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**BUSINESSEUROPE 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", 3 November 2014 – 14 January 2015**

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 investment as such in~~

~~participations". 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.

BUSINESSEUROPE

On behalf of the BUSINESSEUROPE Tax Policy Group

Yours sincerely,

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