Irish Tax Institute

Leaders in Tax

Irish Tax Institute

Response to OECD Discussion Draft: Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services

January 2015

About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's AITI Chartered Tax Advisers (CTA) and is the only professional body exclusively dedicated to tax. Our members provide tax expertise to thousands of businesses and individuals in Ireland and internationally. In addition many hold senior roles within professional service firms, global companies, Government, Revenue and state bodies.

The Institute is the leading provider of tax qualifications in Ireland, educating the finest minds in tax and business for over thirty years. Our AITI Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice.

A respected body on tax policy and administration, the Institute engages at the most senior levels across Government, business and state organisations. Representing the views and expertise of its members, it plays an important role in the fiscal and tax administrative discussions and decisions in Ireland and in the EU.

Irish Tax Institute response

The Irish Tax Institute is writing in response to the Discussion Draft on the Transfer Pricing Guidelines related to Low Value-Adding Services, which the OECD released on 3 November 2014. We prepared this submission with consideration and input from a number of our members. For ease of reference, we structured this response in the following way:

Section A – Background
Section B – Acknowledgements
Section C – Comments on the Simplified Method
Section D – Comments on Shareholder Activities and Other Costs

Section A: Background

It is recognised that in some jurisdictions management fees and head office expenses may be viewed as base eroding payments. Chapter VII of the OECD Transfer Pricing Guidelines addresses the principles to identify, price and document many forms of intra-group services, including management or head office services.

In an effort to balance the need to charge for low value adding services while protecting the tax base of payor countries, the Discussion Draft is suggesting a simplified approach to:

(i) identify categories of intra-group services that are low value-adding,
(ii) apply consistent allocation keys for all recipients, and
(iii) require adequate reporting through documentation and allocation of cost pools (collectively the **Simplified Method**).

The Simplified Method is suggested to be applied in certain circumstances of services, to require a limited mark-up between 2 and 5 percent, and is to reduce the administrative burden to multinationals electing into the Simplified Method.

Section B: Acknowledgements

The Discussion Draft incorporates numerous helpful changes to improve the ability for Irish MNEs to be compliant with transfer pricing obligations in Ireland and abroad. We support the work by the OECD to simplify the transfer pricing obligations for this frequent yet less complex group of intercompany transactions. In particular, we welcome these additions:

1. Proposing simplification measures to price and document low value-adding services including:
   - Examples of low value-adding services.
   - Services that cannot qualify for the Simplified Method.
   - Documentation and information that satisfies the Simplified Method.
2. Further examples of shareholder activities.

Section C: Comments on the Simplified Method

The introduction of a new approach for low value-adding services is a positive step in the right direction for both MNEs and tax administrations. We provide the following comments and suggestions to enhance the Simplified Method for the Irish business community.

1. **Widespread adoption** – The Discussion Draft notes that this guidance document does not represent a consensus view of the OECD members. Incomplete acceptance of the Simplified Method will limit the intended benefit of the guidance. Projects by the OECD to effect safe harbour mechanisms, in the context of Chapter IV of the Guidelines, could be revisited for this purpose. The OECD should consider drafting a sample Memorandum of Understanding (MOU) for its member states to adopt. MOUs would provide MNEs additional certainty in choosing to apply the Simplified Method.

   Because it is unlikely that every country will adopt the Simplified Method, the OECD should grant flexibility to price low value-adding services using the Simplified Method and other approaches, as appropriate. We would welcome the OECD explicitly stating that: (i) not *all* costs need to be included, and (ii) not *all* group affiliates must be charged under this method.

   There are many instances where it would be not be appropriate or practical for all affiliates to be charged. For example, MNEs often comprise affiliates not wholly-owned by the parent. Other interests in such affiliates can present obstacles to charging an arm's length price for low value-adding services, amongst other transactions. It would be burdensome to MNEs in Ireland to be expected to allocate costs of low value-adding services to all affiliates in these circumstances.

2. **Documentation standards** – There is overlap amongst the various BEPS Actions. We would welcome confirmation that documentation satisfying the Simplified Method per D.3 of the Discussion Draft would replace the documentation requirements from Master or Local Country File per BEPS Action 13.

3. **Cost-only allocation** – It would be helpful and consistent with some existing transfer pricing rules by OECD member countries to make the application of a mark-up (per paragraph 7.57) elective to MNEs in many instances. We would welcome the notion of a safe harbour being an acceptable mark-up of 5 percent or less (including no mark-up). Safe harbours like this are valued approaches to provide certainty to taxpayers and to efficiently make use of limited tax authority resources.

   However, we do not maintain that a cost recovery (no mark-up) is appropriate for the provision of **all** low value-adding services. For example, we would recommend a mark-up of 5 percent or less is required for an entity whose *sole* activity is the provision of low value-adding services within an MNE.

   Additionally, section D.2.4 of the Discussion Draft should refer to paragraph 7.36 (*treatment of pass-through costs*) to present a consistent approach to the treatment of costs of activities performed by third parties, i.e. no mark-up should apply.

4. **Arm's length expense** – Invoices for low value-adding services priced on a cost-plus method should be treated as if the services were performed by an independent party. That is, tax authorities should be permitted to review the underlying costs to attest accuracy but be guided against 'looking through' to the underlying expenses of the service provider in order to evaluate the expenses' deductibility in the local country.

   Specific expenses amongst a pool of services costs should only be assessed for deductibility in the country where the original expense was incurred. Otherwise, the same underlying expense may be deemed not deductible in multiple jurisdictions. For example, domestic tax law may restrict deductibility of meals and entertaining costs, e.g. only half the cost is deductible in some countries. If meals and entertaining costs were included in a low value-adding services cost allocation, it would contradict the arm's length principle if the tax authority in the payor country were to apply local deductibility rules to the same expenses when part of a cost allocation.

5. **Adoption** – Business may be hesitant to implement the Simplified Method if the result is different from existing practice to charge for such services. We would welcome guidance that, as an elective method, the Simplified Method should not be applied at the discretion of tax authorities when the MNE has applied another arm's length method to a prior fiscal period.

6. **Consideration for smaller business** – Although Ireland and other countries exempt SMEs from transfer pricing rules, many jurisdictions in which Irish companies conduct business do not exempt SMEs from transfer pricing rules or documentation requirements. To ease the burden on SMEs, the Discussion Draft could suggest further measures for the benefit of SMEs, e.g. in Section D.2.2, allow in such circumstances a single allocation key to apply to a bundle of services cost in place of a specific key for each service.

Section D: Comment toward Shareholder Activities and Other Costs

1. **Guidance on shareholder activities** – While we welcome additional examples in paragraph 7.11, detailed guidance is needed on commonly disputed activities and what does *not* constitute a shareholder activity. Activities that are an obligation of a publicly listed company, e.g. internal controls, do provide a benefit to affiliates of a parent company. However, the allocation of costs incurred are often scrutinised by virtue of the activities' connection to the public nature of the MNE.

2. **Costing of shareholder activities -** A common challenge in this area is identifying costs attributable to shareholder activities from the departments that perform shareholder activities amongst other activities. Allocation keys cited in the Discussion Draft solely address beneficial services and rely on objective data, such as headcount. It would be helpful to provide specific guidance on how to apportion costs related to shareholder activities and to recognise the use of subjective allocation keys. For instance, we would appreciate the Discussion Draft advocate a time-spent allocation key as one acceptable approach to determine costs attributable to shareholder activity.

3. **Hypothetical cost adjustment** – MNEs make decisions to incur/bear cost of services and hire employees absent a tax motivation. The revised language in paragraph 7.35 suggests it may be appropriate to adjust the cost of the services actually rendered to account for the hypothetical cost of a recipient performing the services itself. This new requirement will place an undue burden on MNEs to evaluate its services cost allocations, and likely result in a large number of disputes amongst tax authorities. It would be preferable that Chapter VII is written to suggest tax authorities respect business judgement on how and where cost of services are borne, and not compare to the hypothetical scenario of services costs incurred locally.