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13 January 2015

Andrew Hickman
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Via Email: transferpricing@oecd.org

RE: Public Discussion Draft on *BEPS Action 10: Modifications to the OECD Transfer Pricing Guidelines for Low Value-Adding Intra-Group Services*

Dear Mr. Hickman:

On 19 July 2013, the OECD published an *Action Plan on Base Erosion and Profit Shifting* (hereinafter the Action Plan or the Plan) setting forth 15 actions the OECD will undertake to address a series of issues that contribute to the perception that individual countries' tax bases are being eroded or profits shifted improperly. Pursuant to Action 10 of the Plan, "Other high-risk transactions," the OECD issued a public discussion draft on 3 November 2014 entitled *Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services* (hereinafter the Discussion Draft or Draft). The Discussion Draft sets forth a simplified approach for low value-added services to achieve a balance between appropriate charges for low value-added services and head office expenses and the need to protect the tax base of payor countries.

The OECD solicited comments from interested parties no later than 14 January 2015. On behalf of Tax Executives Institute, Inc. (TEI), I am pleased to respond to the OECD's request for comments.

TEI Background

TEI was founded in 1944 to serve the needs of business tax professionals.[1] Today, the organisation has 56 chapters in Europe, North and South America, and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our nearly 7,000 individual members represent over 3,000 of the largest companies in the world.

TEI Comments

TEI commends the OECD for its work on the Discussion Draft. Overall, the Draft is a significant positive step forward and sets forth a balanced approach to transfer pricing for low value-added services. Multi-national enterprises (MNEs) spend a substantial amount of time and effort to allocate intra-group service charges in a manner that satisfies tax authorities around the world. This is a difficult task because of the tension between payor and payee jurisdictions and a significant amount of effort is expended on administering low value-added services for what is, in the end, not a substantial amount of tax. The Discussion Draft sets forth sensible guidelines to make this area more manageable for MNEs via an elective, simplified approach. This will permit taxpayers and tax authorities to allocate scarce resources to higher risk activities and more difficult to resolve issues. However, the approach provided in the Discussion Draft will be of limited value to MNEs unless it is widely implemented across jurisdictions, and respected by both the payor and payee jurisdictions for particular services and their respective charges.

Benefits test for low value-added services

As stated in our letter to the OECD regarding its Draft Handbook on Transfer Pricing Risk Assessment,[2] intra-group service transactions are an often the subject of transfer pricing adjustments for questionable reasons (*e.g.*, because it is easy for tax authorities to assert such adjustments while documentation can be difficult for taxpayers). In many cases, MNEs provide centralised or regional services to their local affiliates that may appear to duplicate certain activities conducted locally by those affiliates. The centralised or regional services, however, complement or oversee the local activities and permit MNEs to implement group-wide best practices. For example, the regional human resources function may provide talent management

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[1] TEI is a corporation organised in the United States under the Not-For-Profit Corporation Law of the State of New York. TEI is exempt from U.S. Federal Income Tax under section 501(c)(6) of the U.S. Internal Revenue Code of 1986 (as amended).

[2] *See* Letter from TEI to the OECD dated 11 September 2013. This letter is available on TEI's website at http://www.tei.org/news/Pages/TEI-Comments-on-OECD-Draft-Handbook-on-Transfer-Pricing-Risk-Assessment.aspx.

services to support a domestic human resources department. These tasks are often best performed centrally or regionally, and the costs MNEs incur to provide these services need to be shared among the affiliates that benefit.

In this regard, TEI recommends that MNEs should not be required to apply the "benefits test" (described in paragraph 7.7 of the Draft) to low value-added services. Instead, the OECD should introduce a rebuttable presumption for these charges. That is, tax authorities should accept that an intra-group service transaction was necessary for the payor affiliate and properly compensated if a taxpayer fully discloses its cost base and allocation mechanism while applying a cost plus charge for the transaction, in conformance with the approach set forth in the Discussion Draft.

Definitional issues and coordination with other OECD efforts

The Discussion Draft identifies a number of activities that would not be considered low value-added intra-group services, including services of corporate senior management. While TEI agrees with this conclusion, additional clarification on what constitutes corporate senior management would be helpful as it raises difficult issues that may be time consuming to resolve. For example, what level of management is considered corporate senior management? Would this only include corporate senior management that is not responsible for low value-added intra-group services? Would an MNE need to allocate the corporate senior management's salary between low value-added activities and other activities? Would regional senior management be included as corporate senior management or just senior management located in the head office? Thus, while the value added by corporate senior management should not generally be considered "low," as a practical matter it may be simpler to include them as part of low value-added intra-group services due to the difficulty of answering the above questions. Alternatively, the taxpayer could be permitted to elect to treat such services as low value-added and apply the approach set forth in the Draft.

TEI welcomes the proposal of a safe-harbour profit mark-up for low value-added intra-group services. It is unclear, however, in what manner the OECD developed the two to five percent range. For example, the Discussion Draft indicates that cost contribution arrangements are not covered by this safe harbour, and yet many of the services that are included could just as easily be part of a head office cost contribution arrangement. Under such a cost contribution arrangement, there is typically not a requirement to include a mark-up. Moreover, it has been a longstanding practice for MNEs to provide no mark-up for many low value-added services. To give taxpayers flexibility between using a cost-plus mark-up versus a cost contribution arrangement and in recognition of this longstanding practice, we recommend the OECD change the mark-up percentage range to between zero and five percent.

With respect to settling on a particular percentage within the safe harbour range, TEI recommends the OECD specify that taxpayers may choose any percentage within the range without challenge by tax authorities, as long as the taxpayer maintains the appropriate documentation and the services are truly low value-added services. Alternatively, the OECD could recommend that tax authorities implement a simplified mechanism, such as an expedited advanced ruling process, including an opportunity to obtain a bilateral or multilateral ruling, to confirm that the taxpayer's selected percentage within the safe harbour is appropriate.

TEI welcomes the clarification that "stewardship activities" are broader than "shareholder activities." For example, the Discussion Draft states that central coordination activities such as "detailed planning services for particular operations, emergency management or technical advice (trouble shooting), or in some cases assistance in day-to-day management" are not considered shareholder activities and thus chargeable to associated enterprises, although they would otherwise fall within the definition of stewardship activities.[3] In a similar vein, TEI recommends that the OECD clarify the following in the final revisions to Chapter VII:

(a) Whether certain compliance services, such as implementing group-wide risk management and governance regimes/procedures or complying with regulations broadly adopted across the jurisdictions in which an MNE operates (such as Basel banking regulations), can be regarded as non-shareholder activities and thus eligible for reimbursement from benefited group members even though the services are predominantly administered or enforced at the parent company level; and

(b) The appropriate characterization of personnel who perform functions with a mix of shareholder and non-shareholder activities. For example, a business managing director who runs the day-to-day operations of entities in a certain jurisdiction and also serves as a director on the board of the parent or holding company in the jurisdiction. A simplified way to address this would be to permit an MNE to allocate the time of the employee based on the employee's principal function to avoid burdensome allocations of employee time.

More broadly, the OECD should provide some guidance regarding how the guidelines provided in the Discussion Draft under Action 10 will be coordinated with the more general transfer pricing documentation requirements provided under Action 13. For example, it would seem that the documentation required by the local file under Action 13 would not be necessary for low value-added services when the taxpayer elects the simplified approach under the Discussion Draft.

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[3] Discussion Draft, p.8.

Finally, we note the absence of any reference to the OECD's previous work on safe harbours in Chapter IV of the OECD Transfer Pricing Guidelines (Guidelines).[4] It would be useful if the OECD discussed the reasons for this omission. For example, whether the omission represents a shift away from the OECD's previous safe harbour approach under the Guidelines or merely that additional revisions to Chapter IV were beyond the scope of the Draft under BEPS Action 10.

Comments on specific paragraphs in the Discussion Draft

TEI welcomes the inclusion of an example in the Discussion Draft (in paragraph 7.50) of the application of the simplified approach to a wholly-owned shared services company typified by the out-sourcing/off-shoring shared services arrangements common across certain countries, particularly in Asia.[5] The example (a shared services center of a dairy product company whose "only activity of which is to act as a global IT support service centre") is helpful in defining the boundaries of low value-added intra-group services as "support services that are not part of the core business of the MNE group." This boundary is made clear by the further explanation that whether an activity is "core" is to be determined from the perspective of the MNE as a whole, not that of the MNE subsidiary alone. Thus, even if the low value-added service is the core activity of the subsidiary, from the perspective of the MNE group as a whole, the service is not a core business activity and therefore low value-added and eligible for the approach set forth in the Discussion Draft.

With respect to paragraph 7.51, TEI recommends that the following sentence (in italics) be added after the end of the second sentence, so that it reads as follows:

> 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. *An MNE shall not be precluded by any Advance Pricing Agreement(s), Mutual Agreement Procedure determination(s) or other ruling(s) specific to any individual jurisdiction from electing into the simplified method for the MNE as a whole*.

The revisions to Chapter VII of the Guidelines should make it clear that an MNE may adopt the simplified method in the Discussion Draft even if the MNE may be required to use a different approach under the transfer pricing rules of specific jurisdictions that do not accept the OECD endorsed simplified method or that arise from preexisting Competent Authority agreements or other rulings. In other words, if an MNE has a historic APA, MAP agreement or other tax ruling in place that does not fully conform with the conditions of the simplified approach due to

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4 *See OECD Discussion Draft: Proposed Revision of the Section on Safe Harbours in Chapter IV of the OECD Transfer Pricing Guidelines and Draft Sample Memoranda of Understanding for Competent authorities to Establish Bilateral Safe Harbours* (6 June 2012).

5 *See* Discussion Draft, p.17-18.

the specific non-OECD compliant practices of certain jurisdictions (or is in the process of obtaining such an agreement or ruling at the time a jurisdiction adopts the OECD approach), such agreements, determinations or rulings should not preclude the MNE from electing to apply the simplified method for the rest of its operations, particularly for those in other jurisdictions that have adopted the OECD approach.

Conclusion

TEI appreciates the opportunity to comment on the OECD Discussion Draft under BEPS Action 10 addressing low value-added services. These comments were prepared under the aegis of TEI's European Direct Tax Committee, whose Chair is Nick Hasenoehrl. If you have any questions about the submission, please contact Mr. Hasenoehrl at +41 786 88 3772, nickhasen@sbcglobal.net, or Benjamin R. Shreck of the Institute's legal staff, at +1 202 638 5601, bshreck@tei.org.

Sincerely yours,
TAX EXECUTIVES INSTITUTE, INC.

Mark C. Silbiger
International President