

# Dbriefs Bytes Transcript

14 November 2014

For comments on Action 10, see [the highlighted text below](#).

## BEPS

### 1. BEPS : Action 10 discussion draft on low value-adding intra-group services

Well, as promised in last week's Dbriefs Bytes, let me take you through the BEPS Action 10 discussion draft which was issued on 3 November.

The discussion draft proposes amendments to chapter VII of the OECD's Transfer Pricing Guidelines. Most of the changes are in regard to low value-adding intra-group services, but there is a small number of other changes as well.

#### 1.1 Sub-divider slide : Low value-adding intra-group services

Let's start with low value-adding intra-group services. The changes here are essentially to provide a simplified transfer pricing model for such services – in other words, low compliance. One point to note at the outset is that this simplified model is by taxpayer election : if the multinational group does not want to implement this simplified model, then it can choose not to do so.

Low value-adding intra-group services are defined in the discussion draft in this way :

"...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."

However, there's a carve-out for types of services which are provided to third parties.

The discussion draft puts it this way :

"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."

The discussion draft gives us a **negative** list of services which do **not** qualify as low value-added intra-group services, and it also gives us a list of **examples** of services which **ordinarily would** qualify as such services.

Here's the negative list :

- 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; and
- Services of corporate senior management.

And here are the examples of services which ordinarily would qualify as low value-adding intra-group services :

- Accounting and auditing;
- Processing and managing of accounts receivable and accounts payable;
- HR activities;
- Activities related to health, safety and environmental matters;
- Information technology;
- Public relations support;
- Legal and tax activities; and
- General services of an administrative or clerical nature.

The OECD's proposed simplified approach contains seven steps :

Step 1 : Determination of the cost pool

Step 2 : Exclusion of "self" and "one-to-one" services

Step 3 : Allocation of the cost pool to the MNE group members

Step 4 : Profit mark-up

Step 5 : Total charge for low value-adding intra-group services

Step 6 : Documentation and reporting

And Step 7 : Simplified benefits test

I'll go through each of these in turn.

Firstly, **step 1** : determination of the cost pool.

The discussion draft describes it in this way :

"This initial step.....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."

**Step 2** is to exclude, from the cost pool, what I call "self" services and "one-to-one" services.

In regard to “**self**” **services**, the discussion draft says :

“The cost pool should exclude costs that are attributable to an in-house activity that benefits solely the company performing the activity (including the shareholder activities performed by the shareholding company).”

And in regard to “**one-to-one**” **services**, the discussion draft says :

“...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.”

**Step 3** is to allocate the cost pool amongst the MNE group members.

This employs the indirect charging mechanism, using appropriate allocation keys for each category of service.

The discussion draft says :

“The same allocation key must be used on a consistent basis for all allocations of costs relating to the same category of services....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.”

**Step 4** concerns the profit mark-up which should be added to the pool, prior to the allocation.

The discussion draft says this :

“ 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 utilized 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.”

**Step 5** describes the total charge for low value-adding intra-group services.

The total charge levied on a member of the MNE group, will be **the sum of A plus B**.

**A** is the cost of any “one-to-one” services provided to that member (as described in step 2), plus the mark-up which has been selected in step 4.

And **B** is the share of pooled costs which have been allocated to that member under step 3, again plus the mark-up which has been selected in step 4.

The discussion draft says :

“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.”

**Step 6** concerns the documentation and reporting requirements for this simplified model.

The discussion draft identifies four types of documentation or reports :

- Firstly : A description of the categories of low value-adding intra-group services which are provided – and, in particular :
  - Description of the benefits or expected benefits of each category of services;
  - Description of the selected allocation keys and the rationale for their selection;

- And confirmation of the selected mark-up.
- Secondly : written contracts
- Thirdly : calculations showing the determination of the cost pool
- And fourthly : calculations showing the application of the specified allocation keys

And then finally **step 7** provides a simplified benefits test, in order to secure deductibility of the charge.

The discussion draft says this :

“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 [simplified documentation and reporting rules in step 6] 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 [step 6] 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 [in other words, “one-to-one” services], it is expected that the benefits to the service recipient will be capable of separate demonstration.” [bolding added]

## 1.2 Sub-divider slide : Other proposed changes

Apart from low value-adding intra-group services, the discussion draft also proposes a small number of changes to the existing parts of chapter VII.

Here are the important changes that I've spotted :

- There are additional examples of **shareholder activities**. In particular, the following two examples are proposed to be added :
  - Costs relating to compliance of the parent company with relevant tax laws
  - And costs which are ancillary to the corporate governance of the MNE as a whole

However, I don't believe that the OECD intends to widen the scope of shareholder activities.

- There is a proposed clarification in regard to the issue of **duplication**.

The following new passage is proposed to be added :

“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.”

- And the discussion of **R&D activities** is proposed to be amended to make it consistent with the Action 8 views on intangibles.

This particular passage in the existing chapter VII :

“However, the research company itself is often insulated from financial risk since it is normally arranged that all expenses will be reimbursed whether the research was successful or not. In addition, intangible property deriving from research activities is generally owned by the principal company and

so risks relating to the commercial exploitation of that property are not assumed by the research company itself. In such a case a cost plus method may be appropriate...”

is proposed to be replaced by this passage :

“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.”

### 1.3 Sub-divider slide : Discussion draft

As with all of the BEPS discussion drafts, this is not a consensus document.

Instead, it's a substantive proposal for public analysis and comment. That comment is requested by 14 January 2015.

The OECD has indicated that the discussion draft will be discussed, together with other topics, at a public consultation meeting in Paris on 19 and 20 March.

If you would like to obtain a copy of the discussion draft and our Tax Alert on the document, please go to BEPS Central.

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