

# **EBIT**

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

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EBIT’s Members at the time of writing this submission:  
AIRBUS GROUP, BP, CATERPILLAR, CONSTELLATION BRANDS, DEUTSCHE LUFTHANSA,  
DIAGEO, GSK, INFORMA GROUP, INTERNATIONAL PAPER, JOHNSON & JOHNSON, JTI,  
NASPERS, PEPSICO, PFIZER, PROCTER & GAMBLE, RELX, SCHRODERS, SHV GROUP,  
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Brussels, 20 June 2018

Dear Jeff,

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

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

### **Comments**

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

### **Symmetry in the allocation / deduction of costs**

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

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

### **Head-office costs**

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

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

### **Misuse of local comparables**

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

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

### **Benefits Test**

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

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

### **Direct-charge versus indirect charge methods**

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

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

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

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

Currently, to the knowledge of EBIT, only the transfer pricing country profiles indicate<sup>1</sup> whether the country concerned has a simplified approach with regard to low value-adding intra-group services but no further analysis has been undertaken yet. EBIT regrets to see that not even all OECD Member countries follow the guidance on the simplified approach.

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

### **5% profit mark-up for low value adding services**

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

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<sup>1</sup> Item 16 of the country profile

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

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

### **Identifying in practice duplicated activities**

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

### **Finding an appropriate allocation key**

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

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

Yours sincerely,

**European Business Initiative on Taxation – June 2018**

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

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