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Submitted by email: TransferPricing@oecd.org

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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 Fees1. 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.

[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 prevision 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 headquarter 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

Will Morris, Chair
BIAC Tax Committee