

Public Discussion Draft

**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



**DISCUSSION DRAFT OF THE PROPOSED MODIFICATIONS TO CHAPTER VII
OF THE TRANSFER PRICING GUIDELINES RELATING TO
LOW VALUE-ADDING INTRA-GROUP SERVICES**

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Work in relation to Action 10 of the BEPS Action Plan (other high risk transactions)

In the 19 July 2013 BEPS Action Plan, the OECD was directed to “[d]evelop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to provide protection against common types of base eroding payments, such as management fees and head office expenses.”

Under this mandate, Working Party No. 6 on the Taxation of Multinational Enterprises has developed a simplified transfer pricing approach for low value-adding intra-group services which leads to revisions in Chapter VII of the OECD Transfer Pricing Guidelines. The resulting guidance seeks to achieve the necessary balance between appropriate charges for low value added services and head office expenses and the need to protect the tax base of payor countries.

In particular, the Discussion Draft reduces the scope for erosion of the tax base through excessive management fees and head office expenses by proposing an approach which:

- i. Identifies a wide category of common intra-group services fees which command a very limited profit mark-up on costs;
- ii. Applies a consistent allocation key for all recipients; and
- iii. Provides greater transparency through specific reporting requirements including documentation showing the determination of the specific cost pool.

The main aspects of this additional guidance include:

- a) A standard definition of low value-adding intra-group services;
- b) Clarifications of the meaning of shareholder activities and duplicative costs, specifically in the context of low value-adding intra-group services;
- c) Guidance on appropriate mark-ups for low value-adding intra-group services;
- d) Guidance on appropriate cost allocation methodologies to be applied in the context of low value-adding intra-group services;
- e) Guidance on the satisfaction of a simplified benefit test with regard to low value-adding services; and
- f) Guidance on documentation that taxpayers should prepare and submit in order to qualify for the simplified approach.

The views and proposals included in this Discussion Draft do not represent the consensus views of the

CFA or its subsidiary bodies but are intended to provide stakeholders with substantive proposals for analysis and comment.

This Discussion Draft is submitted for comment by interested parties. Comments should be submitted by **14 January 2015 (no extension will be granted)** and should be sent by email to **TransferPricing@oecd.org** in Word format (in order to facilitate their distribution to government officials). They should be addressed to Andrew Hickman, Head of Transfer Pricing Unit, Centre for Tax Policy and Administration. It is preferred that comments be provided in separate text containing references to paragraph numbers of the Discussion Draft, rather than in the form of a mark-up of the text of the Discussion Draft itself.

Please note that all comments submitted in the name of a collective “grouping” or “coalition”, or by any person submitting comments on behalf of another person or group of persons, should identify all enterprises or individuals who are members of that collective, or the person(s) on whose behalf they are acting.

The OECD intends to hold a further public consultation on the Discussion Draft and other topics on 19-20 March 2015 at the OECD Conference Centre in Paris, France. Registration details for the public consultation will be published on the OECD website in due time. Speakers and other participants at the public consultation will be selected from among those providing timely written comments on the Discussion Draft.

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<p>It is proposed that the text of Chapter VII of the OECD Transfer Pricing Guidelines be deleted in its entirety and replaced with the following language.</p>

CHAPTER VII

SPECIAL CONSIDERATIONS FOR INTRA-GROUP SERVICES

A. Introduction

7.1 This chapter discusses issues that arise in determining for transfer pricing purposes whether services have been provided by one member of an MNE group to other members of that group and, if so, in establishing arm's length pricing for those intra-group services. The chapter does not address except incidentally whether services have been provided in a cost contribution arrangement, nor, in such a case, the appropriate arm's length pricing, *i.e.* where members of an MNE group jointly acquire, produce or provide goods, services, and/or intangible property, allocating the costs for such activity amongst the members participating in the arrangement. Cost contribution arrangements are the subject of Chapter VIII.

7.2 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. Such services may include management, coordination and control functions for the whole group. The cost of providing such services may be borne initially by the parent, by a specially designated group member ("a group service centre"), or by another group member. An independent enterprise in need of a service may acquire the services from a service provider who specialises in that type of service or may perform the service for itself (*i.e.* in-house). In a similar way, a member of an MNE group in need of a service may acquire it directly or indirectly from independent enterprises, or from one or more associated enterprises in the same MNE group (*i.e.* intra-group), or may perform the service for itself. Intra-group services often include those that are typically available externally from independent enterprises (such as legal and accounting services), in addition to those that are ordinarily performed internally (*e.g.* by an enterprise for itself, such as central auditing, financing advice, or training of personnel).

7.3 Intra-group arrangements for rendering services are sometimes linked to arrangements for transferring goods or intangible property (or the licensing thereof). In some cases, such as know-how contracts containing a service element, it may be very difficult to determine where the exact border lies between the transfer of intangibles or rights in intangibles and the provision of services. Ancillary services are frequently associated with the transfer of technology. It may therefore be necessary to consider the principles for aggregation and segregation of transactions in Chapter III where a mixed transfer of services and property is involved.

7.4 Intra-group services may vary considerably among MNE groups, as does the extent to which those services provide a benefit, or an expected benefit, to one or more group members. Each case is dependent upon its own facts and circumstances and the arrangements within the group. For example, in a decentralised group, the parent company may limit its intra-group activity to monitoring its investments in its subsidiaries in its capacity as a shareholder. In contrast, in a centralised or integrated group, the board of

directors and senior management of the parent company may make all important decisions concerning the affairs of its subsidiaries, and the parent company may support the implementation of these decisions by performing general and administrative activities for its subsidiaries as well as operational activities such as treasury management, marketing, and supply chain management.

7.5 A particular category of intra-group services is often referred to as low value-adding intra-group services. Section D, below, contains special simplified rules relating to the allocation of low value-adding intra-group service costs among members of an MNE group.

B. Main issues

7.6 There are two issues in the analysis of transfer pricing for intra-group services. One issue is whether intra-group services have in fact been provided. The other issue is what the intra-group charge for such services for tax purposes should be in accordance with the arm's length principle. Each of these issues is discussed below.

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

B.1.1 Benefits test

7.7 Under the arm's length principle, the question whether an intra-group service has been rendered when an activity is performed for one or more group members by another group member should depend on whether the activity provides a respective group member with economic or commercial value to enhance or maintain its commercial position. This can be determined by considering whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in-house for itself. If the activity is not one for which the independent enterprise would have been willing to pay or perform for itself, the activity ordinarily should not be considered as an intra-group service under the arm's length principle.

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.

7.9 Some intra-group services are performed by one member of an MNE group to meet an identified need of one or more specific members of the group. In such a case, it is relatively straightforward to determine whether a service has been provided. Ordinarily an independent enterprise in comparable circumstances would have satisfied the identified need either by performing the activity in-house or by having the activity performed by a third party. Thus, in such a case, an intra-group service ordinarily would be found to exist. For example, an intra-group service would normally be found where an associated enterprise repairs equipment used in manufacturing by another member of the MNE group.

B.1.2 Shareholder activities

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 holding company) performs solely because of its ownership interest in one or more other group members, *i.e.* in its capacity as shareholder. This type of activity would not be considered to be an intra-group service, and thus would not justify a charge to the recipient companies. It may be referred to as a "shareholder activity",

distinguishable from the broader term “stewardship activity” used in the 1979 Report. Stewardship activities covered a range of activities by a shareholder that may include the provision of services to other group members, for example services that would be provided by a coordinating centre. These latter types of non-shareholder activities could include detailed planning services for particular operations, emergency management or technical advice (trouble shooting), or in some cases assistance in day-to-day management.

7.11 The following are examples of shareholder activities, under the standard set forth in paragraph 7.7:

- a) Costs relating to the juridical structure of the parent company itself, such as meetings of shareholders of the parent, issuing of shares in the parent company, stock exchange listing of the parent company and costs of the supervisory board;
- b) Costs relating to reporting requirements (including financial reporting and audit) of the parent company including the consolidation of reports, costs relating to the parent company’s audit of the subsidiary’s accounts carried out exclusively in the interest of the parent company, and costs relating to the preparation of consolidated financial statements of the MNE (however, in practice costs incurred locally by the subsidiaries may not need to be passed on to the parent or holding company where it is disproportionately onerous to identify and isolate those costs);
- c) Costs of raising funds for the acquisition of its participations and costs relating to the parent company’s investor relations such as communication strategy with shareholders of the parent company, financial analysts, funds and other stakeholders in the parent company;
- d) Costs relating to compliance of the parent company with the relevant tax laws;
- e) Costs which are ancillary to the corporate governance of the MNE as a whole.

In contrast, if for example a parent company raises funds on behalf of another group member which uses them to acquire a new company, the parent company would generally be regarded as providing a service to the group member. 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 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.

B.1.3 Duplication

7.12 In general, no intra-group service should be found for activities undertaken by one group member that merely duplicate a service that another group member is performing for itself, or that is being performed for such other group member by a third party. An exception may be where the duplication of services is only temporary, for example, where an MNE group is reorganising to centralise its management functions. Another exception would be where the duplication is undertaken to reduce the risk of a wrong business decision (*e.g.* by getting a second legal opinion on a subject). Any consideration of possible duplication of services needs to examine the nature of the services in detail. The fact that a company performs, for example, marketing services in-house and also is charged for marketing services from a group company does not of itself determine duplication, since marketing is a broad term covering many levels of activity. Examination of information provided by the taxpayer may determine that the intra-group

services are different, additional, or complementary to the activities performed in-house. The benefits test would then apply to those non-duplicative elements of the intra-group services.

B.1.4 Incidental benefits

7.13 There are some cases where an intra-group service performed by a group member such as a shareholder or coordinating centre relates only to some group members but incidentally provides benefits to other group members. Examples could be analysing the question whether to reorganise the group, to acquire new members, or to terminate a division. These activities could constitute intra-group services to the particular group members involved, for example those members who may make the acquisition or terminate one of their divisions, but they may also produce economic benefits for other group members not directly involved in the potential decision since the analysis could provide useful information about their own business operations. The incidental benefits ordinarily would not cause these other group members to be treated as receiving an intra-group service because the activities producing the benefits would not be ones for which an independent enterprise ordinarily would be willing to pay.

7.14 Similarly, an associated enterprise should not be considered to receive an intra-group service when it obtains incidental benefits attributable solely to its being part of a larger concern, and not to any specific activity being performed. For example, no service would be received where an associated enterprise by reason of its affiliation alone has a credit-rating higher than it would if it were unaffiliated, but an intra-group service would usually exist where the higher credit rating were due to a guarantee by another group member, or where the enterprise benefitted from the group's reputation deriving from global marketing and public relations campaigns. In this respect, passive association should be distinguished from active promotion of the MNE group's attributes that positively enhances the profit-making potential of particular members of the group. Each case must be determined according to its own facts and circumstances.

B.1.5 Centralised services

7.15 Other activities that may relate to the group as a whole are those centralised in the parent company or a group service centre (such as a regional headquarters company) and made available to the group (or multiple members thereof). The activities that are centralised depend on the kind of business and on the organisational structure of the group, but in general they may include administrative services such as planning, coordination, budgetary control, financial advice, accounting, auditing, legal, factoring, computer services; financial services such as supervision of cash flows and solvency, capital increases, loan contracts, management of interest and exchange rate risks, and refinancing; assistance in the fields of production, buying, distribution and marketing; and services in staff matters such as recruitment and training. Group service centres also often carry out research and development or administer and protect intangible property for all or part of the MNE group. These types of activities ordinarily will be considered intra-group services because they are the type of activities that independent enterprises would have been willing to pay for or to perform for themselves.

B.1.6 Form of the remuneration

7.16 In considering whether a charge for the provision of services would be made between independent enterprises, it would also be relevant to consider the form that an arm's length consideration would take had the transaction occurred between independent enterprises dealing at arm's length. For example, in respect of financial services such as loans, foreign exchange and hedging, all of the remuneration may be built into the spread and it would not be appropriate to expect a further service fee to be charged if such were the case. Similarly, in some buying or procurement services a commission

element may be incorporated in the price of the product or services procured, and a separate service fee may not be appropriate.

7.17 Another issue arises with respect to services provided “on call”. The question is whether the availability of such services is itself a separate service for which an arm’s length charge (in addition to any charge for services actually rendered) should be determined. A parent company or a group service centre may be on hand to provide services such as financial, managerial, technical, legal or tax advice and assistance to members of the group at any time. In that case, a service may be rendered to associated enterprises by having staff, equipment, *etc.*, available. An intra-group service would exist to the extent that it would be reasonable to expect an independent enterprise in comparable circumstances to incur “standby” charges to ensure the availability of the services when the need for them arises. It is not unknown, for example, for an independent enterprise to pay an annual “retainer” fee to a firm of lawyers to ensure entitlement to legal advice and representation if litigation is brought. Another example is a service contract for priority computer network repair in the event of a breakdown.

7.18 These services may be available on call and they may vary in amount and importance from year to year. It is unlikely that an independent enterprise would incur stand-by charges where the potential need for the service was remote, where the advantage of having services on-call was negligible, or where the on-call services could be obtained promptly and readily from other sources without the need for stand-by arrangements. Thus, the benefit conferred on a group company by the on-call arrangements should be considered, perhaps by looking at the extent to which the services have been used over a period of several years rather than solely for the year in which a charge is to be made, before determining that an intra-group service is being provided.

7.19 The fact that a payment was made to an associated enterprise for purported services can be useful in determining whether services were in fact provided, but the mere description of a payment as, for example, “management fees” should not be expected to be treated as *prima facie* evidence that such services have been rendered. At the same time, the absence of payments or contractual agreements does not automatically lead to the conclusion that no intra-group services have been rendered.

B.2 Determining an arm’s length charge

B.2.1 In general

7.20 Once it is determined that an intra-group service has been rendered, it is necessary, as for other types of intra-group transfers, to determine whether the amount of the charge, if any, is in accordance with the arm’s length principle. This means that the charge for intra-group services should be that which would have been made and accepted between independent enterprises in comparable circumstances. Consequently, such transactions should not be treated differently for tax purposes from comparable transactions between independent enterprises, simply because the transactions are between enterprises that happen to be associated.

B.2.2 Identifying actual arrangements for charging for intra-group services

7.21 To identify the amount, if any, that has actually been charged for services, a tax administration will need to identify what arrangements, if any, have actually been put in place between the associated enterprises to facilitate charges being made for the provision of services between them.

B.2.2.1 Direct-charge methods

7.22 In certain cases, the arrangements made for charging for intra-group services can be readily identified. These cases are where the MNE group uses a direct-charge method, *i.e.* where the associated

enterprises are charged for specific services. In general, the direct-charge method is of great practical convenience to tax administrations because it allows the service performed and the basis for the payment to be clearly identified. Thus, the direct-charge method facilitates the determination of whether the charge is consistent with the arm's length principle.

7.23 An MNE group should often be able to adopt direct charging arrangements, particularly where services similar to those rendered to associated enterprises are also rendered to independent parties. If specific services are provided not only to associated enterprises but also to independent enterprises in a comparable manner and as a significant part of its business, it could be presumed that the MNE has the ability to demonstrate a separate basis for the charge (*e.g.* by recording the work done and costs expended in fulfilling its third party contracts). As a result, MNEs in such a case are encouraged to adopt the direct-charge method in relation to their transactions with associated enterprises. It is accepted, however, that this approach may not always be appropriate if, for example, the services to independent parties are merely occasional or marginal.

B.2.2.2 Indirect-charge methods

7.24 A direct-charge method for charging for intra-group services is so difficult to apply in practice in many cases for MNE groups that such groups have developed other methods for charging for services provided by parent companies or group service centres. In these cases, the practice of MNE groups for charging for intra-group services is often to make arrangements that are either a) readily identifiable but not based on a direct-charge method; or b) not readily identifiable and either incorporated into the charge for other transfers, allocated amongst group members on some basis, or in some cases not allocated amongst group members at all.

7.25 In such cases, MNE groups may find they have few alternatives but to use cost allocation and apportionment methods which often necessitate some degree of estimation or approximation, as a basis for calculating an arm's length charge following the principles in Section B.2.3 below. Such methods are generally referred to as indirect-charge methods and 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. While every attempt should be made to charge fairly for the service provided, any charging has to be supported by an identifiable and reasonably foreseeable benefit. Any indirect-charge method should be sensitive to the commercial features of the individual case (*e.g.* the allocation key makes sense under the circumstances), contain safeguards against manipulation and follow sound accounting principles, and be capable of producing charges or allocations of costs that are commensurate with the actual or reasonably expected benefits to the recipient of the service.

7.26 In some cases, an indirect-charge method may be necessary due to the nature of the service being provided. One example is where the proportion of the value of the services rendered to the various relevant entities cannot be quantified except on an approximate or estimated basis. This problem may occur, for example, where sales promotion activities carried on centrally (*e.g.* at international fairs, in the international press, or through other centralised advertising campaigns) may affect the quantity of goods manufactured or sold by a number of affiliates. Another case is where a separate recording and analysis of the relevant services for each beneficiary would involve a burden of administrative work that would be disproportionately heavy in relation to the activities themselves. In such cases, the charge could be determined by reference to an allocation among all potential beneficiaries of the costs that cannot be allocated directly, *i.e.* costs that cannot be specifically assigned to the actual beneficiaries of the various services. To satisfy the arm's length principle, the allocation method chosen must lead to a result that is

consistent with what comparable independent enterprises would have been prepared to accept. See Section B.2.3 below.

7.27 When an indirect-charge method is used, the relationship between the charge and the services provided may be obscured and it may become difficult to evaluate the benefit provided. Indeed, it may mean that the enterprise being charged for a service itself has not related the charge to the service. Consequently, there is an increased risk of double taxation because it may be more difficult to determine a deduction for costs incurred on behalf of group members if compensation cannot be readily identified, or for the recipient of the service to establish a deduction for any amount paid if it is unable to demonstrate that services have been provided.

B.2.2.3 Form of the compensation

7.28 The allocation might be based on turnover, or staff employed, or some other basis. Whether the allocation method is appropriate may depend on the nature and usage of the service. For example, the usage or provision of payroll services may be more related to the number of staff than to turnover, while the allocation of the stand-by costs of priority computer back-up could be allocated in proportion to relative expenditure on computer equipment by the group members.

7.29 The compensation for services rendered to an associated enterprise may be included in the price for other transfers. For instance, the price for licensing a patent or know-how may include a payment for technical assistance services or centralised services performed for the licensee or for managerial advice on the marketing of the goods produced under the licence. In such cases, the tax administration and the taxpayers would have to check that there is no additional service fee charged and that there is no double deduction.

7.30 In identifying arrangements for charging any retainer for the provision of “on call” services (as discussed in paragraphs 7.17 and 7.18), it may be necessary to examine the terms for the actual use of the services since these may include provisions that no charge is made for actual use until the level of usage exceeds a predetermined level.

B.2.3 *Calculating the arm’s length compensation*

7.31 In trying to determine the arm’s length price in relation to intra-group services, the matter should be considered both from the perspective of the service provider and from the perspective of the recipient of the service. In this respect, relevant considerations include the value of the service to the recipient and how much a comparable independent enterprise would be prepared to pay for that service in comparable circumstances, as well as the costs to the service provider.

7.32 For example, from the perspective of an independent enterprise seeking a service, the service providers in that market may or may not be willing or able to supply the service at a price that the independent enterprise is prepared to pay. If the service providers can supply the wanted service within a range of prices that the independent enterprise would be prepared to pay, then a deal will be struck. From the point of view of the service provider, a price below which it would not supply the service and the cost to it are relevant considerations to address, but they are not necessarily determinative of the outcome in every case.

B.2.3.1 Methods

7.33 The method to be used to determine arm’s length transfer pricing for intra-group services should be determined according to the guidelines in Chapters I, II, and III. Often, the application of these guidelines will lead to use of the CUP or cost plus method for pricing intra-group services. A CUP method

is likely to be the most appropriate method where there is a comparable service provided between independent enterprises in the recipient's market, or by the associated enterprise providing the services to an independent enterprise in comparable circumstances. For example, this might be the case where accounting, auditing, legal, or computer services are being provided subject to the controlled and uncontrolled transactions being comparable. A cost plus method would likely be the most appropriate method in the absence of a CUP where the nature of the activities involved, assets used, and risks assumed are comparable to those undertaken by independent enterprises. As indicated in Chapter II, Part II, in applying the cost plus method, there should be a consistency between the controlled and uncontrolled transactions in the categories of cost that are included. Transactional profit methods may be used where they are the most appropriate to the circumstances of the case (see paragraphs 2.1-2.11). In exceptional cases, for example where it may be difficult to apply the CUP method or the cost-plus method, it may be helpful to take account of more than one method (see paragraph 2.11) in reaching a satisfactory determination of arm's length pricing.

7.34 It may be necessary to perform a functional analysis of the various members of the group to establish the relationship between the relevant services and the members' activities and performance. In addition, it may be necessary to consider not only the immediate impact of a service, but also its long-term effect, bearing in mind that some costs will never actually produce the benefits that were reasonably expected when they were incurred. For example, expenditure on preparations for a marketing operation might *prima facie* be too heavy to be borne by a member in the light of its current resources; the determination whether the charge in such a case is arm's length should consider expected benefits from the operation and the possibility that the amount and timing of the charge in some arm's length arrangements might depend on the results of the operation. The taxpayer should be prepared to demonstrate the reasonableness of its charges to associated enterprises in such cases.

7.35 Where the cost plus method is determined to be the most appropriate method to the circumstances of the case, the analysis would require examining whether the costs incurred by the group service provider need some adjustment to make the comparison of the controlled and uncontrolled transactions reliable. In some cases, the costs that would hypothetically be incurred by the recipient were it to perform the service for itself may be instructive of the type of arrangement a recipient would be prepared to accept for the actual service.

7.36 When an associated enterprise is acting only as an agent or intermediary in the provision of services, it is important in applying the cost-plus method that the return or mark-up is appropriate for the performance of an agency function rather than for the performance of the services themselves. In such a case, it may not be appropriate to determine arm's length pricing as a mark-up on the cost of the services but rather on the costs of the agency function itself. For example, an associated enterprise may incur the costs of renting advertising space on behalf of group members, costs that the group members would have incurred directly had they been independent. In such a case, it may well be appropriate to pass on these costs to the group recipients without a mark-up, and to apply a mark-up only to the costs incurred by the intermediary in performing its agency function.

B.2.3.2 Considerations on including a profit element

7.37 Depending on the method being used to establish an arm's length charge for intra-group services, the issue may arise whether it is necessary that the charge be such that it results in a profit for the service provider. In an arm's length transaction, an independent enterprise normally would seek to charge for services in such a way as to generate profit, rather than providing the services merely at cost. The economic alternatives available to the recipient of the service also need to be taken into account in determining the arm's length charge. However, there are circumstances (*e.g.* as outlined in the discussion on business strategies in Chapter I) in which an independent enterprise may not realise a profit from the

performance of services alone, for example where a supplier's costs (anticipated or actual) exceed market price but the supplier agrees to provide the service to increase its profitability, perhaps by complementing its range of activities. Therefore, it need not always be the case that an arm's length price will result in a profit for an associated enterprise that is performing an intra-group service.

7.38 For example, it may be the case that the market value of intra-group services is not greater than the costs incurred by the service provider. This could occur where, for example, the service is not an ordinary or recurrent activity of the service provider but is offered incidentally as a convenience to the MNE group. In determining whether the intra-group services represent the same value for money as could be obtained from an independent enterprise, a comparison of functions and expected benefits would be relevant to assessing comparability of the transactions. An MNE group may still determine to provide the service intra-group rather than using a third party for a variety of reasons, perhaps because of other intra-group benefits (for which arm's length compensation may be appropriate). It would not be appropriate in such a case to increase the price for the service above what would be established by the CUP method just to make sure the associated enterprise makes a profit. Such a result would be contrary to the arm's length principle. However, it is important to ensure that all benefits to the recipient are properly taken into account.

7.39 While as a matter of principle tax administrations and taxpayers should try to establish the proper arm's length pricing, it should not be overlooked that there may be practical reasons why a tax administration in its discretion exceptionally might be willing to forgo computing and taxing an arm's length price from the performance of services in some cases, as distinct from allowing a taxpayer in appropriate circumstances to merely allocate the costs of providing those services. For instance, a cost-benefit analysis might indicate the additional tax revenue that would be collected does not justify the costs and administrative burdens of determining what an appropriate arm's length price might be in some cases. In such cases, charging all relevant costs rather than an arm's length price may provide a satisfactory result for MNEs and tax administrations. This concession is unlikely to be made by tax administrations where the provision of a service is a principal activity of the associated enterprise, where the profit element is relatively significant, or where direct charging is possible as a basis from which to determine the arm's length price.

C. Some examples of intra-group services

7.40 This section sets forth several examples of transfer pricing issues in the provision of intra-group services. The examples are provided for illustrative purposes only. When dealing with individual cases, it is necessary to explore the actual facts and circumstances to judge the applicability of any transfer pricing method.

7.41 One example involves debt-factoring activities, where an MNE group decides to centralise the activities for economic reasons. For example, it may be prudent to centralise the debt-factoring activities to better manage liquidity, currency and debt risks and to provide administrative efficiencies. A debt-factoring centre that takes on this responsibility is performing intra-group services for which an arm's length charge should be made. A CUP method could be appropriate in such a case.

7.42 Another example of an activity that may involve intra-group services is manufacturing or assembly operations. The activities can take a variety of forms including what is commonly referred to as contract manufacturing. In some cases of contract manufacturing the producer may operate under extensive instruction from the counter-party about what to produce, in what quantity and of what quality. In some cases, raw materials or components may be made available to the producer by the counter-party. The production company may be assured that its entire output will be purchased, assuming quality requirements are met. In such a case the production company could be considered as performing a low-risk

service to the counter-party, and the cost plus method could be the most appropriate transfer pricing method, subject to the principles in Chapter II.

7.43 Research is similarly an example of an activity that may involve intra-group services. The terms of the activity can be set out in a detailed contract with the party commissioning the service, commonly known as contract research. The activity can involve highly skilled personnel and vary considerably both in its nature and in its importance to the success of the group. The actual arrangements can take a variety of forms from the undertaking of detailed programmes laid down by the principal party, extending to agreements where the research company has discretion to work within broadly defined categories. In the latter instance, the additional functions of identifying commercially valuable areas and assessing the risk of unsuccessful research can be a critical factor in the performance of the group as a whole. It is therefore crucial to undertake a detailed functional analysis and to obtain a clear understanding of the precise nature of the research, and of how the activities are being carried out by the company, prior to consideration of the appropriate transfer pricing methodology. The consideration of options realistically available to the party commissioning the research may also prove useful in selecting the most appropriate transfer pricing method. See Section B2 of Chapter VI.

7.44 Another example of intra-group services is the administration of licences. The administration and enforcement of intangible property rights should be distinguished from the exploitation of those rights for this purpose. The protection of a licence might be handled by a group service centre responsible for monitoring possible licence infringements and for enforcing licence rights.

D. Low value-adding intra-group services

7.45 This Section provides specific guidance relating to low value-adding intra-group services. It begins by defining low value-adding intra-group services. Thereafter the section sets out an elective, simplified approach including a simplified benefits test for determining the amount of low value-adding intra-group services to be charged to and paid for by individual members of an MNE group. Taxpayers not electing to apply the simplified approach set out in this section should address transfer pricing issues related to low-value-adding services under the provisions of section A and B, above. In summary, the simplified approach recognises that the arm's length price for such services is closely related to costs, allocates the costs of providing each category of such services to those group companies which benefit from using those services, and then applies the same mark-up to all categories of services.

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

7.46 Low value-adding intra-group services are services performed by one member or more than one member of an MNE group on behalf of one or more other group members which

- are of a supportive nature;
- are not part of the core business of the MNE group;
- do not require the use of unique and valuable intangibles and do not lead to the creation of unique and valuable intangibles; and
- do not involve the assumption or control of substantial or significant risk and do not give rise to the creation of significant risk.

The guidance in this section is not applicable to services that would ordinarily qualify as low value-adding intra-group services where such services are rendered to unrelated customers of the members of the MNE

group. In such cases it can be expected that reliable internal comparables exist and can be used for determining the arm's length price for the intra-group services.

7.47 The following activities would not be considered as qualifying for the simplified approach outlined in this section:

- Services constituting the core business of the MNE group;
- Research and development services;
- Manufacturing and production services;
- Sales, marketing and distribution activities;
- Financial transactions;
- Extraction, exploration, or processing of natural resources;
- Insurance and reinsurance;
- Services of corporate senior management.

7.48 The following bullet points provide examples of services that would likely meet the definition of low value-adding services provided in 7.46:

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

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

7.49 The following examples illustrate an important element of the definition of low value-adding intra-group services, namely, that they should not include services which are part of the MNE's core business. Services that may seem superficially similar in nature (in the example, credit risk analysis) may or may not be low value-adding intra-group services depending on the specific context and circumstances.

- a) Company A, situated in country A, is a shoe manufacturer and wholesale distributor of shoes in the North-West region. Its wholly-owned subsidiary B, situated in country B, is a wholesale distributor in the South-East region of the shoes manufactured by A. As part of its operations, A routinely performs a credit risk analysis on its customers on the basis of reports purchased from a credit reporting agency. A performs, on behalf of B, the same credit risk analysis with respect to B's customers, using the same methods and approaches. Under the facts and circumstances, it could be reasonably concluded that the service A performs for B is a low value-adding intra-group service.
- b) Company X is a subsidiary of a worldwide investment banking group. Company X performs credit risk analysis with respect to potential counter-parties for transactions involving financial derivatives contracts and prepares credit reports for the worldwide investment banking group. The credit analyses performed by Company X are utilised by the group in establishing the prices of financial derivatives for the group's clients. The personnel of Company X have developed special expertise and make use of internally developed, confidential credit risk analysis models, algorithms and software. Under the facts and circumstances of this case, it could not be concluded that the service Company X performs for the worldwide investment banking group is a low value-adding intra-group service.

7.50 The definition of low value-adding intra-group services refers to the supportive nature of such services, which are not part of the core business of the MNE group. The provision of low value-adding intra-group services may, in fact, be the principal business activity of the legal entity providing the service, e.g. a shared service centre, provided these services do not relate to the core business of the group. As an

example, assume that an MNE is engaged in the development, production, sale and marketing of dairy products worldwide. The group established a shared services company, the only activity of which is to act as a global IT support service centre. From the perspective of the IT support service provider, the rendering of the IT services is the company's principal business activity. However, from the perspective of the service recipients, and from the perspective of the MNE group as a whole, the service is not a core business activity and may therefore qualify as a low value-adding intra-group service.

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

7.51 This subsection sets out the elements of a simplified charge mechanism for low value-adding intra-group services. An MNE group electing to adopt this simplified method would apply it on a consistent, group wide basis in all countries in which it operates. This simplified method is premised on the proposition that all low value-adding service costs incurred in supporting the business of the MNE group members should be allocated to those members. A possible alternative approach for dealing with the issues discussed in this subsection would be the use of Cost Contribution Arrangements, covered in Chapter VIII.

D.2.1 Determination of cost pools

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

7.53 As a second step, the taxpayer should identify and remove from the pool those costs that are attributable to services performed by one group member solely on behalf of one other group member. In creating a pool of payroll costs, for example, if group company A provides payroll services solely to group company B the relevant costs should be separately identified and omitted from the pool. However, if group company A performs payroll services for itself as well as for company B, the relevant costs should remain within the pool.

7.54 At this stage in the calculation, the taxpayer has identified a pool of costs associated with categories of low value-adding services which are provided to multiple members of the MNE group.

D.2.2 Allocation of low value-adding service costs

7.55 The third step in this simplified charge method for low value-adding intra-group service costs is to allocate among members of the group the costs in the cost pool that benefit multiple members of the group. The taxpayer will select an allocation key to apply for this purpose based on the following principles. The appropriate allocation key will depend on the nature of the services. The same allocation key must be used on a consistent basis for all allocations of costs relating to the same category of services. In accordance with the guidance in 7.25, the allocation key selected with respect to costs for each relevant category of services should reasonably reflect the level of benefit expected to be received by each recipient of the particular service. As a general rule, the allocation key should reflect the underlying need for the particular services. By way of examples, the allocation key for services related to people might employ each company's share of total group headcount, IT services might employ the share of total users, fleet management services might employ the share of total vehicles, accounting support services might employ the share of total relevant transactions or the share of total assets. In other cases, the share of total turnover may be the most relevant key.

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

D.2.3 Profit mark-up

7.57 In determining the arm's length charge for low value-adding intra-group services, the MNE provider of services shall apply a profit mark-up to all costs in the pool. The same mark-up shall be utilised for all low value-adding services irrespective of the categories of services. The mark-up selected by the taxpayer should be no less than 2% of the relevant cost and should be no greater than 5% of the relevant cost. It should be noted that these intra-group services mark-ups should not, without further justification and analysis, be used as benchmarks for the determination of the arm's length price for services not within the definition of low value-adding services, nor for similar services not within the elective, simplified scheme.

D.2.4 Charge for low value-adding services

7.58 Subject to the provisions of paragraph 7.60, the charge for services to any member of the electing MNE group shall be the sum of (i) the costs incurred by another group member in providing services specifically to the member under the second step as detailed in paragraph 7.53, plus the selected profit mark-up, and-, (ii) the share of pooled costs allocated to the member under the third step as detailed in paragraph 7.55 using the selected allocation key, plus the selected profit mark-up. The charge is payable to the group member that incurred the costs in the pool, and where there is more than one group member incurring those costs, in proportion to each member's share of the pooled costs.

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

7.59 As discussed in paragraph 7.7, under the arm's length principle an obligation to pay for an intra-group service arises only where the benefits test is satisfied, *i.e.* the activity must provide the group member expected to pay for the service with economic or commercial value to enhance or maintain its commercial position, which in turn is determined by evaluating whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in-house for itself. However, because of the nature of the low value-adding intra-group services discussed in this section, such determinations may be difficult or may require greater effort than the amount of the charge warrants.

7.60 While low value-adding intra-group services may provide benefits to all recipients of those services, questions may arise about the extent of the benefits and whether independent parties would have been willing to pay for the service or perform it themselves. The documentation and reporting discussed in section D.3 below should provide sufficient evidence that the benefits test is met given the nature of low value-adding intra-group services. In evaluating the benefits test, tax administrations should consider

benefits only by categories of services and not on a specific charge basis. Thus, the taxpayer need only demonstrate that assistance was provided with, for example, payroll processing, rather than being required to specify individual acts undertaken that give rise to the costs charged. Provided such information outlined in paragraph 7.61 is made available to the tax administration, a single annual invoice describing a category of services should suffice to support the charge, and correspondence or other evidence of individual acts should not be required. With regard to low value-adding intra-group services that benefit only one recipient entity in the MNE group, it is expected that the benefits to the service recipient will be capable of separate demonstration.

D.3 Documentation and reporting

7.61 An MNE group electing for application of this simplified methodology shall prepare the following information and documentation and make it available upon request to the tax administration of any entity within the group either making or receiving a payment for low value-adding intra-group services.

- A description of the categories of low value value-adding intra-group services provided; the reasons justifying that each category of services constitute low value-adding intra-group services within the definition set out in section D.1; the rationale for the provision of services within the context of the business of the MNE; a description of the benefits or expected benefits of each category of services; a description of the selected allocation keys and the reasons justifying that such allocation keys produce outcomes that reasonably reflect the benefits received, and confirmation of the mark-up applied;
- Written contracts or agreements for the provision of services and any modifications to those contracts and agreements reflecting the agreement of the various members of the group to be bound by the allocation rules of this section;
- Calculations showing the determination of the cost pool as described in D.2.1, in particular a detailed listing of all categories and amounts of relevant costs, including costs of any services provided solely to one group member;
- Calculations showing the application of the specified allocation keys.