TAXAND

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Comments on the scoping of future revisions of Chapter VII (intra-group services)

Dear Sir or Madame,

First of all, we would like to thank you for providing the opportunity to comment on the scoping of future revisions of Chapter VII (intra-group services). From our point of view, subjecting your work to public scrutiny constitutes an indispensable aspect of building and maintaining credibility with taxpayers and tax administrations.

Having said that, we would like you to consider the following comments as constructive criticism aimed at achieving better and generally accepted Transfer Pricing Guidelines.

I. Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient

The current OECD Transfer Pricing Guidelines 2017 (hereinafter: "OECD-TPG") state that the questions of whether a service has been rendered "should depend on whether the activity provides a respective group member with economic or commercial value". In addition, there is a reference to the arm's length principle. Furthermore, there is the statement that "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" but that "some intra-group services are performed […] to meet an identified need [in which case] it is relatively straightforward to determine whether a services has been provided" (Sec. 7.6 et seq.). All in all, from our point of view these guidelines are far too general and brief to constitute practical, hands-on guidelines and help taxpayers and tax administrations to find agreement on the question of whether a service has been rendered.

Furthermore, it should be clearly stated that if a service has been rendered, the costs associated with this service provision to constitute deductible expenses from the point of view of the service recipient in principle. For this to be the case the central requirement that needs to be met is the demonstration of an expected benefit for the recipient. It should be noted that business decisions between unrelated parties may, and in fact, often do result in a loss. Consequently, the service recipient should only be requested to present the options realistically available at the time of entering into service transaction, thus meeting the "willing to pay" test.
As regards the scope of the benefits test, we believe that aspects which should be addressed include:

- The taxpayer should solely need to demonstrate an *expected* benefit. This means that the benefit does not actually need to have been realized (even though often this will be the case). Instead, before or at the point in time the service is provided/the respective agreement concluded from the subjective point of view of the (potential) service recipient the realization of a benefit from receiving that service should have seemed to be more likely than not.
- The expected benefit may constitute cost savings but also (possibly and indirectly) increased income. Cost savings should take into account the concept of opportunity costs and the idea of alternative options for action.
- The benefit does not necessarily need to be expected to be realized in the same period the services are charged/costs are incurred. Instead, looking at the total period a benefit needs to be expected.
- The service recipient should not be required to quantify a benefit, even an expected benefit, from entering into the transaction, as long as the "willing to pay" test is satisfied.
- The taxpayer should not be required to demonstrate a direct link between the costs incurred and a specific revenue but only that a relationship between the costs and, in general terms, the overall activity of the company exists, even if such costs are only potentially able to increase revenues or taxable income.
- The fact that the costs are disproportionate to the revenues of the taxpayer should not constitute by itself conclusive evidence that the service has not been rendered.
- That a service has been rendered can i.a. be demonstrated by technical-accounting documents, i.e. reports drawn up by the parent company and certified by an international audit firm in which the nature and the composition of the services provided and their functionality in respect of the company's activity receiving the services are highlighted. The fact that the reports are certified should be considered a sufficient proof that the service has been provided considering that the international audit firm carries out a public control function, is in a position of independence with respect to the person conferring the task and is exposed to civil and criminal responsibility when it attests untrue data. In turn, it should be the tax authority's task to conclusively and convincingly demonstrate if – in contrast to the impression conveyed by such technical-accounting documents – a service has in fact not been rendered.
- The fact that the service recipient does not have the internal resources (know-how, capacity etc.) to provide these services internally (which is why the service is sourced externally) should be taken as indication that a service has been rendered.

II. Finding an appropriate allocation key

If intra-group services are not rendered directly (i.e. "bilaterally) the costs (generally, including a mark-up) incurred by the service provider are allocated to all service recipients based on an allocation key. In this regard, we believe the guidelines regarding low value-adding services (Sec. 7.59 et seq.) to offer sensible guidance. This refers i.a. to the following aspects, to which we would like to comment as follows:

- The appropriateness of an allocation key will depend on the nature of the service. However, this does not imply that different services necessarily require different allocation keys; instead, a single allocation key (e.g. revenue-based) may also be appropriate to allocate the costs associated with various services.

- Allocation keys should be used consistently. However, we would like to point out that indeed there may be appropriate reasons to change and/or amend allocation keys. Thus, provided that there are sound reasons, a change/amendment of allocation keys should be accepted.
- An appropriate allocation key will reflect the benefit expected to be received by each recipient of the service. This means that – if all participants in e.g. a cost allocation agreement are viewed jointly – the allocation key should reasonably approximate the expected benefit of each recipient as compared to the expected benefit of any other recipient.
- When choosing an allocation key, a balance needs to be struck between theoretical sophistication and practical administration. If in doubt, the taxpayer should be allowed to choose the easier (although less precise) allocation key over the more sophisticated allocation key that is hard to handle.
- Guidance on which allocation keys should in principle be acceptable per type of service would assist in reducing the number of disputes between taxpayers and tax administrations on the matter. In this regard, e.g. a matrix with practical examples of which allocation keys might be usually acceptable for certain types of services would be useful.
- It should be clearly noted that amongst third parties it is highly unlikely that a service provider will share the calculation of its costs with regard to that service with the service recipient. In practice the service recipient will only receive the invoice to be paid, theoretically knowing the allocation key that is used but not knowing any details with regard to its application in practice.
- It should be acknowledged that allocation keys based on the time spent for the relevant service carry a significant administrative burden for MNEs and are less preferable compared to other allocation keys which refer to objective data (sales, assets, headcount etc.).
- An appropriate allocation key is not necessarily based on measures that concern the same period of time as the costs that are to be allocated. For instance, an allocation key might be determined based on revenues in t=0 and be used to allocate costs incurred in t=1.
- An appropriate allocation key may also be determined using average numbers over time. For instance, an allocation key might be determined based on average revenues in t=-5 to t=0 and be used to allocate costs incurred in t=1 etc.
- Regarding the expected benefit reflected by the allocation key, the benefit of doubt should lie with the taxpayer meaning that the taxpayer does not need to proof the allocation key's appropriateness. Instead, the taxpayer should merely need to explain the reasoning behind choosing a particular allocation key.
- Tax administrations must not assess an allocation key's appropriateness by looking at the actual/realized benefits. Instead, tax administrations should be required to – based on the information available at that time – try to understand the taxpayers reasoning behind choosing an allocation key.

III. Identifying in practice duplicated activities

The current OECD-TPG state that "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" (Sec. 7.11 et seq.).
In general, this assessment is fully appropriately and accurately reflects the behavior of an unrelated, independent company. However, in practice the difficulty is to identify such duplicated activities and to properly distinguish duplicated activities from activities that complement each other and/or constitute additional activities. In this regard we would like to comment as follows:

- Also regarding the question of duplicated activities, the benefit of doubt should lie with the taxpayer, i.e. as a general rule the taxpayer will be much better qualified to judge whether in fact a duplicated activity exists or whether there is a case of different, additional or complementary activities.
- As stated correctly in the OECD-TPG, an exception must exist for cases of temporary duplication. Thus, if the taxpayer can provide sound business reasons of why a duplication of activities was acceptable from a business perspective, this should also be actable from the point of view of tax authorities.
- Identifying duplicated activities must be the tax authority's task, i.e. they must conclusively and convincingly demonstrate that in fact a duplicated activity exists.
- Duplicated activities cannot be described in the abstract but rather can only be identified by analyzing the activity in question in detail, evaluating the expected benefit of such activity against the background of a company's economic activity and comparing/contrasting such activity with other activities undertaken on the company's behalf.
- The fact that the taxpayer lacks a structure suitable for carrying out the service received by another group member should constitute evidence that such service has effectively been provided and does not constitute duplicated activities.
- With regard to the taxpayer it is recommendable to describe the services received in detail, in order to help tax authorities understand each type of service, its nature, the counterparty and the corresponding amounts. As similar services are often received from both related and/or unrelated parties (i.e. between independent enterprises), including a detailed description of the intra-group services received will strengthen the taxpayers position.

IV. Determining the costs

When determining the relevant costs, tax authorities should be encouraged to apply more general approaches (e.g. the use of ledger accounts instead of separate invoices) when auditing a fiscal year more than e.g. three years ago. The benefit of such an approach lies in the fact that it may be extremely burdensome to identify all separate transactions for the year in scope of the tax audit. One should therefore be allowed to defend the transfer pricing system with a more general approach (in line with the overall idea of the OECD-TPG on Low-value-adding services).

We hope that these brief remarks will contribute to the further discussion of the topic.

Yours sincerely on behalf of Taxand,

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