or day rates.

The paragraph also now includes revised wording regarding the selection of method. We consider that the new wording in the last two sentences of this paragraph does not correctly direct the functional analysis. Where contract R&D is carried out, in our experience, 'the precise nature of the research' is less important than where and how the strategic direction of the research is carried out. As detailed in the revised chapter VI, it will be important to consider where the significant people functions in relation to development, enhancement, exploitation and protection of the intellectual property are based. We suggest that this point is clarified within this paragraph.

**Section D Low value-adding intra-group services**

It is interesting to note that in the OECD report 'Multi-Country Analysis of Existing Transfer Pricing Simplification Measures' (published in June 2012) that a number of territories indicated that they have simplification methods directed at low value adding intra-group services. The commentary in this report suggested that such transactions were deemed simple with limited differential tax at stake. As such, in this earlier paper prepared by the OECD, such payments were not considered as base eroding, but merely requiring some administrative guidance in order to limit the resources used in documenting and auditing such charges.

A similar view was taken by the EU Joint Transfer Pricing forum in its 2011 paper 'Guidelines on low value adding intra-group services'. This paper was aimed at allowing more efficiency in dealing with the transfer pricing aspects, as the problem was seen to be that excessive resources were being devoted to documenting and auditing these low-value services. We concur with this view, and we are concerned that the mounting pressure asserting that all deductions for group charges are 'base eroding' is being accepted by default every time it goes unchallenged.

It appears that the discussion draft as it stands will have most effect in limiting the ability to charge an arm's length price for genuine services, instead of being a genuine simplification process that is easy for businesses and tax authorities to operate and understand, and which would truly be helpful to all parties.

**Definition of low value-adding intra-group services**

A standard definition of low value adding intra-group services is to be welcomed. We consider that examples of services at para 7.48 are helpful. However there is a risk that some tax authorities may try to view this as an exhaustive list. We would like to see the text make it clear that this is an illustrative and not an exhaustive list of examples, and that depending on the facts and circumstances of the Group there may be additional activities that could be included on this list.

We consider that the list of non-low-value-adding services provided at para 7.47 is less helpful, especially given the categorical wording (eg 'would not'). In addition, given the limited nature of services that apparently could qualify for the safe harbour 'simplified approach' we would also welcome guidance on pricing for higher value services.

**Simplified determination of arm’s length charge for low value-adding intra-group services**

We welcome an approach to dealing with low value-adding services without the need for exhaustive benchmarking. We suggest the mark-up on full costs range given of 2-5% is low and in our experience a range of 3-10% would be more suitable (and could also perhaps encompass some of the currently excluded services in 7.47. It is unclear why in Para. 7.57, if the rates provided are considered benchmarks for arm's length pricing of such services (and if they are not, one has to ask why they have been proposed) that the revised chapter expressly states they cannot be used as such in the case of 'similar' services.

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1 OECD Report: Multi-Country Analysis of Existing Transfer Pricing Simplification Measures para 11
The reference in 7.51 to Cost Contribution Arrangements as a 'possible alternative' to the simplified method seems odd and there is no explanation of why it has been included. It does not seem likely to us that most low value added services would qualify as the sort of costs that third parties might cost-share.

**Documentation and reporting**
We note that if an MNE Group is to elect to apply the simplified methodology they will need to document specific information set out in the discussion draft and make it available at a tax administration’s request. It is unclear how this would interact with the recommended documentation approach in revised chapter V and we would request that guidance is included here. A 'light touch' is key if the methodology is going to be useful in practice.

**Closing comments**
The other key determinant as to whether this methodology is going to be useful will be consistency of adoption. If some important countries are prepared to 'buy in' only when they are the payor of these charges, yet when they are the recipient of service fees they continue to insist on very substantial mark ups far in excess of the safe harbours mooted here, the guidance will not be helpful.

We should be pleased to expand on any of the points raised here. Please contact Wendy Nicholls, Partner for Grant Thornton UK LLP (wendy.nicholls@uk.gt.com) or Lorna Smith, Associate Director Grant Thornton UK LLP (lorna.smith@uk.gt.com) for further details.

Yours sincerely

Global head - tax services
francesca.lagerberg@gti.gt.com
January 14, 2014

Andrew Hickman  
Head of Transfer Pricing Unit,  
Centre for Tax Policy and Administration  
Organisation for Economic Cooperation and Development  
2, rue André Pascal  
75775 Paris Cedex 16, France

Subject: Grant Thornton Canada Comment Letter on the OECD Discussion Draft on BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services

Dear Mr. Hickman,

Grant Thornton Canada¹ appreciates the efforts of the OECD to address the matter of low value-adding intra-group services. There has been significant confusion and difference in opinion between corporations and tax authorities around the issue of whether mark-ups should be included for these services. In our experience, the Canada Revenue Agency has generally disallowed mark-ups for “routine”, “back-office” or “administrative services”. Although the mark-up are not usually a material component of the overall charge, it has been very costly and time consuming for Taxpayers to address these matters in the audit stage, appeals and/or competent authority. Further, we are of the view that at arm’s length corporations would not perform services at cost whether administrative or otherwise. The OECD’s guidance should help reduce the number of unnecessary audits and reduce the costs to taxpayers of documenting and defending their transfer pricing policies related to these services.

Grant Thornton Canada supports the guidance provided in the OECD’s discussion draft dated 3 November 2014 – 14 January 2015 and its implementation of a simplified approach. We believe the definitions of low value-adding intra-group services and clarification of when these transfer pricing methods should be followed to be quite helpful. We have seen situations where certain countries have denied management fees outright or treated as non-deductible certain expenses included in the management fee cost pools (including those of low-value services). We would appreciate some additional guidance added to the draft to address these matters which potentially create double taxation.

¹ Grant Thornton LLP is a leading Canadian accounting and advisory firm providing audit, tax and advisory services to private and public organizations. We help dynamic organizations unlock their potential for growth by providing meaningful, actionable advice through a broad range of services. Together with the Quebec firm Raymond Chabot Grant Thornton LLP, Grant Thornton in Canada has approximately 4,000 people in offices across Canada. Grant Thornton LLP is a Canadian member of Grant Thornton International Ltd, whose member firms operate in close to 100 countries worldwide.
Revisions to Existing Chapter and Approach to Low Value-Added Services

The clarification that services are not necessarily duplicative just because similar types of costs may be incurred locally (7.12) is welcome as is the commentary on “incidental benefits”.

Paragraphs 7.48 and 7.49 illustrate some examples of when a low value-adding service is or is not occurring. We find these examples useful. We understand that it would not be feasible to provide examples for every case, however, we believe more examples may be helpful as this topic poses a significant issue for business and audit/dispute resolution. For example, some areas where we have experienced conflict are in respect of the following services: warehousing, transportation, logistics and repair.

We strongly agree with paragraph 7.56’s statement that there should be a balance between theoretical sophistication and practical administration. In addition, we agree with the statement that there may be no need to use multiple allocation keys as long as the taxpayer can explain the reasons for concluding that a single key provides a reasonable reflection of the benefits received by a certain services.

We welcome the addition of a standard range of mark-ups for low value-adding services. The arm’s length principle provides that a service provider would not agree to render its services merely at cost and would rather seek to obtain profits via the application of a mark-up. It is exhaustive and costly to identify arm’s length mark-ups for low value-adding services, such as administrative services. Further, the cost/benefit is rarely supported due to the materiality of the mark-up component. Setting a standard range to apply to these common low value-adding services will reduce taxpayer’s costs for compliance.

Closing Comments

We have observed many instances of mark-ups applied on routine services being denied which have been very costly to resolve. The guidance provided by the OECD relating to documentation and reporting discussion points are reasonable and should help to mitigate transfer pricing adjustments associated with differences in opinion on the theoretical application of mark-ups and insufficient documentation relating to low value-adding services.

Thank you for your assistance. Please do not hesitate to contact me at (1+) 403 260 2547 if you require further information or any clarification in respect of my comments.

Yours truly,
Grant Thornton LLP

Glen Haslhofer, CA
Principal, Grant Thornton LLP
Re: Comments on Discussion Draft on BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services

Dear Mr. Hickman:

The International Alliance for Principled Taxation (IAPT or Alliance) is a group of major multinational corporations based throughout the world, and representing business sectors as diverse as consumer products, media, mining, telecommunications, oilfield services, transportation, computer technology, energy, pharmaceuticals, entertainment, software, IT systems, publishing, and electronics. The group’s purpose is to promote the development and application of international tax rules and policies based on principles designed to prevent double taxation and to provide predictable treatment to businesses operating internationally.

The Alliance appreciates the opportunity to provide input to the OECD with respect to its Discussion Draft on BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services (Discussion Draft) released on 3 November 2014. Our comments are set forth in the Annex to this letter.

1 The current membership of the IAPT is made up of the following companies: Adobe Systems, Inc.; Anheuser-Busch InBev NV/SA; A.P. Møller-Mærsk A/S; AstraZeneca plc; Baker Hughes, Inc.; Barrick Gold Corporation; BP plc; Chevron Corporation; Cisco Systems, Inc.; ExxonMobil Corporation; Hewlett-Packard Company; Johnson Controls, Inc.; Microsoft Corporation; Procter & Gamble Co.; Reed Elsevier plc; Repsol S.A.; Sony Corporation; Texas Instruments, Inc.; Thomson Reuters Corporation; Tupperware Brands Corporation; and Vodafone Group plc.
We look forward to the opportunity to participate in the consultation to be held on 19-20 March 2015 with respect to this topic and stand ready to respond to any questions or to provide further input as the work of the OECD on this item continues.

Sincerely yours on behalf of the Alliance,

Caroline Silberztein
Baker & McKenzie SCP
Counsel to the Alliance

Annex
ANNEX

INTERNATIONAL ALLIANCE FOR PRINCIPLED TAXATION

COMMENTS ON 3 NOVEMBER 2014 DISCUSSION DRAFT ON BEPS ACTION 10: PROPOSED MODIFICATIONS TO CHAPTER VII OF THE TRANSFER PRICING GUIDELINES RELATING TO LOW VALUE-ADDING INTRA-GROUP SERVICES

14 JANUARY 2015
IAPT Comments on the November 3, 2014 Discussion Draft on BEPS Action 10, Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services

1. Executive Summary

1. We are pleased to provide hereafter our comments on the November 3, 2014 Discussion Draft on BEPS Action 10, Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services (hereafter “the Draft”).

2. The IAPT welcomes and strongly supports the OECD efforts to simplify and harmonize the approach to low-value adding intragroup services, a definition of chargeable and non chargeable services, a range of acceptable markup rates and documentation requirements. We find that the proposed guidance addresses many of the issues encountered in practice. We welcome, in particular, the proposal for a simplified benefit test.

3. More generally we fully support the objective to achieve balance between appropriate charges for low value-adding services and head office expenses and the need to protect the tax base of payor countries. We believe that the draft could be significantly improved in this respect by better recognizing that the critical issue at stake relates to an agreement among countries of where costs incurred should be deductible, rather than a profit shifting issue. The main concerns of our members relate to systemic and significant double taxation incurred in cases where service charges are regarded as non deductible in the countries of affiliates but chargeable in the countries of the service providers.

4. We include below some suggested amendments which we believe could help refine the proposed guidance. Our focus has been on limiting risks of double taxation and reflecting practicalities of business organisations. Of particular concern to our members is the suggestion that cost bases would need to be adjusted to the standards of the recipient countries, for the reasons explained in section 7.1 below.

2. General balance of the Discussion Draft

5. The IAPT welcomes and strongly supports the OECD efforts to simplify and harmonize the approach to low-value adding intragroup services, a definition of chargeable services, a range of acceptable markup rates and documentation requirements. We also fully support the objective to achieve balance between appropriate charges for low value-adding services and head office expenses and the need to protect the tax base of payor countries.

6. We realise that this Draft was produced in the context of Action 10 of the BEPS Action Plan and is focused on base eroding issues. We nevertheless find that the Draft insufficiency reflects the perspective of the countries of the service providers. It also remains silent on the systemic double taxation encountered in the area of headquarters cost allocations and management fees, which in our experience is largely due to the existence of local restrictions on management fee charges whether in legislation or in audit practices in many countries. This adds up to foreign exchange control, withholding taxes and other measures that may restrict the ability to allocate headquarters costs to affiliates, especially - but not only - in emerging and developing countries.
7. Issues surrounding headquarters cost allocations and management fees are generally a question of agreement among countries as to where the costs incurred belong. That is, this is all about allocating costs, not profits (except for a limited mark-up on costs). This is especially true for low value-adding services on which a zero\(^2\) or small markup rate is generally applied. We respectfully submit that the OECD guidance should not fuel the wrong perception that headquarters cost allocations and management fees are largely base eroding payments. Our view is that where group expenses are incurred for business purposes, they should be deductible somewhere. This overarching principle was helpfully affirmed by the European Commission in its guidance on low value-adding services,\(^3\) and we suggest it should also be expressly endorsed by the OECD.

8. Keeping in mind the objective to achieve balance between appropriate charges for low value-adding services and head office expenses and the need to protect the tax base of payor countries, we think that the OECD final guidance should discourage countries of affiliates from disallowing significant portions of headquarters costs in cases where such costs are real and incurred for business purposes, as doing otherwise creates a BEPS issue, i.e. erosion of the taxable base of the service providing countries. We further think that the OECD final guidance should contain a solid mechanism ensuring that whatever is regarded by the OECD as not chargeable to affiliates (whether because it would qualify as shareholder activities, or be regarded as duplicative services, or would not meet the local benefit test, or because of a proposed adjustment to the cost base to reflect local cost standards, or any other issue) will be deductible at the level of the parent company or service provider, in order not to create serious double taxation concerns.

9. Finally, we believe that the OECD’s consideration of low value-adding services should not be limited to transfer pricing but should encompass a discussion of withholding taxes. Both issues are connected. In effect, as confirmed in the proposed transfer pricing guidance, low value-adding services should be charged with a very small mark-up. In other instances, where costs are recharged through regional or business line hubs, the latter typically treat them as pass through costs on which they do not add any mark-up, or a very small one. As a consequence, even a 5% withholding tax rate is economically inappropriate: in many cases it is higher than the profit element earned on the services concerned, and post-withholding tax, the service provider may not even be in a position to recover its total costs - notwithstanding a share in the profit element. This also creates a base erosion issue for the country of the service provider.

3. Need for a large and solid consensus, as well as effective elimination of double taxation

10. Transfer pricing disputes are steadily increasing in number, complexity and amounts at stake. It is more than ever essential for the transfer pricing guidance to be grounded in a solid consensus which will ensure that the proposed rules are acceptable and will be respected by all jurisdictions concerned, and a global enforceable mechanism to effectively and timely resolve disputes and eliminate double taxation in practice.

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\(^2\) A zero markup rate can be applied on low value-adding services by U.S. service providers in accordance with the Services Cost Method (“SCM”), which evaluates whether the price for covered services, as defined, is arm’s length by reference to the total services costs with no markup.

\(^3\) See COM(2011)/16/Final : “The report outlines certain underpinning principles. For example: all relevant costs are deductible, subject to domestic law provisions; good quality and relevant information should be made available and a flexible approach should be taken in the review of low value adding intra-group services.”
11. We urge the OECD to reach consensus on its proposed new guidance on low value-adding services and to embrace the need to more effectively resolve double taxation, despite the current greater focus on double non-taxation, and look forward to the effective implementation of the outcomes of Action 14 in this respect.

4. OECD proposal for an optional regime for low value-adding services

4.1 The OECD should clarify what the benefits of the option are

12. In order for an option to be attractive and effective, it would need to provide the taxpayers opting in with significant benefits compared to the default situation. Such benefits could be as follows:

- Simplified documentation process, including:
  - No need to perform benchmarking analyses to support mark-up rates,
  - Simplified benefits test endorsed by the countries of affiliates,
  - Alternative, simplified documentation package endorsed by the countries of affiliates.

- Increased certainty, for instance:
  - Effective adoption and enforcement of the OECD proposed guidance in OECD and key non-OECD country domestic legislations,
  - No requirement for taxpayer to apply the proposed mechanism in countries which do not endorse the proposed guidance in their domestic legislation.

- Streamlined audit mechanism, for instance:
  - One tax administration or independent expert only could review the compliance of the cost pooling and allocations with the OECD guidance.

- Streamlined dispute resolution processes, for instance:
  - Fast track access to bilateral and multilateral mutual agreement procedures and arbitration.

13. We suggest that the OECD should further clarify what exactly the benefits of the option are from the perspective of taxpayers.

4.2 What should the legal and administrative parameters of the option be?

14. The Draft currently does not provide any guidance as to how the option should be formalized and would operate in practice. Given its intended multi-jurisdictional effects, a number of potentially complex legal and administrative questions arise as to the modalities of the option and its binding effects on the various entities of the MNE group as well as the tax administrations concerned. For instance, should each affiliate providing or receiving services formalize an option with its local tax administration, or could the option be made by the parent company on behalf of the group with its own tax administration, or with the OECD Secretariat? Would the taxpayer be required to apply the
mechanism only in countries which expressly endorse it, or also in countries where the option is not available? What guarantees would be provided by local tax administrations to taxpayers making the option? What would be the effects in case of acquisition or sale of subsidiaries or businesses? Could the option be made for a region or business unit, or should it be global? If the latter, how would the option deal with Joint Ventures and cases where management fees are charged to entities which are not 100% controlled? How long would the option be made for? In what language? What would the audit points be? Etc.

4.3 A global option should not be required from taxpayers

15. The Draft indicates that the simplified method is premised on the proposition that all low value-adding service costs incurred in supporting the business of the MNE group members should be allocated to those members. We agree that there should be consistency to the largest extent possible of the mechanism put in place to charge low value-adding costs to affiliates. However, the reality is that not all countries accept the proposed OECD principles. For instance, China and Brazil, among others, have their own domestic views and restrictions about management fees and headquarters costs allocation. In many countries, transfer pricing disputes about HQ costs and management fees typically end up in settlements, which may not be in line with the proposed OECD guidance. Also, there is not always a bilateral tax treaty in force between the country of the service provider and the country of the affiliate benefitting from the services.

16. In addition, many MNE groups do not have a single entity providing low value-adding services. There can be regional headquarters and / or heads of business units or divisions. We think that the proposed mechanism would be more attractive and effective if flexibility is provided for groups to apply it to a given business unit or regional area only.

17. We think that the OECD guidance could more realistically indicate that the proposed mechanism to charge low value adding costs should be deployed “as consistently as possible”.

5. Determining whether intra-group services have been rendered

5.1 IAPT especially welcomes the proposed guidance on the satisfaction of a simplified benefit test with regard to low value-adding services.

18. MNE groups increasingly face difficulties in relation to benefits tests and documentation standards in practice. The level of proof required from local tax administrations is not harmonized and often times auditors set unrealistic thresholds. We observe that stringent benefits test requirements are increasingly common in practice and often lead to tax administrations disallowing a large portion of HQ costs not because services are not actually rendered, but because a very demanding threshold to demonstrate local benefits is set which cannot be met.

19. Benefit tests are very burdensome and difficult to satisfy in practice because they require tracking and valuing benefits received throughout the years by a large number of persons within the group. Services are sometimes materialized (e.g. memos, studies, meetings), sometimes not (e.g. phone calls, access to shared databases). Benefits are sometimes expected (e.g. the mere possibility of calling the legal department is a benefit an affiliate may be paying for, notwithstanding the number of times it actually called the legal department during a given year). Furthermore, the quantification of individual benefits is often a complex and huge task.
20. We believe that benefits tests should not be used by tax authorities to challenge a group’s decision to implement a global project such as the deployment of an ERP (e.g. SAP), even though costly.

21. We therefore strongly support and welcome the proposed guidance on a simplified benefit test for low value-adding services which we find more proportional to the nature of said services. We note however that the effectiveness of such a simplified benefit test proposal fully relies on the willingness of the countries of affiliates, within and outside the OECD, to apply it. We would be concerned if the proposal resulted in a simplified benefit test being regarded as satisfactory by the countries of a parent company or service provider but not by the countries of affiliates as this would not help elimination of double taxation. We therefore urge the OECD to further strengthen its guidance on acceptability of a simplified benefit test.

22. We further suggest clarifying at paragraph 7.8 that any benefit test intended to support the deduction of service charges by a given affiliate should be limited to testing the value that the affiliate concerned could reasonably anticipate from the service charge (i.e. it should not require an analysis of the value that other group members may possibly receive from the activities).

5.2 Definition of shareholder activities

23. The definition of shareholder activities is one typical area of dispute in relation to management fees. China’s SAT, for instance, expressed a view in the context of United Nations discussions that the OECD definition of shareholder services is too narrow: “One example is services provided by a parent company that are associated with its own strategic management, but not classified as “shareholder activities”. Although the subsidiary may benefit from such services, the parent company will benefit more. Therefore, the parent company should not charge service fees to the subsidiary merely because the subsidiary may benefit from such services.”

Lacking consensus on the definition of shareholder costs, MNE groups will continue to face situations whereby the tax administration of the parent company may argue that, for instance, such strategic management services provided by the parent company do not fall within the definition of shareholder services and should be charged to the affiliates which benefit from them.

24. We suggest the following edits to the proposed guidance at paragraphs 7.10-7.11:

7.10 A more complex analysis is necessary where an associated enterprise undertakes activities that relate to more than one member of the group or to the group as a whole. In a narrow range of such cases, an intra-group activity may be performed relating to group members even though those group members do not need the activity (and would not be willing to pay for it were they independent enterprises). Such an activity would be one that a group member (usually the parent company or a regional or business line holding company) performs solely because of its ownership interest in one or more other group members, i.e. in its capacity as shareholder.

This type of activity would not be considered to be an intra-group service, and thus would not justify a charge to the recipient companies. It may be referred to as a “shareholder activity”, distinguishable from the broader term “stewardship activity” used in the

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1979 Report. Stewardship activities covered a range of activities by a shareholder that may include the provision of services to other group members, for example services that would be provided by a coordinating centre. These latter types of non-shareholder activities could include detailed planning services for particular operations, emergency management or technical advice (trouble shooting), or in some cases assistance in day-to-day management which are chargeable activities.

There are also cases where the performance of shareholder activities is outsourced to a group member which is not the parent or holding company. In such cases, the related costs should be charged by the entity performing the activities to the parent or holding company benefitting from them and treated as shareholder costs by the latter.

7.11 The following are examples of activities which generally qualify as shareholder activities, under the standard set forth in paragraph 7.7: […]

25. Furthermore, based on some EU member countries’ published guidance and practices and guidelines from the EU Joint Transfer Pricing Forum, we suggest that the following items could be added to the list of examples of shareholder activities at paragraph 7.11:

- All Presidential costs, including costs of the President’s Cabinet.
- Costs related to the study and implementation of the capitalization structure of the subsidiaries.
- Costs for the increase of the share capital of the subsidiary.
- Costs of supervision, managerial and control (monitoring) activities related to the management and protection of the investments in participations.
- Costs of internal audit activities within the group as long as the conclusions derived from the activities are primarily reported to the parent and not to the subsidiary/ies audited.
- Costs to reorganize the group, to acquire new members or to terminate a division, when the objective aimed is to benefit the group as a whole (increase its financial ratios, reduce costs, etc.) and it does not directly benefit one or several subsidiaries.
- Activities relating to the establishment of group policies (financial policies, tax policies, human resources policies, insurance policies, etc.).
- Activities related to the definition, measurement and promotion of the strategic principles in terms of the group’s reputation.

26. Finally, we suggest the following paragraph could be added at the end of 7.11:

There are also cases where a review of the activities performed evidences activities which benefit both the parent or holding company in its capacity as investor and the affiliates. In such situations, the related costs should be allocated in part to the category of non-chargeable shareholder costs and in part to the category of allocable services, based on an analysis of the activities performed by the department concerned.
5.3 **Duplication of services**

27. We support the statement that “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.”

28. This statement is a critical one in practice. In many MNE groups, local affiliates may be vested with local management and administrative functions (e.g. legal, human resources, accounting, finance, marketing, quality control, etc.) working in close coordination and/or under the supervision of teams working in the same area of services at central, regional, business unit or other level. The coordination or supervision functions should not be regarded as duplicative services. They add value by, for instance, raising and/or harmonizing the standards, sharing and ensuring implementation of best practices, collecting and disseminating relevant information.5

29. We recommend that this point be further strengthened in the final guidance.

6. **Definition of low value-adding services**

6.1 **Examples of services that would not be considered as low value-adding services**

30. We support the principled definition provided at paragraph 7.46 and believe that it should prevail over any prescriptive list of services. Accordingly, we believe that the list of services at paragraph 7.47 should be deleted or that it should be made clear that it is not prescriptive and provided for illustrative purposes only.

31. For instance, distribution activities are currently excluded from the list of qualifying low value-adding activities, although we think that there are many situations where logistic and other physical distribution activities would meet the requirements of paragraph 7.46 and should therefore qualify as low value-adding.

32. Similarly, financial transactions, insurance and reinsurance are excluded from the list of qualifying activities at paragraph 7.47. These labels are very broad and may in fact encompass both high value-adding and back office, low value-adding activities. We therefore suggest that they not be excluded altogether from the scope of qualifying services.

33. We further note that transfer pricing work on financial transactions including guarantees is to be done in the context of Action 4. We therefore respectfully suggest that no definitive guidance on financial transactions and guarantees (whether on the characterization of the payments as services or otherwise, or on their pricing) should be developed as part of this Draft.

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5 We note that possibly diverging views from China’s SAT who indicated that “most of the subsidiaries in developing countries have their own management teams, and they only need management decision approvals from the parent companies due to authorization requirements. In this situation, SAT believe[s] that these types of management services are likely to be duplicative activities or shareholder activities and, therefore, should not be charged”, Ibid.
34. Finally, we note that the services of corporate senior management are excluded from the list of qualifying services. It is unclear to us what the definition of “corporate senior management” is. In any event, we urge the OECD to clarify that there is no intention to regard these services as shareholder activities by default as there is no reason to consider that activities of corporate senior management do not provide value to affiliates.

35. Furthermore, we believe that the costs related to the management of the teams providing qualifying low value-adding services should be treated in the same manner as the costs of the team providing the services.

6.2 Examples of likely low value-adding services

36. Accounting and auditing are included in the list of likely low value-adding services. We would find it helpful to further clarify which of these services qualify as low value-adding services and which consist in shareholder activities.

7. Determination of the cost base

7.1 We do not support comparability adjustments to cost base

37. We note the proposed guidance at TPG 7.35: “Where the cost plus method is determined to be the most appropriate method to the circumstances of the case, the analysis would require examining whether the costs incurred by the group service provider need some adjustment to make the comparison of the controlled and uncontrolled transactions reliable. In some cases, the costs that would hypothetically be incurred by the recipient were it to perform the service for itself may be instructive of the type of arrangement a recipient would be prepared to accept for the actual service.”

38. We are concerned with the suggestion that such comparability adjustments should be made for at least three reasons.

39. First, the determination of such adjustments is not workable in practice as it would create a disproportionate burden for MNE groups which have affiliates in several dozen countries.

40. Secondly, we think that this proposal relies on the wrong premise that affiliates have a commercially realistic option to source services locally, and that groups have a commercially realistic option, equivalent to the maintenance of central headquarters, which would consist in sourcing all the HQ services from third parties in the various jurisdictions in which they operate.

41. The decision by a group to internalize certain support functions is a management decision which should be respected. Furthermore, we believe that MNE groups have the right to decide where to locate their internal services and that the decision of a particular MNE group to locate part or all of its HQ services in a high cost jurisdiction should not be second guessed by tax authorities. Some MNE groups maintain HQ with thousands of employees in the parent jurisdiction, and some other groups create dispersed shared service centers. For instance, some MNE groups may decide to outsource some accounting tasks to a low cost shared service center, and some other groups may find this arrangement not suitable for management purposes, quality control or any other reason which has nothing to do with tax planning.
42. Accordingly, we believe that while tax authorities, when auditing HQ costs allocations, have the right to verify that the costs are real and correspond to business purposes, they should not question the group’s decision as to the amount it decides to expend for the performance of its internal services.

43. If tax authorities in a low cost country were able to deny deductibility of part of HQ costs on the grounds that the HQ is located in a higher cost country, then following the same logic questions might possibly arise as to whether the HQ can be located in a premium location in town or whether the deductibility of the costs should be limited to the lower costs of a location in the suburbs, or in another area within the same country, or in a neighboring country, etc.; whether employees should have expensive laptops or less expensive laptops, whether the costs of the cafeteria are excessive, etc. We believe that these are decisions made by the group which should not be challenged by tax authorities as long as the expense itself is real, serves a business purpose, and is appropriately allocated.

44. Thirdly, this would create systematic double taxation unless there is a clear and solid commitment by tax authorities worldwide that such comparability adjustments will be accepted in the country of the service provider, i.e. that the amount that may not be chargeable to service recipients in low cost countries will be deductible in higher cost countries in the hands of service providers. This seems unrealistic to us, and in any case far reaching as it would call into question the very possibility of maintaining headquarters in high cost jurisdictions.

45. Based on discussions with tax authorities of emerging and developing economies, we think the OECD should be careful not to open up such a possibility unless it can guarantee that the corresponding comparability adjustment will be accepted by the tax authorities of all the countries of service providers.\(^6\)

7.2 Cost base: stock options and similar employee benefits

46. In its Tax Policy Study “The Taxation of Employee Stock Options”, the OECD noted “Since the premise in this study is that stock options are remuneration, it follows that the costs of stock options attributed to employees participating in a given controlled transaction should be included in the cost basis irrespective of their accounting treatment, to the extent that other components of said employee remuneration are included in the cost basis at arm’s length” and provided an example whereby a parent company TOPCO is providing management services to a number of affiliates in other jurisdictions, charged on a cost plus basis.

47. However, some tax administrations, when auditing local affiliates that receive service charges from foreign related parties, do not accept that stock options and similar employee benefits should be included in the cost base of HQ allocations, on the grounds that these are benefits provided by the parent company which would not be provided by the affiliate on a standalone basis if it was not a member of the group.

48. We recommend that the OECD clarify its position in this respect.

\(^6\) Note for instance the view expressed by China’s SAT: “various advisory and legal services provided by a parent may confer some benefits to a manufacturing sub in China. However, these high-end services may not be needed from the perspective of the sub”, Ibid.

7.3 Cost base: other issues

49. We suggest the following edits to the first sentence of paragraph 7.52 of the proposed guidance:

The initial step in applying the simplified approach to low value-adding intra-group services is for the MNE group to calculate, on an annual basis, a pool of all relevant costs incurred by all members of the group in performing low value-adding intra-group services. As noted at paragraph 2.95, actual costs, standard or budgeted costs may be appropriate to use as the cost base, depending on the facts and circumstances of the case. Where charges are made throughout the year based on budgeted costs and/or budgeted allocation keys while actual costs and/or actual allocation keys are used to determine the final amount to be charged to each affiliate, true ups (or downs) may be needed at the year-end.

50. It would also be helpful to clarify whether the guidance on pass-through costs at paragraph 7.36 also applies to qualifying low value-adding services or whether the reference to “all costs” means that there should not be any pass-through costs under the proposed mechanism.

8. Cost pooling method

51. We think that the proposed guidance in paragraphs 7.52-7.53 related to the determination of cost pools is over-prescriptive. What is important is to ensure that all costs related to the rendering of the low value-adding services, and only those costs, be included in the cost pool. Each MNE group should be free to determine the method it will use to achieve this outcome, depending on the organization of its accounting system and service flows. For instance, groups should be free to issue invoices from each of the regional service providers to the service recipients in the region concerned, instead of being required to first pool all the costs at global level. Otherwise, additional administrative burden as well as withholding tax and VAT issues may arise, notwithstanding possible adverse effects on transparency and readability of the service charges.

9. Allocation keys

52. We support the proposed guidance at paragraphs 7.55 and 7.56. We note that disputes commonly arise about appropriate allocation keys. Given allocation keys are proxies to estimate the relative needs for services of various group entities, we believe that tax authorities should refrain from challenging them in cases where they are reasonable. Further, we note that if one country disagrees with the allocation key used by the MNE group, the requirement that the same allocation key must be used on a consistent basis for all allocations of costs relating to the same category of services will not be met. Therefore we urge the OECD to take a flexible and realistic approach in this respect.

10. Profit mark-up

53. We understand that one of the benefits of electing for the proposed mechanism is the ability to use a 2-5% mark-up rate without the need to perform benchmarking analyses.

54. As a matter of policy we would support a zero percent mark-up rate, as already provided by the United States for low value-adding services. This is assuming that all the relevant costs are
chargeable, with no cost base adjustment and a simplified benefit test in the country of the service recipient.

55. Although this may seem superfluous to some, we further suggest that the OECD clarify that countries should accept the proposed range both for inbound and outbound low value-adding services.

56. We note that the OECD does not specify how to select the most appropriate point within the 2-5% range. The current wording refers to “the mark-up selected by the taxpayer”, so that we understand the guidance to mean that tax administrations should not challenge the rate selected by the taxpayers as long as it is within the range. It would be helpful for the OECD to clarify this point.

57. Finally, we note that the proposed range differs from the one provided by the European Commission in its guidelines on low value-adding services. Many MNE groups currently rely on the EC guidance for their HQ allocations and management fees charged within the EMEA region at least. Although both ranges overlap, there will inevitably be cases where intra-group services are charged at a mark-up rate which is higher than the OECD range but within the EC range (i.e. between 5% and 10%). Such situations may need to be resolved through Mutual Agreement Procedures.

11. Documentation and reporting

58. We understand that one of the benefits of the proposed optional regime is the possibility to produce simplified documentation for HQ costs and management fees as outlined at paragraph 7.61, in lieu of the full transfer pricing documentation package developed under Action 13. We suggest this should be clarified.

59. We further ask the OECD to confirm that each tax authority should be given the information relevant to support the charge made to the affiliate(s) in its jurisdiction but should not require the provision of documentation supporting the charges made to and benefits received by other affiliates.

60. Concerning the requirement to provide written contracts or agreements, the guidance should not assume that all MNE groups will have one multilateral agreement covering all the intra-group low value-adding services. Groups may organize their contractual relationships in various ways in order to manage the signing and updating process of management services agreements with tens or hundreds of affiliates. For instance groups may not find it practical to require all the affiliates to sign a single multilateral agreement and may decide to have an umbrella agreement with a series of bilateral agreements. Some groups may have regional service agreements and/or agreements per Business Unit. We therefore suggest that the guidance should read “written contracts or agreements concerning the taxpayer, to the extent available”.

12 Practical implementation

61. In addition to the above, we would welcome clarification of how the OECD intends to implement the proposed mechanism: will amendments to domestic laws be needed? Will a multilateral instrument be used?

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8 "In cases where it is appropriate to use a mark up, this will normally be modest and experience shows that typically agreed mark ups fall within a range of 3-10%, often around 5%. However that statement is subject to the facts and circumstances that may support a different mark up". Ibid.
The IAPT thanks the OECD for this opportunity to comment and would welcome the possibility to speak at the public consultation.
ICAEW welcomes the opportunity to comment on the Public Discussion Draft *BEPS Action 10: Proposed modifications to Chapter VII of the transfer pricing guidelines relating to low value-adding intra-group services* published by OECD on 3 November 2014.

This response of 14 January 2015 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty’s Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.
ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW’s regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 142,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

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icaew.com
1. In paragraph 7.47 we think that “purchasing activities” should be added to the list of activities considered as qualifying for the simplified approach outlined.

2. In paragraph 7.48 there should be some recognition that the legal services mentioned may not all be of a routine nature and so “low value-adding”.

3. We consider that the proposed mark-up in paragraph D.2.3, in the range of 2% to 5%, is reasonable and agrees with the views of our business members as to what is an appropriate mark up.

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APPENDIX 1

ICAEW TAX FACULTY’S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person’s tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see icaew.com/en/technical/tax-tax-faculty/-/media/Files/Technical/Tax/Tax%20news/TaxGuides/TAXGUIDE-4-99-Towards-a-Better-tax-system.ashx)
Comments to the OECD Discussion Draft on BEPS Action 10:
“Proposed modifications to Chapter VII of the transfer pricing guidelines relating to low value-adding intra-group services”

The International Chamber of Commerce (ICC), as the world business organization speaking with authority on behalf of enterprises from all sectors in every part of the world, welcomes the opportunity to provide comments on the Discussion Draft regarding BEPS Action 10 to modify the transfer pricing guidelines relating to low value-adding intra-group services. Many multinational enterprises (MNEs) choose to centralise or regionalise activities for reasons of commercial efficiency, and this inevitably leads to a need to recover costs cross border. ICC therefore welcomes modifications to the transfer pricing guidelines where this will enhance certainty and clarity for taxpayers and tax administrations alike.

No commercial business incurs an expense solely for the purpose of obtaining a tax deduction, as it is a poor strategy returning less than the amount of the initial outlay. For that reason no business would deliberately set out to duplicate costs. On the contrary most multinational businesses need to remain competitive, and are therefore very focussed on reducing costs in real terms year on year through productivity improvements in their supply chain and support costs. For these reasons we believe that:

1. The risk of duplicative costs is low.
2. The risk that an activity would be undertaken that is not needed is also low, with a corresponding impact on the risk that benefits have not been provided.

In ICC’s view the key practical challenge facing a taxpayer is to ensure that the costs are properly recharged to the operating businesses that have benefitted overall from the business expenditure. If the expense is a valid business expense, in principle it seems fair that such costs should be able to be recharged and should be able to be deducted considering it is implicit in the arm's length standard that there are two parties to every transaction, and that therefore both the income and the expense are within the charge to tax.

ICC believes that it would be helpful at the beginning of section B to explicitly recognise that a business will not generally incur an expense unless it is necessary, and that due to competition the majority of businesses operate continuous business improvement programmes in order to become more efficient. This is important context in which the benefits test should be evaluated and whether the services being provided are duplicative.

Paragraph 7.12 on duplication does not mention the fact that in a regulated industry such as banking, local regulatory requirements have a strong influence on how certain support functions are organised. Even where branches and subsidiaries are subject to consolidated supervision by the home regulator, local regulators will still expect to see controlling and reporting functions such as compliance, finance, risk and internal audit performed in country. This may result in some inevitable duplication of the control functions.

ICC welcomes the acknowledgement that MNEs may have few alternatives but to use cost allocation and apportionment methods. In practice some tax authorities still expect to audit to the level of individual third party invoices based on the idea of a direct one to one service relationship. We recommend that paragraph 7.27 is strengthened to make it clear that the indirect nature of the service provision should not be a reason by itself for the expense to be denied.

ICC welcomes the opportunity provided by the simplified charge mechanism set out in D.2 to reduce the tax compliance burden for both taxpayers and tax administrations for what should be a low risk area in tax audits. In particular we welcome the comments at D.2.5 which make clear how the benefits test is to be applied in connection with low value-adding services, as this is often one of the most difficult problems...
experienced by taxpayers in practice seeking to recover costs incurred and to avoid double taxation.

However there are still two common scenarios where double taxation is incurred and which will not be helped by the discussion paper:

1. Even where all the requirements are satisfied, there are a number of countries that impose absolute limits on the amount of services recharged by foreign affiliates – whether low value-adding or not – generally by reference to a percentage of sales. Clearly, this penalises MNE taxpayers that operate a highly centralised business model compared with other MNE taxpayers and compared with domestic taxpayers. Moreover ICC understands that the Discussion Draft does not represent a consensus view and urges member states to reach agreement to reduce double taxation on the issues described. Similarly, ICC encourages the OECD to engage with non-OECD members to obtain further commitment on a common treatment.

2. High withholding taxes (where the services are sourced outside of the country levying the withholding taxes) or irrecoverable indirect taxes levied on the gross amount of services recharged by foreign affiliates may mean that in the case of low value-adding services with a mark-up on costs in the range of 2-5% there may be a net cost to the taxpayer for making the recharge.

In the case of a mark-up on costs of 2-5% applied to an appropriate cost base, it is clear that eroding the tax base to take advantage of differences in corporate income tax rates is not the primary motivation.

The proposal requires that all costs related to providing low-value adding services incurred by any members of the group are pooled, before being allocated to group members. In practical terms, this would have a severe impact on certain taxpayers as it appears that complex allocation processes would have to be combined. In practice, the same result would be achieved if the teams responsible for both sets of charges were simply to apply the same cost mark-up to their low-value adding services. It would be helpful if taxpayers were given the option to set up sub-pools where different categories of costs are handled by different parts of the organization. Furthermore, the proposal should make it clear that there is no requirement for a mark-up to be applied to pass through costs.

In case of divestments it may take some time to reduce the group low value-adding services, e.g. due to legal restraints to laying-off people, etc. Thus, while the charge-out basis is reduced at the time of the divestment, the level of the costs related to low value-adding services is reduced later on. It is important for the taxpayer that also these temporarily higher costs regarding low value-adding services can be deducted from the tax base, in order to prevent double taxation.

Regarding paragraph 7.61 on documentation, it would be helpful if the final version would refer to the paper on Action 13 (i.e. whether this information should be included in the Master File or Local File).

ICC believes that removing these specific impediments and permitting businesses to centralise low value-adding services in the location where it makes most commercial sense (without concerns about double taxation) would make a more positive contribution to global economic growth.

ICC also recommends that the following aspects be covered by OECD in BEPS Action 10:

a) The range of mark-ups could be from 0%-5% to allow for those industry sectors where the charging of a mark-up may not be permitted (e.g. some production sharing arrangements) or where the tax payer is using a 0% mark-up in compliance with the country’s cost sharing regulations.

b) The draft guidelines tend to address simplification measures largely from a service provider’s perspective. More emphasis should also be given to respecting the election of the simplification measure from the perspective of the service recipient; or the low value-adding intra-group services should be made part of a bilateral safe-harbour.
The International Chamber of Commerce (ICC) Commission on Taxation

ICC is the world business organization, whose mission is to promote open trade and investment and help business meet the challenges and opportunities of an increasingly integrated world economy. Founded in 1919, and with interests spanning every sector of private enterprise, ICC’s global network comprises over 6 million companies, chambers of commerce and business associations in more than 130 countries. ICC members work through national committees in their countries to address business concerns and convey ICC views to their respective governments.

The fundamental mission of ICC is to promote open international trade and investment and help business meet the challenges and opportunities of globalization. ICC conveys international business views and priorities through active engagement with the United Nations, the World Trade Organization, the Organisation for Economic Co-Operation and Development (OECD), the G20 and other intergovernmental forums.

The ICC Commission on Taxation promotes transparent and non-discriminatory treatment of foreign investment and earnings that eliminates tax obstacles to cross-border trade and investment. The Commission is composed of more than 150 tax experts from companies and business associations in approximately 40 countries from different regions of the world and all economic sectors. It analyses developments in international fiscal policy and legislation and puts forward business views on government and intergovernmental projects affecting taxation. Observers include representatives of the International Fiscal Association (IFA), International Bar Association (IBA), Business and Industry Advisory Committee to the OECD (BIAC), Business Europe and the United Nations Committee of Experts on International Cooperation in Tax Matters.
Via e-mail
transferpricing@oecd.org
Mr. Andrew Hickman
Head of Transfer Pricing unit
Centre for Tax Policy and Administration

Dear Mr. Hickman,


1) Comments to paragraph 7.9

7.9 Some intra-group services are performed by one member of an MNE group to meet an identified need of one or more specific members of the group. In such case, it is relatively straightforward to determine whether a service has been provided. Ordinarily an independent enterprise in comparable circumstances would have satisfied the identified need either by performing the activity in-house or by having the activity performed by a third party. Thus, in such a case, an intra-group service ordinarily would be found to exist. For example, an intra-group service would normally be found where an associated enterprise repairs equipment used in manufacturing by another member of the MNE group.”

Paragraph 7.9 provides as a general principle that in order to consider that the intra-group service has been rendered, it is necessary to analyze whether an independent third party would have been willing to pay for such service and 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 specific, paragraph 7.9 establishes that an intra-group service is rendered when an independent enterprise in a comparable circumstance is willing to perform the service in-house or by having the activity performed by a third party.

In this sense, it is important to mention that in such cases some intra-group services may be difficult to prove its effective render under this basis, due to the fact that some services that are rendered between related parties may be unique and no independent party will be willing to perform them in-house or by having evidence that a third party is performing them.
In relation with the abovementioned, paragraph 1.11 of the OECD Transfer Pricing Guidelines establishes the following:

1.11 A practical difficulty in applying the arm’s length principle is that associated enterprises may engage in transactions that independent enterprises would not undertake. Such transactions may not necessarily be motivated by tax avoidance but may occur because in transacting business with each other, members of an MNE group face different commercial circumstances than would independent enterprises. Where independent enterprises seldom undertake transactions of the type entered into by associated enterprises, the arm’s length principle is difficult to apply because there is little or no direct evidence of what conditions would have been established by independent enterprises. The mere fact that a transaction may not be found between independent parties does not of itself mean that it is not arm’s length.

We suggest to clearly establish in the document that the tax administrations must presume, except if there is proof on the contrary, (i) that the service or activity has effectively been rendered and (ii) that said activity or service that has been paid for, provides economic or commercial value to enhance or maintain its commercial position in a general and broad sense.

In addition to this presumption (principle) in favor of the taxpayer, the administrations must apply this interpretation so that this fundamental principle is not deteriorated. That is, the document must clearly include a wording in favor of the previously indicated principle because if it is not applied as indicated in the Guidelines or tax authorities include specific exceptions, it will be impossible in certain tax jurisdictions to record a deductible expense for intra-group services that were truly rendered if the compensation was establish by using an indirect-charge method or “pro-ratio” due to the nature of the service being provided and the costs and expenses incurred in the rendition of said service.

2) Comments to paragraph 7.14

7.14 Similarly, an associated enterprise should not be considered to receive an intra-group service when it obtains incidental benefits attributable solely to its being part of a larger concern, and not to any specific activity being performed. For example, no service would be received where an associated enterprise by reason of its affiliation alone has a credit-rating higher than it would if it were unaffiliated, but an intra-group service would usually exist where the higher credit rating were due to a guarantee by another group member, or where the enterprise benefitted from the group’s reputation deriving from global marketing and public relations campaigns. In this respect, 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. Each case must be determined according to its own facts and circumstances.

Paragraph 7.14 provides as a general rule that an associated enterprise should not be considered to receive an intra-group service when an incidental benefit attributable solely to its being part of a large concern, and not to any specific activity being performed, is obtained.

It continues by mentioning an example where an intra-group service is rendered when an enterprise is benefitted from the group’s reputation deriving from global marketing and public relations campaigns.

In this sense, the incidental benefit that an enterprise might obtain by its solely association with a certain group should not be considered as an intra-group service. Any royalty payments or marketing expenses incurred by the affiliates should be analyzed as separate related party transactions.

As paragraph 7.9 establishes, 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, as well as the fact that each case must be determined according to its own facts and circumstances.

Therefore, we suggest OECD reviewing this example as an incidental benefit or clarifying the context of such case.

3) Comments to paragraph 7.16

7.16 In considering whether a charge for the provision of services would be made between independent enterprises, it would also be relevant to consider the form that an arm’s length consideration would take had the transaction occurred between independent enterprises dealing at arm’s length. For example, in respect of financial services such as loans, foreign exchange and hedging, all of the remuneration may be built into the spread and it would not be appropriate to expect a further service fee to be charged if such were the case. Similarly, in some buying or procurement services a commission element may be incorporated in the price of the product or services procured, and a separate service fee may not be appropriate.

Paragraph 7.16 provides that it would be relevant to consider the form that remuneration is established between independent parties in order to assure the arm’s length nature of the remuneration that associated parties should establish for the provision of services.

It continues by mentioning an example where the building of the remuneration in the provision of financial services and buying or procurement
services should be based on the form that remunerations established between independent parties is built.

In this sense, independent parties may engage in transactions that establish different ways of remunerations from the transactions carried out between associated parties. Such cases may respond to different economic circumstances that might drive the entities to follow certain way of remuneration or another.

Specifically for purchases or procurement services, related parties may determine the consideration as incorporated in the price of the products or as a service commission, as applicable. Therefore, we suggest adjusting the example, or clarify that the remuneration that associated enterprises might establish for the provision of services must be determined according to its own facts and circumstances.

4) Comments to paragraph 7.31

7.31 In trying to determine the arm’s length price in relation to intra-group services, the matter should be considered both from the perspective of the service provider and from the perspective of the recipient of the service. In this respect, relevant considerations include the value of the service to the recipient and how much a comparable independent enterprise would be prepared to pay for that service in comparable circumstances, as well as the costs to the service provider.

Paragraph 7.31 provides that the analysis of the arm’s length compensation must consider the perspective of the service provider and the perspective of the recipient of the service, as well as some other relevant considerations that include the value of the service to the recipient and the costs of the service provider.

In transactions between independent parties it is not possible to have information from both, the service provider and the recipient so this kind of information should not be mandatory for testing related party transactions. Also, in general it is very difficult for affiliates to obtain information from the related service provider.

Thus, recommendation to access service provider information could probably be limited to past-through costs only where CUP methodology is used to prove compliance with arm’s length principle.

Of course, affiliates should be encouraged to make their best efforts to request and obtain the information but the effective obtaining of all foreign information the tax authorities may request to the taxpayer should not be a requirement for the deduction of the service.
It is important to consider that more often than not service providers might consider for their billing process cost pools comprised of (i) actual figures corresponding to expenses incurred from X to Y months and (ii) estimated figures for the last months of the year. Authorities need to consider that true-ups might be done in future periods and be flexible when reviewing the information used by the service provider for its billing process. In other words, it is important to encourage tax administrations to consider estimated figures as valid when reasonable or proven close to actual or final ones.

Therefore, we suggest that in order to calculate an arm’s length consideration for the services provision between associated entities, applicable transfer pricing methods should be considered, and any specific information to be requested by the tax authorities related to a foreign based related party should be requested through the applicable procedures for exchange of information between competent authorities.

Additionally it is our opinion that alternative approaches could be explored in terms of (i) agreed consideration between related parties (i.e agree on a fixed fee as third parties may in some cases do, rather than entering into the complexity of allocating costs and determining the most appropriate allocation key which could likely be subject to several interpretations on appropriateness) and; thus, (ii) documenting compliance with arm’s length principle potentially considering the service recipient’s perspective as tested party by testing its results, with the overall results of similar enterprises in comparable conditions.

5) Comments to Section D. Low value-adding intra-group services

We do believe the information included in the Action 10 of the BEPS Action Plan –“Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services” regarding low value –adding intra-group services is focused to try to simplify the administrative burden and analysis of some kind of related party services, although at this stage the guidelines are complicated for its application since all the information mentioned therein is not fully available or at hand for affiliates of the MNE’s.

Regarding the simplified determination of arm’s length charges for low value-adding intra-group services section, such section sets out the elements of a simplified charge mechanism for low value-adding intra-group services. Such simplified method has to be applied on a consistent, group wide basis in all countries in which the company operates.

In this sense, the requirements that the document establish in order to follow the simplified method are excessive and unduly onerous, which transform the methodology into a complicated one rather than to simplify it.
Also, the documentation does not provide a plenty identification of the services considered as low value-adding intra-group services for which the mark-up within the 2% to 5% range should be applied. This is, it could be worth including a “white” list and a “black” list of services that could be used or not for the 2% to 5% safe harbour of net cost plus mark-up.

This simplification should qualify to the kind of service engaged by the related parties. Allocation of costs or cost sharing agreements should be analyzed separately under general guidelines also included in Chapter VII.

* * *

The participation of IFA Grupo Mexicano, A.C. is made on its own behalf exclusively as an IFA Branch, and in no case in name or on behalf of Central IFA or IFA as a whole.

We hope you find these comments interesting and useful. We remain yours for any questions or comments you may have.

Sincerely,

IFA Grupo Mexicano A.C.
Response to OECD Discussion Draft: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services

January 2015
About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland’s AITI Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax. Our members provide tax expertise to thousands of businesses and individuals in Ireland and internationally. In addition many hold senior roles within professional service firms, global companies, Government, Revenue and state bodies.

The Institute is the leading provider of tax qualifications in Ireland, educating the finest minds in tax and business for over thirty years. Our AITI Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice.

A respected body on tax policy and administration, the Institute engages at the most senior levels across Government, business and state organisations. Representing the views and expertise of its members, it plays an important role in the fiscal and tax administrative discussions and decisions in Ireland and in the EU.
Irish Tax Institute response

The Irish Tax Institute is writing in response to the Discussion Draft on the Transfer Pricing Guidelines related to Low Value-Adding Services, which the OECD released on 3 November 2014. We prepared this submission with consideration and input from a number of our members. For ease of reference, we structured this response in the following way:

Section A – Background
Section B – Acknowledgements
Section C – Comments on the Simplified Method
Section D – Comments on Shareholder Activities and Other Costs

Section A: Background

It is recognised that in some jurisdictions management fees and head office expenses may be viewed as base eroding payments. Chapter VII of the OECD Transfer Pricing Guidelines addresses the principles to identify, price and document many forms of intra-group services, including management or head office services.

In an effort to balance the need to charge for low value adding services while protecting the tax base of payor countries, the Discussion Draft is suggesting a simplified approach to:

(i) identify categories of intra-group services that are low value-adding,
(ii) apply consistent allocation keys for all recipients, and
(iii) require adequate reporting through documentation and allocation of cost pools (collectively the Simplified Method).

The Simplified Method is suggested to be applied in certain circumstances of services, to require a limited mark-up between 2 and 5 percent, and is to reduce the administrative burden to multinationals electing into the Simplified Method.

Section B: Acknowledgements

The Discussion Draft incorporates numerous helpful changes to improve the ability for Irish MNEs to be compliant with transfer pricing obligations in Ireland and abroad. We support the work by the OECD to simplify the transfer pricing obligations for this frequent yet less complex group of intercompany transactions. In particular, we welcome these additions:

1. Proposing simplification measures to price and document low value-adding services including:
   • Examples of low value-adding services.
   • Services that cannot qualify for the Simplified Method.
   • Documentation and information that satisfies the Simplified Method.
2. Further examples of shareholder activities.
Section C: Comments on the Simplified Method

The introduction of a new approach for low value-adding services is a positive step in the right direction for both MNEs and tax administrations. We provide the following comments and suggestions to enhance the Simplified Method for the Irish business community.

1. **Widespread adoption** – The Discussion Draft notes that this guidance document does not represent a consensus view of the OECD members. Incomplete acceptance of the Simplified Method will limit the intended benefit of the guidance. Projects by the OECD to effect safe harbour mechanisms, in the context of Chapter IV of the Guidelines, could be revisited for this purpose. The OECD should consider drafting a sample Memorandum of Understanding (MOU) for its member states to adopt. MOUs would provide MNEs additional certainty in choosing to apply the Simplified Method.

Because it is unlikely that every country will adopt the Simplified Method, the OECD should grant flexibility to price low value-adding services using the Simplified Method and other approaches, as appropriate. We would welcome the OECD explicitly stating that: (i) not all costs need to be included, and (ii) not all group affiliates must be charged under this method.

There are many instances where it would be not be appropriate or practical for all affiliates to be charged. For example, MNEs often comprise affiliates not wholly-owned by the parent. Other interests in such affiliates can present obstacles to charging an arm’s length price for low value-adding services, amongst other transactions. It would be burdensome to MNEs in Ireland to be expected to allocate costs of low value-adding services to all affiliates in these circumstances.

2. **Documentation standards** – There is overlap amongst the various BEPS Actions. We would welcome confirmation that documentation satisfying the Simplified Method per D.3 of the Discussion Draft would replace the documentation requirements from Master or Local Country File per BEPS Action 13.

3. **Cost-only allocation** – It would be helpful and consistent with some existing transfer pricing rules by OECD member countries to make the application of a mark-up (per paragraph 7.57) elective to MNEs in many instances. We would welcome the notion of a safe harbour being an acceptable mark-up of 5 percent or less (including no mark-up). Safe harbours like this are valued approaches to provide certainty to taxpayers and to efficiently make use of limited tax authority resources.

However, we do not maintain that a cost recovery (no mark-up) is appropriate for the provision of all low value-adding services. For example, we would recommend a mark-up of 5 percent or less is required for an entity whose sole activity is the provision of low value-adding services within an MNE.

Additionally, section D.2.4 of the Discussion Draft should refer to paragraph 7.36 (treatment of pass-through costs) to present a consistent approach to the treatment of costs of activities performed by third parties, i.e. no mark-up should apply.
4. **Arm’s length expense** – Invoices for low value-adding services priced on a cost-plus method should be treated as if the services were performed by an independent party. That is, tax authorities should be permitted to review the underlying costs to attest accuracy but be guided against ‘looking through’ to the underlying expenses of the service provider in order to evaluate the expenses’ deductibility in the local country.

Specific expenses amongst a pool of services costs should only be assessed for deductibility in the country where the original expense was incurred. Otherwise, the same underlying expense may be deemed not deductible in multiple jurisdictions. For example, domestic tax law may restrict deductibility of meals and entertaining costs, e.g. only half the cost is deductible in some countries. If meals and entertaining costs were included in a low value-adding services cost allocation, it would contradict the arm’s length principle if the tax authority in the payor country were to apply local deductibility rules to the same expenses when part of a cost allocation.

5. **Adoption** – Business may be hesitant to implement the Simplified Method if the result is different from existing practice to charge for such services. We would welcome guidance that, as an elective method, the Simplified Method should not be applied at the discretion of tax authorities when the MNE has applied another arm’s length method to a prior fiscal period.

6. **Consideration for smaller business** – Although Ireland and other countries exempt SMEs from transfer pricing rules, many jurisdictions in which Irish companies conduct business do not exempt SMEs from transfer pricing rules or documentation requirements. To ease the burden on SMEs, the Discussion Draft could suggest further measures for the benefit of SMEs, e.g. in Section D.2.2, allow in such circumstances a single allocation key to apply to a bundle of services cost in place of a specific key for each service.

**Section D: Comment toward Shareholder Activities and Other Costs**

1. **Guidance on shareholder activities** – While we welcome additional examples in paragraph 7.11, detailed guidance is needed on commonly disputed activities and what does *not* constitute a shareholder activity. Activities that are an obligation of a publicly listed company, e.g. internal controls, do provide a benefit to affiliates of a parent company. However, the allocation of costs incurred are often scrutinised by virtue of the activities’ connection to the public nature of the MNE.

2. **Costing of shareholder activities** - A common challenge in this area is identifying costs attributable to shareholder activities from the departments that perform shareholder activities amongst other activities. Allocation keys cited in the Discussion Draft solely address beneficial services and rely on objective data, such as headcount. It would be helpful to provide specific guidance on how to apportion costs related to shareholder activities and to recognise the use of subjective allocation keys. For instance, we would appreciate the Discussion Draft advocate a time-spent allocation key as one acceptable approach to determine costs attributable to shareholder activity.
3. **Hypothetical cost adjustment** – MNEs make decisions to incur/bear cost of services and hire employees absent a tax motivation. The revised language in paragraph 7.35 suggests it may be appropriate to adjust the cost of the services actually rendered to account for the hypothetical cost of a recipient performing the services itself. This new requirement will place an undue burden on MNEs to evaluate its services cost allocations, and likely result in a large number of disputes amongst tax authorities. It would be preferable that Chapter VII is written to suggest tax authorities respect business judgement on how and where cost of services are borne, and not compare to the hypothetical scenario of services costs incurred locally.
14th January 2015

Andrew Hickman  
Head of Transfer Pricing Unit,  
Centre for Tax Policy and Administration, OECD, Paris  

For e-mail transmission to: TransferPricing@oecd.org  

Dear Mr Hickman,

Discussion Draft, BEPS Action 10, Proposed modifications to Chapter VII of the Transfer Pricing Guidelines relating to low value-adding intra-group services

Thank you for inviting comments on the above Discussion Draft, issued on 3rd November 2014. We appreciate the opportunity to provide input and will focus on the questions which are of particular relevance to our members and to the insurance industry in general.

The International Underwriting Association of London (IUA) represents international and wholesale insurance and reinsurance companies operating in or through London. Its purpose is to promote and enhance the business environment for its members. We estimate that premium income for the London company market in 2013 was some £24bn.

In general, we very much welcome the proposed revisions to Chapter VII, as disputes around management charges take up a significant amount of time and resource on tax audit and can lead to double taxation: the tax authority in the country providing the services wants to charge out as much as possible and the tax authority in the recipient country seeks to deny a deduction for any part of the cost which it deems to be excessive. The clear guidance and safe harbours detailed in the Draft should help to reduce time and resource spent on disputes by both tax administrations and taxpayers.

We support the proposal to make it an elective regime, as that does allow for some flexibility for groups for which the option may not be of benefit.

We are unclear about how the rules are intended to operate for a group in the event that there is disparity over the interpretation of the rules for the provision of low value-adding services (LVAS) between companies in two jurisdictions – for example, if one is in an OECD country which adopts the proposals and one is in a non-OECD country which is not adopting the proposals.

The differences between shareholder costs and stewardship costs are understood and well acknowledged. However, the document seems to seek to redefine the explanation of shareholder costs. It would be helpful to have some further guidance, as there seem to be a number of grey areas which will be difficult to apply in practice. Additionally, the document appears to intend that stewardship costs can/would be treated as LVAS, but it would be greatly appreciated if that could be explicitly clarified.
A proposed methodology with steps 1, 2 and 3 is outlined at D2 in determining the cost pools. It is helpful
to note that there is an expectation that the methodology, once set, would not need to be proved year on
year if the business model remains broadly steady. That is positive and should be retained in the final set
of regulations.

The document suggests that no benchmarking is required to prove or justify the mark-up chosen between
2% and 5% for LVAS. We would be grateful for some clarification of what the expected position may be if
a group has elected into the regime, but, say, one country believes the correct mark-up should be 5% and
the other country believes it should be 2%. The taxpayer could be caught out by a lack of clarity over the
percentages to be applied to its entities in those jurisdictions, which could result in double taxation.
Perhaps the rules could include a requirement to the effect that that the company making the recharge
should set the percentage and, provided it is within the range (which should then be referred to as a “safe
harbour”), then the payer company has to accept it.

One concern we have relates to the new wording in paragraph 7.35, which seems to move away from the
arm’s length principle. It suggests that, when the transaction is being priced, in some cases, it may be
appropriate to take account of the costs that would hypothetically be incurred by the recipient were it to
perform the service for itself. That is an unusual requirement, particularly as in many instances, it is simply
not possible even to hypothesise what such costs may be, since the entity in question is not in a position to
provide such services. It is accepted elsewhere in the guidance that MNEs choose to centralise certain
services in the group for reasons of efficiency and control. If those services were to be provided by every
individual local entity, costs for the MNE would increase substantially and control would be diminished.
The decision to centralise services should be respected and the actual costs incurred in the central entity
should be taken into account in the pricing of the transaction.

Lastly, we are grateful for the opportunity to comment on changes proposed and we welcome the move
towards simplification.

We hope you will find this submission helpful and would be happy to provide you with further comments.

Yours sincerely,

Nick Lowe
Director of Government Affairs
Mr. Andrew Hickman,
Head of Transfer Pricing Unit,
Centre for Tax Policy and Administration
Organisation for Economic Cooperation and Development

Accounting & Tax Committee
Japan Foreign Trade Council, Inc.

Comments on Discussion draft on
Action 10 (the Proposed Modifications to Chapter VII of the TP Guidelines
Relating to Low Value-Adding IGS) of the BEPS Action Plan

The following are the comments of the Accounting & Tax Committee of the Japan
Foreign Trade Council, Inc. (JFTC) in response to the invitation to public
comments by the OECD regarding the “BEPS Action 10: the Proposed
Modifications to Chapter VII of the TP Guidelines Relating to Low Value-Adding
IGS”.

The JFTC is a trade-industry association with Japanese trading companies and
trading organizations as its core members. One of the main activities of JFTC’s
Accounting & Tax Committee is to submit specific policy proposals and requests
concerning tax matters. Member companies of the JFTC Accounting & Tax
Committee are listed at the end of this document.

General Comments

1. The purpose of the Discussion Draft proposed by OECD is to define low
value-adding Intra Group Service (IGS), and to achieve the necessary balance
between the simplification of the calculation of appropriate charges for low
value-adding IGS and the need to protect the tax base of payor countries. We
are in basic agreement with the direction of this proposal.

2. In order to apply this proposal to entire MNE groups, we believe it is essential
to have the full support of all related payor and payee countries, including
non-OECD states.
3. We request clarification on how Action 10 relates to Action 13 (such as, does Action 13 transfer pricing documentation apply to IGS related documentation determined in this discussion draft).

Specific Issues

**Paragraph 7.15**

It is problematic to view all “Centralised Services” as constituting IGS. These include activities pertaining to the organizational structure of MNE groups that are performed for the parent company and by sole decision of the parent company without the consent or approval of group members. Member companies would not willingly pay compensation for these activities, or would not undertake these services for their own benefit.

**Paragraph 7.47**

For example, it is not appropriate to deem all services of corporate senior management to not qualify for the simplified approach merely due to the formality that the services are provided by corporate senior management.

**Paragraph 7.51**

The paragraph states, “simplified method would apply it on a consistent, group wide basis in all countries in which it operates.” However, in reality, there are various regulatory issues in certain countries such as remittances restrictions. Moreover, some countries may not adopt Action 10 proposals and that collection of IGS fees may not be possible. With these issues in mind, the paragraph should be re-worded to state, “simplified method would apply it on a consistent, group wide basis in all countries in which it operates and the method is accepted in line with the OECD recommendation.”

**Paragraph 7.52**
In calculating cost pools, the basis of categorization should not be limited to type of services. Other reasonable methods should be allowed, such as categorization by companies providing the services.

Regarding factors to be included in cost of IGS provided (such as, are only direct costs included), clarification should be given in the commentary or by other means to avoid differences in the understanding between the tax administrations and taxpayers.

**Paragraph 7.57**

- Based on cost-plus method, a mark-up of no less than 2 percent and no greater than 5 percent is proposed for low value-adding IGS. We request that clearer guidance be given on the background and application of the mark-up rates.

- Regarding the mark-up on low value-adding IGS set within the range of no less than 2 percent and no greater than 5 percent, we request clarification on whether this range can be considered to be a safe harbor that is free of the risk of tax audit adjustments.

- Paragraph 7.36 allows zero mark-up (that is, related costs only) in certain cases. On the other hand, Paragraph 7.57 stipulates a mark-up range. The consistency between the two paragraphs should be considered.

**Paragraph 7.60**

The paragraph states that documentation and reporting discussed should provide sufficient evidence that the benefits test is met for low value-adding IGS. In light of the nature of low value-adding IGS, we request that due consideration be given to the administrative efficiency such as administrative costs.

**Paragraph 7.61**

- Companies electing to apply the simplified methodology are required to prepare documentation and to make it available upon request to the relevant tax administration. However, there are certain difficulties to prove the link between
amounts received and benefits. Moreover, it can be assumed that the administrative cost of responding to the requests of tax administration, including the cost of documentation, would be very large compared to the actual amounts received. For this reason, we request that due consideration be given to efficiency and that mention be made of the balance with administrative costs. We also request the inclusion of a stipulation that, related information and documentation are to be submitted to the tax administration with jurisdiction over the country of residence of the IGS receiving company (the parent company) in compliance with information exchange agreements between the tax authorities.
Japan Foreign Trade Council, Inc.

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Sojitz Corporation
Sumitomo Corporation
Toyota Tsusho Corporation
Yuasa Trading Co., Ltd.
To: Andrew Hickman
   Head of Transfer Pricing Unit,
   Centre for Tax Policy and Administration, OECD

From: KPMG’s Global Transfer Pricing Services professionals

cc: Clark Chandler, KPMG in the U.S.

Date: January 15, 2015

Ref: Comments to the OECD: BEPS Action 10 – Proposed Modifications to Chapter VII and Low Value-Adding Intra-Group Services

Professionals in the Global Transfer Pricing Services practice of KPMG welcome the opportunity to comment on the OECD’s Discussion Draft titled “BEPS ACTION 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines relating to Low Value-Adding Intra-Group Services” (“Discussion Draft”). KPMG commends the OECD for providing additional guidance around services and especially for providing guidance for a simplified elective approach.

In this regard, KPMG’s comments are focused on the following key areas:

1) Sections A through C in Chapter VII of the OECD Guidelines (paragraphs 7.1 through 7.44); and
2) Section D in Chapter VII of the OECD Guidelines (paragraphs 7.45 through 7.61) (“Low Value-Adding Services Section”).

Sections A through C of Chapter VII

We recognize that many intercompany services are quite specific to each multinational enterprise (“MNE”) and providing general comments could be very difficult. It would be very helpful, however, if the benefits test guidance (Paragraphs 7.7 through 7.9) in the OECD Guidelines included examples of what i) taxpayers should provide to demonstrate that the benefits test has been met, and/or (2) tax authorities should request to confirm that the service was rendered. This would be especially helpful since there is not a consistent approach across tax authorities as to what they request under audit to prove that the benefits test has been met.

The OECD has proposed to add examples of shareholder and duplicative activities (Paragraphs 7.11 and 7.12), which still maintains the relatively narrow definition of shareholder and duplicative costs in the existing guidelines. The additions, however, are helpful examples for MNEs.

In Paragraph 7.35, the OECD has proposed to add the following language “In some cases, the costs that would hypothetically be incurred by the recipient were it to perform the service for itself may be instructive of the type of arrangement a recipient would be prepared to accept for the actual service.” when applying a cost plus method. The added language could be used by tax authorities especially in low-cost jurisdictions to challenge the pricing of services provided by entities in high-cost jurisdiction. This potential consequence could make it difficult for MNEs to charge out intercompany services and it could also lead to additional mutual agreement procedures (“MAP”)
Even though underlying costs are available, we recommend that tax authorities should treat intercompany services invoices/charges as if it were issued by a third party. Specifically, it would be helpful if the OECD recommended that individual tax authorities should not apply domestic deductibility tests to individual costs (e.g. share-based compensation, depreciation, meals & entertainment, etc.).

**Sections D of Chapter VII**

The proposed simplified method for low value-adding intra-group services, if widely adopted, could significantly mitigate compliance costs of some MNEs. Some tax authorities currently request detailed documentation of services received in order to support a deduction. To the extent the proposed simplified method reduced or eliminated such requests for low value-adding services, the costs of compliance in such cases would be mitigated. Furthermore, KPMG believes that this Discussion Draft accurately reflects the fact that low value-adding services should be treated in a way that allows taxpayers to comply with the expectations of tax authorities but that there should be no need for an extensive and costly analysis of low value-adding services charges. Thus, KPMG commends the OECD for putting forth such a recommendation. For this to be meaningful though, many countries will need to adopt this guidance.

Below we provide some additional comments on Section D for low value-adding intra-group services.

1. KPMG believes that it is important for the simplified method for low value-adding intra-group services to be elective, like the OECD has recommended.

2. KPMG was very encouraged to see the recommendation of the “presumed benefit test” for low value-adding intra-group services, if certain documentation and reporting requirements are met (Paragraph 7.60). This is one of the most critical recommendations included in the Discussion Draft.

3. The Discussion Draft includes guidance as to what services are not eligible for the simplified approach and provides examples of services that “would likely” meet the definition of low value-adding services (Paragraphs 7.47 and 7.48). It would be helpful if there was a more explicit list of services that potentially qualify as low value-adding (similar to list for the Services Cost Method (“SCM”) in the U.S. transfer pricing service regulations).

4. It may be helpful for a profit mark-up on low value-adding intra-group services to be elective and therefore, permitting a fully loaded cost recovery approach. This would align with jurisdictions that already have such services safe harbors (e.g., United States and the SCM).

5. KPMG recommends that the language in Section D for low value-adding services link to
commentary on the OECD’s initiative for safe harbors (Section E in Chapter IV of the OECD Guidelines).

6. Paragraph 7.51 requires an MNE group electing to adopt this simplified method to apply it on a consistent, group wide basis in all countries in which it operates. It may be difficult for many MNEs to gather all this information consistently on a group wide basis and based on the current wording it may preclude MNEs from using the simplified approach. For example, what if one service provider out of many within the MNE can’t provide the necessary data to be eligible for the simplified method? Does this mean that the other service providers within the MNE cannot use this simplified method for low value-adding services? Thus it may be helpful to allow MNEs to apply the simplified approach consistent on a group wide basis, as far as reasonably possible.

About KPMG

KPMG is a global network of professional firms providing Audit, Tax and Advisory services. We operate in 155 countries and have more than 162,000 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.
Centre for Tax Policy and Administration
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2 rue André Pascal
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To the attention of Andrew Hickman
Head of Transfer Pricing Unit

Via e-mail TransferPricing@oecd.org

Dear Sirs,


I am pleased to respond to the OECD’s request for comments on this discussion draft.

In addition, I would welcome an opportunity to speak in support of these comments at the public consultation meeting on Action 10 Discussion Draft scheduled for March 20-21, 2015 in Paris.

Respectfully submitted,

Laurence Delorme
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INTRODUCTORY COMMENTS

BEPS action plan was directed to "protection against common types of base eroding payments, such as management fees and head-office expenses".

While it is true that management fees and head office expenses have historically proven to be (and still are) an easy target for tax adjustments upon audit by tax administrations, the preliminary assumption that these intra group service charges are used as a tool by MNEs for BEPS reflects tax authorities views only.

For businesses, the key issue is to obtain a tax deduction (once, but only once) for bona fide business expenses, either at head-office level (shareholder costs) or at operating subsidiary level (through management fees and head-office expenses charged to the various subsidiaries benefiting from the centralized/shared services).

With the globalization of MNEs and the increased centralization of various functions at regional or global level, intra group services flows are getting much more complex and amounts at stake may be very significant relative to local subsidiaries expenses.

However, the crucial issue remains basically the same, i.e. ensuring that the costs associated to these centralized/shared services get tax deducted (i) where the services are received, or (ii) for the remaining part corresponding to shareholder activities, at the level of the parent.

A. Introduction

7.2 This paragraph (unchanged from previous OECD TPG chapter VII) provides a simplified, historical view of the nature of intra group services based on traditional decentralized organizations with one head-office concentrating central administrative and oversight functions, and various operating subsidiaries to which it invoices management fees. Indeed, it refers merely to "administrative, technical, financial and commercial services", as well as "management, coordination and control functions for the whole group" and "legal and accounting services, ..., central auditing, financing advice, or training of personnel".

In reality, the increased globalization of many MNEs triggered many changes in this historical, conventional view of intra-group services, with the implementation of matrix organizations around multiple Business Units, and multiple shared services centers supporting the operations (specialized by function/region). These types of organizations
generate much more complex issues around the invoicing of intra group services, and do not seem to be addressed in this DD.

In contrast, see JTPF Guidelines on low adding value intra group services ("IGS Guidelines": " It is also important to note the distinction between straight forward charging and delivery mechanisms and more complex arrangements. It is not envisaged that a single centrally provided low value adding service charged out to several associates by means of a readily identifiable allocation key would give cause for concern. This paper therefore concentrates on multiple low value adding services that will often be provided through a single contract and generally involving a cost pool and allocation keys".\(^1\)

7.4 Same comment as under 7.2 above. The two examples provided, although making a distinction between centralized/integrated and decentralized groups, are restricted only to a relationship between a parent company and its subsidiaries, whereas in reality, as pointed out above, the operating structures of many MNEs are much more complex, and centralized services giving rise to intra group service charges are rendered by multiple entities across the world, generating multiple, complex intra group invoicing flows.

7.5 This new paragraph introduces the notion of "low adding value intra group services", which is further developed in section D.

There should be a clear, unambiguous distinction between such low adding value services under the present Chapter VII, and those low adding value services provided under a Cost Contribution Arrangement ("CCA") on services not creating IP under Chapter VIII.

We would therefore recommend to also make reference in this paragraph 7.5 to the "low risks" associated with "low adding value services", consistent with the definition under para.7.46 below "low value adding intra group services...do not involve the assumption or control of substantial or significant risk and do not give rise to the creation of significant risk".

This would also be consistent with JTPF definitions in the IGS Guidelines: "The paper does not ...address services that intrinsically add high value... Similarly, activity that inherently relies on the potential to attract a high level of reward associated with exposure to high risk will not be within the parameters envisaged. Specifically the paper does not address cost contribution arrangements"\(^2\).

Reference may also be usefully made to paragraph 12 of the JTPF Report on Cost Contribution Arrangements (7 June 2012), which provides for a clear description of the distinction between intra group services (TPG Chapter VII) and CCAs on services not creating IP (TPG Chapter VIII).

\(^1\) JTPF Guidelines on low adding value intra group services ("IGS Guidelines"), 25 January 2011, para. 13
\(^2\) JTPF IGS Guidelines para. 12
B. Main issues

B.1.2 Shareholder activities

7.11 See JTPF detailed description in Annex 2 to IGS Guidelines: 5 pages providing more detailed guidance on those activities to be analyzed as shareholder activities, and providing useful concrete examples.

B.1.3 Duplication

7.12 "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".

For businesses, it does not make economic sense to allege that activities would be undertaken several times by different persons/teams in different parts of an organization on a recurring basis, generating duplication of costs for no additional benefit. Why would an MNE act in such a way in good faith and based on sound business behaviour and prudent business management principle?

B.1.5 Centralised services

7.15 Same comment as under 7.2 and 7.4 above: traditional and conventional description of intra group central management and administrative services, not representative of current organisation of numerous global MNEs. Description of services should be widened to reflect current business realities.

B.2.2.1 Direct Charges Method

7.23 "An MNE group should often be able to adopt direct charging arrangements,..."

B.2.2.2 Indirect Charges Method

7.24 "A direct-charge method for charging for intra-group services is so difficult to apply in practice in many cases for MNE groups that such groups have developed other methods,..."

Para. 7.23 and 7.24 are contradictory. In reality, direct charges methods are indeed extremely difficult to apply in practice. We suggest amending paragraph 7.23 accordingly.

7.3.5 "Where the cost plus method is determined to be the most appropriate method to the circumstances of the case, the analysis would require examining whether the costs incurred by the group service provider need some adjustment to make the comparison of the controlled and uncontrolled transactions reliable."

This new paragraph opens the door to difficult discussions on the need for comparability adjustments in relation to costs incurred by the group service provider vs those incurred by comparable independent service providers. In practice, how to do such comparability adjustments and on which basis? Examples would be welcome.
C. Examples of intra group services

Several examples are provided in this section under para. 7.41 (debt-factoring), 7.42 (manufacturing or assembly operations under contract manufacturing arrangement), 7.43 (contract research), 7.44 (administration of licenses).

We note that these various examples of intra group services are quite different in nature from those listed in above Section A Introduction (para. 7.2 and 7.4) which are restricted to services rendered by a parent to its subsidiaries (central administrative and oversight functions within conventional view of management fees), making this whole section a bit perplexing.

We would suggest adding in paragraph 7.40 a sentence indicating that these examples supplement other examples provided in previous sections of the DD, in particular description of centralized administrative and oversight services in paragraphs 7.2, 7.4 and 7.15.

D. Low value-adding intra-group services

D.1 Definition

7.50 "As an example, assume that an MNE is engaged in the development, production, sale and marketing of dairy products worldwide. The group established a shared services company, the only activity of which is to act as a global IT support service centre. From the perspective of the IT support service provider, the rendering of the IT services is the company's principal business activity. However, from the perspective of the service recipients, and from the perspective of the MNE group as a whole, the service is not a core business activity and may therefore qualify as a low value-adding intra-group service."

The conclusions to be drawn from this paragraph are unclear, as its wording opens the door to a different qualification for the same services depending on which side of the transaction is being looked at (principal business activity for the IT service provider vs low value adding intra group transaction for the IT service recipient), possibly calling for different levels of margins as meeting the ALP leading to transfer pricing disputes and exposure to double taxation.

D.2 Simplified determination of arm's length charges for low value-adding intra-group services

7.51 "This subsection sets out the elements of a simplified charge mechanism for low value-adding intra-group services. An MNE group electing to adopt this simplified method would apply it on a consistent, group wide basis in all countries in which it operates. This simplified method is premised on the proposition that all low value-adding service costs incurred in supporting the business of the MNE group members should be allocated to those members. A possible alternative approach for dealing with the issues discussed in this section would be the use of Cost Contribution Arrangements, covered in Chapter VIII."

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The last sentence is in contradiction with the introductory comment in paragraph 7.1 stating that "Cost Contribution Arrangements are the subject of Chapter VIII", and therefore it creates some confusion which may be source of uncertainty for taxpayers.

Indeed, low value added intra group services as described under present TPG Chapter VII should be attributed a profit mark-up as per paragraph 7.57, whereas no profit mark-up is warranted for low value adding services provided under a CCA as per TPG Chapter VIII.

D.2.1 Determination of cost pools

7.52 This paragraph should provide comments and guidance on the question of accounting standards to be used for determination of cost pools. This is of particular relevance when several different entities located in different countries provide low value adding services, for which the costs are all pooled in order to set the basis for allocating and charging the services. Consistency would require that all costs be pooled using the same accounting standard, however this may lead to actual profitability deviating from the applied mark-up on costs, when testing the results generated by each individual service provider.

Given the "low adding value" nature of the services and the associated routine mark-up (2 to 5% of costs), existence of such deviations should be accepted as they would not be expected to be material.

D.2.3 Profit mark-up

7.57 "In determining the arm's length charge for low value-adding intra-group services, the MNE provider of services shall apply a profit mark-up to all costs in the pool. The same mark-up shall be utilised for all low value-adding services irrespective of the categories of services. The mark-up selected by the taxpayer should be no less than 2% of the relevant cost and should be no greater than 5% of the relevant cost. It should be noted that these intra-group services mark-ups should not, without further justification and analysis, be used as benchmarks for the determination of the arm's length price for services not within the definition of low value-adding services, nor for similar services not within the elective, simplified scheme".

This paragraph should specify that the applied profit mark-up does not need to be justified by a benchmark of comparable independent services providers, so long as it falls within the 2 to 5% safe harbour range.

It may be helpful to add some comments and/or practical examples providing some guidance on criteria for selecting the lower or higher end of the safe harbour range.

There should also be some reference to the cost base on which the mark-up should be applied. As worded, the sentence refers to "all costs in the pool". However, it may be that some "pass through costs" incurred by the service provider as an agent or intermediary should be excluded from the pool of costs, and charged with no mark-up (see paragraph 7.36).
D.2.4 Charge for low value-adding services

7.58 As worded, paragraph 7.58 assumes that all cost incurred are marked-up, although there may be some pass through costs incurred as an intermediary which would not be mark-up (see comment under 7.57 above).

There should also be some reference to the possibility (although no obligation) for taxpayers to charge the amounts of service fees during year n based on budgets, and adjust the computations to actuals at year end or at the beginning of year n+1. Differences between actual and budgeted amounts may, depending on the MNE transfer pricing methodologies and practices and on contractual arrangements, generate some year-end adjustments or true-up, booked in year n or n+1. Acceptability of such practices should be clarified, while leaving full flexibility to MNEs to decide (or not) to proceed through such year-end adjustments.

D.2.5 Application of the benefits test for low value adding services

7.59 & 7.60

Simplification measures are welcome with regard to the benefits test for low value adding services.

However, additional clarifications would be helpful besides the sentence which states that: "Provided such information outlined in paragraph 7.61 is made available to the tax administration, a single annual invoice describing a category of services should suffice to support the charge, and correspondence or other evidence of individual acts should not be required."

Indeed, there is a concern that, despite this very helpful statement, some tax administrations may still request evidence at the level of the service recipient, and as a condition for accepting a tax deduction, that the price charged reflects an arm's length compensation for the services actually received locally by the individual legal entity, which in practice is extremely difficult if not impossible to establish.
Milan, 14 January 2015

To: Mr. Andrew Hickman,
Head of Transfer Pricing Unit,
Centre for Tax Policy and Administration
OECD/CTPA


Dear Mr. Hickman,

We are pleased for the opportunity to submit our comments on the OECD Public Discussion Draft BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low-Value Adding Intra-Group Services (the Discussion Draft).

In this respect, we respectfully provide hereinafter our observations on the proposed amendments to Chapter VII of the OECD Transfer Pricing Guidelines (the Guidelines).

General remarks

1. We commend the OECD for the effort pursued in streamlining the approach towards the compliance activities required for identifying and determining the appropriate arm’s length remuneration of certain types of low-value adding services. Such issue represents indeed one of the most controversial areas of transfer pricing which, in our experience, gives rise to increasingly substantive disputes with tax authorities. Against this background, the Discussion Draft shows however in our view some inconsistencies, that may not lead to achieve the objective outlined within the context of Action 10 of the BEPS Action Plan, i.e. to provide protection against common types of (purported) base eroding payments, such as management fees.

2. The Discussion Draft does not specify the key features of management fees, nor outlines what type of services may fall within such a definition. It does hence leave
open the question of whether the OECD considers that low-value adding services encompass management fees or is instead refers to two different concepts.

3. A clarification of what is meant by management fees may be achieved by providing a clear and unquestionable definition of the benefits test. The current definition included in Section B, paragraph 7.7 revolves around the subjective test of determining whether the service activity performed has enhanced or maintained the commercial position of the service recipient. In our experience, such a determination is often subject to disputes between taxpayers and tax administrations, as it requires the exercise of discretionary judgment by both parties. We would suggest instead streamlining and refining the definition of “benefits test” by including a reference to a “functionality test”, i.e. including reference to the performance of a functional analysis at the level of the service recipient in order to determine its underlying commercial rationality. Such a strengthened benefits test allows a clearer evaluation of whether the service performed is enabling – actually or potentially – the recipient to either, develop, maintain or enhance its commercial position or it is a shareholder activity which does not justify any deductible payment. Paragraph 7.34 states that a functional analysis is “necessary” (rather than merely “helpful” as specified in paragraph 7.32 of the current version of the Guidelines) in the context of calculating the arm’s length compensation. In our view, such an analysis is however necessary also in relation to the benefits test.

4. Moreover, it seems to us that the Discussion Draft is not taking fully into account the developments currently occurring in other areas of the BEPS Project, such as the work currently going on with respect to risk allocation. Within this line of reasoning, certain paragraphs move from conceptual assumptions relating to the centralized or decentralized structure of an MNE Group and infer the type of services performed from those assumptions (e.g. para. 7.4 replicating the corresponding paragraph of the current version of the Guidelines). In our view, it would be preferable to avoid this type of assumptions as they would lead to unintended situations of adjustments, which would be unwarranted under a proper application of a comparability (including functional) analysis.

5. Lastly, as the BEPS project wants to avoid instances of double non-taxation as well as an unintended proliferation of international tax disputes, we would suggest avoiding new, undefined terms (see for example the frequent recourse to the term “ancillary” with respect to certain types of services, which is at odd with a consistent application of the arm’s length principle). In other words, a service may be “ancillary” or “core” only if benchmarked vis-à-vis the overall business of the service recipient and its “functionality” to the core business of the receiving enterprise.
A. Comments to Section B: Main Issues

6. As mentioned above, we would favour strengthening the definition of “benefits test” as currently endorsed in paragraph 7.7. by introducing a reference to a “functionality test”, i.e. the activity provided in favour of the service recipient has to be instrumental vis-à-vis its value chain. We believe that such an approach would be consistent with what has currently being debated in the context of Actions 8-10 of the BEPS Action Plan regarding a refinement in the application of the profit split method. In addition, in our view, this approach would depart from a definition of “benefits test”, with respect to which controversies often arise due to its subjectivity element currently existing within its application.

7. Another major area of concern relates to the definition of “shareholder activities”. In particular, para. 7.11 sub (e) treats as shareholder activities “costs which are ancillary to the corporate governance of the MNE as a whole”. Undefined “corporate governance” activities were also referred to in the documents issued by the EU Joint Transfer Pricing Forum as an example of shareholder cost (Guidelines on low value adding intra-group services, Appendix I to the EU Commission Communication, COM(2011) 16 final of 25 January 2011). We believe that a more precise definition of such concept may however be appropriate. Indeed, a number of significant intercompany service activities (e.g. legal assistance for undertaking a business restructuring or costs associated with the management of the group accounting) may prove to be relevant for generating value for group companies, and (in)directly have an impact on the group’s “corporate governance”. Accordingly, we respectfully suggest to delete such paragraph unless a clear definition of what is meant by “corporate governance” is introduced. In the contrary, we fear that such paragraph may lead to a number of substantive disputes between taxpayers and tax administrations.

8. With respect to duplication of services, it may be appropriate that the guidance at paragraph 7.12 is strengthened by including a reference (let alone the fulfilment of the requirement of examining “the nature of the services in detail”), also to what we would refer to as the “functionality test” in the hands of the service recipient, i.e. whether the activity performed is instrumental to generate value in the hands of the enterprise receiving the service, actually or potentially, in light of its functional and comparability analysis.

9. Finally, it seems to us that paragraph 7.15 could better serve its purpose if moved in Chapter VIII of the Guidelines, as it seems to cover the type of services carried out in the context of Cost Contribution Arrangements.
B. Comments to Section D: Low value adding intra-group services

10. As mentioned above, we believe that clearer guidance would be appropriate in respect of the definition of “management fees” vis-à-vis the notion of “low-value adding intra-group services”. To this end, the only reference in the Discussion Draft to the former term is in paragraph 7.19, whereby a somewhat pejorative language is utilized in referring to these type of payments. We believe that pursuing a factual substantive approach, which goes beyond the mere labelling of a payment, would be the decisive factor for justifying whether a service has been actually rendered and what type of arm’s length remuneration has to be set.

11. As to the various requirements to meet the definition of “low-value adding services” listed in paragraph 7.46, we would appreciate a clarification aimed at clarifying that they should not be read in a cumulative manner. To this end, we would suggest adding some wording clarifying when a service is (i) of a “supportive nature” and (ii) “not part of the core business of a group”. The underlying concept, which may be inferred (and maybe more explicitly stated), is that the service performed has to fit in the functional and comparability analysis of the service recipient. Based on the above, we would favor deleting any reference to the existence of unique and valuable intangibles and to the notion of assumption or control of “substantial or significant risk” until the work on Actions 8-10 of the BEPS Project on these two related topics is finalized.

12. Lastly, it seems rather inconsistent the reference in paragraph 7.47 to “services of corporate senior management” as being excluded from the simplified approach, whereas activities ancillary to the corporate management of the MNE as a whole are deemed to be shareholder activities (see the above mentioned reference to para. 7.11 sub (e)). Therefore, we would suggest removing reference to a term (“corporate senior management”), the boundaries of which are undefined in order to avoid unintended misunderstandings with tax administrations that would eventually lead to costly and time consuming disputes.

*   *   *

Yours sincerely

(Paolo Ludovici)
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France

14 January 2015

Our ref MJZ/EYW

Dear Mr Hickman,

We write in response to the request for comments on the Discussion Draft: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services. We are pleased to offer our comments as follows:

General Comments

Overall, we support the introduction of simplified alternatives for less complex transactions where such measures reduce compliance costs and provide greater certainty of tax outcomes without double taxation. Many of the BEPS initiatives will increase tax compliance costs and also increase uncertainty for taxpayers. Consequently the extent to which this can be offset by simplifying measures is greatly welcomed. We are, therefore, generally encouraged by the modifications proposed relating to low value-adding intra-group services. However, we would note that the extent to which these proposals will help depends on the proposals being widely adopted by countries and in a consistent manner.

The comments below relate to specific references in the Discussion Draft.

1) On Call services (7.17 to 7.18)

Paragraphs 7.17 and 7.18 discuss “on call” services. While it seems clear that on call services provide benefits to enterprises by reducing the level of risk, we believe it is fundamental to use a functional analysis to determine the need for such a service. Paragraph 7.18 states that it is unlikely that an independent enterprise would incur stand-by charges where the potential need for the service was remote. However, we believe that when determining the need for an on call service, the potential costs of not having that service on call should be assessed. There will be cases where the potential need for the service is remote but not having the on call service may lead to unacceptably high levels of risk that lie outside the risk / reward parameters tolerated by the investors. We believe, that the Discussion Draft provides a helpful approach to assess the need for these services, however further clarification should be given on the approaches that can be used to price them. We are concerned that in practice the lack of clarification may lead to inconsistencies in the pricing of on call services if risk preferences are ignored.

2) Management Fees (7.19)

A key aim of this Discussion Draft is to reduce the scope for erosion of the tax base through excessive management fees and head office expenses. We feel that the term “management fees” is one that tends to be used loosely, meaning different things to different people. Sometimes it is used as a generic term to include a wide range of services which may not even include the provision of management services;
effectively a synonym for head office activities or support services. In other cases it is properly used by taxpayers to mean fees for the services of the organisation’s management personnel. Paragraph 7.19 partially addresses this point; however we believe that definitions of management fees and head office expenses in the guidelines would help to provide a common understanding of these terms for transfer pricing purposes.

3) Use of internal comparable for low value-adding intra-group services (7.46)

Paragraph 7.46 defines low value-adding intra-group services and states that the simplified approach is not applicable to services that would ordinarily qualify as low value-adding intra-group services where such services are rendered to unrelated customers of the members of the MNE group. The paper explains that in such cases it can be expected reliable internal comparables exist and can be used for determining the arm’s length price of the intra-group services. In our view, it is possible that in practice a comparability analysis may show that internal comparables are not a good match and therefore cannot be used to determine the price of low value-adding intra-group services, even though available.

4) Allocation keys for low value-adding intra-group services (7.55 and 7.56)

We welcome the recognition stated in paragraph 7.56 that a balance between “theoretical sophistication and practical administration” should be considered, bearing in mind that the costs involved are not generating high value for the group. We agree that the allocation key should correlate with the benefits received by the group member. However we feel that an allocation metric which can be measured objectively should always be preferred to one that cannot be measured accurately and easily, even if the latter correlates more directly to the benefits. We believe this approach can provide mutual benefits to business and tax administrations through reduced compliance and audit costs. Consequently the guidelines should state this explicitly.

5) Profit mark-up for simplified test (7.57)

Paragraph 7.57 states that the mark-up selected by the taxpayer should be no less than 2% of the relevant cost and should be no greater than 5% of the relevant cost. However, we revert to our concern that this approach could cause significant double taxation if the same mark-up is not adopted by all the jurisdictions in a particular case, for example where countries have not adopted the proposed measures. Some MNE groups charge out considerable amounts of these costs. A significant variance between the selected point in the “safe harbour” range and the arm’s length rate imposed by a jurisdiction that does not adopt the proposals may represent a considerable amount of tax.

Should you wish to discuss any of our comments we remain at your disposal. Please contact the undersigned.

Yours sincerely

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Discussion Draft on BEPS Action 10: Proposed Modifications to Chapter VII of the transfer pricing guidelines relating to low value-adding intra-group services

Comments by NERA Economic Consulting (Submitted 14 January 2015)

Dear Mr. Hickman,

In the context of the BEPS Action Plan, Working Party number 6 of the OECD has released on November 3, 2014, a discussion draft (the “Draft”) of the proposed modifications to Chapter VII of the Transfer Pricing Guidelines relating to Low Value-Adding Intra-Group Services, issued under item 10 of the BEPS Action Plan. NERA wishes to thank you for the opportunity to provide comments on this document.

Introduction: Service charges and BEPS

Intra-group services of the kind that do not contribute significantly to fundamental risks of success and failure of a business (“low value-adding” services) tend to be some of the most scrutinized categories of intercompany transactions in some jurisdictions and are responsible for many instances of double taxation. Yet, based on our experience and on the fact that – due to their very nature – charges for these types of services tend to be close to the costs incurred to provide these services, we do not believe that intercompany transactions involving such low value-adding services constitute a significant opportunity for BEPS. As such, we support the OECD’s position not to have developed specifically an action for service transactions under the BEPS Action Plan, even though certain member states or observing states were in favor of such an initiative. On the contrary, we believe that the current Transfer Pricing Guidelines (“TPG”) and the arm’s length principle are sufficient, if properly applied, to impede any such BEPS.

Conversely, we think that, as correctly pointed out in the Draft, one of the key issues revolving around low value-adding service transactions relate to the allocation of MNEs compliance efforts and tax administration audit resources, which today may be disproportionately dedicated to services, to the detriment of other transactions, structures or issues, such as intangibles, which (i)
may show a far greater potential for BEPS, if inappropriately / wrongfully dealt with and / or (ii) which are genuinely complex and fact intensive.

Consequently, striking the right balance between a compliance burden and a fair and traceable enforcement of the arm’s length principle seems to us to be one of the key issues related to service transactions. Certain bodies, such as the European Union Joint Transfer Pricing Forum, or member states, such as the USA, for instance, have already implemented methods or developed arguments that head in this direction. We note that within the U.S. Services Regulations that were finalized in 2009, the Service Costs Method (“SCM”) allows to allocate costs of certain services that meet certain criteria with no markup, although such method is not being contemplated by the OECD in the current Draft.

Yet, some issues may be left unaddressed, while other new questions may arise from the new Draft language. Those are highlighted in the detailed comments we have on the particular sections of the Draft attached to this letter.

But, above all, there is a number of areas, that, we think, are associated with intercompany services charges, and which we discuss below.

**Interaction with “high-value-adding” transactions and value chain analysis**

We believe that a number of concerns of the member states or observers related to intra-group services, in fact, arise from an improper association of services with high-value-adding transactions. We believe that high-value-adding transactions, insofar as they provide businesses unique or valuable competitive advantages, should be addressed in Chapter VI instead.

Consequently, we believe that it would be worthwhile to mention that the value chain analysis and the functional analysis are the foundation for any transfer pricing analysis, as only these analyses allow to differentiate between high-value-adding transactions and medium / low value-adding services.

In light of this, the change from “helpful” to “necessary”, with regard to the functional analysis, in §7.34 would be more than welcome. An additional reference to a value chain analysis could be added there as well.

**Interaction between service charges and local costs of services**

We also think that a revised Chapter VII should reflect the fact that intercompany services usually arise when the Group, as an integrated economic entity, has decided to incur some costs to obtain (or render) a service. In some circumstances, a bulk of these costs may be incurred in arm’s length transactions (salaries, costs of services by external providers). In those situations, the cost of intercompany service may often be close to arm’s length prices. In our opinion, this fact should be considered by tax authorities in the course of tax audits.
Tax auditors in recipient countries may challenge the appropriateness or the amount of costs charged to the local office by headquarters. Often these controversies arise in cases where headquarters providing services are located in one of high-cost countries and the recipient is located in a low cost country where, tax authorities may argue, identical services can be obtained at lower costs. Although, in certain instances, intra-group service charges may indeed be unrelated to the benefits received and/or have non-arm’s length prices, we believe that more attention of tax administrations should be devoted to examining the decision making at the group level behind these service charges. The group as a whole decides to incur the cost of services, which typically, has a significant arm’s length component (e.g., salaries), based on the cost-benefit considerations at the group level. Providing certain types of services on a centralized basis for the entire group may minimize the costs incurred by the group on the global scale and may increase efficiency of providing these services, as compared to performing these services locally or sourcing them from unrelated parties, and, therefore, service charges may be fully economically rational.

Based on our experience, we think that a major source of non-arm’s length charges by MNEs acting in good faith in the context of indirect-charge systems relate to insufficiently precise allocation methods. Allocation methods that are based merely on financial keys and fail to reflect the level of resources available locally may, in fact, lead to the situations where local subsidiaries with significant resources to perform services for themselves pay more than their arm’s length share for centralized services and hence subsidize the cost of services for other subsidiaries with limited resources.

Consequently, we believe that Chapter VII, and in, particular, section 7.2.2.2. on Indirect Charge methods could be more explicit in warning taxpayers from the consequences of the issue described above. It could mention best practices, such as:

- Examination of whether a charge is consistent with the functional profile of the company and is considered in the context of other transactions (in this regard, the language of §7.29 “The compensation for services rendered to an associated enterprise may be included in the price for other transfers.” is absolutely the key; perhaps it could be worthwhile to put more emphasis on it)

- The level of resources available locally: if not appropriately taken into account, group companies with significant local resources to perform services for themselves may end up economically subsidizing group companies with lesser local resources.

From this perspective, thoughtful, appropriately engineered systems of indirect cost charges must be established. Such systems may, for instance, incorporate adjustments to the allocation keys reflecting the level of local resources, so as to effectively allocate the costs incurred centrally to the subsidiaries according to the benefits received by them.
Conclusion: Achieving the potential of the simplified approach

Overall, we think that the draft prepared by Working Party N°6 is clearly headed in the right direction.

As mentioned previously, based on our experience and on the fact that – due to their very nature – charges for low value-adding services are very close to actual costs incurred, we do not think that service transactions indeed constitute a major opportunity for BEPS. The current TPG and the arm’s length principle are sufficient, if properly used, to impede any such BEPS. The key issues for the low value-adding service transactions, in our opinion, relate to setting the right level of compliance requirements for taxpayers and allocating appropriate resources of tax administrations commensurate with the BEPS risk for these transactions compared to the BEPS risk of other types of transactions.

As such, the introduction of a “simplified approach”, which is one of the major contributions of the Draft, is welcome, even though it raises a number of technical questions and it leaves some issues unaddressed, as discussed further in the appendix to this letter.

Yet, we do believe that the Draft will achieve its full potential only if the simplified approach is robust and accurate enough so as to be able to substitute the standard approach for most of the low value-adding services which are rendered at a number of MNEs by global or regional headquarters or by shared service centers. For an MNE, having to maintain simultaneously two different systems for intercompany service pricing, one under the simplified approach and the other under the standard framework would nullify the benefit of this initiative.

As such, from this perspective, we think it would be worthwhile to design the simplified approach so that MNEs would still benefit from the provisions of article §7.57 on regarding the “safe-harbor” profit mark-up when the services proved fall into the category of low value-adding services, even in cases when complex transactional structures prevent application of all of the conditions set out in article §7.45.

As mentioned, we think that the one of the furthest reaching elements of the simplified approach is in alleviating the documentation requirements and in transferring the burden of the proof from the taxpayers to the tax administrations. But as also mentioned, we do not think that the regulatory framework that currently applies to the low value-adding service transactions is significantly deficient. Hence we do not believe that the OECD may achieve much by improving this framework under Action 10. We think that tax administrations need to come to the conclusion that most MNEs do not use services to achieve base erosion and that all non-shareholder centralized costs are, by design, incurred for the benefit of the operating companies in the group.

Consequently, we think that reducing the number of incidences of double taxation with respect to intra-group services requires not only a change to the OECD transfer pricing guidelines, but moreover: (i) a genuine commitment of tax administrations to take a more “empathic” stance toward services, (ii) complementary guidance, potentially under Action 13 (documentation), and
more importantly, under Action 14 (more effective dispute resolution). Indeed, we believe that improvements in the area of dispute resolution will be necessary in making MNEs and tax administrations converge on a globally accepted set of practices compliant with the arm’s length principle.

Sincerely yours,

Stuart Harshbarger

Vladimir Starkov

Guillaume Madelpuech

New York/Chicago/Paris
Appendix - Detailed review of the language of the Draft

1. Treatment of transfer pricing costs and reassessments (§7.11)

The Draft introduces, in §7.11, a new language with regard to the treatment of tax compliance costs:

   d) Costs relating to compliance of the parent company with the relevant tax laws [are an example of shareholder activity];

This language as stated may be ambiguous and may have far-reaching consequences. Should one read this language as implying that transfer pricing costs, for instance, which arise because the parent is a parent (i.e. the company is not a stand-alone company but has to comply with transfer pricing regulations) should be borne by the parent company? Wording may need to be amended to clarify which costs should really be included in that category.

2. Definition of shareholder activities (§7.11)

The Draft introduces the following language:

   e) Costs which are ancillary to the corporate governance of the MNE as a whole [are an example of shareholder activity];

Yet, one definition of corporate governance which may be found and endorsed in the OECD public communications is the following:

Procedures and processes according to which an organization is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organization – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making.

As such, corporate governance appears to be a very broad and vague term, which may be understood to include group-level strategic decision functions which go beyond the scope of what

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is usually understood by the shareholder activities. Consequently, we are concerned that such language introduces additional uncertainty for taxpayers.

3. **Interaction between control & advisory services (§7.11)**

There is usually a significant interaction between control and advisory services as, for certain services (e.g. internal audit), these two functions are much intertwined. The Draft does not provide additional guidance in this regard, and we believe this is the wisest approach to be taken there, as the application of the arm’s length principle will directly derive from the careful considerations of the facts and circumstances. The reference to the arm’s length principle in the following section of §7.11 below seems to be sufficient in this regard:

> Whether the [“managerial and control (monitoring) activities related to the management and protection of the investment as such in participations] activities fall within the definition of shareholder activities as defined in these Guidelines would be determined according to whether under comparable facts and circumstances the activity is one that an independent enterprise would have been willing to pay for or to perform for itself.

4. **Applicability of the indirect-charge method (§7.27)**

The Draft still includes the following language, in §7.27, from the previous version of Chapter VII:

> When an indirect-charge method is used, the relationship between the charge and the services provided may be obscured and it may become difficult to evaluate the benefit provided. Indeed, it may mean that the enterprise being charged for a service itself has not related the charge to the service. Consequently, there is an increased risk of double taxation because it may be more difficult to determine a deduction for costs incurred on behalf of group members if compensation cannot be readily identified, or for the recipient of the service to establish a deduction for any amount paid if it is unable to demonstrate that services have been provided.

Even though we think that technically, this language is not disputable, its inclusion in a revised version of Chapter VII might send the wrong signal to MNEs and tax administrations. As mentioned earlier, we do not believe that services and head office expenses, when appropriately handled and documented by taxpayers, are a source for BEPS. In order to avoid double taxation issues and to allocate resources of MNEs and tax administrations efficiently, OECD should promote indirect charge methods which, in practice, are often the only way to allocate the bulk of service charges. Consequently, we believe a right message would be sent out by taking out this language.
5. **Methods: Cost Plus & TNMM (§7.33, §7.35 and §7.42)**

The Draft makes reference to the Cost Plus method in a number of instances. Yet, in a number of practical situations, lack of the necessary data for both the independent and dependent transactions makes the Cost Plus method difficult to apply in practice, and, the Transactional Net Margin Method becomes the most appropriate method. Consequently, we think that references to the “Cost Plus method or TNMM” rather than the Cost Plus method alone can improve the Draft.

6. **Agency costs and pass-through entities (§7.36)**

The Draft preserves the language from the previous version of Chapter VII with regard to agency costs, in §7.36 in particular:

> It is important in applying the cost-plus method that the return or mark-up is appropriate for the performance of an agency function rather than for the performance of the services themselves

We think that it is important in benchmarking the profit of related agents, commissionaires, pass-through entities, purchasing companies, etc. to ensure that the cost structure of the related entity to which the return benchmarked by a PLI is applied is similar to the cost structure of comparable independent parties from which the PLI is derived, and to ensure comparability, adjustments may have to be made.

7. **Reference to Option Realistically Available (§7.43)**

The draft makes reference, in paragraph §7.43, to the consideration of Option Realistically Available in the context of research arrangements. We believe such analysis should be indeed at the cornerstone of every transfer pricing analysis and think this reference is very much welcome and could be further generalized to all types of arrangements and transactions.

8. **“Intra-company” transactions (§7.52)**

The Draft seems to be adding some confusion in §7.52:

> The cost pool should exclude costs that are attributable to an in-house activity that benefits solely the company performing the activity

As a matter of fact, it is often the case that some departments within a headquarters company provide services to other group companies ("type A services"), while other departments provide services only to the departments within the headquarters, but not to other group companies ("type B services").

Under the arm’s length principle, the appropriate cost base for type A services should include the share of type B services cost required to provide the service.
We would argue that this should be explicitly stated in the Draft.

9. **Scope of the “simplified approach (§7.46, §7.47, §7.48)**

It would neither be possible nor desirable to establish a comprehensive list of services which should or should not qualify for the approach. As such, we fully support the approach of the Draft to set defining principles for the scope, potentially complemented by - non-binding - examples which may be helpful to shed some light of the intent and purpose of the regulation.

**Reference to the core business**

As mentioned in the Draft, it is paramount that the simplified approach does not apply to the services that relate to the core business of the Group (which, by definition rely on unique and valuable intangibles and/or lead to the creation of unique and valuable intangibles, involve the assumption or control of substantial or significant risk and give rise to the creation of significant risk). However, the determination of whether a particular service is related to the core business of a Group may, by itself, be a delicate and complex question.

We believe it is worthwhile to make reference at this stage to the necessity of the Value Chain Analysis that should be used to determine which services may be considered core or non-core.

**Concept of “Supportive nature” and low value-adding services**

We believe the guidance should be made clearer with regard to what should be understood as “supportive nature”. For instance let’s consider a global headquarters providing financial services for its operating subsidiaries that go beyond the compilation of data and information gathering, which are listed as examples of low value-adding service. Should such services qualify for the application of the simplified approach? Equally, other services that are excluded from the list of services of a “supportive nature” may very well include services that are indeed of a low value-adding nature. Value chain analysis should enable to identify these services.

We believe that the scope of the simplified approach should make reference to the fact that low value-adding services, for the purpose of section D of the revised Chapter VII be indeed… low value-adding.

In order to meet the objectives of reducing the compliance burden on taxpayers, the simplified approach should be designed so as to be applicable to the full range of headquarter services for a maximum of MNEs. As such, for a MNE, having to maintain simultaneously two different systems, one under the simplified approach and one under the standard framework of Section A and B would be burdensome and would nullify the benefit of the initiative. We believe that the aim of the guidance should be to have the standard approach restricted only to (i) services provided by group companies other than headquarters / Shared Service Centers or to (ii) integrated groups where low and high value-adding services or other transactions may be intertwined.
List of excluded and likely included services

As such we think that:

- The list of likely included services should make a broader reference to financial support services and global marketing services.

- The language in the list of likely included services might be edits as follows:
  - *Training and employee development: to the extent that no high-value know-how is attached to such training*
  - *Information technology services where they are not part of the principal activity of the group, for example installing, maintaining, exploiting and updating IT systems.*

10. Identification of recipients (§7.51)

The Draft provides the following language:

*An MNE group electing to adopt this simplified method would apply [...] in all countries in which it operates. This simplified method is premised on the proposition that all low value-adding service costs incurred in supporting the business of the MNE group members should be allocated to those members.*

We believe that this language may be confusing as the premise that all MNE group members benefit from the centralized services may not always be true.

We think that the Draft should provide that the simplified approach would only be applicable in case the above premise is acceptable, conversely the MNE would have to segment its group companies in baskets where the premise would be acceptable.

However, in any case, sections §7.57 on profit mark-up, and §7.60 and §7.61 on benefit test and documentation should be applicable for Low Value-Adding Services.

11. Profit mark-up (§7.57)

As an introductory comment, we want to stress the fact that, even though the mark-up is usually the most prominent aspect in a transfer pricing system for service transactions and will often draw the attention of tax auditors, the key issue with regard to services is the deductibility of the cost of services by themselves, while the discussion on the profit mark-up is secondary.

Yet, we think it is a great step forward to propose a safe-harbor for low value-added services, and more generally to design solutions which may lower the compliance burden associated with “vanilla” comparable searches for low value-adding services.
We believe it should be explicit that the safe harbor profitability range in the Draft is expressed in terms of operating margin, computed according to IFRS (or US GAAP) and considering all direct and indirect costs, including depreciation & amortization, SG&A, etc. For instance, server costs should be included in the cost of IT services (please refer to section 7 above for additional details).

The range of 2 – 5% seems reasonable to us given the actual nature of services considered in the Draft. Yet, as we suggest to broaden the range of the profit margins considered to be within the safe harbor under the simplified approach to the range of 0 – 7% to make this markup consistent with the one prescribed for the SCM application in the U.S. regulations. We think that the profit element attached to services is of secondary importance compared with the question of the deductibility of the cost base.

A refinement with a range of profit markup differentiated by geography of the provider might be a reasonable option as well. We would like to stress the fact that databases from where financial data are drawn for the comparable searches have experienced huge progress in terms of detail and comprehensiveness since 1995, when the last version of Chapter VII was drafted. We believe that in the future, this trend will continue and will allow for a more accurate determination of what independent providers of low value-adding services might earn, by geography.

Yet, we think that the paragraph §7.57 should be applicable only to the extent that it is reasonable to expect that this profit level should allow to achieve a result reasonably close to the arm’s length profit level, which would be determined under the standard approach. As such, in certain situations, such as pass-through entities, where the portion of internal costs is minimal, the application of a 2% mark-up on costs may result in widely inappropriate results.

The Draft should also provide for the fact that this section may be specifically updated in the future.

12. Burden of proof, documentation and reporting (§7.60, §7.61)

We think that one of the furthest reaching elements of the simplified approach is the provision of the simplified requirements for documentation and consequently, alleviating the compliance burden for taxpayers acting in good faith, which is much welcome.

Yet, we think the language in §7.60 could be even clearer, if changed from

The documentation and reporting discussed in section D.3 below should provide sufficient evidence that the benefits test is met given the nature of low value-adding intra-group services

To

Except in case of frivolous application or blatant evidence that this approach does not provide arm’s length results, it will be presumed by tax administrations that the
documentation and reporting discussed in section D.3 below provide sufficient evidence that the benefits test is met given the nature of low value-adding intra-group services.

Conversely, in §7.61, it may be useful to add that the expenses incurred by the service provider, if those were audited by a statutory auditor and confirmed to take place, have to be considered by tax administrations in the course of their audit.

Furthermore, we believe that it would be very useful to add that, even if, in the course of an audit, it appears that the “simplified approach” was in fact not applicable (for example, because the services provided were not low value-adding and/or the premises of article §7.45 were not satisfied), then – to the extent that the taxpayer acted in good faith, penalties will not be imposed.
January 13, 2015

Organisation for Economic Cooperation and Development
Centre for Tax Policy and Administration
Attn. Andrew Hickman, Head of Transfer Pricing Unit
2, Rue André Pascal
75775 Paris, France

Re: Comments on Discussion Draft on BEPS Action 10: Low Value-Adding Intra-Group Services

Dear Mr. Hickman:

The National Foreign Trade Council (the “NFTC”) is pleased to provide written comments on the Discussion Draft on BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines relating to Low Value-Adding Intra-Group Services, published November 3, 2014.

The NFTC, organized in 1914, is an association of some 250 U.S. business enterprises engaged in all aspects of international trade and investment. Our membership covers the full spectrum of industrial, commercial, financial, and service activities. Our members value the work of the OECD in establishing international tax and transfer pricing norms that provide certainty to enterprises conducting cross-border operations, and we appreciate the opportunity to comment on this important project. A list of the companies comprising the NFTC’s Board of Directors is attached as an Appendix.

The NFTC commends the OECD for addressing the issue of management fees and head office expenses, in particular by proposing a simplified transfer pricing approach for low value-adding intra-group services. According to the language in the introductory box on page 3 of the discussion draft, the objective of this simplified approach is to “achieve the necessary balance between appropriate charges for low value added services and head office expenses and the need to protect the tax base of payor countries.” Underlying both objectives, and consistent with Article 9 of the OECD Model Tax Convention, is the avoidance of double taxation by ensuring that expenses actually incurred by an MNE group are accounted for and recoverable for income tax purposes either in the jurisdiction in which they are incurred or in the jurisdiction or jurisdictions in which the group members benefiting from the activities operate. An additional objective of the simplified approach is to avoid undue burden both on MNE groups and tax
authorities by providing relaxed documentation and reporting standards.

In light of the objectives of the simplified approach for low value-adding intra-group services, consideration should be given to guidelines that more explicitly provide that all expenses incurred by an MNE group related to headquarter and other support activities should be allocable either to the shareholder (in the case of shareholder activities) or to the group members that benefit from them, and therefore should be accounted for and recoverable for income tax purposes. Many jurisdictions, including jurisdictions that are participants in the BEPS process, deny deductions for certain categories of intra-group service charges or allocated charges, either as a matter of law or administrative practice. Other jurisdictions impose gross-basis withholding taxes on such charges, which is tantamount to denying a deduction given these charges are largely based on costs. These practices result in double taxation of the same income in a manner that is difficult or impossible to relieve through domestic-law remedies such as exemption or a foreign tax credit. A clear statement of principle on this matter would be welcome.

Relatedly, consideration should be given to ensuring that the technical rules of the benefit test cannot be interpreted to result in a category of un-allocable expenses that are not recoverable in any jurisdiction. The definition of shareholder activities, which is elaborated on to some extent in the Discussion Draft, includes activities performed solely in the shareholder’s capacity as shareholder. Such activities are not considered intra-group services unless undertaken by a group member that is not the shareholder, in which case they are services performed for the shareholder. Activities undertaken by the shareholder or another group member that duplicate an activity being performed by another group member, or that provide only incidental benefits to another group member, also are not intra-group services. The OECD should clarify that activities determined to be duplicative or to provide only incidental benefits to group members other than the shareholder should be considered shareholder activities. This would ensure that expenses related to headquarter and other support activities are allocable to one or more group members, and recoverable for income tax purposes, in every case, thereby avoiding double taxation.

Regarding the specific examples of shareholder activities provided in paragraph 7.11, we believe example (e) – Costs which are ancillary to the corporate governance of the MNE as a whole – is superfluous at best and dangerously vague at worst. For one thing, the other examples listed already include numerous activities which could fall under the broad heading of “corporate governance.” Also, as used in the example, the term “corporate governance” lacks a clear definition. We believe that this example should be either eliminated or revised with a more precise definition of the costs and activities envisioned.

With respect to paragraph 7.11, example (d) – Costs relating to compliance of the parent company with the relevant tax laws – we believe the example should be revised to specify that it refers to tax laws unique to the parent company. The development and implementation of policies on international tax matters pertaining to many entities should be considered beneficial to them and therefore not shareholder activities. For example, given that many countries have adopted transfer pricing documentation requirements in their tax legislation, and given that the BEPS project itself likely will accelerate that trend, entities operating in each of these countries would benefit from core transfer pricing documentation reports that satisfy local requirements.
Regarding paragraphs 7.15 on centralized services and 7.39 on practical considerations in pricing services, it may be appropriate to provide references in these paragraphs to the simplified approach at Part D and perhaps organizing these paragraphs to better align with Part D. Many, but not all, of the activities listed in paragraph 7.15 are eligible for the simplified approach. It may be appropriate to separately list and distinguish the activities that are eligible (administrative services, financial services, and staff matters) from those that typically are part of the core business of the MNE group and therefore are not eligible (e.g., production, distribution, marketing, and R&D). Paragraph 7.39 acknowledges the practical reasons for a less rigorous approach to low value-adding intra-group services and seems to signal that something like the simplified approach is appropriate. It would be worthwhile to better align this language with Part D.

Regarding the activities described in paragraph 7.47 that are not considered to qualify for the simplified approach, we disagree with the Discussion Draft’s approach of automatically excluding “[s]ervices of corporate senior management” from the scope of potential low value-adding intragroup services. We believe that “corporate senior management” is too vague a term to be applied evenly and, as a result, will likely give rise to inconsistency and disputes. We believe that it would be advisable to strike this item from paragraph 7.47.

Regarding the simplified approach for low value-adding intra-group services, while we generally welcome the new guidance, we recommend the following changes. First, the guidance should state that an MNE group will be considered to elect the application of the approach either if such election is noted in its transfer pricing documentation or if the MNE group’s course of conduct is consistent with an application of the simplified approach. Tax authorities should not be permitted to prevent the application of the simplified method based on a procedural oversight.

Second, consideration should be given to permitting MNE groups to charge low value-adding services at cost and without a profit mark-up. The Discussion Draft requires a mark-up of 2% - 5%, consistently applied. While the inclusion of an upper bound is sensible given the nature of low value-adding services and base erosion concerns expressed by some jurisdictions, it is not clear why MNE groups are required to charge a mark-up of at least 2% to apply the simplified approach. The transfer pricing guidelines already provide that cost may be an appropriate arm’s length charge, either as a general matter (see paragraphs 7.37 – 7.39) or in the context of a Cost Contribution Arrangement.

Third, consideration should be given to additional practical guidance on the application of the simplified method. In particular, the guidance in 7.60 regarding a relaxed application of the benefit test is welcome, helpful and important in this area. It should be expanded and perhaps illustrated using practical and realistic examples. The draft should make clear, in addition, that even where intra-group services would not qualify as low value-adding services, taxpayers using an indirect charge approach for intra-group services should not be required “to specify individual acts undertaken that give rise to the costs charged.” Para. 7.60. Indirect charge approaches are permitted by the current transfer pricing guidelines and the proposed modifications even outside of the context of low value-adding services. Para. 7.24 – 7.27. A standard should be set, or guidance should be provided, for what would constitute reasonable evidence for purposes of applying the benefits test where an indirect charge approach is used. A reasonable sample of
activities, documented with materials prepared in the ordinary course of business, should suffice to provide evidence that the activity is taking place and that members of the group are receiving benefits from the activity.

Sincerely,

Catherine G. Schultz
Vice President for Tax Policy
National Foreign Trade Council
cschultz@nftc.org
202-887-0278 ext. 2023
Appendix to NFTC Comments on Discussion Draft on BEPS Action 10: Low Value-Adding Intra-Group Services

NFTC Board Member Companies:
McKenna Long & Aldridge LLP
ABB Incorporated
AbbVie Pharmaceuticals
Applied Materials
Baxter International Inc.
British American Tobacco
Caterpillar Incorporated
Chevron Corporation
Chrysler Corporation
CIGNA International
Cisco Systems
Coca-Cola Company
ConocoPhillips, Inc.
Deloitte & Touche
DHL North America
eBay, Inc.
E.I., du Pont de Nemours & Co.
Ernst & Young
ExxonMobil Corporation
Fluor Corporation
Ford Motor Company
General Electric Company
Google, Inc.
Halliburton Company
Hanesbrands Inc.
Hercules Group
Hewlett-Packard Company
Johnson & Johnson
JPMorgan Chase & Co.
KPMG LLP
Mars Incorporated
Mayer Brown LLP
McCormick & Company, Inc.
Microsoft Corporation
Occidental Petroleum
Oracle Corporation
Pernod Ricard USA
Pfizer International Inc.
PricewaterhouseCoopers LLP
Procter & Gamble
Prudential Insurance
Ridgewood Group International, Ltd.
Siemens Corporation
Sullivan & Worcester LLP
TE Connectivity
Toyota
Tyco International
United Parcel Service, Inc.
United Technologies
Visa, Inc.
Walmart Stores, Inc.
Dear Mr. Andrew Hickman,

Head of Transfer Pricing Unit, Centre for Tax Policy and Administration

I think the whole Public Discussion Draft is very wonderful. I learned a lot of things from this Public Discussion Draft, about the company applications for the Low Value Adding Intra-Group Services.

I would like to add only one idea, that is 'the sector based keys'. As kindly explained in the Draft, the reasonable keys should be used to allocate the amounts. Then, the companies should use different keys (besides service types and other criteria) according to the business field or sector in which the company operates. I think the company sector is a different dimension for 'to group or to classify the expenses'.

Although Draft kindly explained everything about the issue and Draft kindly mentioned about 'the nature of the business' in several places (like 7.49, 7.50) but I think the expense cost pool (D.2.2) should be divided into the parts as 'sector based groups level' before the company level in order to make it easier and more standardized.

Draft encourages the people to think much more sophisticated calculations (paragraph 7.56) and I think 'the sector based company classification' can be another useful tool to consider before the allocation.

Best regards,

Orhan Özer
Kind Attn: 
Mr. Andrew Hickman,  
Head of Transfer Pricing Unit,  
Centre for Tax Policy and Administration.

By email

Subject: Comments to Public Discussion Draft under BEPS Action 10 (Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services)

Dear Sir,

I’m grateful for the opportunity to comment and provide suggestions on Public Discussion Draft of the ‘Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services’.

It is a welcome measure by Working Party No. 6 on the Taxation of Multinational Enterprises to provide guidance on this topic which would help to standardize the approach of tax authorities across the globe notwithstanding that many countries’ domestic tax law already contains legislation relating to transfer pricing for such low value-adding intra-group services. Apart from benefiting from its practical application, this topic is of particular interest to me since I have had the opportunity to conduct research in the past on the topic of transfer pricing for intra-group services under the guidance of Mr. T.P.Ostwal [Current Member of United Nations Subcommittee on Article 9 (Associated Enterprises): Transfer Pricing & First Vice President of Executive Committee of IFA- Netherlands].

I am pleased to make the following comments in relation to the aforementioned Public Discussion Draft:

1. **Paragraph 7.46:**

   One of the attributes of low value-adding intra-group services is the non-assumption of substantial/significant risk and that the performance of such services does not give rise to creation of significant risk.

   It becomes necessary here to qualify the word ‘risk’ to refer to ‘core business risks’ since substantial risk could persist even when providing low value-adding intra-group services. (For eg: Risk of accounting misstatements could be significant enough even leading to bankruptcy situations as has been historically witnessed).
2. **Paragraph 7.50:**

It has been mentioned in this paragraph that providing low value-adding intra-group services may be the principal business activity of group entity providing such services to the MNE group. However, from the perspective of the service recipients, and from the perspective of the MNE group as a whole, the service may not constitute core business activity and may therefore qualify as a low value-adding intra-group service.

A concept borrowed from Taxation Ruling TR 1999/1 issued by Australian Taxation Office could be incorporated here to the effect that a threshold test may be introduced to qualify a service as a low value-adding intra-group service. (For eg: If the total amount charged by the legal entity providing services is less than 15% of the total annual costs in the books of accounts of the MNE group as a whole, then such services could qualify as low value-adding intra-group services). Keeping in mind the documentation & reporting guidelines as prescribed by this discussion draft, verification of the aforesaid threshold test would not pose challenges to the tax authorities.

3. **Paragraph 7.59 vs. paragraph 7.61:**

The last sentence of paragraph 7.59 states that application of benefits test may be difficult or may require greater effort than the amount of the charge that the low value-adding intra-group services may warrant.

This sentence appears to contradict with the documentation & reporting requirements as contained in the first bullet point of paragraph 7.61 wherein it is stated that a description of the benefits or expected benefits of each category of services is to be maintained even in the case of low value-adding intra-group services payments.

I sincerely hope that the above comments may be useful to the OECD.

Yours sincerely,
Harshal Bhuta

P. R. BHUTA & CO. Chartered Accountants

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Centre for Tax Policy and Administration  
Organisation for Economic Co-operation and Development  
2, rue Andre Pascal  
75775 Paris Cedex 16  
France  

TransferPricing@oecd.org

13 January 2015

Dear Mr Hickman,

Comments on the ‘Public Discussion Draft on the Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines relating to Low Value-Adding Intra-Group Services’

Thank you for the opportunity to provide comments on the Public Discussion Draft on BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines relating to Low Value-Adding Intra-Group Services (the Discussion Draft) dated 3 November 2014.

PricewaterhouseCoopers LLP (PwC), on behalf of its international network of Member Firms, welcomes the consideration given by the OECD to add a specific section to Chapter VII of the OECD Transfer Pricing Guidelines containing special simplified rules relating to the allocation of low value-adding intra-group services costs among members of an MNE group. Many MNEs have centralised such low value-adding intra-group services activities and it is our experience that the current compliance burden required both to prepare detailed transfer pricing documentation and manage the ensuing tax audits can be significantly out of proportion to the actual profit potential of the intra-group charges or the actual tax risk involved.

PwC believes that, through the inclusion of a specific section on low value-adding intra-group services in Chapter VII that (1) lowers the burden on MNE groups to demonstrate the beneficial nature of those low value-adding activities for other MNE group members; and (2) allows for an elective approach for reducing the administration involved in the pricing of low value-adding services, the OECD is achieving 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.

Whilst the OECD is in the process of developing increasingly detailed transfer pricing guidance for complex transactions under some of the other Action Points of the BEPS Action Plan, PwC’s view is that it is also essential for the OECD to continue promoting a cost effective use of taxpayers’ and tax administrations’ resources for improved compliance and enforcement processes. Already in its 2011 report on Multi-Country Analysis of Existing Transfer Pricing Simplification Measures, the OECD identified a number of countries (i.e. Australia, Austria, Japan, the Netherlands, New Zealand and the US) applying simplification measures for low value-adding services (i.e. services deemed to carry a limited risk). The simplification measures for those types of services were found to be consistent with
the pragmatic risk assessment strategy adopted by those tax authorities with the aim to keep compliance costs proportionate with the size and complexity of the transactions.

Given the overall strong support for the proposals the Discussion Draft sets forth, the usefulness of the proposed measures will depend on how many countries agree with and adopt the proposed measures. As the OECD is a standard setting organisation, it is hoped that the OECD and G20 countries participating in the drafting of the proposed measures recognize the mutual benefits that would inure to both taxpayers and tax administrations from the widespread adoption of a uniform approach to this issue.

In the remainder of this letter we have identified a number of items for further consideration by the OECD in its next version of the document. We believe that it would be beneficial if the output of the current OECD work results in an updated Chapter VII of the Transfer Pricing Guidelines.

**Detailed Comments:**

1. **Definition of low value-adding intra-group services:**

   PwC welcomes the inclusion of criteria to determine whether a service could qualify as a ‘low value adding service’ under the elective approach. In this respect, PwC recommends to the OECD to confirm the following:

   - Based on the text of the Discussion Draft, the activities listed in paragraph 7.47 cannot be considered as ‘low value-adding intra-group’ services but this does not mean that they necessarily add high value to the MNE group. This is a question that must be addressed by each individual MNE through the normal transfer pricing analysis and the functional analysis in particular. As such, for those services that do not qualify as a ‘low value adding service’ under the elective approach, the full transfer pricing analysis performed by MNE groups may still lead to the same or a similar result including a similar level of profit mark-up as for services that do qualify for the elective approach (i.e. between 2% and 5%).

   - The definition of ‘corporate senior management’ should be clarified by means of examples, as a too broad definition is likely to result in discussions between tax authorities and taxpayers. For instance, whereas the head of legal and HR could be part of an MNE’s ‘corporate senior management’ and thus be excluded from the simplified approach based on the current Discussion Draft, legal and HR services are listed as examples of services qualifying for the elective approach. We therefore recommend the OECD to limit in its next version of this document the type of corporate senior management functions that need to be excluded from the elective approach.

   - The examples listed in paragraphs 7.47 and 7.48 are not meant to be exhaustive so as to provide sufficient flexibility to taxpayers to demonstrate the low-value adding (or vice versa) nature of activities in their documentation file.

2. **Simplified determination of arm’s length charges for low-value adding intra-group services:**

   a) **Determination of cost pool:**

   The OECD should provide more explicit guidance on how the pool of costs needs to be determined as otherwise there could be room for different interpretations by different tax authorities, potentially resulting in increased administration and, in the worst case, increased double taxation.
In order to avoid this, PwC recommends the OECD to consider the following elements:

**Cross-charges** – It would be helpful if the OECD could make it clear that a cost pool represents a composite service of administration in which all participants (providers and recipients) have agreed to cooperate and delegate tasks in order to improve efficiency. Thus it should be sufficient for each company to engage in a single contract for that composite service or set of services and to issue or receive a single invoice such that each bears the appropriate level of cost.

It would also be helpful if the OECD would reference the indirect charge method of paragraphs 7.24-7.27 of the OECD TP Guidelines which is likely to be appropriate in the case of services to which the new Section D applies. This will make it clearer that at arm’s length a company providing such a service can be doing so as part of a general arrangement to a single recipient acting on behalf of a group in the same way that an independent lawyer or an accountant might advise one customer that then shares the advice with other interested parties from whom it might separately recover a part of its costs. In such a case the lawyer or accountant would not need to engage separately with every party or invoice them separately.

**The extent of the service** – An issue arises where two or more companies cooperate. In a simple example, two companies both employ corporate lawyers engaged in services that fall within para 7.48. Company A incurs costs of 60; Company B costs of 40. The appropriate allocation key suggests each should bear 50. PwC believes that the correct interpretation is that Company A has supplied a service worth 10 to Company B. An alternative view which can be deduced from the current draft is that Company A has supplied a service worth 35 to Company B which has, in turn, supplied one worth 15 to Company A. It would be helpful if the OECD could be clear that the service is of 10.

Similarly, the simplified approach with a single pool and single mark-up for these ‘supportive’ services are probably best characterised as general administration. In the same example, if Company A incurs legal costs of 60 and Company B HR costs of 40, an approach consistent with the OECD’s suggested approach is that the correct interpretation is that Company A has actually supplied a composite administrative service of 10 to support the actual business of B. If the OECD intends that each category of activity in the pool retains a specific nature then it would be helpful to say so.

The draft implies that all companies providing services could charge one entity which then charges all those receiving services. Such a company would likely be unable to recover indirect taxes and withholding taxes suffered are likely to be a cost to that company. It would therefore need to include the taxes borne as a cost when making charges to service recipients. The Discussion Draft needs to clarify that these costs are validly included in the cost pool.

**Local deductions, duties, assessments or charges** – PwC recommends that, by virtue of their low value-adding nature, payment for the services should in principle not be subject to any type of local withholding. Alternatively, we recommend the OECD to make it explicit in its next publication that in case the service recipient’s country requires for any type of deduction or withholding on the service payment, the amount of such a deduction or withholding to be added to the payment to be made to the service recipient. This should allow the latter to receive a payment equal to the actual value of the service rendered as if the local deduction or withholding had not been made.
b) Allocation of low value-adding service costs:

PwC welcomes that the Discussion Draft seeks to strike a balance between theoretical sophistication and practical administration as regards the selection of the most appropriate allocation key(s). In this respect, PwC recommends the OECD to make it (more) explicit that:

- the examples of allocation keys listed in the Discussion Draft for particular services are for illustration purposes only and not intended to be exhaustive or binding in any way; and
- a single allocation key could be applied to the total pool of costs where it best reflects the needs to allocate the pooled costs.

c) Profit mark-up:

Cost cross-charge – A number of countries reported to the OECD in 2011 the availability of simplification measures for low value-adding services. Certain of those countries allow for the charging of costs related to low value-adding services without a profit mark-up whereby the mere cost cross charge is deemed to be arm’s length.

The US explicitly mentioned in 2011 that the goal of their simplification measure for low value-adding services is to take them off the audit table so that both taxpayers and tax authorities can devote their attention to more significant transfer pricing or other audit issues.

PwC recommends the OECD to take a similar stance – i.e. allow for a mere cost cross charge - towards the low value-adding intra-group services and go a step further in creating a true low risk environment for low value-adding intra-group services which would also benefit tax authorities in both developed and developing countries through the conservation of audit resources for more important transfer pricing issues.

Safe-harbour range – A literal reading of the current Discussion Draft seems to support the position that taxpayers can select any point within the proposed safe-harbour range of 2% to 5%. It may serve to eliminate all doubt if the OECD could make this point explicit in its next version of this document.

Cost contribution arrangements – Although PwC understands that cost contribution arrangements have not been addressed by the OECD in this Discussion Draft, the OECD should say so where necessary in this Discussion Draft to achieve consistency so that any centralized services related to a cost contribution arrangement can also be cost shared without a profit element even if those relate to low value adding intra-group services.

3. Pass-through costs:

The OECD should address certain inconsistencies between general services versus low-value adding intra-group services such as ‘pass-through’ costs. Para 7.36 which is a reasonable attempt to allow for pass-through of costs (except for the agency function aspect) should also apply to similar costs even when a taxpayer elects the low-value adding intra-group services treatment. Paragraph 7.57 of the Discussion Draft appears not to allow for pass-through of costs.

4. Documentation and reporting:

PwC welcomes the inclusion of a prescriptive list of documentation that would need to be available within an MNE under the elective approach. In this respect, PwC believes that it would be worthwhile for the OECD to make it explicit in its next version of the document that:
• The level of the transfer pricing documentation to be maintained for the low value-adding intra-group services under the elective approach does not fall within the scope of Action Point 13 of the BEPS Action Plan. As such, a documentation file prepared at group level containing the criteria prescribed by paragraph 7.61 would be sufficient thus not creating the need for a separate local file for each participating MNE group member.

• A single intra-group contract would be sufficient thus creating an additional layer of practical administration and harmonisation in line with the low risk and low profit nature of the services concerned.

On behalf of the global network of PwC Member Firms, with the contribution of our colleagues David Ernick, Patrick Boone, Ian Dykes, Andrew Casley and Jonas Van de Gucht, we respectfully submit our response to the Public Discussion Draft on BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines relating to Low Value-Adding Intra-Group Services. For any clarification of this response, please contact the undersigned or any of the contacts below.

Yours faithfully,

Isabel Verlinden
Partner
PricewaterhouseCoopers, Brussels

Adam M. Katz
Partner
PricewaterhouseCoopers LLP, New York

cc Stef van Weeghel, Global Tax Policy Leader

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To Mr. Andrew Hickman - Head of Transfer Pricing Unit, Centre for Tax Policy and Administration.

Email: TransferPricing@oecd.org

Dear Mr. Hickman,

Please find attached the comments on behalf of Quantera Global on The Proposed modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services.

Kind regards,

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The Transfer Pricing Specialists  
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www.quanteraglobal.com
Comments on The Proposed modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services

By

Quantera Global
Quantera Global welcomes the opportunity to provide its comments to BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services (“Discussion Draft”).

We highly appreciate the work that the OECD Working Party No. 6 has done so far. We believe that the Discussion Draft is a helpful step towards a more consistent approach for the treatment of intra-group services charges. It contains further clarifications by way of definitions and examples, and suggests a simplified approach for low value-adding services.

The focus of our comments has been on the newly added section D. on Low value-adding intra-group services. We will provide some general comments first and then address specific issues following the order of the Discussion Draft, making reference to the relevant paragraph numbers of the Discussion Draft where appropriate.

We look forward to discussing these matters in more detail during the public consultation on the 19th and 20th of March 2015 in Paris.

**General observations**

**Introduction of an elective, simplified approach**
We welcome the introduction of the simplified approach for low value-adding services, in particular the simplified benefit test and the safe harbor for the profit mark-up. We consider these welcome steps in lowering the administrative burden for MNEs.

**Other guidance on low value-adding service**
In 2010 the EU Joint Transfer Pricing Forum provided guidelines on the transfer pricing of low value-adding intra-group services (“EU JTPF 2010 Guidelines”). The EU JTPF 2010 Guidelines show similarities, but also include a number of deviations from the Discussion Draft. We would appreciate if the OECD could provide some additional guidance on how the Discussion Draft relates to the EU JTPF 2010 Guidelines.

**Practical implementation**
Under the simplified approach, all costs incurred by the MNE related to the low value-adding services need to be pooled, and subsequently allocated and charged to the benefiting group members. Although this pooling and allocation mechanism as a concept is clearly described in a stepped approach, we feel that some guidance on the practical implementation of these steps would be a welcome addition.

For example, the Discussion Draft does not explicitly indicate that the costs need to be actually pooled in a single legal entity. But assuming that this would be the situation, a subsequent question is how the actual flow of invoices would have to be routed. On the one hand, the way the pooling of the costs is described seems to suggest that group service providers that are not considered the ‘head of the cost pool’ would send an invoice to the latter. Once all costs are pooled and an allocation has been determined, the head of the cost pool would probably subsequently send invoices to the benefiting group members.
However, paragraph 7.58 seems to indicate that there may be direct payments by the service recipients to multiple other service providers in the situation “… where there is more than one group member incurring those costs [attributable to the cost pool of low value adding services – addition of authors]”. In case the pooling could only be a virtual pooling the practical compliance might be rather complex in respect of invoicing. Considering the above, we feel that it would be helpful if the OECD could provide additional guidance as to the practical implementation of the suggested pooling and allocation of the costs relating to low value-adding services.

D.1. Definition of low value-adding intra-group services

Paragraph 7.45
The simplified approach is to be an elective approach. As indicated in paragraph 7.51 it is intended that an MNE would elect as a group rather than group members electing individually. We suggest to avoid confusion in this respect and use consistent wording. We therefore suggest to replace the reference to “taxpayers not electing....” by a references to “MNEs not electing....”

Paragraph 7.46
The guidance in the section would not be applicable for services that are rendered to unrelated customers of the MNE group. We feel that this exclusion might be too rigid. We believe the guidance should also be applicable in case the services are only incidentally rendered to unrelated customers. In case of incidental transactions with unrelated customers these will likely not provide for a realistic internal comparable as the relevant circumstances of the transaction would differ. We would like to suggest to add wording that would restrict the exclusion to situations where reliable internal comparables would be available.

D.2. Simplified determination of arm’s length charges for low value-adding intra-group services

Paragraph 7.51
Although the discussion draft points out that an MNE has to elect for the application of the simplified method on a consistent, group wide basis, the Discussion Draft does not elaborate on the election process. For example, would it be necessary to file an election form, or would it be sufficient to indicate the election in the MNE’s tax return or transfer pricing documentation. Another question that arises is whether election for the simplified approach should be made known to the tax authorities in the home country of the MNE’s head office, or to all tax authorities where the MNE operates. Would it be necessary to make the election year after year? Could a MNE choose to switch from year to year in respect of the application of the simplified approach? We would welcome some additional guidance on the election process.

Paragraph 7.52
This paragraph seems to suggest that an MNE that elects for the simplified approach should -as initial step- create one global cost pool for all costs incurred by all members of the group in performing any low value-adding intra-group services. This suggests an “all or nothing” approach that does not allow for a pooling of only certain categories of qualifying services or pooling between a selection of group companies. As it may not always be certain whether specific activities would qualify as low value adding services
we believe it would facilitate implementation if MNEs would have the opportunity to apply
the simplified approach on a category by category basis. This would also avoid that an
isolated dispute whether a specific category would qualify could jeopardize the
application to other categories not in dispute.

The creation of one cost pool (per category of services) on a global basis could lead to
inappropriate allocations in case low value-adding activities are performed by different
service providers for different subsets of group companies. For example, if an MNE has two
IT support service providers. One Asian IT support service provider performs IT-services
exclusively to the MNE’s Asian subsidiaries and one European IT service provider, which
provides IT-services exclusively to the European subsidiaries. However, the IT costs incurred
by the IT service provider in Asia are only one tenth of the IT costs incurred in Europe,
mainly due to local cost differences for IT support staff. The allocation key opted for is
number of users. The number of users is more or less equal in Asia and Europe. Under the
assumption that all IT services are first pooled globally, and subsequently charged on the
basis of the same consistent allocation key (refer to paragraph 7.55), the Asian group
companies would probably get a higher charge due to the relatively more expensive IT
services in Europe. In our view, this might not be in line with the arm’s length principle. In
this example a regional pooling might make more sense.

We would therefore recommend the OECD to consider allowing the creation of more
than one cost pool, e.g., per region, or per business unit. We believe that such ‘sub-cost
pools’ would enhance the nexus between the services rendered and the related costs
incurred. Alternatively we would welcome some additional wording that would clarify
that in setting allocation keys a MNE may use a two (or more) tiered approach that would
allow segregation of costs to sub-groups before applying any allocation key.

Another topic that we would like to address in relation to this paragraph is the question
whether the cost pool needs to take into consideration budgeted cost or actual costs
incurred. The reference in this paragraph to “costs incurred” seems to suggest that actual
costs need to be used. The use of actual costs would indeed be practical and have our
support but in the full context of the OECD TP Guidelines this seems to present a deviation
from the use of budgeted figures. We believe that it would be helpful if the OECD could
confirm that they indeed expect that actual costs (rather than budgeted costs) should be
pooled.

Paragraphs 7.53 and 7.54
Also here we would suggest to replace the word “taxpayer” by the word “MNE group” to
avoid confusion. A taxpayer as a single group entity will not be able to identify the global
pool but only its own contribution to it. See previous remarks.

Paragraph 7.55
Using one allocation key on a consistent basis for all allocations of costs relating to the
same category of services may provide for deviations from the arm’s length principle. See
also our remarks to Paragraph 7.52.

Paragraph 7.57
As indicated before, we highly appreciate the fact that the OECD introduces a safe
harbor for the profit mark-up on the service charges for low value- adding services. One
important reason is that it will reduce the number of discussions between tax authorities
and MNEs about the question whether an applied profit mark-up is at arm’s length. In addition, it would save the efforts of MNEs to conduct a benchmark study to substantiate the profit mark-up.

Relating to the range of profit mark-ups from 2% - 5%, we wonder whether it would be possible to change the profit mark-up applied in a particular year in the subsequent year as long as it stays within the range of 2% - 5%. Or would an MNE be obliged to apply a chosen mark-up consistently year after year, unless there is a justified reason to change? The use of a range could facilitate different interpretations which could result in unwelcome discussions. To avoid this it might be considered to apply a single profit mark-up (e.g. 5%) rather than a range. We would appreciate if the OECD could provide further clarification in this respect in order to avoid misunderstandings.

An MNE could provide low value-adding services, but may decide not to elect for the simplified approach. Assume that it uses benchmark studies to substantiate a profit mark-up for the services rendered of, for example, 8%. We could imagine that in this situation the tax authorities in the country of the service recipient may want to challenge the size of the profit mark-up. However, we feel that it is unfair if such a situation would increase the likelihood of a tax audit for an MNE. The guidance already indicates that the safe harbor range of mark ups does not in itself provide for a benchmark of arm’s length pricing of the services involved. We would suggest that the OECD further includes additional wording in the Discussion Draft that explicitly addresses that a profit mark-up percentage different from the safe harbor range should not in itself trigger a tax audit.

**Paragraph 7.58**

We would welcome further guidance in respect of practical implementation of the charging mechanism. Who would need to charge who, for what part of the total allocation? See our remarks above under General observations.

**D.3 Documentation and reporting**

**Paragraph 7.61, first bullet**

An MNE shall prepare certain information and documentation in order to evidence that the benefit test is met given the nature of the low value-adding intra-group services. One of the items required is “a description of the benefits or expected benefits of each category of services”. In paragraph 7.60 this has been explained by way of an example: “Thus, the taxpayer need only demonstrate that assistance was provided with, for example, payroll processing, rather than being required to specify individual acts undertaken that give rise to the costs charged”.

We certainly recognise that this paragraph is meant to express a difference between the ‘levels’ of evidence required to meet the ‘existing’ and the simplified benefit test. However, the distinction is in our view not clear cut, which may in practice still give rise to discussions on the (expected) benefits. We would therefore highly recommend to further elaborate on the required level of evidence the tax authorities might expect. We consider that it may also be helpful to provide some examples of benefits per category of low value-adding services.
Comments on the Public Discussion Draft

BEPS Action 10:

Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services

January 13, 2015

Mr. Andrew Hickman
Head of Transfer Pricing Unit
OECD, Centre for Tax Policy and Administration
By email: TransferPricing@oecd.org

Sir,

We are pleased to comment on public discussion draft BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services through the consultation taking place from November 3, 2014 to January 14, 2015.

This document may be posted on the OECD website. Full credit goes to Robert Robillard, RBRT Transfer Pricing. ¹

1. General comments on new Chapter VII

1.1. Part D of new Chapter VII of the OECD Transfer Pricing Guidelines exacerbates a conceptual drift that is already palpable in the Guidance on Transfer Pricing Aspects of Intangibles released on September 16, 2014. ²

1.2. The Guidance on Transfer Pricing Aspects of Intangibles suggests “that transfer pricing methods not directly based on comparables, including profit split

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methods and valuation techniques” may be used to establish the arm’s length price of a controlled transaction.\(^3\)

1.3. This is, in other words, formulary apportionment for transfer pricing purposes.

1.4. We do not adhere to the alternate thesis that Part D of the draft is an application of the safe harbour principles suggested in Part E of Chapter IV of the \textit{OECD Transfer Pricing Guidelines} (as it was amended on May 16, 2013). There are simply too many indirect references to formulary apportionment in the public discussion drafts released by the OECD lately.

2. \textbf{Specific comments on new Chapter VII}

2.1. Parts A, B and C of the draft do not differ significantly from the actual Chapter VII of the \textit{OECD Transfer Pricing Guidelines}.

2.2. However, there is little doubt regarding the fact that Part D of the draft is indeed grounded in the formulary apportionment philosophy, as it would apply to alleged “low value-adding” intra-group services through the use of a one-sided transfer pricing method.

2.3. Surprisingly, paragraph 7.46 states that “[…] the guidance in this section is not applicable to services that would ordinarily qualify as low value-adding intra-group services where such services are rendered to unrelated customers of the members of the MNE group. In such cases it can be expected that reliable internal comparables exist and can be used for determining the arm’s length price for the intra-group services.”

2.4. This signals a troublesome first-step drift from the arm’s length principle toward formulary-like approaches.

2.5. These transactions, which would be considered with the arm’s length principle granted they are also provided to third parties, must now be considered otherwise when they are rendered in the absence of internal comparables.

2.6. The OECD is hence inferring that internal comparables are better than external comparables for comparability purposes. Language in Chapter III of the \textit{OECD Transfer Pricing Guidelines} should be updated accordingly.\(^4\)

\(^3\) \textit{Ibid.}, par. 6.57
\(^4\) See paragraph 3.27-3.35.
2.7. To apply this purported elective approach, the MNE group must identify the low value-adding intra-group services. To that effect, paragraphs 7.47-7.50 of the draft take a second step toward the edge of the formulary apportionment cliff by suggesting a comprehensive definition of what may indeed qualify as “low value-adding intra-group services”.

2.8. Remarkably, no clear or direct relationship is made to the relevance of the comparability analysis as per Chapter I of the *OECD Transfer Pricing Guidelines.*

2.9. The cosmetic references in paragraphs 7.8, 7.34 and 7.43 to “actual facts and circumstances” and “functional analysis” are insufficient to provide the much-needed clarity in light of the wide-ranging definition of low value-adding intra-group services in paragraphs 7.47-7.50 of the draft.

2.10. Paragraph 7.57 of the draft finally jumps head first into the formulary-like approaches precipice, stating:

“In determining the arm’s length charge for low value-adding intra-group services, the MNE provider of services shall apply a profit mark-up to all costs in the pool. The same mark-up shall be utilised for all low value-adding services irrespective of the categories of services. The mark-up selected by the taxpayer should be no less than 2% of the relevant cost and should be no greater than 5% of the relevant cost.”

2.11. The OECD then curiously adds in that same paragraph of the draft that:

“It should be noted that these intra-group services mark-ups should not, without further justification and analysis, be used as benchmarks for the determination of the arm’s length price for services not within the definition of low value-adding services, nor for similar services not within the elective, simplified scheme.” [emphasis added]

2.12. It is somewhat troubling to see that this formulary-like approach may therefore be used, *with further justification and analysis,* for services that are not within the definition of low value-adding intra-group services.

2.13. Moreover, other issues may arise. For example, which analysis may be performed and which justifications may be provided considering the stringent

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5 This may have been an oversight. Although based on the complete draft, this omission makes sense.
definition of “low value-adding intra-group services” in paragraph 7.48 of the draft? How could this formulary-like approach be used for such other types of intra-group services in the first place?

2.14. As for benchmarking, it is defined in the Merriam-Webster dictionary as follow: “a point of reference from which measurements may be made”. 6

2.15. Part D of new chapter VII of the OECD Transfer Pricing Guidelines is undeniably all about benchmarking and formulary-like approaches as far as purported low value-adding intra-group services are concerned.

2.16. As a point of comparison, in the United States, the notion of “low margin covered services” is indeed found in §1.482-9(b)(3)(ii) of the transfer pricing regulations “for which the median comparable markup on total services costs is less than or equal to seven percent.” Benchmarking to be sure.

2.17. However, the US regulations explicitly refer back to the functional analysis in order to make the determination that a service is in fact a “low value-adding intra-group services” prior to benchmarking its value for transfer pricing purposes. 7

2.18. Benchmarking on profit markup is also seen in the European transfer pricing approach to intra-group services; although there is no conclusive definition of what may be a “low value-adding” service. 8

2.19. To this day, benchmarking is absent from the Canadian transfer pricing landscape. 9


7 See for example §1.482-9(b)(5) which indicates that “[…] in evaluating the reasonableness of the conclusion required by this paragraph (b)(5), consideration will be given to all the facts and circumstances.” More to the point, see §1.482-9(a) which refers directly to the comparability analysis found in §1.482-1(d).


9 It is nowhere to be found in section 247 of the Canadian Income Tax Act or in Information Circular IC 87-2R International Transfer Pricing.
3. Conclusion

3.1. The benchmarking rules contained in Part D of new Chapter VII of the *OECD Transfer Pricing Guidelines* in regard to some categories of intra-group services will likely generate a new stream of double taxation cases.

3.2. The temptation by tax administrations all around the world to assign a “low value-adding” label to various intra-group services will likely become more and more common to circumvent the transfer pricing issues arising from these types of legitimate commercial transactions.

3.3. However, it has always been our understanding that the OECD member countries are against global formulary apportionment and formulary-like approaches to transfer pricing.

3.4. After all, paragraph 1.32 of the *OECD Transfer Pricing Guidelines* indicates that: “[…] the theoretical alternative to the arm’s length principle represented by global formulary apportionment should be rejected.”

3.5. Based on the draft of new Chapter VII, global formulary apportionment does not sound so “theoretical” anymore…

3.6. As it was said before: “Would you tell me, please, which way I ought to go from here?” To which it was wisely answered: “That depends a good deal on where you want to get to.”

3.7. And here we are at the gates of global formulary apportionment for intra-group services….

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January 13, 2015

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10 Lewis Carroll, *Alice in Wonderland*; the Cheshire Cat in answer to Alice question... Previously quoted in Robillard, Robert, *OECD Request for input (ref.: BEPS ACTION 11: Establish methodologies to collect and analyse data on BEPS and the actions to address it)*, September 17, 2014.
12 January 2015

Dear Sir/Madam

**BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services**

We are writing in response to the OECD’s request for comments in relation to the Discussion Draft on Low Value-Adding Services released on 3 November 2014.

Reed Elsevier is a world leading provider of professional information solutions. We operate across several professional market segments through five business divisions comprising of Elsevier, LexisNexis Legal and Professional, LexisNexis Risk Solutions, Reed Exhibitions and Reed Business Information. Reed Elsevier operates in more than 30 countries and employs approximately 28,500 people worldwide.

We set out below our representations on the discussion draft. Our representations are focussed on the key issues for our business and we have structured our response based on the 6 main aspects of the additional guidance as outlined on page 3 of the discussion draft.

In general we welcome the introduction of additional guidance to simplify the process for low value-adding services. This should help to reduce the compliance and administrative burden on MNEs in assessing and documenting the arm’s length nature of routine transactions. Our principal concerns are that the exclusions should not be drawn too widely so that genuine low value-adding services are excluded from the guidance. We consider that the terms in relation to what is included as low value or not should be more clearly defined. We would also hope that applying the guidance would not require significant additional resources and would be consistent with the current operating processes established by the business.

**Standard Definition of Low Value-Adding Intra-Group Services**

1. Paragraph 7.47 of section D1 excludes the “services of corporate senior management” from qualifying for the simplified approach. We consider that the term “services of corporate senior management” should be further defined.

For example, Reed Elsevier has 5 separate business division which each have their own CEO / CFOs in addition to the CEO / CFO of the combined business. Many of the activities listed in paragraph 7.48 of section D1 would typically be overseen by senior management within the business. For example accounting and finance services may be overseen by a Finance Director or CFO of a particular business and therefore a typical management services recharge for an MNE could include time spent by individuals who fall under the definition of senior management. Excluding this element of the cost base from the low value-adding services recharge could mean that a second recharge with a different mark-up is also required, therefore replacing a single management recharge with 2 separate recharges with different mark-ups. This would
create more work in terms of calculation and management of the charges than under the previous methodology.

2. Paragraph 7.47 of section D1 additionally excludes “services constituting the core business of the MNE group” from qualifying for the simplified approach. We note the examples given at paragraph 7.49 of section D1 but consider that this exclusion could be open to interpretation and more detailed guidance would be welcomed as to how to define the core business.

For example, a standard intra-group IT services recharge could include infrastructure support and data hosting at internal data centres. As a provider of professional information solutions, some of our services provided to third parties may also include data hosting. Based on the proposed guidelines this could result in the intra-group IT services recharge being excluded from the simplified approach, even though we would not consider the provision of IT services to be part of the core business of Reed Elsevier.

Clarification of the Meaning of Shareholder Activities and Duplicative Costs

3. We welcome the introduction of further clarification of the meaning of shareholder activities and duplicative costs. We note that paragraph 7.11 of section B.1.2. expands the prior list of examples of shareholder activities. We consider that the list could be expanded further to provide some specific examples of such activities, particularly for points d and e of the list.

Guidance on Appropriate Mark-ups for Low Value-Adding Intra-Group Services

4. Paragraph 7.57 of section D.2.3. indicates that an MNE should select a mark-up between 2% and 5% for all low value services. Our understanding from the guidance is that any value in this range can be selected without the need for additional support and that this value should then be applied to all categories of low value services provided by all entities within the MNE. If this interpretation is correct we consider that this should be explicitly stated in the guidance to eliminate the need for any additional discussions with tax authorities regarding how an MNE has arrived at a particular value within the 2% to 5% range.

5. Paragraph 7.51 of section D2 indicates that the simplified approach should be applied in a consistent, group wide basis across all countries in which the MNE group operates. Historically we have seen particular countries apply location savings arguments to result in higher mark-ups for services that would be considered low value-adding services under the guidance. Additionally as a large MNE, Reed Elsevier operates in a number of non OECD countries that may not adopt the OECD guidance in relation to low value-adding services. It may therefore not be possible for an MNE to apply the same mark-up to low value-adding services in all countries in which it operates and we therefore consider that this should be reflected in the guidance. This will permit an MNE to comply with local rules where necessary while still being considered to be consistently applying the simplified approach.

6. Some jurisdictions have provisions in their regulations to allow routine services to be provided at cost with no mark up (e.g. the election for the Services Cost Method ("SCM") in the US). Given that paragraph 7.51 of section D2 of the guidance indicates that the approach should be applied on a consistent basis, it is not clear from the guidance whether electing to operate the simplified approach for low value-adding services would therefore preclude the use of the SCM in the US. We therefore consider that a discussion of the interaction between such rules be included in the guidance.
7. The guidance does not include any reference to third party costs incurred as part of the provision of low value-adding services and whether a mark-up should be applied to those costs. Intra-group services recharges can often include amounts paid to third parties as part of the cost base. It is typically the case that no additional value is added by an MNE to the services provided by third parties and therefore, in many instances, the amounts paid to third parties are passed on to other group entities at cost. We therefore consider that the guidance should be updated to include a discussion of the treatment of third party costs included in the cost base for low value-adding services.

Guidance on Appropriate Cost Allocation Methodologies

8. Paragraphs 7.52 and 7.53 of section D2 set out an overly prescriptive approach for determination of the cost pool. This starts by creating a pool of costs of all low value-adding intra-group services for the MNE group and then removes costs relating to services provided by one group member solely to another group member to arrive at the pool of costs to be allocated. The guidelines would therefore appear to require a single calculation for the MNE covering all of its low value-adding services.

This approach is not workable on a practical level for a number of reasons. Firstly, as outlined above, Reed Elsevier is comprised of 5 separate divisions and there are intra group services that are specific to each separate division. Secondly, recharges solely between two entities are currently not included as part of any cost pool and are recharged on a direct basis. Thirdly, intra-group services within Reed Elsevier are usually calculated and recharged separately for each specific category of services and a different individual may be responsible for the recharge calculation for each service. For these reasons, to create a single cost pool of all low value-adding intra-group services for Reed Elsevier as a whole would require significant changes to our existing processes and create a significant burden centrally in terms of collating the data from a wide number of sources within the business for no discernable benefit.

We therefore consider that the guidance should be less prescriptive and allow MNEs to use alternative approaches which are more consistent with the operation of their particular business, while achieving the same overall result.

Guidance on the Satisfaction of a Simplified Benefit Test

9. We welcome the introduction of the simplified benefit test at paragraph 7.59 and 7.60 for low value-adding services. In practice we have seen requests for large amounts of detailed information from certain tax authorities to evidence the benefit obtained by a local entity from what we would consider to be low value-adding services. In some jurisdictions this has led to recommendations from professional advisors for the preparation of a “defence file” for each tax year to support the benefit obtained from routine services provided by group entities. Such defence files take substantial time and resource to prepare and can include a high level of detail, often going as far to include copies of email correspondence from individuals performing the services to evidence that those individuals have in fact been carrying out those services. As some tax authorities may now be accustomed to receiving such defence files, we consider that the guidance should explicitly state that such additional defence files are not required to support low value-adding services.

Guidance on Documentation

10. Paragraph 7.61 of section D3 outlines the documentation required in order to support the low value-adding intra-group services. The guidance doesn’t explicitly state whether this information should be presented in
a separate document or as part of the master file / local country file. We would consider that, in practice, the information required under this section would be included in the master file / local country file and therefore should not require an additional separate report. It is therefore our view that the guidance should be updated to clarify this point.

We would like to thank you for providing us with the opportunity to comment on the discussion draft and look forward to being included in the discussion process.

Yours faithfully

Paul Morton
Catherine Goodman
Paul Hewitt
Dear Mr. Hickman,

On November 3rd, 2014, the OECD published a further Discussion Draft: “Proposed modifications to Chapter VII of the transfer pricing guidelines relating to low value-adding intra-group services”, indicating on its website that written comments on this paper should be submitted by interested parties by January 14th, 2015.

The Discussion Draft deals with the charging for intercompany services. This topic is of particular importance for the daily work of our clients. We greatly appreciate the initiative of the OECD to modify Chapter VII of the Transfer Pricing Guidelines (hereinafter “OECD TPG”) and in so doing to factually accommodate and confirm the increasing importance of intra-group services within cross-border business models and the relating need for legal certainty. Whereas even appropriate cost allocation schemes still seem to be considered by many domestic tax authorities as models for mere base eroding payments, it can be deemed as a matter of fact that any intra-group operative business as well as any proper exercise of the arm’s length principle itself would not work without there being a reliable and efficient framework for the allocation of costs for intercompany services in place.

In this context, we examined the paper with great interest and trust that we will be able to provide you with constructive suggestions. According to the above, we are most thankful for the opportunity given to us by the OECD to participate in this project and hope that you will find useful remarks in our comments below.

Please do not hesitate to contact us should you require any clarification on those comments that are sent on behalf of the Rödl & Partner Global Transfer Pricing Group which encompasses transfer pricing professionals in 27 countries.

With best regards,

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Proposition

Our comments will be structured as follows: The first part will focus on general issues and remarks of overriding importance. In the second part of our comments starting on page 3, however, the particular aspects of the individual paragraphs shall be highlighted in chronological order. Finally, our memorandum shall conclude by summarizing the most important aspects from our point of view.

Overall general remarks

First of all the Discussion Draft deserves the merit to disprove the preconceived idea that charging for intercompany services is in general an instrument for profit shifting. The effort which the OECD invested in clarification is very appreciated by the taxpayers and will reduce hurdles within the international economy. Regarding this the OECD reconfirms the general principle that charging for intercompany services considering the arm’s length principle is an appropriate transaction from the transfer pricing point of view.

Regarding the proposed modifications to Chapter VII of the OECD TPG, the OECD concentrates from our standpoint indeed on a practical topic and thus leaves the field of an exclusively academic discussion. From our perspective, this is a commendable development. According to this the proposed modification will generate more interest especially among the taxpayers. In practice, a guideline regarding the charging of intercompany services is necessary for the taxpayers because the topic is frequently and controversially discussed in tax audits.

In comparison to the previous version of Chapter VII the proposed modifications introduce a clearer structure. According to the well-structured table of content the remarkable points regarding the charging for intra-group services can be followed easier by the taxpayer than before because the proceeding for charging, which must be considered by the taxpayer, is already mentioned in the table of content. Additionally, we absolutely appreciate the introduction of an additional Section D devoted to low-value adding services which mainly attempts to reduce the administrative burden of the MNEs which is an important aim in order to establish an effective guideline-system.

Moreover, the Discussion Draft includes numerous examples regarding the definition of intercompany services in general, stewardship services and low-value adding services. These examples enable a suitable classification and reinforce the practical usage of the OECD TPG. In practice, this may give valuable guidance for particular cases when designing a transfer pricing regime for intra-group services and furthermore, we trust that making reference to a specific example of the OECD TPG may facilitate defending service charges within a tax audit, providing a higher degree of legal certainty for both the taxpayers and the competent tax authorities.

Nevertheless, the examples focus mainly on definitions and only to a minor extent on implementation issues. In other words, there are many examples regarding the question which services are chargeable or not and which services are low-value adding but there are less examples dealing, for e.g., with the concrete implementation of billing. For instance, there are no examples regarding the appropriate cost base or mark-up. This point will be considered in more detail later on.

The OECD has offered a proposal for a charging mechanism which is convenient to meet a high degree of acceptance among the current OECD members. This possible far-reaching consensus at
least among the OECD members could lead to a unified regulation and according to this to legal certainty within a broad area which is very important for the MNE groups because it is burdensome for them to deal with several different domestic law regulations and in the next step complying with their requirements. Although the efforts at OECD level will not per se have any impact outside of the OECD where tax jurisdictions often do not accept for instance the indirect cost allocation at all or at least implement obstacles which may lead to implementation problems for the MNE groups. Consequently, we appreciate that at least the OECD makes further attempts to create among the member states a broad acceptance range. Regarding this, the work of the OECD is an essential contribution to establishing global transfer pricing guidelines, which is a desirable development from the MNEs’ perspective.

We appreciate the OECD argumentation coming from an economic point of view. This opens a certain degree of flexibility for the MNEs and facilitates the implementation of different approaches depending on individual cases. According to this the transfer pricing system can go along with the operative business model.

However, in addition to the need for flexibility and a case-based approach there are two more characteristics which a well-balanced regulative environment has to fulfill from our point of view: Legal certainty and reduction of administrative burden. In such context it appears that there is a sort of trade-off between flexibility on the one hand and legal certainty on the other hand. Especially, our clients which are mostly SMEs (small and medium-sized enterprises), many of them being family owned, prefer legal certainty to flexibility and discretion. SMEs often have limited resources to administer tax issues themselves, therefore they also have a strong interest in reducing the administrative burden and desire clear framework conditions for charging intercompany services. According to this, it would be helpful especially for SMEs if the OECD could be more concrete in terms of its examples and suggested approaches such as for instance the introduction of safe harbors or regarding the cost base. We are going to explain this point in more detail in the following sections.

It is worth emphasizing that in the Discussion Draft indirect cost allocation receives legitimation by the OECD which is conspicuous especially because of the resulting reduction of the administrative burden. Practice shows that direct cost allocation is often only feasible under the consideration of a disproportional effort. Regarding the direct and the indirect cost allocation the Discussion Draft at hand offers the taxpayer the possibility to harmonize cost allocation with the operative business model.

According to this, the proposed changes to Chapter VII are a successful step further in the right direction to establishing a general guideline for the charging of intercompany services.

**B.1 Determining whether intra-group services have been rendered**

- **Pr. 7.7, line 7-8** It should be highlighted that the reference to determine whether intra-group charges are deductible or not, should be the behavior of third-parties under comparable circumstances. However, there may be cases in which a particular service may not normally occur between independent parties but which nevertheless constitutes a chargeable service from the transfer pricing point of view. There may be activities which can be characterized as services even if they do not generate a direct benefit to the services provider nor to the recipient but provide commercial value to enhance or maintain the commercial position (e.g.
repair services beyond guarantee periods without charge for key-account clients) or even services that do not provide direct benefit to the services provider nor to the recipient (i.e. the costs exceeding the related incomes) but still enhance or maintain the commercial position of the services provider, of the services recipient or both (Pr. 7.7) or provide incidental benefits (Pr. 7.13-7.14) to the MNE group. This behavior may be related to business strategies, the market characteristics and competitors behavior (who may as well be members of MNE groups or not) or when the compensation for the services are included in the price for other transactions (Pr. 7.29). The costs related to these services should be allocated to and shared between the enterprises involved in the provision of such services according to the expected benefits or the behavior of third-parties under comparable circumstances.

- **Pr. 7.10** We appreciate the detailed definition of shareholder services and the resulting consequences for cost allocation. However, in this paragraph the OECD also mentions the term stewardship services. According to definition, both could be seen as synonyms, but the OECD indicates in the Discussion Draft that there are differences between stewardship services and shareholder activities (line 7). However, from our point of view the differences and their consequences are not defined clearly enough. Therefore the question arises as to whether both expressions may be used as synonyms or whether there are essential differences. According to this it would be helpful if the OECD could make an attempt to explain in more detail the differences, if any, and the resulting consequences for the taxpayer. If both expressions should express the same meaning, from our point of view it would appear preferable to confirm this in the given context.

- **Pr. 7.11** In our judgment, the example which is mentioned in this paragraph is too general so that it would be more meaningful if the OECD could explain under which circumstances the respective scenario could be classified as a shareholder activity. Unfortunately, the OECD only mentions: “... independent enterprise would have been willing to pay ...” (line 7). This expression appears to be too theoretical and general in order to provide significant guidance in practice. It is a definition rather than an example. Accordingly this example would not have the desired effect. Therefore from our point of view the OECD should formulate a more concrete example.

- **Pr. 7.12** The restrictions regarding the duplication of intra-group services are commendable because they show the operative reality of MNEs. According to this every case needs to be considered individually. We appreciate also the reasons mentioned for duplication like restructuring or protection of important decisions. Regarding this the OECD authorizes operative reasons for duplication. This suggestion is very helpful for the taxpayer. We would appreciate even more if the OECD could make an attempt to mention further examples for duplications which go along with the arm’s length principle in order to intensify the discussion about these circumstances.

- **Pr. 7.13** It is mentioned that incidental effects are not considered as intercompany services. This is commendable in order to reduce the administrative burden of the taxpayers because external effects like incidental effects are hard to quantify for taxpayers. Additionally, it is almost impossible to distinguish whether the external effects result from the group structure
Proposed modifications to Chapter VII of the transfer pricing guidelines relating to low value-adding intra-group services

or from other circumstances. Moreover, charging external effects would discriminate MNEs in comparison to third persons because the latter are ordinarily not charged for external effects. In general incidental effects appear to be comparable with shareholder activities.

- **Pr. 7.14** We agree with the OECD that an associated enterprise should not be considered to receive an intra-group service when it obtains incidental benefits attributable to its being part of a group. However, we would like to expand the example and its explanation. In our judgment, in general every entity should be rated under the assumption of a stand alone basis and to the extent possible like in the case of a guarantee. Whereas in some cases due to an affiliation to a group it is not possible or it is only possible under an inappropriate burden to identify the single rating, no transaction should be deemed to exist. In such cases a group rating is acceptable. However, in cases in which identification of a single rating is feasible with reasonable effort such approach should prevail. We would appreciate it if the OECD could initiate a discussion regarding this.

- **Pr. 7.15** In the context with centralized services further guidance could be added as to how to allocate cost advantages resulting from the centralization which can be characterized as synergy effects. A centralized service center results in most cases in price advantages. The OECD should give a recommendation regarding how to allocate these advantages. Insofar the OECD should make reference to the OECD/G20 Base Erosion and Profit Shifting Project, ACTION 8: 2014 Deliverable¹, Chapter I-II, “D.8 MNE group synergies” considering MNE group synergies and also distinguishing between advantages which depend on special deliberate structures and external effects.

In our understanding it would be helpful if the following passage were to be added to the last sentence of the paragraph: “... for themselves under comparable circumstances, even though the fact that there are services that do not normally occur between independent parties”. According to the extension of this statement the acceptance of intra-group services based on the behavior of the parties and the related benefits rather than on the nature or the name of the services could be increased. We would appreciate it if the OECD would accept this passage hence all intercompany services are included which have a commercial value for the MNEs.

- **Pr. 7.17** The costs for offering low value-adding “on call” services should be included in the cost pool of the low value-adding intra-group services. This would reduce the administrative burden as well (Pr. 7.52-7.54). From our point of view “on call services” can refer to both, low-adding services and common services. We would appreciate it if the wording could put this distinction straight.

From our point of view it is a general principle that the services provider receives for its activities, regardless of whether they refer to an actual provision of services or mere ‘on call’ offering, an arm’s length remuneration.

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Other issues arise with respect to services provided “on budget”. Independent enterprises offer and obtain services according to budget (lump-sum). As a result the service recipient is usually aware of the estimated fees before receiving the services, and they accept the estimated fees after comparing them, or not, with the offers of other services providers or with the costs of performing the services themselves. Nonetheless and under specific circumstances it may turn out that the actual fee is higher or lower than the estimated fee, but always with a justification by the services provider of this modification.

In this regard, it should be more important whether the services provider obtains an arm’s length remuneration during a given period of time (e.g. fiscal year), even if specific services or specific service recipients would not be profitable to the services provider when analyzed separately.

- Pr. 7.18-7.19 From our point of view it would be helpful if the OECD could provide more guidance concerning the information which should be kept to show that intercompany services have been rendered.

B.2 Determining an arm’s length charge

- Pr. 7.25 “sound accounting principles” As the accounting principles may vary country by country and also enterprise by enterprise, more guidance should be provided relating to which costs are to be included/excluded in/from the cost basis in order to apply the cost plus method. Additionally, we would also appreciate more guidance regarding the possibility of applying the transactional net margin method when the cost plus method is not available (due to the lack of appropriate financial information or when the costs of obtaining such information are disproportionate).

- Pr. 7.26, line 11-12 “The allocation method chosen must lead to a result that is consistent with what comparable enterprises would have been prepared to accept”. There are circumstances in which the enterprises would prefer to estimate the services fee according to direct or indirect-calculation methods depending on variables other than the costs assumed for providing the services (e.g. the mark-up over the costs charged by a third-party). These methodologies should be accepted as well. In these cases, the margins obtained are cost-sensitive (however without calculating the actual costs incurred by the services provider for providing the services, in particular when it is disproportionate to calculate these costs). Third-parties may apply the same methodology under comparable circumstances and/or third-parties may be willing to accept the services fees resulting from these methodologies, depending on the facts and circumstances of the case. Therefore, in our opinion such methods should be accepted as well.

- Pr. 7.32 The Discussion Draft addresses the following issue: the required price by the service provider is higher than the willingness to pay of an independent entity. Practice shows that this is a common issue. However, no general solution seems to be available for this mismatch. Thus, we agree with the OECD not to provide such a general solution. However, some kind of guidance could be provided nonetheless. We suggest that in this situation bargaining power should be decisive, e.g., the price may be based on an entrepreneurial decision.
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- Pr. 7.33 The Discussion Draft mentions that if the CUP method and the cost plus method are not applicable the usage of more than one method may be helpful. From our experience, in most cases the cost plus method should be applicable but if the administrative burden implementing one of these methods would be too high or another method would be more appropriate, any other method which is appropriate in this case should be accepted as well.

- Pr. 7.35 According to the cost plus method, there is no concrete advice regarding which cost basis should be used. For instance, the OECD does not give advice regarding whether the taxpayer should use the budgeted or actual costs (as already mentioned in the general remarks), nor does it explicitly state that such decision should be made at the taxpayer’s discretion. Furthermore, the OECD gives no recommendation on how to deal with costs caused by third parties. In this case the mark-up should not be added on to the full costs but only on to the value contribution of the service provider.

- Pr. 7.36, line 7-9 Taking into account the guidelines of this paragraph but in the context of low value-adding services, the cost base respectively, the cost pool and the mark-up are not defined in sufficient detail. Under the circumstances of Pr. 7.36 and when the activities are part of low value-adding intra-group services according to the new Section D, the corresponding costs for providing the services should be included in the costs pool (Pr. 7.52) and the external costs should be recharged without mark-up to the end-beneficiaries of the costs.

The administrative activities related to the recharge of external costs that are high value-adding (e.g. insurance premiums) could be classified as low value-adding intra-group services (e.g. intra-group administrative services).

- Pr. 7.37, line 4 The Discussion Draft includes the following wording: “... rather than providing the services merely at cost”. From our point of view the following wording should be added to the sentence mentioned above: “...even assuming all the costs without charging the services recipient”. There may be circumstances in which independent enterprises would assume the costs of the services if this behavior were to enhance or maintain their commercial position.

- Pr. 7.37-7.38 The Discussion Draft also discusses cost allocation without a mark-up. This suggestion is acceptable from an economic point of view. We have already addressed this point in 7.35. However, it is worth mentioning that some tax authorities would not accept a cost allocation without mark-up. This may lead to a clash with domestic tax laws. However, in general the suggestion should be accepted in case this behavior corresponds to the behavior of third-parties under comparable circumstances. Nevertheless, it would appear helpful to maintain a flexible approach insofar.

D.1 Definition of low value-adding intra-group services

- Pr. 7.46 We appreciate the detailed definition of low value-adding services. The definition makes a clear classification possible and regarding this the certainty for taxpayers is encouraged. In particular, the mentioned examples are helpful.
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- Pr. 7.47 We agree with the definition of these activities not being low value-adding, but there may be activities of a supportive nature related to these activities that should be considered as low value-adding intra group services (e.g. invoicing related to insurance activities, financial transactions, etc.) when such do not form part of the core business of the MNE group (Pr. 7.50).

D.2 Simplified determination of arm’s length charges for low value-adding intra-group services

- Pr. 7.51 et seq. In our judgment more guidance regarding how to create a proper cost pool (e.g. salaries (fixed or variable, both, perks, among others), overhead, depreciation, etc.) should be provided by the OECD. It is also not clearly defined which costs can be combined in one cost pool. The total costs of all low value-adding services or only the costs of the services which are similar? We would support the idea of allocating the costs of all low value-adding services into one cost pool.

- Pr. 7.52 The Discussion Draft often mentions the expression cost pool. However, there is no definition of the composition of the cost pool. Regarding the cost pool the OECD is unfortunately very reluctant. The OECD mentions no recommendations about the implementation of an appropriate cost base.

- Pr. 7.52 et seq. The taxpayer is not bound to make use of the simplified approach for low value-adding services. According to this the taxpayer has flexibility which is commendable. However, we suggest that the OECD should also consider extending the simplified pool approach to include common intercompany services, for example with regards to a development community. If every member of such community benefits from the joint activities but also contributes to such, it would be more practical to implement a cost pool and to allocate the costs as well, as it is suggested for low value-adding services. In this case, no mark-up should be applied.

In our understanding it should be possible to exclude from the cost pool those costs relating to low value-adding intra-group services which are external costs and where the end-beneficiary is clearly identified. Therefore, it would be better to recharge such costs to the beneficiary of these external costs by using another methodology (i.e. recharge of costs without adding a further mark-up as proposed in Pr. 7.36 of the Discussion Draft).

There is a difference between charging on the basis of the budgeted costs or of the actual costs. However, the OECD does not mention how to deal with differences in the results according to the usage of variable cost bases. In this case the question arises as to whether the taxpayer has to make year-end adjustments. We would appreciate it if the OECD could take a position under which premises an adjustment shall be necessary. We suggest defining a certain benchmark determining the extent to which the actual costs may differ from the estimated costs. In general the deviation should not exceed the mark-up, in order to limit potential losses (in case a deviation exists).

- Pr. 7.57 The Discussion Draft suggests for low value-adding services a mark-up between 2% and 5%. In order to further increase the legal certainty, it may appear advisable to define the mark-ups as safe harbors as in some tax jurisdictions a mark-up of 2% may be difficult to
defend. For SMEs which have limited resources to administer tax issues themselves and thus are dependent on an adequate degree of legal certainty, safe harbors would constitute an essential reduction of the administrative burden.

Furthermore the OECD suggests using the same mark-up for all services. We support the suggestion of using a uniform mark-up for all included services. However, we would also appreciate it if the taxpayer could have the discretion to implement different mark-ups for different services within the cost pool.

D.3 Documentation and reporting

- Pr. 7.61 There is no clarification by the OECD regarding the contemplated three-tier documentation approach if the documentation of the intercompany services should become part of the Master File or of the Local File. A suggestion could be distinguishing between services assigned at headquarter level (documentation in the Master File) and central services, for example to be provided by shared service centers (documentation in the respective local file).

We appreciate the clear recommendations concerning the documentation of low value-adding services. In this context, the wording should also indicate how to update an existing documentation report in the following years if the underlying services have not changed. In this case no update of the documentation should be necessary, except an update of the relating figures (calculation of the cost pool and invoicing). This would provide for legal certainty.

However, the differences of the documentation requirements between common intercompany services and low value-adding services are not well-defined. There are no simplifications. We would appreciate it if the OECD could expand this paragraph.

Conclusion

Concluding we would like to refer positively to the serious attempt of the OECD to reduce the administrative burden. The simplified benefit test regarding the fact that all low value-adding services can be summarized in one pool which is mentioned in the Discussion Draft and the pooling approach considering low value-adding services should facilitate the provision of intra-group services especially. The OECD-draft makes an attempt to establish guidelines which provide a further step in the right direction to introduce a joint understanding of charging intercompany services inside the OECD. A common procedure is of particular importance for the MNEs in order to implement an efficient transfer pricing system.

In general we appreciate the flexibility regarding the applicable charging approach. According to this we prefer informal guidelines to strict instructions. However, as already mentioned above in some cases the taxpayers, especially SMEs, need engaging information.

From an economical perspective, guidance on the cost base used is more essential than on the mark-up used. Unfortunately, the OECD gives no guidance for the implementation of an appropriate cost base. According to this we would like to request that the OECD be more specific on this point. This also includes the cost base of the cost pool for low value-adding services. Regarding such and in our
opinion also costs of “on call services” which are low value-adding should be accepted in the cost pool. SMEs particularly need support in this case.

The suggested mark-up for low value-adding services by the OECD has not been formulated as a safe harbor regulation. We advocate that the range between 2 - 5% mark-up should be treated as a safe harbor with the consequence that within this range any mark-up should be accepted.

Regarding intra-group services and its charging, we would like to highlight that the activity of the service provider and its commercial value to enhance or maintain the commercial position of the service recipient should generally prevail over the name or the nature of the respective intra-group service.

Munich, January 14th, 2015

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By E-Mail
OECD
Attn. Mr. Andrew Hickman
Head of Transfer Pricing Unit,
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Dear Mr. Hickman,

Please find below the comments of RBS RoeverBroennerSusat GmbH & Co. KG Wirtschaftsprüfungsgesellschaft Steuerberatungsgesellschaft ("RBS RoeverBroennerSusat") on the public discussion draft regarding "BEPS Action 10: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services" issued on 3 November 2014 ("OECD Discussion Draft"). RBS RoeverBroennerSusat acts as tax advisor and auditor of the small and medium size entities ("SME") as part of the German mid cap market (Mittelstand). Thus, the focus of our comments is set on the impact of the OECD Discussion Draft on SMEs.

As announced by the OECD the revision of Chapter VII of the OECD Transfer Pricing Guidelines aims at providing protection against common types of base eroding payments, such as management fees and head office expenses. The guidance provided by the OECD generally seems suitable to facilitate a balance between appropriate charges for low value added services and the need to protect the tax base of payor countries. The addition of an optional simplified benefit test for the taxpayer is highly welcome, as it reduces legal uncertainty in respect to transfer pricing of low value added services. We encourage the OECD to widen the scope of application for the simplified benefit test. While RBS RoeverBroenner-Susat broadly supports the aim of the OECD, we consider it of the essence to minimize the corresponding administrative burden, particularly for SMEs.
A. Introduction

RBS RoeverBroennerSusat supports the general view of the OECD that intra-group services vary considerably among MNE groups, as does the extent to which those services provide a benefit (para. 7.4). Each case thus depends on the specific facts and circumstances and it is generally possible to identify low-value services within a broad range of activities, including manufacturing and sales. Hence, disqualifying all manufacturing and production services as well as all sales marketing and distribution activities from the simplified benefit test (para. 7.47) appears unnecessarily restrictive – see also below.

B. Main Issues

B1. Determining whether intra-group services have been rendered

The wording adopted to illustrate that the arm’s length principle is reflected in an analysis of the economic and commercial value of the services that have been rendered for one or more group members (para 7.7) should be modified to explicitly clarify that an economic analysis takes precedence over formal consideration (e.g. existence of a written contract – para 7.19).

RBS RoeverBroennerSusat supports the adoption of a narrower definition of shareholder costs, opposed to the broader term stewardship activities (para. 7.10). The examples provided by the OECD (para. 7.11) should, however, be specified – e.g. are costs relating to the new Country-by-Country Reporting considered as costs relating to compliance of the parent company with the relevant tax laws? What kind of benefit test or documentation would be considered adequate to demonstrate that costs relating to the parent’s company’s audit of the subsidiaries accounts are not carried out exclusively in the interest of the parent company (e.g. audit requirements relating to debt financing)?

RBS RoeverBroennerSusat supports the view that incidental benefits derived from global marketing campaigns should be considered as constituting an intra-group service (para. 7.14). In this context, further elaboration would be welcome in regards to valuation and allocation of respective costs.

We concur that in evaluating the arm’s length nature of on-call arrangements a multiple year approach should be adopted (para. 7.18). It should be clarified, under which conditions the termination of an on-call arrangement prior to any services actually being rendered may be considered arm’s length – (e.g. stipulating a safe harbor period of three years).

B2. Determining an arm’s length charge

The adopted wording, namely that a MNE group should often be able to apply direct charging agreements (para. 7.23) could facilitate respective requests by tax authorities. As recognized by the OECD, however, a direct charge method is rather difficult to apply in practice (para. 7.24). From the perspective of SMEs this is of utmost relevance, as the availability of the data required for applying a direct method is often limited. In this context it would appear sensible to put even...
stronger emphasis on the principle of proportionality (para. 7.26). The adoption of respective de minimis clauses to safeguard SMEs would be welcome.

For the sake of providing unambiguous guidance, the two-sided approach to determining the arm’s length price in relation to intra-group services (para. 7.31) should be further specified. While the OECD correctly points out that it would not be appropriate to increase the price for services established by applying the CUP method in order to make sure the associated enterprise makes a profit (para. 7.37 and 7.38), it should be clarified that the charge for value-adding services may substantially exceed the related costs. By integrating specific guidance, the definition of low-value-adding services should contain a clear delineation to value adding services (e.g. in the context of para. 7.45).

D. Low value-adding intra-group services

RBS RoeverBroennerSusat supports the elective simplified benefit test (para. 7.45). To underline the elective nature of these guidelines for the benefit of the taxpayer, it should be explicitly stipulated that the simplified approach, including the suggested profit mark-up, cannot be utilized by tax authorities in the course of tax audits.

D1. Definition of low value-adding intra-group services

According to the OECD Discussion Draft the simplified benefit test cannot be applied for services which would ordinarily qualify as low-value adding intra-group services where such services are rendered to unrelated parties (para. 7.46). While the respective assumption of the OECD, namely that in such cases it will often be feasible to identify reliable internal comparable, is generally sensible, automatic disqualification of all otherwise qualified low-value adding intra-group services appears excessively restrictive. In this context, we consider it imperative to emphasize the principle of proportionality. In case the services rendered to unrelated parties are comparatively insignificant (e.g. services are merely offered to utilize excess capacity), the low-value adding nature of these services should be recognized – qualifying the services for the application of the simplified benefit text. This should also apply for shared service centers (para. 7.50).

As mentioned above, disqualifying all manufacturing and production services as well as all sales marketing and distribution activities from the simplified benefit test (para. 7.47) appears unnecessarily restrictive – particularly, in view of other services generally considered eligible for the simplified benefit test. Considering that contract manufacturing and sales support services are widespread, it appears worthwhile to evaluate under which conditions respective activities could qualify for the simplified benefit test. The integration of a de minimis clause could provide efficient solution.

The wording adopted in the context of providing examples for services that would likely meet the definition of low value-adding services (para. 7.48.) should be refined to avoid possible misinterpretation. In particular, the wording suggests that most services provided by an in-house legal counsel would likely meet the definition of low-value added services. Considering that the
EUJTPF analysis of margins for intra-group services (DOC:JTPF/018/BACK/2009/EN) found that services relating to “Legal/Accounting” (NACE Rev.2 code, 69) exhibit the 4th highest Median FCMU (from a total of 30 NACE Rev.2 codes) it appears, at least for Europe, questionable whether legal services would qualify as low value-adding services without providing a more nuanced example. To avoid any respective discussion in tax audits, we would welcome a more elaborate explanation of the relevant consideration by directly referencing the conditions stipulated in para. 7.46. – e.g. under which conditions are in-house legal service assumed to not involve the assumption or control of significant risk?

D2. Simplified determination of arm’s length charges for low value-adding intra-group services

The guidance regarding cost pooling according to categories of services (para. 7.52) should allow for more flexibility, as compulsory segmented accounting would lead to additional administrative burden, particularly for SMEs. In this context it should also be considered, that due to the limited transaction volumes segmented cost accounting is often not required from a business point of view. Furthermore, considering that the same mark-up shall be utilized for all low-value adding services irrespective of the category (para 7.57), segmented cost accounting should be of rather limited practical relevance. In respect to the bandwidth of acceptable mark-ups, it should further be clarified that the selection of any specific mark-up within this bandwidth rests in the sole discretion of the taxpayer.

The OECD Discussion Draft correctly points out the need for striking a balance between theoretical sophistication and practical administration in the context of selecting and applying allocation keys (para. 7.56).

RBS RoeverBroennerSusat strongly supports the provision that tax administrations should consider benefits only by categories of services and not on a specific charge basis (para. 7.60). Analogous to para. 7.52 it should be emphasized that the level of detail applied in the categorization will depend on the relevant facts and circumstances. We further concur with the view of the OECD that a single annual invoice describing the category of services should suffice to demonstrate that respective services were rendered – provided documentation according to para. 7.61 is made available to tax authorities.
D3. Documentation and Reporting

We generally find that the provisions regarding documentation and reporting outlined in the OECD Discussion Draft (para. 7.61) are reasonable. It should, however, explicitly be ensured that the provision will extent neither the scope nor the frequency of transfer pricing documentation requirements. Respective request by tax authorities should be confined to tax audit proceedings.

We remain at your disposal for any further discussion of these issues.

Yours sincerely,

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January 7, 2015

Subject: Comments on the BEPS Action 10: Public Discussion Draft on proposed modifications to Chapter VII of the Transfer Pricing Guidelines relating to low value-adding intra-group services

Dear Mr. Hickman,

Ryan Netherlands B.V. (hereinafter referred to as “Ryan”) is pleased to comment on the BEPS Action 10: “Public Discussion Draft on proposed modifications to Chapter VII of the Transfer Pricing Guidelines relating to low value-adding intra-group services” (hereinafter referred to as “discussion draft” or “draft”).

First of all Ryan is enthusiastic on the discussion draft as it provides new guidance on various topics related to low value-adding intragroup services. The practical examples and illustrations are useful and can be referred to when dealing with concrete issues. We support the OECD’s leadership efforts to promote and maintain a broad international consensus on transfer pricing issues related to low value-adding services and are convinced the discussion draft is a step forward in this matter.

Our comments on the discussion draft are as follows:

**Benefit test (section B.1)** - The discussion draft elaborates on the benefit test. For low value adding services, the benefit test may be challenging in instances where the intercompany services are provided irregularly. Such service may include IT support, legal support or even management support. A group entity making use of these services may only require these services when a certain event occurs. For example a group entity may use the legal department once it is confronted with a legal dispute. In the event a group entity does not make use of the service for a specific period in time, the benefit test as currently described may fail, as no concrete/identifiable benefit was obtained. However, the fact that some services are available upon demand does provide value even though they are not used frequently. More guidance would be welcomed on how to approach the benefit test...
for intercompany services that are used irregularly. In this regard, guidance provided in paragraph 7.60 is useful (even though it is provided in a different context) as it states that tax administrations should consider benefits only by categories of services and not on a specific charge basis.

**Benefit test (§7.9)** - The example provided in §7.9 should in our view be replaced. The service mentioned in the example does not qualify as low value-adding intra-group service (i.e. the topic of the discussion draft).

**Numbering of examples and specific cases (section D)** - Considering the large number of examples and specific cases, Ryan would welcome the numbering of the numerous examples and subcases.

**Non-qualifying activities for the simplified approach (§7.47)** - Compared to §7.48, where relatively detailed guidance is provided, there is no guidance for the list of activities not considered as qualifying for the simplified approach (hereafter “non-qualifying services”). Ryan believes the current wording may introduce unnecessary discussion and dispute between tax payers and tax authorities. In this regard, we believe attention should be given to the following issues:

- **Non-qualifying services** - Paragraph 7.47 provides an overview of services that should not be considered as qualifying for the simplified approach. Currently no examples or further guidance is provided that would facilitate the identification of these services. To avoid potential discussions with tax authorities, a more detailed description of the services would be welcomed. Alternatively, leaving out the overview could be considered.

- **Core business of the group** - The discussion draft introduces the term “core business of the group”. However this term is not defined. It is not uncommon that MNE’s are simultaneously active in different industries (i.e. conglomerates). Moreover with the rapidly developing economy the core business of a company may be changed or redefined. For example, a financial institution may (or may not) consider its IT department as core business of the group. Ryan would welcome more guidance on or a definition of the term “core business of the group”.

- **Potential duplication or partial duplication** - Most of the “non-qualifying services” may contain an administrative, low value-adding element which is covered by the guidance of §7.48. For example, sales, marketing and distribution activities may consist of client focusing activities (not qualifying) as well as support activities (qualifying). The discussion draft provides no guidance regarding the potential split of a service into “non-qualifying” and “qualifying” services.

**General services of an administrative nature (§7.48)** - Ryan believes that the description of the service “General services of an administrative or clerical nature” should be reviewed. The current description is too vague / generic and may lead to a wide range of interpretations. The discussion draft provides no guidance on which services fall within or should be excluded from this category. Ryan would welcome additional guidance.

**Cost pooling (section D.2)** - A 3-step approach is introduced to allocate intra-group charges among recipients. Ryan supports guidance on step 1 (cost pooling) and step 3 (application of the allocation key) but believes the guidance for step 2 should be reviewed (elimination of costs). Currently, step 2
requires the tax payer to eliminate cost from the cost pool that are related to services performed by one group member solely on behalf of one other group member. Ryan believes that step 2 should be described in a more generic way and should include the elimination of all costs where it can be anticipated that the use of the cost pool model will result in a cost allocation that significantly deviates from a cost allocation based on the benefit test. Ryan believes the OECD should encourage taxpayers to fine tune a cost allocation model where possible. Step 2 can be used for this purpose. Fine tuning should however not only be limited to costs related to services performed by one group member solely on behalf of one other group member (current guidance) but should cover all costs where the tax payer should be able to anticipate that the cost pool model is not appropriate.

**Mark-up on total costs (§7.57)** - The discussion draft subjectively sets an acceptable range of 2%-5% profit mark-up on the total costs incurred for the provision of the low value-adding intragroup services. We believe that the introduction of a range rather than a fixed rate (e.g. 5%) may lead to an arbitrary/tax-driven selection of the mark-up. Ryan believes alternative options should be considered including: (i) a single fixed rate for all categories or (ii) a single fixed rate for each category. Alternatively, more guidance on how to apply the range should be provided.

**Introduction of extensive documentation requirements (§7.61)** - This paragraph introduces extensive documentation requirements related to low value-adding services. It is unclear why (1) a (detailed) benefit test (2) a rationale for the provision of services and (3) a description of the benefits are required when a service would qualify as a low value-adding service. Reduced documentation requirements may alleviate both taxpayers and tax authorities from burdensome and time-consuming tasks with uncertain usefulness.

Ryan is pleased to provide these comments to contribute to the further development of the proposed modifications to Chapter VII of the Transfer Pricing Guidelines relating to low value-adding intragroup services.

Yours sincerely,

Roderick Veldhuizen

*On behalf of Ryan Netherlands*
Andrew Hickman  
Head of Transfer Pricing Unit  
Centre for Tax Policy and Administration  
OECD  

By email: TransferPricing@oecd.org

12 January 2015

Dear Mr. Hickman

SABMiller plc response to the OECD Discussion paper on Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines relating to Low Value-Adding Intra-Group Services

The SABMiller Group is one of the world’s leading brewers, involved in the manufacture, distribution and sale of beverages across six continents. Listed on the London Stock Exchange it is ranked as one of the top 20 companies on the FTSE. It has some 70,000 employees, with over 200 branded beverages sold in over 75 countries, including a number of market-leading local brands. As a large multinational group transfer pricing is clearly an important area for the Group.

We appreciate the OECD’s intention to simplify the processes and reduce the need for excessive resources to be allocated to the calculation, documentation and auditing of low-value, low-risk charges, both from a taxpayer and tax authority point of view.

Our single overarching comment is that any new guidelines from this proposal must have consistent application throughout all OECD and non-OECD territories in order that the objectives of no double-taxation and reduced compliance are achieved. Without this, the objectives of reduced compliance (to focus resource on other transactions and documentation) and no double-taxation will not be achieved.

General comments

1. **Global application of the proposed guidelines is required**

In its current format we remain cautious about the willingness of all tax authorities to accept and adopt the proposals laid out. As noted above, without the multilateral application of the proposals there is a risk that the proposals may increase the compliance burden on the taxpayer, and expose the risk of double-taxation of certain transactions.

For example, we are aware of multinational enterprises ('MNEs') providing services which would be eligible as low value-adding services from India. We understand that Indian APA and tax audit situations would expect to apply a safe harbour 15%+ mark-up, significantly above 5% which is not compatible with the paper's recommendations. We are also aware that China and some
African territories would also follow a similar approach, and therefore urge the OECD to ensure sufficient soundings and agreement are sought from these territories on the proposals. The proposals need to resolve such a potential conflict before implementation, otherwise uncertainty and the compliance burden will increase.

As with our previous representations made in relation to the proposed changes to Transfer Pricing Documentation requirements and Country By Country reporting, we would re-iterate that the objectives of the project will not be met unless the requirements are accepted and applied consistently across all territories. Without this consistency there is little or no benefit to MNEs and tax authorities in creating simplified documentation standards, as it will result in the proliferation of different requirements and duplication of effort in preparing different documentation for different territories.

2. Beneficial commentary of commercial principles and effect

We agree with several of the OECD's comments on intra-group services and believe that the clarification of a number of items in the proposal will be beneficial in mediating disputes between MNEs and tax authorities. In particular, we welcome the articulation of the complementary nature of certain group services (para 7.12, specific comments below), and that certain services may not deliver the actual benefits that were reasonably expected at the start of service delivery (para 7.34, specific comments below), or indeed that benefits may be in excess of what was reasonably expected at the start.

3. Reduced documentation requirements are not sufficiently extensive

Taking the proposals as they currently stand, their application to MNEs may be limited as the simplified methodology and documentation requirements appear to be very similar to the existing OECD requirements for intra-group services. Therefore we do not see, at the moment, that there would be a significant reduction in documentation compliance, or increased transparency, in applying them (specific comments at 7.52-55 below).

To achieve the proposals objectives we believe the documentation requirements should be further reduced for the election to be sufficiently beneficial to tax payers and tax authorities.

4. Inherent differentiation of low and high value-adding services

The proposal's specification of low value-adding services inevitably leads to questions regarding other services which must therefore be interpreted as 'high value-adding services'. We therefore assume that the OECD expect these services to receive a mark-up greater than 5%, as well as expecting more detailed documentary evidence for these higher value-adding services.

We recognise that services can achieve different arm's length returns, but it is possible, for example, that marketing departments can provide services which are correctly remunerated at the same level as low value-adding services. The proposals therefore can increase the documentation required for these services to demonstrate if they are '2-5% ' or greater than 5%,
and this will in turn come down to the functional analysis of the services and appropriate benchmarking.

We know that this comes to the heart of the OECD proposals and we accept this, but it requires tax payers and tax authorities to adopt the proposals reasonably.

Specific Comments

7.12 "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."

We welcome the OECDs recognition and explicit clarification of the above point as there are many instances where services described under the same broad function (e.g., marketing) are performed at both local and central levels. Services can be delivered in the same functional area but the activity of local and centre are different and are complementary to ensure commercial effect. For example, central activity can set frameworks and best practice, and this is followed with local implementation.

7.34 "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."

We support the inclusion of this comment, recognising that it is not always possible to show a direct correlation between the service provided and the actual benefits realised as a result. This exists for all commercial transactions, whether they are with external or internal service providers.

In practice we have observed a preference from some Tax Authorities to see evidence of direct actual benefits in order to satisfy the benefits test. As the proposals note, and we agree, it is not always practical, or indeed possible, but should not, in itself, represent evidence that a service was not received.

7.48 "The following bullet points provide examples of services that would likely meet the definition of low value-adding services..."

The list of example services that would likely meet the definition of low value-adding services is useful in highlighting those areas that may be suitable for this election. We would suggest that, where possible, further detailed examples are provided of the specific services that may meet the required definition, for example as provided in ‘Annex 1’ of the "EU Joint Transfer Pricing Forum Proposal on Low Value Adding Intra-Group Services", published January 2011.

We would also note that there are often very different levels of value provided by different services that sit within the same function. We therefore recommend that the list in para. 7.47 be
noted as 'not exhaustive'; or, equivalently, that the list in para. 7.48 be pre-faced with the comment that the qualification of a service as low value-adding is based on the specific activity performed, and not merely as a consequence of the function that the service sits within.

**7.52 - 7.55 Determination of cost pools & Allocation of low value-adding service costs**

Whilst these steps are useful in setting out the correct approach to the charging of intra-group services, SABMiller already follows this approach and we would expect most MNEs do the same. The guidance therefore appears to be applicable to all levels of service, and so there would appear to be few tangible changes in the charging methodology and transparency achieved as a result of the low value-adding election.

**7.55b “The same allocation key must be used on a consistent basis for all allocations of costs relating to the same category of services.”**

We appreciate that this proposal enables a degree of simplicity to be applied in the allocation methodology. At the same time, some level of commerciality may be lost as a result and a balance needs to be maintained between these two competing priorities. We would suggest that the language is softened to make the use of the same allocation key possible, but not mandatory.

**7.57a "In determining the arm's length charge for low value-adding intra-group services, the MNE provider of services shall apply a profit mark-up to all costs in the pool."**

We would seek clarification of the wording used in this paragraph, to ensure that it is appropriate and correct to apply a profit mark-up to all costs in the pool, including any third party costs that form part of the service charge.

In particular, we would want to compare the comments made here with those in paragraph 7.36 of the discussion draft: "In such a case, it may well be appropriate to pass on these costs to the group recipients without a mark-up, and to apply a mark-up only to the costs incurred by the intermediary in performing its agency function." Are we to understand that these comments apply only in an agency situation, as is described in 7.36, and that this is therefore not applicable in all other service provider scenarios?

**7.57b “The same mark-up shall be utilised for all low value-adding services irrespective of the categories of services. The mark-up selected by the taxpayer should be no less than 2% of the relevant cost and should be no greater than 5% of the relevant cost.”**

Please refer to the concern raised in General Comments section above concerning the universal application of a standard mark-up of 2-5% and situations where we are aware tax authorities would expect higher arm's length pricing.

We would also ask for clarification in the proposal as to the level of benchmarking support required in selecting a specific point within the 2% - 5% range. Having satisfied the criteria to be
within the low value-adding category of service, would any point within the stated limits be acceptable in the absence of further detailed benchmarking searches? If no, what purpose has the setting of limits achieved, assuming that the required detailed benchmarking will produce a definite and precise point at which to select a mark-up? Will it be the case that broader services benchmarking searches will be allowed? If yes, we suggest that this is stated explicitly in the guidance.

A solution to eliminate the requirement for further benchmarking would be to specify a specific percentage, rather than a range, as the acceptable mark-up for a service deemed to be low value-adding.

7.59 "Under the arm's length principle an obligation to pay for an intra-group service arises only where the benefits test is satisfied... However, because of the nature of the low value-adding intra-group services discussed in this section, such determinations may be difficult or may require greater effort than the amount of the charge warrants."

We support the recognition in this paragraph that the compliance burden in respect of the benefits test for low value-adding services may be disproportionately large. However, as per our comment on paragraph 7.34, we would seek assurances that this will be taken into consideration by all Tax Authorities before we as a Group would feel fully comfortable (although supportive of the principle) in reducing our documentation of such services and their related benefits.

7.61 "An MNE group electing for application of this simplified methodology shall prepare the following information and documentation and make it available upon request to the tax administration of any entity within the group either making or receiving a payment for low value-adding intra-group services."

The list of documentation requirements in paragraph 7.61 is substantially the same as the current documentation prepared by the SABMiller Group in respect of its intra-group services. We would recommend that, in order to further incentivise taxpayers to make the election for low value-adding services, the documentation requirements be further amended in order to materially reduce the compliance burden in relation to these transactions. This would enable a further concentration of effort, from both tax authorities and tax payers alike, on the higher value, higher risk transactions, thus helping to achieve one of the ultimate aims of this proposal.

We would also seek clarification as to whether the preparation and presentation of a full benchmarking study for the relevant services would be required under the new proposals. If this is the case we would request that this is explicitly stated as not being required in the guidance.

Other

In order to further the application of the low value-adding proposals, we would also recommend the setting of certain \textit{ae minimis} thresholds under which the revised requirements for low value services may be automatically applied, without the need for further analysis and justification. This
would have the effect of reducing the volume of immaterial service charges requiring full
documentation, re-focusing resources on more material issues.

**Conclusion**

Overall, as commented, we support the initiative to simplify the processes and reduce the need
for excessive resources to be allocated to this class of intra-group services, however consistent
global application must be achieved for the proposals to have their intended effect.

We trust that our comments are useful to the OECD's further consideration. If you would like to-
contact us directly in relation to any of the above issues we would be more than happy to discuss
in more detail.

Yours sincerely

[Signature]

Graham Holford

**Director: Group Tax, SABMiller plc**
Dear Sirs,

Thank you for the opportunity to comment on Action 10 of the OECD's Action Plan on Base Erosion and Profit Shifting ("BEPS"), which proposes a simplified transfer pricing approach for low value-adding intra-group services.

In the following, we provide our comments on the discussion draft according to our experience and, therefore, present topics and suggestions from a practical perspective.

We agree to have our comments posted on the OECD website.

Sincerely yours,

Siemens Aktiengesellschaft

[Signatures]

Dr. Christian Kaeser

Dr. Sven Bremer
Enclosure

1) Introduction

We applaud OECD's present initiative as this work provides reasonable suggestions in order to fulfill the interest of both taxpayers and tax authorities. However, some remaining practical issues need to be further analyzed, though this proposal can be regarded as a realistic guidance.

As part of the Action Plan dated 3 November 2014, the OECD released the discussion draft on the proposed modifications to Chapter VII of the OECD Transfer Pricing Guidelines relating to low value-adding intra-group services (Action 10 of the BEPS program). Action 10 has the goal to achieve a balance between appropriate charges for low value-adding services and the need to protect the tax base of countries in which local entities are the payers of the service fees. We trust that the OECD took a step in the right direction to achieve such balance by including a regulation on low value-adding services that lowers the burden on MNE groups to establish the beneficial nature of these services and by limiting the profit mark-up which can be applied on such activities. Although, it is important to mention that the success of the OECD’s proposal relies on its implementation in local regulations worldwide.

Throughout our comments to the discussion draft, we address practical issues faced by an MNE regarding low value-adding intra-group services, aiming, in this vein, to provide the OECD with an overview about disputes experienced worldwide by MNEs.

2) Comments

The discussion draft presents six topics in which the OECD proposes additional guidance. Based on our practice, please find our observations to each topic below:

1. A standard definition of low value-adding intra-group services

We agree with the definition presented by the OECD, as this definition reflects most of tax authorities’ and taxpayers’ understanding. Besides, for those jurisdictions where disputes related to the definition of low value-adding services occur, we trust that such statement would provide further guidance.

2. Clarifications of the meaning of shareholder activities and duplicative costs, specifically in the context of low value-adding intra-group services

Shareholder activities

We concur with the definition provided in § 7.10 regarding the shareholder activities and also agree with the non-chargeability of such services because of their nature.

However, from a practical point of view, we hope that the OECD can elaborate more on the differentiation between shareholder/stewardship activities and management/headquarter activities. For example, the Chinese SAT has submitted a letter to publish its view on service fees and management fees to the UN transfer pricing manual in April 2014. It states that the definition of shareholder services in the OECD TP Guidelines is too narrow. More stewardship activities (for example, those involving management decisions and approvals) are likely to be classified as shareholder activities and deemed not chargeable by the Chinese tax authorities or other tax authorities holding a similar view. As companies in developing countries are more likely to receive service charges from their headquarters, it could be the tax authorities’ intent to narrow the chargeable activities in those countries.

Additionally, complex MNEs might have more than one entity carrying on entrepreneurial functions and each of those entities might perform their own local/regional “headquarter activities” or stewardship activities on behalf of the ultimate parent company.

We would hope that the OECD can provide more guidance and examples on these types of activities and differentiate in more detail shareholder/stewardship activities from management and/or local/regional headquarter activities.
Incidental benefits

We agree with the statement provided by the OECD regarding incidental benefits, which is also in accordance with the regulation presented in § 1.99 and § 7.13 of Action Plan 8 concerning group synergies. We trust that this guidance will be very helpful for tax authorities and taxpayers.

"On call" services

"We believe that it would be difficult and burdensome to monitor such services over a period of several years in order to determine that an intra-group service is being provided.

In case an MNE would be able to monitor such activities, the discussion draft does not clarify the beginning term of the period that the MNE should take into account. Assuming the individual "on call" service would be retroactively considered to be beneficial, and subsequently charged, accounting issues and others may arise.

Another issue concerns the acceptance of the chargeability of "on call" services by individual countries. We believe that it would result in disputes between jurisdictions, as each jurisdiction might interpret such "on call" service differently by either classifying it as shareholder activities or not.

Besides, even if most countries were to adhere to the proposal, the level of usage of such services may be regarded merely as occasional or immaterial compared to the overall service transactions volume of an MNE. Therefore, it might be helpful if these services should only be charged in case they were material. Thus, a definition of materiality (e.g. establishment of a threshold or percentage in relation to all service transactions) would be appreciated.

3. Guidance on appropriate mark-ups for low value-adding intra-group services

Profit Mark-up

The discussion draft establishes a range of 2% to 5% in order to determine the arm's length charge for low value-adding intra-group services. It also mentions that the same mark-up must be applied for all low value-adding services irrespective of the service categories.

We appreciate the OECD's proposal of a mark-up range for intra-group services and consider this a very practical solution. That being said we would like to point to the following issues which might occur though:

MNEs usually have complex structures and different transaction types. Therefore, it might be necessary for more complex MNEs to have at their disposal a wider mark-up range and the possibility to apply different mark-ups within the range to different service types, as each activity category might differ at some degree from each other and this differentiation should be reflected by different mark-ups of the range. A range of 2% to 5%, as suggested by the OECD, might not be able to reflect such situation faced by complex MNEs. For instance, the work of the EU Joint Transfer Pricing Forum with respect to low value-adding intra-group services determines a wider range of 3% to 10%, often around 5%. The Czech low value-adding services regulation determines a range of 3% to 7% and the Hungarian transfer pricing legislation establishes a mark-up between 3% and 7% for low value-adding services.

Having said this, there is a concern about how an MNE should interpret the range established by the OECD. The discussion draft does not mention if the range should be considered as a safe harbour rule or not. A failure to further clarify this topic may lead to disputes between tax administrations in the respective service provider and service recipient locations (with an evident contrast of interests in how they interpret and apply the arm's length range). We understand that the application of any mark-up within the range would indemnify that there will be no adjustments. Therefore, we would suggest that the taxpayer should have the right to choose and apply a mark-up within the range provided by the OECD and, thus, that tax authorities could not make any adjustments to the median or any other point of this range.

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1 Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee; Brussels, 25.1.2011; European Commission.
2 Decree on Low Value Adding Services of the General Financial Directorate (D-10); 01.01.2013; Czech Republic.
3 Decree No. 22/2009 of the Ministry of Finance on the Documentation Requirements Related to Transfer Pricing; Hungary.
There are also sometimes discussions about completely different mark-ups (usually considerably higher mark-ups) that are supposedly more accurate to service transactions in specific local jurisdictions. We have experienced – and we believe that most MNEs have seen similar – discussions between different tax authorities, especially involving the BRIC countries, about different views with regard to the mark-up to be applied.

This issue is very problematic considering that MNEs have most of their transactions in countries which do not consistently follow or apply OECD guidelines (e.g. BRIC countries). Payee countries which follow OECD’s rules accept considerably lower mark-ups when compared to the mark-ups applied by payee countries which do not follow OECD regulations. Therefore, payor jurisdictions following the OECD may have a risk of double taxation when the payee country does not apply OECD rules. For example, Indian tax authorities require mark-ups in the range of 10% to 15%. Furthermore, the challenge relies on the comparables selected by the Indian tax authorities in order to establish the arm’s length price. For the purpose of establishing the benchmark of low value-adding services, the following topics are generally raised by the Indian tax authorities: (i) justification of the provision of services with tangible benefit, (ii) reason for the preference for services provided by foreign affiliates instead of by local service providers or performing it in-house and (iii) extensive documentation in order to justify how the services are performed in form of correspondences and to specify the technical expertise of people providing the services. These Indian requirements differ from the discussion draft’s requirements. Another example concerns the Brazilian tax authorities which require a mark-up of 15% for the locally rendered services whilst the OECD suggests a range of 2% to 5% for the same service type. On the other hand, Chinese tax authorities currently do not provide any safe harbour mark-up to be applied in intra-group services, hence, it remains to be seen whether the range of 2% to 5% will be accepted by the SAT.

Even further, the US Transfer Pricing Regulations introduced the “service cost method” for valuing low value-adding services which allows such services to be charged at cost, without any mark-up. This method results in greater tax liability for taxpayers due to the fact that taxpayers which receive payments at cost for the low value-adding services do not run the risk of the US tax authorities adjusting transfer prices upward on audit. The goal of the IRS is to decrease taxpayers’ administrative costs and compliance burdens for services which have low margins and involve activities which do not contribute to the core business of an MNE. The application of the Service Cost Method, however, is not that simple. First, the taxpayer needs to make a business judgment (this is a subjective test) that the services do not contribute key competitive advantages, core capabilities or fundamental risks of success and failure. At the next stage, the taxpayer needs to make sure that the services planned to be charged at cost are not on the list of excluded services — manufacturing, engineering, reselling, etc. Once these two hurdles have been overcome, the service regulations provide two categories of services that will be eligible to be charged at cost: (i) specified covered services identified in Rev. Proc. 2007-13 that are 101 types of largely clerical or administrative in nature services; and (ii) low margin covered services. A service is classified as low margin covered service if the median mark-up on the total cost of the service derived from an arm’s length range of comparable results is less than or equal to 7%. It is quite clear that the application of this method is based on a complex decision-making tree with a certain level of subjectivity. This method may create an issue in cases when from a US perspective qualifying services are charged at cost while at the same time the same type of services are charged to a US entity with a 2% to 5% mark-up as low value-adding services following the proposed OECD approaches.

Taking the foregoing into account, it can be assumed that the simplified approach as proposed by the OECD would largely be attractive for MNEs which have transactions involving only the countries that follow the OECD guidelines which would be a quite unrealistic scenario.

Finally, we understand that there might be a contradiction in the discussion draft regarding the treatment of pass-through costs. The OECD’s simplified approach asks for the application of mark-up on all costs and, thus, it might be assumed that the possibility of qualifying specific cost as pass-through costs is excluded. We would like to point out that this statement is differing from the general rule presented in the § 7.36 of the discussion draft where it allows treating costs as pass-through costs on which no profit mark-up needs to be applied. We believe that the OECD’s intention is to permit the possibility of qualifying specific cost as pass-through costs without mark-up. We agree with this suggestion, as there might be services in which an entity acts as an intermediary and, therefore, there is no reason to apply a mark-up. This proposal is also in accordance with the work of the EU Joint Transfer Pricing Forum which states that it is not always the case that a mark-up should be applied. In order to avoid misunderstandings, clarity on this topic is welcomed.

4 § 1.482-9, Services Cost Method; Section 482 Regulations on Services; Treasury Department; the USA; 2009.
Cost base

The discussion draft mentions that the cost base should contain all costs related to the service category. It can be assumed that the OECD means that the mark-up should be applied to the fully loaded costs. However, the draft is not precise and, therefore, we believe that this statement without further guidance might result in discrepancies between jurisdictions as we have experienced that some countries consider different cost bases regarding the provision of low value-adding services. In some cases, the mark-up is applied to fully loaded costs and in other cases the mark-up is applied to direct costs.

For example, Brazilian tax authorities apply a mark-up of 15% on direct costs, Indian tax authorities ask for a mark-up of 12.4% on fully loaded costs and the Chinese tax authorities apply a certain mark-up on fully loaded costs. In contrast, the Mexican tax authorities apply certain mark-up on direct costs or, depending on the case, pass through the direct costs without any mark-up.

Furthermore, there is also an issue when an MNE’s activity contains internal and external costs. There might be a concern on how such activity should be classified. These issues increase disputes and, therefore, need further guidance and clarity.

We would suggest that the OECD provide a clearer statement that the fully loaded costs should be considered in order to avoid misunderstandings, for example similar to the Dutch Decree that determines that “the relevant actual costs to be charged include the direct cost and indirect cost associated with the respective supporting services as well as the overheads. Therefore, the relevant costs also include financing costs and non-operating expenses (...)”.

In connection with internal and external costs, in situations where an activity is provided only in-house, the related costs are internal and should be pooled as determined in section D.2.1 of the discussion draft. In situations where an activity is performed by an external service provider and the entity acts merely as an intermediate, the related costs are external and should be charged without mark-up as mentioned in § 7.36. Such approach is reasonable. However, there might be an activity which is composed of both internal and external costs. The entity could separate the external costs from the internal costs and apply the mark-up just on the internal costs and pass through the external costs without mark-up. However, for simplification reasons, we would suggest to establish a threshold (e.g. percentage of the costs according to their nature — internal or external) in order to classify the activity accordingly. For example, in case an activity is composed of 20% of internal costs and 80% of external costs, such activity should be considered as being pass-through activity.

Another topic where guidance would be welcomed is the one regarding the disproportion in the costs incurred in different jurisdictions. The discussion draft does not provide any discussion on the disparity in the costs incurred in high-cost developed countries where services are provided to low-cost developing countries where comparable services cannot be obtained locally.

A further additional issue important to mention is that there are some cost recovery disputes which are related to the supposedly high costs incurred in the intra-group services. It has been observed that tax auditors sometimes compare the intra-group services and their related costs with third party services and their related costs, and then argue that the service recipient could have the same service at a lower cost by hiring a third party. In this case, the tax auditor is questioning the service efficiency of the MNE group.

In order to avoid such challenges, we would suggest that the discussion draft should provide clarity that the business judgment of an MNE should not be part of a tax audit and that, in this case, it should not be questioned whether an alternative transaction would have been more reasonable than the transaction actually entered into.

In order to establish a uniform regulation at least for the countries which follow the OECD’s proposal and, thus, to decrease disputes, we would suggest that the OECD provides a clearer statement on the determination of the cost base.

5 Decree of the Dutch Ministry of Finance, 14.11.2013
4. Guidance on appropriate cost allocation methodologies to be applied in the context of low value-adding intra-group services

Cost-pools

For the simplified approach application, the OECD proposes that MNEs should calculate, on an annual basis, a pool of all costs incurred by all entities of the group performing low value-adding intra-group services. The guidance specifies that the costs should be pooled according to the category of the services and should identify the accounting cost centers used in creating the pool. The costs which are attributable to an in-house activity that only benefits the entity performing the activity (including shareholder activities performed by the shareholding entity) should be excluded. Subsequently, the costs which are attributable to services performed by one entity on behalf of one other entity should be identified and excluded from the pool. Lastly, a pool of costs associated with categories of low value-adding services which are provided to multiple members of the MNE has been created.

The OECD’s standards are, in principle, helpful and welcomed. However, we would like to address that the discussion draft’s suggestion reflects a rather simple model which is — according to our experience — usually difficult to find in practice.

The discussion draft’s scenario illustrates a centralized perspective where few service providers are involved. This is rarely reflected in an MNE with a complex structure. More often than not, regional headquarters or service Hubs provide services to the companies covered in their regions, rather than only a global service provider which provides services to worldwide recipients. Therefore, several service providers are involved and the services are provided to numerous entities within the group. In such case, the administrative burden to comply with the OECD’s proposal might increase considerably. Therefore, we believe it might be helpful if the OECD could include guidance and examples with decentralized service-structures (e.g. regional structures) and models including service Hubs where one entity of the group collects all costs related to low value-adding services and then allocates them to the other entities according to an appropriate allocation key.

Guidance on the satisfaction of a simplified benefit test with regard to low value-adding services

§ 7.60 of the discussion draft proposes that, in evaluating the benefit test, tax authorities should consider benefits only by categories of services and not on specific charge basis. Thus, it would be sufficient if taxpayers only demonstrate that assistance has been provided with specific categories of services. There should be no need to specify individual acts performed that lead to the costs charged. In this case, if such information is available to the tax authorities, a single annual invoice describing a category of services should be sufficient to support the charge.

We completely agree with such suggestion and we understand it is in accordance with the goal to simplify the process. However, there is a concern whether tax authorities are going to accept such approach.

Unfortunately, we have experienced that such a simplification approach is not always sufficient. Tax authorities may ask for detailed information, including the benefit test, but apply a more stringent approach than the benefit test (e.g. China). Besides the benefit test, the Chinese SAT raised the concept of several tests (namely, benefit test, duplication test, value creation test, remuneration test and authenticity test). The SAT interprets the benefit test from both service recipient and service provider’s perspectives and when the parent company will benefit more than the subsidiary, the service fees may be considered not reasonable. The need test requires that the services are consistent with the core functions and characterization of the Chinese entity, otherwise, the services are considered not needed by the service recipient. Most often required supporting documents also include those which can prove that the service has been provided (authenticity test). Here again, the success in applying the OECD’s proposal will depend on the acceptance and implementation of the OECD’s rules in local regulations.
5. Guidance on documentation that taxpayers should prepare and submit in order to qualify for the simplified approach

Section D.3 of the discussion drafts determines that an MNE which decides on the simplified approach should prepare a documentation containing (i) description of the categories of low value-adding intra-group services provided, (ii) description of the benefits of each service category, (iii) reasons for the allocation key selection, (iv) written contracts, (v) calculations showing the determination of the cost pools and (vi) calculations showing the application of the specific allocation key.

In principle, the documentation package presented in the discussion draft is reasonable. However, considering that the goal of the simplified approach is exactly to provide a less burdensome documentation, we would suggest that a formal written agreement or alternative forms of agreements (e.g. emails and purchase order) should be provided according to normal business practice and its availability.

Additionally, we understand that it would be prudent if the OECD could establish a transfer pricing documentation model that focuses on the most significant low value-adding service transactions. In this vein, it would be of great help for MNEs if a threshold on transactions which should be documented could be established. If materiality thresholds were set for transactions both in terms of amounts and relevance of the transaction based e.g. on total revenues per country or some other standard, this would decrease the documentation process.

In general, it is desirable that all jurisdictions should require similar and consistent information. The OECD also supports such practice (BEPS), given that the BEPS states that divergences of countries' transfer pricing documentation requirements lead to significant administrative costs for business.

3) Conclusion

According to all considerations presented above, it can be concluded that there are still some important topics which deserve more attention from the OECD in order to provide guidance and clarity for tax authorities and MNEs.

We would like to address that the discussion draft does not mention how the guidance on low value-adding services will be impacted by the other BEPS Action works. For example, Action Plan 13 provides new rules for the transfer pricing documentation. This new regulation provides some improvements (e.g. documentation in English and 3-years financial update), but it also increases considerably taxpayers' documentation burden (e.g. CbC reporting). There is a concern about how the proposed documentation package will work with the requirements of Action Plan 13, where it is established that specific information related to intra-group services should be included in the transfer pricing reporting.

We consider that a simplified charge mechanism for low value-adding intra-group services is a worthwhile initiative, as long as it reduces uncertainty and compliance/audit costs both for taxpayers and tax administrations. In order to accomplish this aim, we understand that the issues presented in the present comments must be further discussed, in particular when the payer and/or payee country is not an OECD member and does not follow OECD requirements.

Practice shows that, on one hand, tax administrations of headquarters' locations will argue that more costs, which were incurred by the entity in relation to low value-adding intra-group activities, should be recharged to the other entities at higher margins. On the other hand, tax administrations where payer entities are located tend to allege that part of or the entire recharged amount should be denied (e.g. BRIC countries).

Consequently, the discussion draft faces the same issues as the other reports released by the OECD: the OECD's regulations are not binding. § 7.51 states that an MNE group deciding to adopt the simplified method would apply it on a consistent, group-wide basis in all countries in which it operates. As such, our understanding is that the OECD's proposal would be widely adopted only if countries which do not follow the OECD regulations would also implement the OECD's proposals in their local rules. In the absence of this scenario, as mentioned above, important double taxation risk and challenges are constituted for global MNEs.
That being said, local tax authorities would always seek to protect their domestic interest in the first place. Developing countries and developed countries may hold different views on a number of topics that will give rise to diversified approaches and requirements. It remains to be seen if answers to these "controversial topics" (e.g., different mark-ups and cost base) can be achieved. In the short term, as it appears difficult to reach a consensus on many tax divergences, a unified approach may not necessarily be achieved. In the long run, it is indispensable to reach a global approach based on tax authorities seeking common points of agreement whilst reserving difference.

With regard to the present comments and suggestions, we would like to thank you again for the opportunity to share our issues with the OECD's Action Plan on BEPS.

In the meantime, if you have any questions about the submission, please contact:

Dr. Sven Bremer (Global Head of Group Transfer Pricing) at +49 89 636 30242 (or mailto: sven.bremer@siemens.com)
January 12, 2015

Sent via email to: TransferPricing@oecd.org

To the attention of Mr. Andrew Hickman – Head of Transfer Pricing Unit, centre for Tax and Policy Aministration

Re: Comments on Discussion Draft - Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services

Studio Biscezzi Nobili (SBN) is pleased to provide comments on Discussion Draft – Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services.

SBN commends the work that the OECD has undertaken to date in relation to the BEPS Project, and offers its assistance in support of its further efforts.

SBN appreciates the opportunity to have addressed the WP6, and would welcome the opportunity to further invest in the process and further assist the WP6 by presenting or clarifying our views and comments, if necessary, on the proposed changes to the Transfer Pricing Guidelines.

D.1 – Definition of low value-adding intra-group services

Section D.1 provides guidance in relation to low value-adding intra-group services. In particular, paragraph 7.48 provides a non-exhaustive list of services that would likely meet the definition. The list consists of services such as accounting, information technology, human resources and legal. Among other things, human resources activities includes corporate trainings which are provided to enhance management skills.

In general, trainings are considered essential to the achievements of a business. Therefore, improving employees skills is crucial for the success of the business itself. In this regard, it is important to distinguish between the provision of services which can be categorised as low value-adding intra-group services and
trainings provided with a more strategic view aiming to develop senior management skills.

In light of the above, attention should be paid to this description, taking into account the fact that in today's market place, skilled people and continuous management development can highly increase the success of a business.

**D.2 – Simplified determination of arm's length charges for low value-adding intra-group services**

Section D.2 discusses a simplified charge mechanism for low value-adding intra-group services. The method proposed, allows MNEs to apply their transfer prices on a consistent basis among group members.

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Paragraph 7.51 states that "a possible alternative approach for dealing with the issues discussed in this subsection would be the use of Cost Contribution Arrangements". However, even though in practice Cost Contribution Arrangements (CCAs) and intra-group services may have similar scope, especially when the aim is not the creation of Intellectual Properties (IP), practical differences can be found.

CCAs on services that do not create IP, can be seen as agreements whose aim is to share costs, risks and benefits; whereas, intra-group services are limited to the acquisition and provision of a service by the group members and the risk is borne solely by the service provider.

In addition, when participants in CCAs join or leave, shares are to be adjusted among the remaining members. On the other hand, terminating an intra-group service agreement by a member has generally no implication on the others. Also, the contribution of CCAs' participants is usually valued at costs which reflects the expected benefits; whereas, the service provider of low value-adding intra-group services will not share profits with the recipients, therefore, the profit component is a key element.

Furthermore, for transfer pricing documentation purposes, it is important to note that certain jurisdictions classifies CCAs and intra-group services under different categories. For example, the Italian Tax Authorities require taxpayers to include them under different chapters within the same documentation.
Therefore, in light of the above, it may be helpful if further clarification would be given on the interchangeable use of the two approaches.

*  

Paragraph 7.57 provides an arm’s length mark-up range between 2% and 5% of the relevant costs. In addition, the OECD specifies that “these intra-group services mark-ups should not, without further justification and analysis, be used as benchmarks for the determination of the arm’s length price for services not within the definition of low value-adding services, nor for similar services not within the elective, simplified scheme”.

Although the established mark-up range seems to be appropriate when considering low value-adding intragroup services, it may be beneficial to explain how the proposed range has been established. Moreover, it may be useful if the draft introduces examples with descriptions as to what it is meant by “similar services not within the elective, simplified scheme”.

Furthermore, in relation to the established mark-up range it may be important to identify the cost basis to be utilised. In fact, a low mark-up would not be appropriate if only direct costs were taken into account. Rather, its use it would be better justified when considering a full cost basis. Since Chapter 2 of the Guidelines, as it stands, sets no preference, it may be useful if the discussion draft addresses also this point.

In addition, certain jurisdictions have already in place safe harbour rules for low value-adding intragroup services. These, have been proved useful for Tax Authorities and taxpayers likewise by saving time and resources and, therefore, reducing compliance costs. As a consequence, it is suggested addressing the set range as such.

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Paragraph 7.60 discusses the benefits test and how this should be applied. In particular, the OECD specifies that “the taxpayer need only demonstrate that assistance was provided with, for example, payroll processing, rather than being required to specify individual acts undertaken that give rise to the costs charged”.

The above statement may not be accurate since demonstrating that assistance was provided may be equal to say that individual actions were taken. For instance, assistance in the payroll processing may only be proved by explaining
that specific actions taken by the company personnel involved to facilitate such services. In this regard, it may be useful to provide further examples and descriptions.

D.3 – Documentation and reporting

Section D.3 provides a list of documentation that taxpayers, electing for a simplified approach, should keep at hand and provide to the relevant Tax Authorities upon request. In addition, it states that the listed documentation should be “sufficient evidence to prove that the benefits test is met”.

In general, the listed documentation should be provided in coordination with what is already required to submit for transfer pricing documentation purposes in certain countries. In this regard, it may be beneficial to underline that Tax Authorities from each jurisdiction should address this point as to avoid duplicative actions.

In addition, it is important to note that in some jurisdictions written agreements, as supposed to verbal contracts, may not be compulsory depending on the type of services provided. For instance, one-off consultancy services provided by the management of an associated company, may not need such formal arrangements. Therefore, it may be helpful if the discussion draft considers also this option.

Yours truly,

Franco Pozzi
Marco Abramo Lanza
Roberta D’Angelo
Milan, January 13, 2015

To the attention of Mr. Andrew Hickman
Head of Transfer pricing Unit

Organization for Economic Cooperation and Development
2 rue André-Pascal
75775, Paris
Cedex 16
France

Sent by mail: TransferPricing@oecd.org

Re: Invitation to comment on BEPS ACTION 10: proposed modifications to chapter VII of the transfer pricing guidelines relating to low value adding intra-group services

Dear Sir

I appreciate the significant efforts made so far by OECD Taxation Committee on the BEPS project and I thank you for the opportunity to provide my input and comments.

No client has engaged my tax practice to provide comments or recommendations to the draft document on this subject.

All suggestions and proposals outlined here below are based on the field experience made during the past years of professional activity on transfer pricing matters and are aimed at reducing the controversy between MNE Groups and Tax Administrations.
SELECTION OF AN ALLOCATION KEY

Taxpayer must try to select the allocation key that is the most meaningful from an economical standpoint. This objective is satisfied anytime the increasing or decreasing value of the allocation key adopted permits to adjust the amount to be charged to each beneficial entity in a way that reasonably reflect the lower or higher level of service rendered to each beneficial entity.

Anytime the abovementioned interrelation is high, it is also easier to indirectly demonstrate and satisfy the benefit test.

This explanation, if considered of any benefit, might be inserted at paragraph 7.55 of the Public Discussion Draft after the sentence on “the appropriate allocation key …”.

USE OF MIXED ALLOCATION KEYS

In certain circumstances, such as the provision of certain services and/or when the amounts to be recharged are particularly relevant, it may be useful to adopt mixed allocation keys in order to grant the meaningfulness and the interrelation mentioned in the previous point.

Mixed allocation keys being, of course, the use of two or more allocation keys together in a different percentage and the total weight gives one hundred percent.

At paragraph 7.56, the second sentence might be modified as follows: “Depending on the facts and circumstances more sophisticated allocation keys might be used, including mixed allocation keys”.

PROFIT MARK-UP

Costs sustained by the group service provider in connection with service activities partially or totally subcontracted to “third party” service providers shall have to be considered as pass-through costs, on which no profit mark-up shall be added.

Provided that costs charged by a “third party” service provider to the group service provider already reflects the fair market value, any additional profit mark-up added by the group service provider on these external costs might create the conditions based on which the arms’ length principle is not any longer satisfied.

This important specification may help to reduce points of debate with the tax authorities and it might be inserted at paragraph 7.57.

DOCUMENTATION AND REPORTING
Based on the experience made on the preparation and subsequent defence of intra-group services, I have the following two recommendations:

✔️ In most Countries, the local beneficiary entity manager in charge for the predisposition and signature of the income tax return is requested to ascertain that the intercompany transactions carried out by the local beneficiary company respect the arms’ length principle. In order to do it, and avoid an act of faith, the information and documentation disclosed at paragraph 7.61 must be made available locally before the deadline for the filing of the local income tax return and not only at request of the tax administration. In addition, this way any question made by the manager of the local beneficiary entity can be addressed to the foreign colleagues of the group service provider that have rendered the services and the colleagues that have materially prepared the pool costs. Waiting for the tax administration request implies the risk that most of the aforementioned colleagues of the group service provider are not any longer there, either because they moved to another group or are within the same group but in another entity or in another department.

✔️ The presence of an Agreed Upon Procedure certification made by an independent auditor is extremely useful to limit the discussions with the tax authorities during a tax inspections and the subsequent work to be done to prove the inherence of the pool costs, the reasonableness of the values used for each allocation key and coherent application of the approach defined in the written contracts. In presence of a relevant amount of pool costs to be recharged, such additional activity should substitute the activity provided in the two last bullet points shown at paragraph 7.61 and grant a subsequent simplified defence activity.

I hope the OECD finds these brief comments useful. Should you have any question on the above comments, please feel free to contact me (email: paolo.tognolo@tognolo.com - phone call +39 02 86 09 88).

Yours sincerely,

Paolo Tognolo
13 January 2015

Via E-Mail
TransferPricing@oecd.org

Mr. Andrew Hickman
Head of Transfer Pricing Unit
OECD Centre for Tax Policy and Administration
2, rue André Pascal
75775 Paris Cedex 16
France

Comments of SwissHoldings on the OECD Discussion Draft regarding BEPS Action 10 (Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services) of 3 November 2014

Dear Mr. Hickman

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 OECD Discussion Draft of the Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services (hereafter referred to as “the Draft”).

SwissHoldings supports the introduction of a simplified transfer pricing approach for low value-adding services to minimize risks for lengthy disputes and the administrative burden for both taxpayers and tax administrations. The revised Draft should ensure

- that costs are deductible within the group (i.e., double taxation is avoided) and
- the most simple approach to document and support the deductibility of services (i.e. low value-adding services should be excluded from the very extensive documentation requirements as recently codified in the new Chapter 5).

Although clear principles are very important, the Draft should also provide an appropriate level of flexibility for more complex areas such as the definition of services, cost allocation methods and the determination of the profit mark-up.

The key success factor is a consistent application of the new principles by taxpayers and, more importantly, acceptance by all tax administrations, including those of non-OECD countries.

Further comments on the Draft are provided below.

I. General Comments

1. There is a need to maintain a balance between the level of information requested and the potential compliance and extensive audit management burden for taxpayers.

2. It should be ensured that all (service) costs are tax deductible within the group and double taxation is avoided for taxpayers. In contrast to the assumptions in the general BEPS
discussion, double taxation - as opposed to non-taxation - is one of the main challenges in practice within the context of intragroup service transactions for MNEs. Further clarification and mitigation measures should be added in the Draft (e.g., in section B.1.1., benefits test) and considered in other BEPS actions.

3. Another critical area is the application of withholding taxes (WHT) for intragroup services. Application of WHT often leads to double taxation (no full recoverability) and a significant administrative burden for taxpayers and tax administrations. Therefore, we would recommend limiting the application of WHT for service transactions. Specifically, for low value-adding services with a moderate profit margin, application of WHT should not be applied at all.

4. For the transfer pricing analysis (in particular during tax audits) tax administrations must also analyze and consider the whole transfer pricing model of the taxpayer (service recipient) and assess whether the service fee is eventually passed on to other members of the group via other intercompany transactions (and not only the services in isolation). For instance, one group entity (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 (beneficiary), for example, is to perform distribution activities and provide contract R&D or contract manufacturing services for another group entity and all costs (including the costs related to the “support services”) are (indirectly) passed on via transfer prices for other transactions (e.g., contract manufacturing fee) to another group entity. As the received “support services” represent “pass-through costs” for the beneficiary, lower requirements and efforts should be applied to assess the arm’s length nature of the received “support services”. A tax deduction should always be ensured.

5. We support the clarification in paragraph 7.36 that so called “pass-through costs” can be recharged without a mark-up. A clarification or reference in paragraph 7.57 to clarify that the safe-harbor range would not apply to pass-through costs would also be helpful.

II. Specific Comments

Shareholder activities

6. 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 with the group).

We also recommend avoiding reference to the old 1979 Report in paragraph 7.10 and the 1984 Report in paragraph 7.11. 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.

7. The examples mentioned in paragraph 7.11 are helpful to clarify the distinction. However, the examples need to be clear to avoid disputes in the future. Hence, we recommend dropping the new example in paragraph 7.11(e), “Costs which are ancillary to corporate governance of the MNE as a whole”. At the very least, it needs to be clarified as corporate governance is not defined.
SwissHoldings Comments on BEPS Action 10 (Low Value-Adding Intra-Group Services)

Duplication

8. We welcome the clarification added in paragraph 7.12 that the provided “intra-group services are different, additional or complementary to the activities performed in-house.” In this regard we would like to highlight that this is the rule and not the exception and should therefore be a leading principle in the top of this paragraph and not at the very end. In the (global) competitive environment in which multinationals operate, no one can afford duplicative activities; or probably the more correct economic term an “inefficient operating model/value chain”. Insofar, as this is an “exception” or a more academic topic, taxpayers and tax authorities should apply a simplified approach in the transfer pricing analysis.

Some examples of intra-group services

9. The examples used in section C paragraphs 7.40 to 7.44 have not changed compared to the existing OECD Guidelines. However, given the introduction of a new category of low value-adding services and the examples in paragraph 7.48 we are wondering about the benefits of the examples in section C. As these examples are very general in nature and do not provide further clarity, we recommend to drop section D completely.

III. Low Value Adding Intra-Group Services

Scope of services

10. We recommend clarifying in paragraph 7.48 that the list is not exhaustive and add as a last bullet “other services”. In this regard we would like to clarify that – depending on the specific facts and circumstances - the examples mentioned in paragraph 7.47 could fall under the category of low value-adding services (e.g., specific marketing, R&D or manufacturing services). The list provided in Annex I of the EUJTPF guidance from February 4th, 2010 seems to provide a broader and more appropriate qualification. In particular, it covers many other practical examples for low value-adding service such as “(g) technical services; (i5) logistic services, (i6) inventory management, (i8) warehousing services or (i11) packaging services”.

11. The inclusion of “services for corporate senior management” in paragraph 7.47 is confusing and should be dropped, as corporate senior managers can also be involved in the performance of low value adding services. Focus should be on the nature and type of services and not on who provides the services.

Determination of cost pools

12. Section 7.52 gives the impression that only one pool of costs for low value-adding services in a group is allowed. In practice, especially in large MNEs, there may be several categories or layers of low value-adding services provided by different service providers located in different countries or regions for different service recipients. The multiple use of the simplified rules described in the Draft must be allowed, and Section 7.52 should be clarified accordingly.

Allocation keys

13. We appreciate the clarification that calls for a balanced approach between “theoretical application and practical administration” in paragraph 7.56 with regard to the determination of allocation keys. However, instead of “one-size fits all” in many cases, flexibility in the
application of the allocation keys is required; in particular if different types of low value-adding services are provided by different service providers in different jurisdictions (as is often the case). In such cases, the business model and functional profile of the service recipients may require the use of different allocation keys for the same category of services. Accordingly, the statement in Section 7.55 “The same allocation key must be used on a consistent basis for all allocations of costs relating to the same category of services” must be clarified. The key element is consistent application (in a transparent manner) from the perspective of the respective service provider (and type of service).

**Profit mark-up**

14. We appreciate the proposal for a safe-harbor range for low value-adding services. However, for multinationals, flexibility is required to ensure a right balance between the interests of respective service providers and the beneficiaries of the services in order to minimize risks for lengthy disputes. If service providers are located in developing countries, we sometimes see rates higher than 5% (usually, supported by respective benchmarking studies).

15. Hence, one measure to increase flexibility could be to increase the proposed “safe harbor” range to 2-7%. This would also be more consistent with the EUJTPF guidance from February 4th, 2010. However it is important to clarify that in case a mark-up is selected within a proposed “safe harbor” range, that no benchmark study has to be provided. A respective clarification has to be done in clause 7.61 on documentation. Another and important measure is not to force multinationals to apply the “same” rate for all type of services and jurisdictions where the service providers are located. For example, depending on the nature of services and the location of the service provider, different rates could be applied. The key requirement should be to apply for a specific type of service AND service provider the same rate in a consistent manner. Finally, if a specific benchmarking study is available (unfortunately likely to be required if the service provider is located in a non-OECD country and/or service is main function of the service provider) multinationals should optionally be able use this “specific” rate/range - in contrast to the safer harbor range - as a basis to determine the arm’s length service fee. At request during a tax audit, a copy of the benchmarking study should be provided to the beneficiaries. Any other solution would most likely lead to double taxation.

**Benefit test**

16. We appreciate the clarification for the application of the benefit test for low value adding services in paragraph 7.60 (i.e., focusing only on the invoice describing the category of services). However, from our perspective the documentation and reporting requirements described in the first bullet of paragraph 7.61 are not consistent with this statement and too extensive. Clarification and reduction of requirements in paragraph 7.61 are required.

17. It should further be clarified that the “hypothetical cost test” as proposed in paragraph 7.35 is not applicable for low value-adding services. In this regard we would like to clarify that the potential application of this hypothetical test is complex and subjective. Moreover, in most cases doing the services in-house is not really an option within a group. Hence, we recommend deleting the whole paragraph 7.35.

**Documentation and reporting**

18. Clarification and reduction of requirements in paragraph 7.61 are required in order to be in conformity with the concept provided in that report on low value-adding services and the corresponding low risk profile of profit shifting in that area. Therefore it is proposed to amend...
the first bullet of paragraph 7.61 as follows: “A description of the categories of low value value-adding intra-group services provided; the reasons justifying that each category of services constitute low value-adding intra-group services within the definition set out in section D.1 except for services that are already mentioned in clause 7.48; the rationale for the provision of services within the context of the business of the MNE; a description of the benefits or expected benefits of each category of services; a description of the selected allocation keys and the reasons justifying that such allocation keys produce outcomes that reasonably reflect the benefits received, and confirmation of the mark-up applied, but no benchmark study has to be provided in case a mark-up is selected within the proposed ‘safe harbor’ range”.

19. We appreciate that the documentation and reporting requirements should only be made available upon request. A clarification that there is no requirement to perform a full transfer pricing analysis in the yearly TP documentation (local file) - including penalty protection - would be welcomed. Specifically, additional clarification would also be welcomed on how the proposed documentation package for MNEs which elect the simplified methodology ties in to the work performed under Action 13 on Transfer Pricing Documentation and Country-by-Country reporting.

20. As it would trigger a non-balanced additional compliance burden for multinationals, the requirement for written agreements should be dropped. Focus should be on the determination and allocation of costs (including the applied mark-up) in a consistent and transparent manner. The need for a simplified benefit test is discussed 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

[signature]  [signature]

Christian Stiefel  Dr. Martin Zogg
Chair Executive Committee  Member Executive Committee

cc - SwissHoldings Board
  - Nicole Primmer, Senior Policy Manager, BIAC
  - William Morris, Chair of the BIAC Tax Committee
  - Krister Andersson, Chair BUSINESSEUROPE Tax Policy Group
Andrew Hickman  
Head of Transfer Pricing Unit  
Centre for Tax Policy and Administration  
TransferPricing@oecd.org

14 January 2015

Dear Mr. Hickman,

Re: Taxand responds to the OECD invitation for public comments on the discussion draft of the proposed modifications to Chapter VII of the Transfer Pricing Guidelines relating to low value-adding intra-group services

Further to the publication of the OECD’s invitation for public comments on the discussion draft concerning the proposed modifications to Chapter VII of the Transfer Pricing Guidelines relating to low value-adding intra-group services, Taxand is honoured to provide written comments based on the practical experience we have as tax advisors and transfer pricing specialists.

We would like to salute the efforts of the OECD Committee of Fiscal Affairs for its continual and vast work on laying down the cornerstones for the ambitious and comprehensive Action Plan aimed at addressing base erosion and profit shifting in an open format that allows all stakeholders to provide their views.

The modification of Chapter VII of the Guidelines in order to adapt its contents to the current situation of MNE groups as well as the establishment of a simplified approach for the so-called low value adding intra-group services is a relevant initiative of the BEPS Action Plan, which we support.

In this regard, our suggestions and comments to the contents of the discussion draft can be structured as follows, all of them containing the relevant references to the corresponding paragraphs:

- Section B1: determining whether intra-group services have been rendered
  - Benefits test and evidence of the services rendered
  - Interaction between services and transfers of intangibles (or the licensing thereof)

- Section B2: determining an arm’s length charge
  - Comparability analysis
  - Methods to determine an arm’s length remuneration
  - Calculating the arm’s length compensation
  - Cost base determination

- Section D: low value adding intra-group services
  - Elective nature
  - Definition of low value-adding intra-group services
  - Application of the profit mark-up
  - Documentation and reporting
We appreciate this opportunity to provide comments to the OECD Committee of Fiscal Affairs and would be pleased to discuss this further and to participate in any further discussion on these matters.

More information about Taxand is provided below. Taxand is wholly committed to supporting the OECD Committee of Fiscal Affairs and we look forward to contributing to further debate.

If you wish to discuss any of the points raised in this letter, please do not hesitate to get in touch with us directly via the contact details below.

Yours faithfully,

Taxand

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ABOUT TAXAND

Taxand provides high quality, integrated tax advice worldwide. Our tax professionals, more than 400 tax partners and over 2,000 tax advisors in nearly 50 countries - grasp both the fine points of tax and the broader strategic implications, helping you mitigate risk, manage your tax burden and drive the performance of your business.

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Section B1: Determining whether intra-group services have been rendered

Benefits test and evidence of the services rendered

Taxand supports the general principle adopted by the OECD in paragraph 7.7 of the draft, where the so-called “benefits test” is used to determine if an intragroup service has been rendered. (Whether the activity provides a respective group member with economic or commercial value to enhance or maintain its position).

In order to ascertain if such a circumstance has taken place, the position traditionally adopted (and still included under the above-cited paragraph) is to consider 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.’

Although some general guidance to carry out the above test is provided under paragraph 7.9 (and others later on), this has been a controversial issue for a long time. It is sometimes difficult to determine, in certain situations, if an independent company would have been willing to pay for a given service, taking into account its own resources, circumstances and needs.

In other words, whether this benefit’s test has been fulfilled or not is, in many cases, conditional upon a subjective (and debatable) opinion, and dependent on the concrete features of every single case, as recognised by paragraph 7.8 when stating that ‘the analysis described above quite clearly depends on the actual facts and circumstances’.

The same difficulties may also be encountered when analysing, for example, whether the activities performed may constitute shareholding activities (B.1.2), duplicated services (B.1.3) or provide incidental benefits (B.1.4), despite the very useful examples provided for each of those categories.

In order to reduce uncertainty when conducting this test, we would recommend reinforcing it by making it more focused on the objective and material benefits obtained by the recipient of the services, and less dependent on the likelihood that a comparable independent company would have been willing to pay for them.

To this end, and without prejudice to the work carried out so far in connection with Action 13 of the BEPS Plan on transfer pricing documentation requirements, it may be useful to extend the documentation and reporting request introduced for low value-adding services, in section D.3 (paragraph 7.61), to all categories of services. This would mean MNE groups would be able to ascertain by themselves the real benefits - or expected benefits - deriving from the activities performed.
In addition to the above, the issue of whether these services have truly been rendered has traditionally been very controversial when addressing this matter.

The benefits test is very much oriented to determine if an activity provides its recipient with an advantage, but often a dispute arises when analysing whether the activities for which a charge is being made have effectively been performed.

In many occasions, exhaustive and fully reliable (mainly documentary) evidence on the scope of every single service being charged to a member of an MNE is required at the discretion of the tax auditors. This imposes a high administrative burden which can sometimes be impossible to cope with. In other cases, it is simply unclear what elements of proof are necessary or expected by the tax authorities to evidence the supply of these services.

The high level of subjectivity in this respect usually results in double taxation situations (recognised by this discussion draft in paragraph 7.27, particularly when using indirect-charge methods), as it is often denied that reality of the services being rendered has been sufficiently evidenced.

In order to provide clarity and mitigate the negative consequences described above, further guidance (and / or examples) would be welcomed within the discussion draft on the documentation that MNEs would have to prepare (and tax authorities to accept, if properly and timely provided) to prove that such services have been rendered.

Interaction between services and transfers of intangibles (or the licensing thereof)

Another issue that the discussion draft should ideally address with a greater level of care is the possible interaction between intragroup services and other types of transactions. In particular, those involving intangibles (whether transfers or licenses of the rights to use them).

The borders are sometimes unclear between the provision of a service itself and the services rendered as ancillary to the transfer of an intangible or the license to use it. This is not only to clearly define the type of transaction that is taking place, but also when considering the best approach in determining its form of remuneration or its arm’s length nature.

The discussion draft faces this question and (despite the principles of aggregation and segregation of transactions in Chapter III) acknowledges its complication in paragraph 7.3: ‘In some cases, such as know-how contracts containing a service element, it may be very difficult to determine where the exact border lies between the transfer of intangibles or rights in intangibles and the provision of services’.

In connection with the above, it might be the case (clearly undesired and undesirable), that creating the new category of low value-adding services would make this issue more complicated. The view may arise that any provision of services which would not fall within this low value-added category, entails the use of valuable assets (intangibles), and should therefore be categorised and compensated accordingly.

In order to avoid such an opinion developing, and in alignment with the general principles stated in Chapter VI relating to intangibles (still subject in part to discussion under the OECD BEPS Action Plan), the discussion draft could make this issue clearer, perhaps by including...
some examples of “high value-added” services which do not involve the transfer or the right to use an intangible.

To this end, and without prejudice to the comments made above, the ‘benefits test’ could be of help. The key feature being how remuneration is determined under comparable circumstances between non-related parties. Where the benefits obtained by the recipient are such that the provider would expect part of the income the transaction brings to the recipient, then it may be inferred that a transfer of an intangible (or the licensing thereof) is taking place.

Section B2: Determining an arm’s length principle

Comparability analysis

Section B.2 of the discussion draft contains (as the current version of Chapter VII does) very detailed guidance on how to determine an arm’s length compensation for intragroup services, with a special reference to the methods for charging it, which is, in general terms, supported by Taxand.

However, it lacks specific guidance on how to conduct a comparability analysis to identify potential non-related entities performing similar transactions, in order to reach a conclusion on the arm’s length nature of the compensation agreed for the intragroup services.

In this respect, including such guidance within the discussion draft could be a helpful resource for both tax administrations and MNEs, and therefore Taxand encourages Working Party No. 6 to elaborate on this.

Further to the above, some comments are made available below in connection with this comparability analysis, for the appropriate consideration and benefit of the OECD in this respect:

- Although not specifically referring to the comparability analysis, the discussion draft mentions in paragraph 7.33 the appropriateness of a CUP (comparable uncontrolled prices) method, where there is a comparable service provided by the associated enterprise to an independent enterprise in comparable circumstances.

  While acknowledging the provisions contained in the guidelines in Chapters I to III (and in particular the possibility of performing adjustments), it should be kept in mind that the strategies and costs structures in one case, when compared to another, (services to associated enterprise vs. to independent entities) might differ considerably. This would therefore impact the price charged in both scenarios, the comparability not being so automatic in this respect.

- Even in the absence of these ‘internal comparables’, the above considerations are, in general terms, still applicable if a benchmark analysis is conducted, especially in external databases containing financial information.

  Independent service providers’ arrangements and prices are often set according to parameters which are seldom present in a MNE service provider (normally a ‘captive’, single-purposed entity with very little or no marketing costs and a lot of synergies in the provision of its services).
The above circumstances should therefore be taken into consideration when conducting such a comparability analysis, so that the final set of independent entities may be considered truly comparable to determine an arm’s length compensation.

Methods to determine an arm’s length remuneration

The discussion draft (paragraph 7.23) contains a clear preference for direct-charge methods in order to calculate an arm’s length remuneration, especially in those cases in which similar services are rendered to both related and non-related entities:

‘An MNE group should often be able to adopt direct charging arrangements, particularly, where similar services to those rendered to associated enterprises are also rendered to independent parties. 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 that the MNE has the ability to demonstrate a separate basis for the charge (eg by recording the work done and costs expended in fulfilling its third party contracts). (…)’

In connection with the above, Taxand agrees with the preference for direct-charge methods, although it happens many times in practice that their implementation is limited within MNEs and are frequently subject to controversy with tax administrations.

For example, time reporting sheets, which are one of the most common direct-charge methodologies, are in fact a burdensome procedure for MNEs and tax authorities on many occasions raise serious doubts on their reliability.

Contrary to what the discussion draft states, often MNEs are not able to adopt direct-charging arrangements, not even in cases where similar services are rendered to independent parties contemporaneously.

In accordance with the above, it should not be presumed that an MNE has the ability to demonstrate such a separate basis for the charge, and therefore, both the direct and indirect charging methods should be accepted on equal terms.

Moreover, tax administrations often show a preference for indirect-charging methods when conducting tax assessments on this issue, as they rely on objective and easily verifiable drivers.

1. Calculating the arm’s length compensation

Paragraph 7.31 within Section B.2.3 of the discussion draft holds the general principle that, in trying to determine the arm’s length price in relation to intra-group services, the matter should be considered from both the perspective of the service provider and from the perspective of the recipient of the service (…)’

While Taxand fully supports this view, it acknowledges that there are situations in which mismatches arise in conciliating both perspectives, giving rise to double taxation issues.

Where transactional profit methods are applied (particularly those based on costs), it may happen that the cost structure of a service provider (in jurisdictions where labour costs are
high), greatly exceeds the cost structure of the likely comparable entities. This renders such a service in the country of the service’s recipient (where labour costs are low), or even the price itself (costs and profit element).

In such situations, double taxation is likely to arise as far as part of the costs (or the profit mark-up) may not be considered tax deductible for the entity receiving the service, on the grounds that the resulting price is higher than the one that would be charged by a local provider.

In fact, some countries do not allow the deductibility of any amount of the price paid for services provided by a foreign related company, if this service could likely be obtained in the domestic market.

In light of the above, and while the general provisions included under paragraphs 7.33 (preference for the recipient’s market when applying the CUP method), 7.37 and 7.38 (although they do not refer specifically to the case presented in the previous paragraphs) are recognised; any guidance which might be provided leading to some consensus in this issue would be welcomed.

The provisions in paragraph 7.35 (‘in some cases, the costs that would hypothetically be incurred by the recipient were it to perform the service for itself may be instructive of the type of arrangement a recipient would be prepared to accept for the actual service’) seem to provide some light on the position the OECD is willing to adopt in this respect. Should this be the case, the discussion draft should also contemplate which solutions might be at hand for the counterparty in order to avoid the likely double taxation.

Finally, in connection with the calculation of the arm’s length compensation for intragroup services, and in particular when cost-based methods are used, Taxand would like to call for:

- A flexible and global approach by the tax administrations of both the provider’s and recipient’s jurisdictions to minimise the risk of double taxation arising
- Correct application of the mechanisms in place to avoid double-taxation situations when this takes place

2. Cost base determination

Section B.2.3 addresses the issues of the different methods to be followed in calculating the arm’s length compensation and discusses whether or not a profit element is appropriate in this respect.

Taking into account that most of the contents in this Section refer to the possibility of applying cost-based methods to determine such an arm’s length compensation (in the absence of a valid CUP reference), it could be worth including further guidance to calculate said cost base (i.e. which costs should be considered in this respect).

In this context, and according to our experience, identification and proper consideration of direct costs, such as salaries of the staff rendering the services or lease of equipment used in this regard, do not usually pose a problem.

There are, though, 2 different categories of costs on which further development in the discussion draft could be useful, since its treatment for these purposes has occasionally
given rise to disputes (in particular with the tax administration of the entity providing the services):

- Indirect costs, such as rental of premises, supporting staff, telecommunications, other supplies and overheads.

  A non-exhaustive list of those to be taken into account, together with a general allocation method between the different categories of services rendered (following, for example, the criteria used for direct costs) would be convenient in this respect.

- External costs ie those relating to services rendered by non-related providers in connection with intra-group services.

  Guidance on when these categories of costs are to be considered as a mere recharge (and therefore no mark-up added on them) would be helpful.

  The idea of them being used by the service provider as another input in rendering services to the group members to include a profit element (versus the service provider not adding any value on those services directly provided to the final recipient to treat those costs as a recharge without a profit element) may constitute a good starting point.

Section D: Low value adding in intra-group services

1. Elective nature

According to paragraph 7.45 the low value-adding services methodology is of an elective nature, and ‘taxpayers 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 section A and B’ – sections which are related to common intra-group services.

Since the election seems to lie with the taxpayer, but is of course subject to subsequent review by tax authorities, it would be worth providing additional provisions in order to avoid potential future disputes.

An example of this would be the likely consequences of the challenge or denial of the application of the methodology. Especially if it were accepted by the administration of one of the countries involved, and denied by the other.

2. Definition of low value-adding intra-group services

Taxand is aware of the fact that the differentiation between low value-adding and high value-adding services on a general base, and not on a case by case basis, is a complex exercise, and consequently welcomes the examples contained in paragraphs 7.46 to 7.50.

Nevertheless, there are still certain aspects on which further elaboration would help to reduce uncertainty, bearing in mind that the consideration of a service as low value-adding is the starting and critical point to apply this elective simplified regime.

Therefore, additional guidance or clarifications would be of help in paragraphs 7.46 and 7.47 as regards the terms:
On the other hand, some of the examples contained in paragraph 7.48 could represent valuable services to some extent, depending on the type of activities carried out. This is the case for legal services (drafting and reviewing contracts), human resources (recruitment or training and employee development) or information technology services.

**Application of the profit mark-up**

When determining the arm’s length charge of low value-adding intra-group services, the discussion draft mentions in paragraph 7.57 that ‘the MNE service provider shall apply a profit mark-up to all costs in the pool’ and that ‘the same mark-up shall be utilised for all low value-adding services irrespective of categories of services’ within a range between 2% and 5% of the relevant costs.

The aim of exonerating MNE groups electing this methodology to carry out comparability analyses, as well as the corresponding benchmarking studies, is welcomed by Taxand, especially taking into account that the outcome of those analyses is most of the times within (or very closed to) the proposed range.

This simplified and homogeneous approach could, however, lead to some discussions between MNE groups and tax administrations when being assessed, due to the following issues:

- **The point in the range to be applied.**

  The discussion draft clearly states that, since it is at the taxpayer’s election to apply this simplified regime, any value selected within the arm’s length range provided should not be challenged by the tax authorities of the provider’s nor of the recipient’s jurisdiction.

  In this respect, it is worth noting that although the range provided in the discussion draft is narrow, there may be cases where the volume of costs incurred by a low value-adding service provider is substantially high. Therefore, an assessment by only 1% in the arm’s length mark-up (for example, from 3% to 4%), can be onerous for the taxpayer, and can generate double taxation situations which might be difficult to eliminate.

  Following the above, and as previously expressed, tax authorities should be flexible in this respect (ie bound by the arm’s length value chosen by the MNE) and if - for whatever reason - any double taxation arises, the mechanisms in place to avoid this should be properly applied.

- **Geographical and market characteristics**

  As pointed out in the previous bullet point, the proposed safe harbour range of 2% to 5% is low and narrow, aiming at facilitating these 2 goals of simplicity and homogeneity within the low value-adding intragroup services methodology.

  Such a range could, however, be at odds with the position of developing economies, as they could take the view that such a low mark-up does not adequately compensate them...
for the location savings portion which usually arises when these services are provided in their countries.

In order to mitigate such a view, which could hinder the implementation of this methodology in those countries and hence its global applicability, it may be worth broadening that range up to a maximum of 10% (in line with the recommendations of the European Union, for these kinds of services).

*Documentation and reporting*

Section D.3 (paragraph 7.61) provides for an information and documentation regime to be made available upon request to tax administrations on certain items of the low value-adding intragroup services methodology.

As previously expressed above, Taxand considers such a request useful, not only for tax administrations, but also for MNE groups, so that they can provide solid explanations regarding the key features of their intragroup services' system.

Notwithstanding the above, it would also be convenient to introduce certain thresholds for these reporting requirements (mainly of a quantitative nature), so that these documentation obligations do not become excessively burdensome for small and medium enterprises, or when the value of the services rendered (and therefore the materiality of the likely risks) may be considered low.

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We appreciate this opportunity to provide comments to the OECD Committee of Fiscal Affairs and would be pleased to discuss this further, and to participate in any further discussion on these matters.

More information on how to contact Taxand is provided above. Taxand is wholly committed to supporting the OECD Committee of Fiscal Affairs and we look forward to contributing to further debate.

Yours faithfully,

*Taxand*
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Head, Transfer Pricing Unit
Centre for Tax Policy and Administration
Organisation for Economic Co-Operation and Development
Paris, France

Via Email: transferpricing@oecd.org

RE: Public Discussion Draft on BEPS Action 10:
Modifications to the OECD Transfer Pricing Guidelines
for Low Value-Adding Intra-Group Services

Dear Mr. Hickman:

On 19 July 2013, the OECD published an Action Plan on Base Erosion and Profit Shifting (hereinafter the Action Plan or the Plan) setting forth 15 actions the OECD will undertake to address a series of issues that contribute to the perception that individual countries’ tax bases are being eroded or profits shifted improperly. Pursuant to Action 10 of the Plan, “Other high-risk transactions,” the OECD issued a public discussion draft on 3 November 2014 entitled Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services (hereinafter the Discussion Draft or Draft). The Discussion Draft sets forth a simplified approach for low value-added services to achieve a balance between appropriate charges for low value-added services and head office expenses and the need to protect the tax base of payor countries.

The OECD solicited comments from interested parties no later than 14 January 2015. On behalf of Tax Executives Institute, Inc. (TEI), I am pleased to respond to the OECD’s request for comments.
TEI Background

TEI was founded in 1944 to serve the needs of business tax professionals.\(^1\) Today, the organisation has 56 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 3,000 of the largest companies in the world.

TEI Comments

TEI commends the OECD for its work on the Discussion Draft. Overall, the Draft is a significant positive step forward and sets forth a balanced approach to transfer pricing for low value-added services. Multi-national enterprises (MNEs) spend a substantial amount of time and effort to allocate intra-group service charges in a manner that satisfies tax authorities around the world. This is a difficult task because of the tension between payor and payee jurisdictions and a significant amount of effort is expended on administering low value-added services for what is, in the end, not a substantial amount of tax. The Discussion Draft sets forth sensible guidelines to make this area more manageable for MNEs via an elective, simplified approach. This will permit taxpayers and tax authorities to allocate scarce resources to higher risk activities and more difficult to resolve issues. However, the approach provided in the Discussion Draft will be of limited value to MNEs unless it is widely implemented across jurisdictions, and respected by both the payor and payee jurisdictions for particular services and their respective charges.

Benefits test for low value-added services

As stated in our letter to the OECD regarding its Draft Handbook on Transfer Pricing Risk Assessment,\(^2\) intra-group service transactions are an often the subject of transfer pricing adjustments for questionable reasons (e.g., because it is easy for tax authorities to assert such adjustments while documentation can be difficult for taxpayers). In many cases, MNEs provide centralised or regional services to their local affiliates that may appear to duplicate certain activities conducted locally by those affiliates. The centralised or regional services, however, complement or oversee the local activities and permit MNEs to implement group-wide best practices. For example, the regional human resources function may provide talent management

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\(^1\) TEI is a corporation organised 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).

services to support a domestic human resources department. These tasks are often best performed centrally or regionally, and the costs MNEs incur to provide these services need to be shared among the affiliates that benefit.

In this regard, TEI recommends that MNEs should not be required to apply the “benefits test” (described in paragraph 7.7 of the Draft) to low value-added services. Instead, the OECD should introduce a rebuttable presumption for these charges. That is, tax authorities should accept that an intra-group service transaction was necessary for the payor affiliate and properly compensated if a taxpayer fully discloses its cost base and allocation mechanism while applying a cost plus charge for the transaction, in conformance with the approach set forth in the Discussion Draft.

*Definitional issues and coordination with other OECD efforts*

The Discussion Draft identifies a number of activities that would not be considered low value-added intra-group services, including services of corporate senior management. While TEI agrees with this conclusion, additional clarification on what constitutes corporate senior management would be helpful as it raises difficult issues that may be time consuming to resolve. For example, what level of management is considered corporate senior management? Would this only include corporate senior management that is not responsible for low value-added intra-group services? Would an MNE need to allocate the corporate senior management’s salary between low value-added activities and other activities? Would regional senior management be included as corporate senior management or just senior management located in the head office? Thus, while the value added by corporate senior management should not generally be considered “low,” as a practical matter it may be simpler to include them as part of low value-added intra-group services due to the difficulty of answering the above questions. Alternatively, the taxpayer could be permitted to elect to treat such services as low value-added and apply the approach set forth in the Draft.

TEI welcomes the proposal of a safe-harbour profit mark-up for low value-added intra-group services. It is unclear, however, in what manner the OECD developed the two to five percent range. For example, the Discussion Draft indicates that cost contribution arrangements are not covered by this safe harbour, and yet many of the services that are included could just as easily be part of a head office cost contribution arrangement. Under such a cost contribution arrangement, there is typically not a requirement to include a mark-up. Moreover, it has been a longstanding practice for MNEs to provide no mark-up for many low value-added services. To give taxpayers flexibility between using a cost-plus mark-up versus a cost contribution arrangement and in recognition of this longstanding practice, we recommend the OECD change the mark-up percentage range to between zero and five percent.
With respect to settling on a particular percentage within the safe harbour range, TEI recommends the OECD specify that taxpayers may choose any percentage within the range without challenge by tax authorities, as long as the taxpayer maintains the appropriate documentation and the services are truly low value-added services. Alternatively, the OECD could recommend that tax authorities implement a simplified mechanism, such as an expedited advanced ruling process, including an opportunity to obtain a bilateral or multilateral ruling, to confirm that the taxpayer’s selected percentage within the safe harbour is appropriate.

TEI welcomes the clarification that “stewardship activities” are broader than “shareholder activities.” For example, the Discussion Draft states that central coordination activities such as “detailed planning services for particular operations, emergency management or technical advice (trouble shooting), or in some cases assistance in day-to-day management” are not considered shareholder activities and thus chargeable to associated enterprises, although they would otherwise fall within the definition of stewardship activities. In a similar vein, TEI recommends that the OECD clarify the following in the final revisions to Chapter VII:

(a) Whether certain compliance services, such as implementing group-wide risk management and governance regimes/procedures or complying with regulations broadly adopted across the jurisdictions in which an MNE operates (such as Basel banking regulations), can be regarded as non-shareholder activities and thus eligible for reimbursement from benefited group members even though the services are predominantly administered or enforced at the parent company level; and

(b) The appropriate characterization of personnel who perform functions with a mix of shareholder and non-shareholder activities. For example, a business managing director who runs the day-to-day operations of entities in a certain jurisdiction and also serves as a director on the board of the parent or holding company in the jurisdiction. A simplified way to address this would be to permit an MNE to allocate the time of the employee based on the employee’s principal function to avoid burdensome allocations of employee time.

More broadly, the OECD should provide some guidance regarding how the guidelines provided in the Discussion Draft under Action 10 will be coordinated with the more general transfer pricing documentation requirements provided under Action 13. For example, it would seem that the documentation required by the local file under Action 13 would not be necessary for low value-added services when the taxpayer elects the simplified approach under the Discussion Draft.

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3 Discussion Draft, p.8.
Finally, we note the absence of any reference to the OECD’s previous work on safe harbours in Chapter IV of the OECD Transfer Pricing Guidelines (Guidelines).\(^4\) It would be useful if the OECD discussed the reasons for this omission. For example, whether the omission represents a shift away from the OECD’s previous safe harbour approach under the Guidelines or merely that additional revisions to Chapter IV were beyond the scope of the Draft under BEPS Action 10.

**Comments on specific paragraphs in the Discussion Draft**

TEI welcomes the inclusion of an example in the Discussion Draft (in paragraph 7.50) of the application of the simplified approach to a wholly-owned shared services company typified by the out-sourcing/off-shoring shared services arrangements common across certain countries, particularly in Asia.\(^5\) The example (a shared services center of a dairy product company whose “only activity of which is to act as a global IT support service centre”) is helpful in defining the boundaries of low value-added intra-group services as “support services that are not part of the core business of the MNE group.” This boundary is made clear by the further explanation that whether an activity is “core” is to be determined from the perspective of the MNE as a whole, not that of the MNE subsidiary alone. Thus, even if the low value-added service is the core activity of the subsidiary, from the perspective of the MNE group as a whole, the service is not a core business activity and therefore low value-added and eligible for the approach set forth in the Discussion Draft.

With respect to paragraph 7.51, TEI recommends that the following sentence (in italics) be added after the end of the second sentence, so that it reads as follows:

An MNE group electing to adopt this simplified method would apply it on a consistent, group wide basis in all countries in which it operates. An MNE shall not be precluded by any Advance Pricing Agreement(s), Mutual Agreement Procedure determination(s) or other ruling(s) specific to any individual jurisdiction from electing into the simplified method for the MNE as a whole.

The revisions to Chapter VII of the Guidelines should make it clear that an MNE may adopt the simplified method in the Discussion Draft even if the MNE may be required to use a different approach under the transfer pricing rules of specific jurisdictions that do not accept the OECD endorsed simplified method or that arise from preexisting Competent Authority agreements or other rulings. In other words, if an MNE has a historic APA, MAP agreement or other tax ruling in place that does not fully conform with the conditions of the simplified approach due to

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\(^4\) See OECD Discussion Draft: Proposed Revision of the Section on Safe Harbours in Chapter IV of the OECD Transfer Pricing Guidelines and Draft Sample Memoranda of Understanding for Competent authorities to Establish Bilateral Safe Harbours (6 June 2012).

\(^5\) See Discussion Draft, p.17-18.
the specific non-OECD compliant practices of certain jurisdictions (or is in the process of obtaining such an agreement or ruling at the time a jurisdiction adopts the OECD approach), such agreements, determinations or rulings should not preclude the MNE from electing to apply the simplified method for the rest of its operations, particularly for those in other jurisdictions that have adopted the OECD approach.

Conclusion

TEI appreciates the opportunity to comment on the OECD Discussion Draft under BEPS Action 10 addressing low value-added services. These comments were prepared under the aegis of TEI’s European Direct Tax Committee, whose Chair is Nick Hasenohrl. If you have any questions about the submission, please contact Mr. Hasenohrl at +41 786 88 3772, nickhasen@sbcglobal.net, or Benjamin R. Shreck of the Institute’s legal staff, at +1 202 638 5601, bshreck@tei.org.

Sincerely yours,

TAX EXECUTIVES INSTITUTE, INC.

Mark C. Silbiger
International President
MEMORANDUM


From: True Partners Consulting LLC

Date: January 13, 2015


1. General

True Partners Consulting is pleased to offer this comment on the OECD Working Party’s Action 10 Discussion Draft, which proposes new provisions applicable to intra-group services in general, and introduces a simplified elective regime for determining the arm’s-length charge for “low value-adding services.” In general, we applaud the OECD’s effort to introduce a simplified process for low value-adding services (including accounting, human resources, information technology, legal, and other supporting services). These types of services rarely give rise to the type of base erosion concerns that are central to the BEPS project, and the need to provide detailed analyses of such services can impose significant administrative burdens on taxpayers without providing a corresponding benefit to tax authorities. However, we do have concerns that, in its current form, the Action 10 Discussion Draft does not include sufficient guidance related to (1) the markup on low value-adding services; and (2) the costs includable in the services cost base. We discuss each in detail below.

2. Markups on Low Value-Adding Services

Our first concern relates to paragraph 7.57 of the Discussion Draft:

In determining the arm’s length charge for low value-adding intra-group services, the MNE provider of services shall apply a profit mark-up to all costs in the pool. The same mark-up shall be utilised for all low value-adding services irrespective of the categories of services. The mark-up selected by the taxpayer should be no less than 2% of the relevant cost and should be no greater than 5% of the relevant cost. [emphasis added]
Date: January 13, 2015


Neither this language by itself, nor any other part of the Action 10 Discussion Draft, explicitly states whether the taxpayer may select any markup of its choosing within the 2 percent to 5 percent range (without further analysis or support); or must still perform a transactional net margin method analysis to support the markup it selects within this range. Given that one of the primary goals of the simplified regime is to reduce unwarranted taxpayer burdens, the latter meaning would undermine its purpose. If the intended meaning is that taxpayers may select any point within this range without providing any supporting analysis (an interpretation which is more consistent with the objectives of the Action 10 Discussion Draft), then this should be explicitly stated. In addition, if the intent is for the markup selected within this range to be a true safe harbor, and not subject to potential challenge by a tax authority, this should also be explicitly stated. In either case, the requirement that any markup be applied to low value-adding services adds an unnecessary layer of complication.\(^1\) Paragraph 7.37 of the Discussion Draft aptly describes why this is the case:

\[
\text{[A] cost-benefit analysis might indicate the additional tax revenue [resulting from addition of a markup] that would be collected does not justify the costs and administrative burdens of determining what an appropriate arm’s length price might be in some cases. In such cases, charging all relevant costs rather than an arm’s length price may provide a satisfactory result for MNEs and tax administrations.}
\]

For these reasons, the creation of an elective, safe-harbor percentage markup on low value-adding services would likely best serve the simplified regime’s intended purpose.\(^2\)

### 3. Determination of Cost Pool

Our other concern relates to the lack of clear guidance regarding the costs includable in the pool of allocable service costs.\(^3\) The Discussion Draft provides no meaningful guidance as to proper

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\(^1\) At least one OECD member state has successfully implemented a regime that permits charging for low value-adding services at cost. See United States Treas. Reg. §1.482-9(b).

\(^2\) There is no reason to expect that the absence of a markup on low value-service would disproportionately affect any particular member state or group of member states.

\(^3\) The Discussion Draft provisions related specifically to the simplified regime do not indicate that total departmental costs may be charged without detailed scrutiny of each cost incurred by the relevant department. However, there is no corresponding provision in the sections that refer generally to all services (sections A through C).
Date: January 13, 2015


The proper treatment of overhead, depreciation, and other indirect service costs when using a cost-based method. More detail (including examples) is needed to provide taxpayers with the guidance necessary to apply the principles of the OECD Guidelines in practice. Moreover, we are particularly concerned by the failure to address the contentious issue of the treatment of stock options. To avoid taxpayer uncertainty and unnecessary disputes, we encourage the Working Party to explicitly state that stock-based compensation is includable in the services cost base. Not only would such a provision eliminate uncertainty, it would also reflect the fact that stock-based compensation is a real and economically significant element of many taxpayers’ compensation structures. If no such provision is included, taxpayers will have only the vague and equivocal guidance provided at paragraph 2.84 of the 2010 OECD Guidelines (in relevant part):

The decision whether or not to include [depreciation, amortization, stock options, and pension costs] in the determination of [a cost-based] net profit indicator for applying the transactional net margin method will depend on a weighing of their expected effects on the appropriateness of the net profit indicator to the circumstances of the transaction and on the reliability of the comparison.

Given the vagary of current guidance and the economic significance of stock options, we urge the Working Party to explicitly include stock options in the allocable cost pool. OECD member states today take different approaches to dealing with the inclusion of stock-based compensation in the cost pool for intercompany services, and we view this as a prime opportunity to achieve further symmetry.

4. Conclusion

As noted above, we support the Working Party’s objective of simplification, and we welcome the introduction of a simplified elective regime for low value-adding services and the inclusion of stock-based compensation in the cost pool for intercompany services. We are hopeful that the

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4 The proper treatment of stock options has been the subject of a number of high-profile court cases in the United States, most notably including Xilinx, Inc. v. Commissioner, 125 T.C. 37 (2005). Although that case addressed the treatment of stock options in the cost sharing arrangement context, the substantive issues are equally applicable in the services context.

5 The United States Treasury Regulations include such a provision at Treas. Reg. §1.482-9(j). We urge the Working Party to adopt a similar provision.
Date: January 13, 2015


Working Party will address the issues described above in a manner that furthers the important objectives of the Action 10 Discussion Draft.
December 19, 2014

VIA EMAIL
Andrew Hickman
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Centre for Tax Policy and Administration
Organisation for Economic Cooperation and Development
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Dear Mr. Hickman,

USCIB¹ is pleased to have this opportunity to provide comments on OECD’s discussion draft on guidelines relating to low value-adding intra-group services.

General Comments

USCIB supports the OECD’s efforts to bring clarity to the area of intra-group services, including especially the new guidance on low-value intra-group services. This is a significant issue for business because so many audit and dispute resolution resources are spent resolving these issues. Companies incur intra-group service expenses in order to run their businesses. In recent years, countries where these costs are incurred are demanding that they be charged out to affiliated entities while the countries of the affiliated entities assert that the costs provide no benefit and cannot be deducted. These conflicting positions mean that companies may be effectively denied a deduction anywhere for legitimate business expenses. Effective global resolution of this issue would not only be good for companies, but would also enable tax administrations to refocus limited audit resources.

¹ USCIB promotes open markets, competitiveness and innovation, sustainable development and corporate responsibility, supported by international engagement and prudent regulation. Its members include top U.S.-based global companies and professional services firms from every sector of our economy, with operations in every region of the world. With a unique global network encompassing leading international business organizations, USCIB provides business views to policy makers and regulatory authorities worldwide, and works to facilitate international trade and investment.
The purpose of Article 9, its commentary and the OECD Transfer Pricing Guidelines is to allocate taxing jurisdiction over transaction income to countries based on the arm’s length principle. This principle is so fundamental that sometimes it may be overlooked. USCIB raises this principle here because we believe that agreement on Chapter VII implies agreement with a number of important underlying premises which are described below.

First, Chapter VII is clearly premised on the principles that the source of services income is the place of performance and taxation should be on a net basis. This is consistent with the paragraphs 42.18 and 42.19 of the commentary on Article 5 of the OECD Model Income Tax Convention. Paragraph 42.18 provides:

All member states agree that a State should not have source taxation rights on income derived from the provisions of services performed by a non-resident outside that State.

Paragraph 42.19 provides:

Another fundamental issue on which there is general agreement relates to the determination of the amount on which tax should be levied. In the case of non-employment services (and subject to possible exceptions such as Article 17) only the profits derived from the services should be taxed.

Obviously, the BEPS project includes countries that are not members of the OECD and that may not share this view\(^2\). However, proposed Chapter VII cannot be sensibly applied unless the OECD view is accepted; so it should be made clear when countries agree to Chapter VII they are agreeing to apply the generally accepted OECD principles on sourcing of services and the net taxation of services that generally underly it.

Second, the implication of the line-drawing on shareholder services, direct-charge services, and indirect-charge services, is that costs that fall into each of these categories ought to be deductible as follows: shareholder services by the parent; direct-charge services by the company benefitting from the service; and indirect charge services by the company with respect to its properly determined allocation. Although the Model Convention does not generally deal with the deductibility of expenses, at least with respect to direct-charge and indirect-charge services, the proposed allocation principle will fail and double taxation will result unless the service recipient is permitted to deduct or otherwise reduce its income by the amount of these expenses. It would be appropriate to say that paragraph 2 of Article 9 requires the elimination of these amounts from the income of the service recipient whether by granting a deduction or otherwise. Granting a deduction would seem to be the most obvious solution to what would otherwise be clear double taxation.

Third, Chapter VII should clearly state that services priced in accordance with this Chapter are not base eroding payments. When the Action Plan was published, business was genuinely surprised that it described “management fees and head office expenses” as base eroding

\(^2\) Recent discussions at the UN indicate that some countries believe the “source” of services income is the jurisdiction of the residence of the payor or the jurisdiction in which a PE that bears the cost of the service is located.
payments. USCIB believes there is an important distinction to be drawn here. All cross-border deductible payments reduce the tax base of any country that permits the deduction. If businesses are recovering costs or the payments are for services received and are not excessive, that country’s base has not been eroded. That country’s tax base has been appropriately reduced because the value was created in the jurisdiction of the service provider. If an appropriate payment is not made to the service provider and taxable there, then it is the jurisdiction of the service provider that is being inappropriately “eroded”. Cross-border services benefit the recipient of those services, which in turn benefits the local economy, including the local tax base.

Base erosion should not be defined based on whether the tax loop is closed in any one jurisdiction. The principle of coherence that the OECD has been articulating as part of the BEPS project is that deductible payments in one jurisdiction should generate a corresponding inclusion either in that jurisdiction or in another jurisdiction. If deductible payments are not excessive and generate a corresponding inclusion in another jurisdiction where the recipient is subject to tax, then there is no base erosion even though taxable income in the country from which the payment originated is reduced. Countries need to agree with this or principled resolution of BEPS issues will be impossible.

USCIB believes these three implicit points are the foundation of proposed Chapter VII and should be made explicit.

Specific Comments

In USCIB’s view the most important point is to achieve clarity on the operation of these rules. Important steps have been taken in that direction but further guidance is needed. One point that runs through Chapter VII is that costs are undefined. Business would appreciate guidance providing examples of the types of costs that ought to be included in the cost pools.

B.1 Determining whether intra-group services have been rendered

Paragraph 7.11 of the discussion draft sets forth examples of shareholder activities. This list has been expanded but remains ambiguous. The draft would be more clear if subparagraph c) were divided into two items (since the combined items do not really seem to be related). Subparagraph d) is also unclear. What are the costs of the parent of complying with relevant tax laws? If a company has significant expenses relating to establishing systems to support tax reporting for a PE of an affiliate do those relate to the compliance of that company or the affiliate? We believe these costs relate to the compliance of the affiliate. Subparagraph e) seems broad enough to include virtually anything.

The additions to paragraph 7.12 would be helpful clarifications and USCIB supports their inclusion in Chapter VII.

It is not clear what paragraph 7.27 means, perhaps it could be rephrased to make the point more clearly. We think this paragraph is intending to make a point about the availability of a deduction when the service charge is computed using an indirect method. As stated above, it
should be clear that a deduction should be available to the service recipient when an indirect charge is appropriately determined.

Paragraphs 7.31 and 7.32 are essentially unchanged from the current guidelines. These paragraphs raise significant problems in their current application. Some countries that may have lower cost service providers and may disallow charges for services from service providers outside of the local country asserting the local affiliate should use lower-cost local providers. The argument, in these cases, is not whether a service was provided, or a benefit received; it is an argument whether the taxpayer provided the service in a cost efficient way. There are frequently cases where it is not appropriate to use a local service provider and the higher cost of providers from other countries is justified because of concerns with quality, reliability and confidentiality. Thus, the local service provider is not comparable to the non-local service provider and mark-ups should not be based on local comparables but should include regional or global comparables.

Some examples illustrate these points. If the service provider is repairing equipment and the MNE wants to ensure that the service provider is properly trained on that equipment, the warranty is not invalidated or MNE remains complaint with a maintenance agreement, then it may use a service provider in a higher-cost location. As another example, a central legal team may be a higher cost on an hourly basis than a local lawyer but the experience and consistency gained with centralizing this expertise will help reduce costs overall. As another example, local auditors are not interchangeable with internal auditors with specialized knowledge of the MNE’s business. Accordingly, we urge the OECD to adopt language to clarify that it is not appropriate for tax examiners to substitute their business judgment for the business judgment of the taxpayer.

C. Some examples of intra-group services

The revisions to paragraphs 7.41 and 7.42 concerning debt-factoring activities and manufacturing activities are helpful and USCIB supports their inclusion in Chapter VII.

If changes are made to Article 5 paragraph 4 such that delivery may result in the creation of a PE, particularly if delivery is deleted from subparagraph 4 a) and b), then guidance would be required on the amount of profit that is attributable to the delivery function. The OECD should consider adding a paragraph to Chapter VII on delivery. Given the recent focus on delivery, we believe it is important to acknowledge that in many cases delivery is a low-risk low value-adding function.

Paragraph 7.43 covering research has been substantially revised. We view this as a place holder for the ongoing discussion on intangibles under Chapter VI and Chapter IX and, therefore, do not provide substantive comments here.

D. Low value-adding intra-group services

USCIB strongly supports the addition of an elective simplified approach for dealing with low value-adding intra-group services. We believe that adoption of rules along these lines would
significantly reduce controversy in this area and provide needed certainty with respect to transactions that are covered by these rules. If anything, USCIB members would like to see this method expanded. We strongly supported the adoption of multilateral MOUs, but it seems there has not been any real progress on that initiative. Expansion of this elective method might be a reasonable alternative at least for low-cost services.

D.1 Definition of low value-adding intra-group services

USCIB generally agrees with the standards set forth in paragraph 7.46 for defining low value-adding intra-group services, but believes that the exclusions provided in paragraph 7.47 are unnecessarily broad. For example, the 2014 Action 8 deliverable recognizes that “not all intangibles deserve compensation separate from the required payment for goods in all circumstances and not all intangibles give rise to premium returns.” For example, if an MNE internally developed software for accounting purposes, would those services be excluded because they are “development services” or be included because they are accounting and auditing costs? We believe that such costs ought to be included, but the exclusion for research and development might lead to their exclusion. It would seem that the R&D exclusion ought to be limited to R&D that is intended to lead to “unique and valuable intangibles” described in paragraph 7.46.

We also believe that the exclusion for services of corporate senior management is overbroad. It is not clear where the dividing line is between senior management and other management. This lack of clarity may lead to disputes. In our view, a better way of limiting this would be to look at the activity, to the extent that management is involved in the types of activities listed in paragraph 7.48 those services should be in the cost pool and compensated under these rules.

USCIB also believes that paragraph 7.48 should include warehousing, delivery and logistics (if that is not the core business of the MNE) and marketing procurement.

D.2 Simplified determination of arm’s length charges for value-adding intra-group services

Business accepts the need to make a global election if this simplified method is going to work. This implies, however, that countries will accept this globally. Acceptance of this simplified method acknowledges that the transfer price determined will not reach the same result as application of the regular transfer pricing rules and countries must be willing to accept these results under the simplified calculations for all purposes. In USCIB’s view, however, accepting this method would be fundamentally inconsistent with asserting the right to impose a gross basis withholding tax on the services covered by Chapter VII, Part D.

As discussed in the general comments section of this letter, implicit in any agreement to the proposals in this discussion draft is that the jurisdiction where the services are performed has the primary right to tax income from these services and the appropriate basis for taxation is net income. Under the simplified method, the amount of that net income will be relatively small,

3 To the extent that some countries do not accept these rules, appropriate adjustments would need to be made to account for non-conforming local requirements.
4 To reiterate, we believe agreement to these principles should be made explicit.
between 2 and 5 percent\(^5\). The only conclusion that can be drawn from this is that a gross basis withholding tax imposed by the jurisdiction of the service recipient is insupportable in these circumstances. When the profit attributable to these activities is only in the range of 2 to 5 percent, any gross basis taxation would more than offset the total profit. Absent such an agreement at the OECD/G20 level that gross basis withholding will not apply to these fees, these rules could be rendered meaningless by the imposition of gross basis withholding taxes on low-value intra-group services.

**D.2.1 Determination of cost pools**

For these rules to be fully effective more guidance is needed on how costs should be determined otherwise disputes may simply move to the definition of costs, rather than being eliminated. Clearly payroll and travel expenses ought to be included. Business believes that stock based compensation should also be included, as well as an allocation of overhead such as rent and utilities.

USCIB believes that determination of the cost pools may over allocate expenses to certain members of an affiliated group in some cases and that taxpayers should be able to compute the pools using the method suggested in the Discussion Draft or using an alternative method\(^6\). Under the alternative method the calculation would be as follows: all of the expenses would be included in the pool, the entire amount of the expenses would be allocated based on the allocation key, and any company that performed in-house activities would reduce the amount of its allocated expense by that amount. A simple example illustrates this problem. Assume four affiliated entities with a total of 200 costs in a pool and the allocation key indicates that the expenses should be shared equally. If Affiliate 1 incurred 40 of in-house expenses, then under the proposed rule the cost pool would be reduced to 160 and each entity would be allocated 40 of that reduced expense. Affiliate 1 would effectively end up with 80 of expense, rather than an equal share of the 200 total or 50. If instead, the direct cost pool is not reduced, then Affiliate 1 would be allocated 50 of expense. That amount would be reduced by the 40 of in-house expenses. The effect of this calculation would be that Affiliate 1 bears an appropriate share of the total expense and pays the service provider the appropriate mark-up on 10. USCIB believes that this gives a proper result.

The same problem may exist with respect to direct-charge expenses. The resolution of that issue may be complicated by the existence of a profit element in the direct-charge. That is, the cost pool and the expenses allocated to an affiliate probably should not be reduced by the profit element in the direct-charge expenses. It is not clear how to solve this problem, but it exists whether the direct charges come out of the pool or reduce the allocation to a particular affiliate.

\(^5\) Although see below, where USCIB recommends a broader range. Nevertheless, a gross withholding tax would likely still exceed any profit.

\(^6\) The differences between the two methods may be relatively insignificant and companies may currently be using both methods. So requiring either method may cause some taxpayers to incur significant costs to reconfigure the way they account for these expenses.
D.2.3 Profit mark-up

As noted above, it is important to the effectiveness of this method that there be global acceptance by countries. USCIB is concerned that the profit mark-up rule will limit the willingness of countries to accept the results under this method. We believe that the results are both too high and too low and the requirement to use the same mark-up for all low value-adding services will result in countries rejecting the results under this method. In order to encourage greater acceptance by countries we believe that there ought to be different mark-ups on different categories of services, zero should be an acceptable mark-up in some cases, and the upper end of the range should be higher. This would be a more complex regime; but an overly simple regime that is not acceptable to countries will not achieve the important goals of the discussion draft. In USCIB’s view, the OECD should clearly establish the range and expect countries to accept mark-ups within the range, whether their residents are service providers or service recipients. The scope of the range is less important than that countries accept the mark-ups.

D.3 Documentation and reporting

USCIB believes the documentation requirements generally seem reasonable. We think, however, it is necessary to add some language concerning penalty protection and the interaction of these rules with the generally applicable transfer pricing documentation rules.

In order that the simplified method is effective, it has to be clear that if the reporting and documentation requirements are complied with them, the benefits test has been met. USCIB believes that the use of the word “should” in paragraph 7.60 is too vague. This might be interpreted as allowing countries to treat the satisfaction of the benefit test as a presumption and countries might still ask for proof that a benefit was provided in a particular case. Since one of the principle reasons for the simplified approach is to eliminate these issues, countries should not be permitted to look behind the documentation.

Paragraph 7.61 should explicitly state that the documentation required by that paragraph is in lieu of transfer pricing documentation that might otherwise be required for the low value intra-group services under Chapter V. Further, it is not clear how this documentation requirement ties into the Master or Local Country files. We believe this documentation should not be part of those files, but should be a separate requirement. Further, we believe that the description of the categories, benefits and allocation keys should only be required to be revised if required by changes to the categories or every third year.

We are also concerned about the lack of guidance on the proper method for making the election. It seems that the taxpayer simply uses the method to determine the charge and only provides documentation upon request. This could lead to disputes on whether the taxpayer has in fact made the election. If the tax authorities do not accept that an election has been made and other transfer pricing documentation is not available, then there might be controversy over the availability of the method and the application of penalties.
USCIB also suggests the addition of a new paragraph 7.62. The new paragraph would provide that, provided a taxpayer reasonably believed that the transaction would be within the scope of Chapter VII, Part D, no penalties for failure to file transfer pricing documentation that would be required under Chapter V should apply with respect to that transaction. Penalty protection will be important to taxpayers’ willingness to elect into this regime.

Sincerely,

William J. Sample
Chair, Taxation Committee
United States Council for International Business (USCIB)
Valente Associati GEB Partners
(www.gebpartners.it)

Submitted by Piergiorgio Valente and Filipa Correia
(p.valente@gebnetwork.it)

To the kind attention of: Andrew Hickman, Head of Transfer Pricing Unit, Centre for Tax Policy and Administration

General Comments

The Discussion Draft released on November 3rd, 2014, intends to provide some guidance in order to achieve the “necessary balance between appropriate charges for low value added services and head office expenses and the need to protect the tax base of payor countries” (OECD Discussion Draft on Action 10, Nov. 2014, p. 3). The latter charges for low value added services and head office expenses have been identified in the OECD BEPS Action Plan as a source for further base erosion that needs to be prevented.

Most Countries have resolved to apply the arm’s length principle in order to establish the price of transactions carried out within the context of intra-group services.

There is no standard interpretation, nor is there any consistent application of the arm’s length principle among the various Tax Authorities, nor among Tax Authorities and enterprises. Such kind of scenario might engender, in turn, a climate of uncertainty, increased costs for multinational corporations without excluding the possibility of double taxation or double non-taxation phenomena.

Pursuant to point 7.6 of the OECD Discussion Draft under analysis, “there are two issues in the analysis of transfer pricing for intra-group services. One issue is whether intra-group services have in fact been provided. The other issue is what the intra-group charge for such services for tax purposes should be in accordance with the arm’s length principle. Each of these issues is discussed below”. The latter two areas are also addressed within Chapter 7 of the OECD Transfer Pricing Guidelines.

The OECD Transfer Pricing Guidelines (2010 version), Chapter VII, do not address the issue of “low value-adding intra-group services”. One of the key issues concerns the remuneration of a given type of intra-group services, i.e., the so-called “low value-adding intra-group services”, when having to establish
whether the arm’s length principle has been duly complied with. A crucial aspect involves the need for multinational companies to employ an undue amount/number of resources for the mere purpose of substantiating, by means of documental evidence, that the above-stated kind of service was actually provided. Therefore, Valente Associati GEB Partners (VAGP) is most appreciative of the OECD’s endeavours to offer some guidance in order to identify the said services and also to determine the remuneration thereof.

A number of principles play a fundamental role where the rendering of “low value-adding intra-group services” is to be evidenced. Such principles entail: a) Tax Authorities’ access to comprehensive and accurate information/data; b) Flexible approach in evaluating low value adding intra-group services.

However, such flexible approach is expected to address key issues such as (i) cost pools analysis, (ii) definition of shareholders’ costs, (iii) remuneration on an arm’s length basis, (iv) documental requirements and relevant penalties.

Furthermore, in the VAGP’s view, a key issue – whenever addressing intra-group services – relates to the settlement of double taxation disputes, to which due consideration should be devoted.

To sum up, the proper balance between the documentary burden and the relevant resources multinational enterprises are obliged to employ, including the risk level involved in the supply of such services, should be ensured.

Special Observations

The Discussion draft provides a new section D with the purpose of identifying a streamlined approach for the treatment of “low value-adding intra-group services”, so as to strike the right balance between suitable charges for low value-adding services and corporate expenses, and the necessity to curb the erosion of taxable income, while also protecting the taxable bases of payer countries.

Duplication of Shareholders’ Activities

The VAGP concurs with the fact that any consideration on duplicated services must carefully analyze the true nature of such services and any benefits they might engender, and welcomes the further elucidations provided on duplicative costs, given that – in most cases – the Tax Authorities reject the deductibility of the charged services on the grounds that such services are duplicated.
The VAGP welcomes the further examples included in the Discussion Draft on shareholder activities (such as: costs connected to stock exchange listings of the parent company; financial reporting and audit costs, borne in the interest of the parent company or related to consolidated financial statements; investor relations costs, i.e., communication strategies; parent company’s costs on compliance with tax laws and ancillary costs for corporate governance of the entire multinational group).

The Discussion Draft in its paragraph 7.12 provides that “the fact that a company performs, for example, marketing services in-house and is also 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”. The VAGP welcomes the inclusion of the above example, since the legal entity providing the services could be involved in various marketing activities among those performed by the recipient of the service, which could be considered complementary or additional.

**Low value-adding services**

The VAGP favours the introduction of the new “low value-adding services” category, and welcomes the examples of services provided by the OECD as “low value-adding services”. Such description of “value-adding intra-group services” comprises services carried out by one or more companies of a multinational group which:

- “are of a supportive nature;
- are not part of the core business 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 and do not give rise to the creation of significant risk” (OECD Discussion Draft, Nov. 2014, p. 15).

The Discussion Draft provides a streamlined approach for the purpose of determining the arm’s length remuneration of intra-group services, which multinational group members – as recipients of the said services – should pay, based on cost allocation, and on the application of consistent group-wide allocation keys by adding a small proportional mark-up. Such approach is optional for multinational groups. Moreover, the VAGP concurs with the suggested simplification, as it eases the burden – on Taxpayers and Tax Administration – connected with routine and low value-adding intra-group services transactions. The simplified approach previously mentioned includes five main steps:

- annual determination of cost pools;
- proper cost allocation of low value-adding services by applying special allocation keys that are consistent with the kinds of services provided
(i.e., headcount for services involving human resources, number of users for IT services, etc.);
- determination of mark-up ranging between 2% and 5%;
- calculation of charges connected to low value-adding intra-group services;
- application of a simplified benefit test to low value-adding intra-group services by preparing all appropriate documentation and increasing transparency by means of special reporting requirements.

This simplified approach will benefit both, multinational groups and Tax Authorities. Multinational groups will benefit from a reduction of compliance costs, while Tax Authorities’ transfer pricing audit activities, aimed at ascertaining the arm’s length charge of intra-group services, will be simplified. Therefore, application of the afore-mentioned simplified method might significantly reduce the number of controversies with Tax Authorities in connection with the deductibility of low value-adding intra-group services.

The VAGP welcomes the recommendation included under Paragraph 7.51 of the Discussion Draft that specifically states that the simplified approach, earlier mentioned, would be consistently applied by multinational groups in all countries (whether they are OECD Countries or not) in which they operate. The VAGP emphasizes the need for the OECD to commend that such new rules be applied worldwide on a global scale, underlying the benefits that such standard implementation would produce for Taxpayers and Tax Authorities.

**Determination of Profit Mark-up**

In the VAGP’s view, further clarification as to whether the suggested mark-up within a 2% and 5% range of the relevant costs regardless of the service category stated in the Discussion Draft (Paragraph 7.57) might represent a safe harbour, and – hence – whether a functional and an economic analysis (benchmarking analysis) might not be required in order to ascertain the arm’s length nature of the low value-adding intra-group services, should be provided.

Moreover, the afore-mentioned mark-up is lower than the one suggested by the EU Joint Transfer Pricing Forum’s (JTPF) guidelines for similar kinds of low-value added services, which establish that in such cases “where it is appropriate to use a mark-up, this will normally be modest and experience shows that typically agreed mark ups fall within a range of 3-10%, often around 5%” (COM(2011) 16 final, 25 January 2011). The JTPF’s guidelines point out that the mark-up applied to such service categories should be established on a case-by-case basis, with a view to specific facts and circumstances, which might eventually support a different mark-up.
In addition, and to avoid the risk of uncertainty and dispute, the use of a single mark-up (instead of the suggested range 2% - 5%) would probably be preferable so as to avoid different interpretations by Tax Authorities that could end up applying, one the lower range and the other the highest range.

**Cost-base Calculation**

The VAGP recommends that further guidance be provided on the costs that should be considered for computing the charge on low value-adding intra-group services, since the Discussion Draft makes general reference to all costs incurred in connection with the supply of the low value-adding intra-group services, but does not, however, provide any further guidance on the determination thereof.

**Documentation and reporting**

In VAGP’s opinion the interaction with other Actions provided under the BEPS Action Plan should have been taken into consideration in the current Discussion Draft. Notwithstanding the above mentioned, VAGP welcomes the further guidance/simplification provided on the information required to back the intra-group services charge. However, VAGP would like to stress the importance of considering the impact norms provided under the Discussion Draft (Paragraph 7.61 of the Discussion Draft) might have on the work performed by the OECD on Transfer Pricing Documentation and Country-by-Country Reporting (Action 13 of the OECD BEPS Action Plan). The foregoing by reason of the fact that the Report released on Action 13 in its “three-tiered approach” sets forth that specific information on intra-group services be included in the transfer pricing documentation.

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Comments on the discussion “BEPS action 10: draft of the proposed modifications to chapter VII of the OECD transfer pricing guidelines relating to low value-adding intra-group services”

Dear Mr. Hickman,

Thank you very much for the opportunity to provide our comments on the OECD’s discussion draft of the proposed modifications to chapter VII of the OECD’s transfer pricing guidelines.

The OECD was directed to "[d]evelop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to provide protection against common types of base eroding payments, such as management fees and head office expenses." ¹

The OECD’s Working Party No.6 on the taxation of multinational enterprises states in the preface of the discussion draft that they have developed a simplified transfer pricing approach for low value-adding intra-group services. We fear that the presented approach does not or only partly lead to a simplification of transfer pricing for multinational companies that have low value-adding intra-group services as part of their intra-group transactions.

Furthermore, the OECD’s Working Party No.6 states that resulting guidance seeks to achieve a balance between appropriate charges for low value-added services and head office expenses and the need to protect the tax base of the payor countries.

We appreciate the effort but in our opinion the OECD should aim for the protection of

the taxbase of all countries and not only focus on the payor countries. In that regard the remuneration of services should not be based on prices below the arm’s length price as a possible interpretation of paragraph 7.38 suggests. If prices below the arm’s length price could be considered adequate this would increase the risk for taxpayers as tax authorities would not necessarily have to accept arm’s length prices anymore.

In addition, we have the concern that the OECD missed the chance to implement necessary changes in the wording (that is sections “A” to “C”) of chapter VII of the OECD transfer pricing guidelines in order to provide consistent advice. Please find in the following our comments on the discussion draft (relating in particular, but not only, to the section concerning low value-adding intra-group services):

**Paragraph numbers 7.10 to 7.11 – Clearer definition of “shareholder activities”**

The OECD defines “shareholder activities” as services that are solely performed “because of ownership interest in one or more other group members.” We regard this definition as absolutely adequate from a theoretical point of view. In addition, from a practical point of view the examples of shareholder activities provided in paragraph 7.11 are very helpful for taxpayers, especially as they have been expanded compared to the 2010 OECD guidelines.

Nevertheless, we would suggest providing more detailed examples of services that are not regarded as shareholder expenses (or management fees) at the end of paragraph 7.10. The correct declaration of these two types of services often leads to difficulties and uncertainty for the taxpayer and can lead to double taxation, as some services are regarded as shareholder activities by one jurisdiction / country and at the same time as “regular” services by another jurisdiction / country. More examples (also exceeding those given in paragraphs 7.40 to 7.44) are necessary as from our point of view it is very hard and even nearly impossible for a taxpayer to prove that an independent enterprise would have been willing to pay (or not been willing to pay) for a critical service in a way that it is accepted by the local tax authorities. Therefore, further clarifications and examples by the OECD are necessary.

**Paragraph numbers 7.20 et seq. – Timing issues regarding the price setting**

The problem of timing issues when determining the correct transfer price for intra-group services should also be discussed and analyzed in the sections regarding the correct arm’s length compensation. Guidance regarding timing issues of intra-group services is missing within the draft despite the fact that the matter of timing issues highly relevant for the transfer pricing of intra-group services.

First, there should be a clear guidance and distinction between the setting of ex-ante (arm’s length setting approach) and ex-post (arm’s length outcome approach) transfer prices for services in particular with regard to the benefit test.
If the involved parties can prove that the price for a service was at arm's length ex-ante (i.e. based on internal calculations including expected benefit for the receiving entity (see paragraphs 7.7 to 7.9) or a CUP), there should be no ex-post verification of the profit mark-up and no benefit test (based on actual figures) necessary. The OECD should provide clear guidance regarding this subject.

Second, there should also be clear guidance for “on call services” (see paragraphs 7.17 to 7.18) where the benefit of the service lies within the availability of the service itself and depends on the recipient making use of it. Such services only lead to a measurable benefit for the service recipient when the service was actually performed. Nevertheless, it might be the case that the availability of such services itself provides the service recipient with an implicit benefit. This might for example be the case if the service receiving company knows that there is a skilled legal department in the head office that can support in legal cases and, therefore, provides customer support only if customers claim for such services. If the taxpayer sets an ex-ante price for such services based on the expected benefit for the service recipient there should be limited room for argumentation for the tax authorities if the price is challenged. Also third parties would accept changes to the ex-ante agreed upon prices only under extraordinary circumstances. The same applies for a flat fee arrangement that can be observed quite regularly between independent third parties.

The topic of timing issues has been addressed in detail by the EU Joint Transfer Pricing Forum (“EU JTPF”) at the end of January 2014 and was already discussed by the OECD and the business community during the year 2012. It is important that the proposed changes to chapter VII of the OECD transfer pricing guidelines are consistent with the results of these previous discussions and reflect the a.m. issues.

**Paragraph numbers 7.18 to 7.19 – Documentation that services have actually been provided**

According to our view one of the main problems that remains for taxpayers in this context is to prove and document that (beneficial) services have actually been provided. This problem is in particular relevant for all types of services and not only limited to low-value adding services. The OECD recognizes this fact by stating, that “the absence of payments or contractual agreements does not automatically lead to the conclusion that no intra-group services have been rendered.” in paragraph 7.19. For “regular” services – in contrast to low-value adding services eligible for the simplified approach – it is still very unclear how a taxpayer can provide proof that services have actually been rendered (for example a contract might only serve as the legal framework for the service but not necessary serve as a proof that services have been actually provided).

Therefore, we would suggest establishing an OECD wide standardized mechanism that facilitates these proofs. One starting point could be the method chosen for low-value intra-group services, i.e. the necessary documents stated in paragraph 7.61...
(description of services, description of (expected) benefit, contracts or agreements, underlying calculations).

**Paragraph numbers 7.25 – “Safeguards against manipulation”**

The OECD requires in paragraph 7.25 that every indirect charge method used by the taxpayer should contain so called “safeguards against manipulation” without further specifying the exact meaning and configuration of such safeguards.

In our view it is highly unlikely that such safeguards will be implemented in practice for transfer pricing reasons only as it is very unclear

1. what exactly should be protected against manipulation,
2. against whom these protection should be helpful or necessary,
3. what level of security should be used,
4. which entity should be in charge for the safeguard,
5. If there needs to be an external certificate / confirmation to prove the safeguard measures

and that there are relatively high (internal or even external) costs to be expected.

In order to lead to simplification and clarity in transfer pricing we would suggest deleting this requirement. We also regard - in line with the OECD - safeguard measures against manipulation as necessary within a multinational company. But these measures should not be part of a transfer pricing requirement as there are various compliance requirements for multinational companies within the local jurisdictions. For example compliance with domestic and international tax laws is reviewed by internal and external (tax and general) audits on a regular basis for most multinational enterprises. These safeguards should be sufficient also from a transfer pricing point of view.

**Paragraph numbers 7.37 to 7.39 – “Profit element”**

The OECD regards a profit element as not necessary for services in some cases. This might be correct when the overall global value chain of a multinational company is taken into account and price setting takes place by a superordinate price setter within the multinational enterprise.

But if only the transfer prices of one (small) local company of the multinational enterprise are reviewed, considerations of such high complexity will often not be carried out. The simple argumentation used by local tax authorities in such cases is that an independent enterprise only would perform the service to generate profit. It is again nearly impossible for taxpayers to argue in a contrary way that will easily be accepted by local tax authorities. Therefore, we would encourage the OECD to develop guidelines that simplify such argumentation for taxpayers and develop guidance for the local tax administrations when they have to accept such a simplified argumentation as compliant with the arm’s length principle.
Paragraph numbers 7.43 and 7.47 – “Research and Development” - services

We agree with the OECD that “non-routine” research exists which cannot be regarded as low value-adding service and, therefore, would not be eligible for the simplified approach. According to our experience most enterprises differentiate between different research and development services. One of these services is often referred to as “basic research” and small (product) development and could be regarded as low value-adding in the value chain of a company. Accordingly we would recommend not excluding research and development services from the pool of “low value-adding intra group services” in general and instead adding further explanation on how basic research and development can be distinguished from “high value” research.

Paragraph numbers 7.47 – List of services not regarded as low value-adding

We regard the list of service categories that are strictly not low value-adding services as too exhaustive. We would recommend softening the wording in order to achieve that the listed services “could or could not” be considered as qualifying for the simplified approach. The OECD should put the focus on the facts and circumstances of the actual service in the single case more than on the title of the service itself.

Paragraph numbers 7.45, 7.51 and 7.52 – Election of simplified method

In our opinion the “selection process” for the simplified approach remains rather unclear. It is our concern that tax authorities do not accept the choice of the taxpayer to classify services as low value-adding services eligible for the simplified approach. Therefore, we ask the OECD to implement a safety mechanism for the taxpayers so that such a reclassification cannot be done easily by tax authorities and does not lead to penalties and/or double taxation. A possible solution for the problem could be that the involved countries would be forced to find a solution within a mutual agreement procedure if they elect to reclassify the services. Such a solution could be part of the multilateral instrument planned by the OECD within Action 15 of the BEPS Action Plan.

Paragraph numbers 7.52 to 7.56 – Categories of services

We have concerns that the pooling of low value-adding services into categories of services results in an unintentional raise in complexity regarding the transfer pricing approach, documentation and tax audit defense for low value-adding services. The pooling of low-value adding services results in an obligation of the service providing companies to identify the costs for each service category separately. Furthermore, they have to identify the appropriate allocation key for each service category separately. Even if the OECD refers within paragraph 7.56 to the balance between theory and practice the previous paragraphs could lead to the contrary.

In addition, the regulations regarding the cost base and allocation keys seem inconsistent in comparison to paragraph 7.57. Therein, the OECD states that the same
mark-up shall be utilized for all low value-adding services irrespective of the categories of services. Therefore, only cost base and allocation key have to be analyzed in detail and be adapted for each service category whereas the mark-up has to be homogeneous despite different service categories. As a result the approach does not seem consistent from an overall perspective.

The OECD should rethink its approach regarding this topic. We would appreciate if the costs for all low value-adding services performed by one service provider could be pooled and one homogeneous allocation key could be used for all service categories. If the OECD does not want to adapt the process regarding this point it should be possible for the taxpayer to use individual profit mark-ups for each service category. Overall, each of the two solutions would result in a consistent pricing process. The solution of a possible overall cost pooling for all low value-adding services including only one allocation key would be simpler and, therefore, preferable from a practical point of view.

**Paragraph numbers 7.57 – Profit mark-up**

We see two difficulties regarding this subject. First, the chosen range of mark-up between 2% and 5% is relatively low and differs from the range set up of the EU JTPF. The reasons for the determination of such a low range are not clear. The second difficulty lies within the additional justification and analysis that the OECD regards as necessary when determining the mark-up. According to our understanding it should be one of the main advantages of the simplified approach that there is no further justification necessary. Furthermore, it is not clear what consequences arise if the further analysis and justification results in a mark-up that differs from the mark-up range between 2% and 5%. The OECD should clarify specifically what sort of additional analysis has to be prepared if at all.

We hope our comments are helpful and would like to thank you once again for the chance to comment on the discussion draft.

We welcome any feedback of the OECD and the other commentators on this discussion draft.

With best regards,

WTS Steuerberatungsgesellschaft mbH

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