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June 20, 2018

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

Dear Colleagues,

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

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

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

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

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

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

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

Sincerely,



Will Morris

Chair BIAC Tax Committee

Appendix

A: Introduction

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

B: General Comments

Practical Challenges

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

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

BEPS Actions 8-10 Alignments

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

C: Detailed Comments

Practical Challenges

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

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

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

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

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

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

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

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

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

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

BEPS actions 8-10 alignments

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

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

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

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