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## **EU JOINT TRANSFER PRICING FORUM**

### **WORKING DOCUMENT ON INTRA-GROUP SERVICES TAKING INTO ACCOUNT THE JUNE JTPF MEETING**

**Meeting of 27th October 2009**

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## I. INTRODUCTION:

1. Chapter VII of the OECD transfer pricing guidelines for Multinational Enterprises and Tax Administrations (OECD guidelines) examine *"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"*. Broadly, the chapter then goes on to consider if a service has been provided and what, for tax purposes, the intra group charge for such a service should be to accord with the arm's length principle.
2. The OECD guidelines recognise the wide range of services that may be provided and equally the wide range of benefit provided, or expected, by the provision of such services. The JTPF thought it worthwhile to supplement the list of services mentioned in the OECD guidelines. At annex I is a list of intra-group services commonly provided that may or not be within the scope of this paper.
3. The JTPF identified certain issues, –important to any reviewer (the term reviewer applies to the reviewer function in both the taxpayer and the tax administration)-, in applying the guidelines as they relate to intra group services. The issues include: increasing globalisation and related central service provision; the increasing demand on resources; the potential for costs to be "stranded" in that no tax administration would accept them; and an awareness that some types of service provision represented a lower risk than others although that did not seem to have an impact in a practical application of the OECD guidelines by reviewers.
4. This paper is focused on how best to address those issues. The paper seeks to neither restrict the right of a Tax Administration to conduct an audit nor for an MNE to make representations to reflect an outcome based on the facts and circumstances of their particular case i.e. to either include or exclude a specific service. Nonetheless it is anticipated that fewer audits will be required into the intra group services that fall within the scope of this paper.

## II. Overview:

5. Underpinning this paper is an unequivocal endorsement of the OECD principles to be applied when considering intra group services. The emphasis of the paper, therefore, is on how most expediently and efficiently a reviewer may conclude that the arm's length principle has been applied in the provision of certain intra group services.
6. It is important that the proposals in this paper are applied cumulatively as questions that may be relevant at the beginning of the process may subsequently be satisfactorily answered after the provision of certain information later in the process. For example, there may be a legitimate concern about the provision of a service which is then resolved by information supplied in the narrative.
7. The key elements of the approach developed by in this paper are:
  - (i) Acceptance of certain important working assumptions in establishing an agreed starting point for any review.
  - (ii) The provision of concise and dedicated information to provide an understanding of the type of service provided and the structure by which those services are delivered.

- (iii) Flexibility in deciding the breadth and depth of review required in evaluating the provision of services against the arm's length standard.

### **III. Scope of the paper:**

8. An exhaustive definition of the services to which this paper applies is neither possible nor desirable. This is because of the range of services provided intra group and the differing commercial impact that services can have within the context of a particular commercial activity. Additionally, any attempt to give a definitive statement would reduce flexibility in applying the proposals made in this paper.
9. It is, however, possible to give some parameters to the type of intra group services targeted by reference to the general nature of the services to be included or excluded and the type of structure through which the services are allocated and charged.
10. Whilst certain elements of this paper could usefully be applied to the full spectrum of intra group services they are aimed more specifically at some types of service provision than at others.
11. The services on which the paper *is focused* are the type of services that commentators have variously described as "the glue that holds the corporate structure together to support its main functions" or "of an administrative nature, auxiliary to the business of the recipient" and again "commonly available or readily acquired". The core nature of the service is that whilst required it is of a routine nature and not generating high value to either the provider or recipient.
12. The paper does not focus on direct charge services, the facts and circumstances of which will, in general, be self evident. Nor does the paper address services that intrinsically add high value. What high value means is relative to the service, the provider and the recipient. It would, however, be exceptional if the approach of this paper would satisfy a reviewer's needs in considering services in the nature of innovative research and development, intellectual property, financial transactions or other services that are a significant commercial driver. Similarly, activity that inherently relies on the potential to attract a high level of reward associated with exposure to high risk will not be within the parameters envisaged. Specifically the paper does not address Cost Contribution Arrangements.
13. It is also important to note the distinction between straight forward charging and delivery mechanisms and more complex arrangements. It is not envisaged that a single centrally provided low value services charged out to several associates by means of a readily identifiable allocation key would give cause for concern. This paper therefore concentrates on multiple low value services that will often be provided through a single contract and generally involving a cost pool and allocation keys.

### **IV. Audits and centrally provided intra group services.**

14. It is entirely reasonable that a reviewer will want confidence that any provision of services is in alignment with OECD principles; all appropriate costs are included, inappropriate costs excluded and an arm's length price applied. The level of confidence required and how acquired can be achieved in various ways depending on the particular circumstances of the case and a Tax Administration's overall approach to transfer pricing audits.

15. In addressing those concerns this paper suggests alternative approaches that will achieve an appropriate level of confidence that the arm's length principle has been applied. Equally a balance is sought between available resources, compliance burden and potential level of adjustment.
16. Clearly a full audit of a particular case will satisfy the needs of any reviewer but the approach developed in this paper seeks to arrive at a more expedient way to achieve that same end in the vast majority of the type of cases that are commonly encountered.
17. At the other end of the spectrum to a full audit approach some tax administrations have embarked on MNE relationship building exercises. The desired outcome is to better understand each others perspectives and build trust. The mechanism to achieve that is by means of a non audit driven open and ongoing dialogue between tax administrations and MNEs. So for example in the context of centrally provided intra group services an administration will ask (outside of an audit scenario) for an explanation of how the MNE operates its system. The MNE will engage in an open dialogue with TA to ensure a full understanding of the framework supported as necessary with contemporaneous information. It is also recommended regular updates take place through regular meetings. The outcome may be that the tax administration will consider that particular facet of the MNEs business as compliant and therefore low risk. But if subsequently an audit is considered appropriate then the areas of concern can be better targeted. Additionally certain fundamental questions (e.g. has a service been provided) may not be tested, other than perhaps by affirmation, based on the level of trust and confidence that has been built up in the relationship between the tax administration and the MNE.
18. However, acknowledging that the approach outlined above is not yet widely developed across Europe and a full audit approach will not improve the current situation the following guideline framework is recommended where further examination of the provision of centrally provided intra group services is in point.

## **V. Working assumptions**

19. The starting point for this paper is the acceptance of certain working assumptions which may then subsequently be accepted or tested as the process continues:
  - ❖ MNEs and Tax administrations operate in good faith.
  - ❖ Services concerned are low risk, low value transfer pricing transactions.
  - ❖ A service provided meets the OECD arm's length standard.
  - ❖ An MNE will have its own governance system and audit procedures in place and any services provided will be subject to that governance process.
  - ❖ All costs are allocable but domestic law will not necessarily allow a full deduction of those costs.
  - ❖ Good quality information will be supplied on demand.

## **VI. Narrative**

20. A reviewer in the light of the facts and circumstances of a case, their level of experience and knowledge of the particular MNE concerned may take different approaches in requesting what

they consider sufficient corroborative information to confirm that a service complies with the arm's length principle. In making an informed decision access to sufficient, good quality information is crucial. This paper proposes that the provision of a narrative would largely meet that information requirement.

21. Given the routine nature and low value of the services, the narrative should give sufficient confidence to the reviewer that, from the perspective of the provider the service has been rendered and from the perspective of recipient, the service provides economic or commercial value and the recipient – if it were independent - would have paid for the activity or else performed the service itself. Therefore the question of whether a service has been provided should not be a contentious issue.
  
22. The exact content and extent of a narrative may vary but a comprehensive narrative is envisaged as a relatively modest document. It is particularly important to maintain a balance between the level of information requested, the low risk nature of the services addressed and the potential compliance burden. As appropriate all or some of the following non exhaustive topics will be covered:
  - As part of a sanity check exercise to put the provision of services in context some indicative ratios may be requested (e.g. costs incurred for intra group services compared to overall operating expenses or the level that intra group service provision turnover bears to total turnover). Any such ratios will need to be interpreted within the context of the associate's nature of trade.
  - Explaining a service provision within the overall context of the MNEs business thus to understand the rationale both for the provider and the recipient. For example economies of scale may make it more efficient for a subsidiary to have payroll services or HR services centrally provided. Again, it may make more economic sense to have "on demand" access to IT services.
  - A reconciliation of the MNEs overarching transfer pricing policy to the services actually centrally provided.
  - An account of the type of services provided and to whom.
  - Details of the benefit or expected benefit to the recipients. The benefit derived from certain services will be self evident (e.g. payroll). Other services, where the benefit is not so immediately apparent, may require further explanatory comment. For instance if worldwide promotional activity services are present how does that service benefit an individual subsidiary?
  - An explanation of the structure by which services are delivered. There may be one central service providing entity or alternatively different subsidiaries provided specific services intra group. Again a mix of two systems may be used and the interaction of those systems will need to be understood.
  - A description of the group standard as it relates to its audit approach and as applied to services. For example defining direct and indirect cost for inclusion in the cost pool; safeguards in place to ensure the consistent application of an allocation key for a particular service; ensuring services are not duplicated.
  - A description of how any cost pool is constructed
  - The arm's length justification of the rate of mark up applied or alternatively why no mark up is applied.
  - A record of how services are accounted for to include the invoicing system, settlement dates, payment methods and any budget versus actual adjustments
  - A description of how any mergers or acquisitions are incorporated into the service provision system.
  - An understanding of how new services are integrated into the system and how a service is terminated.

- How on demand services are handled.
- How the service provision system is maintained and updated.
- Available documentation

23. The above information may be made available and provided in a variety of ways. Clearly a dedicated written narrative could be provided. Alternatively, the information may be given verbally. It might also be the case that the examination of written contracts will provide an insight to the wider context and will provide most of the information in any narrative. Each of the approaches or some combination of them is valid. The important point is that the outcome is an understanding of how any service provision system works.
24. After obtaining a narrative the next stage is to consider what, if any, further detailed explanation is needed and how that should be provided

## **VII. Specific Areas**

25. The narrative will set the scene and also provide a level of detail. Some areas are more important than others in coming to a reasoned decision and further guidance is offered:

### **7.1 Has a Service been provided?**

26. It is key that the reviewer is satisfied that, from the perspective of the provider the service has been rendered and from the perspective of recipient, the service provides economic or commercial value to enhance its commercial position and the recipient would have paid for the activity or else performed the service itself.
27. It is not always possible to provide incontrovertible evidence that links a particular associate to the benefit derived from a particular service. For example a worldwide sales drive headed up by a senior director. It may be that some sale improvement or cost reductions can be attributed to the activity other benefits may be harder to attribute for example to maintain profile in the market. A reasonable interpretation should be made of available evidence supported by any MNE representations. The principle that all costs are allocable should be remembered and therefore if a service cost is not felt to be attributable to one particular associate it must be allocated to another.
28. As mentioned above the degree of certainty a reviewer requires in accepting the provision of a service meets the arm's length standard will vary from case to case. Given the routine nature, commonplace provision and low value of the services coupled with any supportive narrative explanation verification of the type of service addressed by the guidelines in this paper should not be a contentious issue

### **7.2 Cost pools:**

29. An area that commonly gives cause for concern is the quantitative and qualitative content of a cost pool.

30. Any reviewer will want a level of confidence that all appropriate costs are within the pool and inappropriate costs are excluded before addressing the questions of mark up and allocation. The level of confidence required will vary depending on the particular circumstances of the case.
31. This section of the guidelines outlines suggested approaches, with differing levels of detail, to verify a cost pool. The section then goes on to consider in more detail certain specific aspects involved in verifying a cost pool.
32. The approaches are focused on achieving a balance between an appropriate level of confidence and the necessary level of detail. Any one of the approaches described may be taken in isolation or in combination and of course other approaches may be taken that are equally valid in reaching agreement on the make up of a cost pool.
33. A reviewer may opt to take a high level assessment of a cost pool by assessing the integrity of the accounting and auditing systems. Such an approach demands a good understanding of the systems on which the MNE relies to verify the integrity of its cost pool. Explanations of the audit criteria, the standard in applying those criteria, and the rationale behind levels of mark ups and allocation keys applied will be needed. By understanding and accepting the inputs one can have confidence in the cost pool that those systems create without requiring any lower level of detail. This approach has clear links with the ongoing MNE dialogue envisaged above.
34. Another reviewer may, in achieving the confidence level they require, opt for some additional selective/random examination of costs. This approach is an extension of the first in that an overall comprehension of the procedures in creating the cost pool is still required but some further limited enquiry is deemed appropriate.
35. Again a reviewer may gauge it appropriate to have somewhat more detail than suggested in the above two approaches. In that case a more detailed description of how the cost pool is operated will be required. It would, however, be exceptional, within the context of this paper, to perform a complete audit of the cost pool. Nonetheless as well as an overall understanding a request may be made for more detail in some relevant areas.
36. Depending on which of the above approaches may align itself best to the facts and circumstance of the case all or some of the following cost pool information could be called for in as far as not already provided in any narrative:
  - The company/group audit standard that is applied to the pool: e.g. materiality limits; standard of proof.
  - An explanation of the cost accounting method used in attributing direct and indirect costs to the pool. A description of how costs are dealt with will be needed where multi service provision centres exist.
  - The basis on which costs identified as shareholder costs were specifically excluded from the pool-shareholder costs. It may be that a separate analysis of these costs will be submitted for the sake of completeness.
  - A description and analysis of the cost pool headings.(e.g. IT, accounting, HR)
  - The origin of any mark up applied and identification of costs allocated with out mark up.

- A description and analysis of costs allocated. Detail here will particularly be in point where worldwide service costs are attributed to individual associates.
- A reconciliation of total pool costs to total allocated costs.

### 7.3 Invoicing

37. Attention is also drawn to what can be described as legitimate expectations in carrying out a critical analysis of any cost pool.
38. Often invoices will not be available where the costs attributed are internally apportioned direct or indirect costs. In those circumstances an explanation of the logic and process applied to arrive at the attributed costs will be needed. In the absence of an absolute figure judgement will need to appraise whether or not a particular cost is appropriate to be included in the cost pool and that the quantum is a fair reflection of the cost incurred.
39. Where invoices do exist frequently they will reflect a mix of external third party costs as well as internal costs in an amalgamated final invoice. The final cost is correctly represented by one final invoice albeit that invoice is the result of earlier invoiced costs incurred by several entities contributing to the final service provided. For example associate A when providing routine IT support may subcontract elements of that support to associate B. Associate B may in turn subcontract to independent C. The invoice appearing in the cost pool of A will be that provided by associate B. In this type of scenario whilst it is a reasonable proposition that an invoice may be requested and its origin traced it would be unreasonable to expect a definitive break down of the constituent parts of any invoice through B to C and possibly beyond. This is not least because an invoice provided by one independent enterprise to another would generally not lead to (or would it necessarily be possible to provide) a breakdown of the origin and constituent parts of that invoice. This principle should guide tax auditors when auditing intra-group services invoices.

### 7.4 SHAREHOLDER COSTS

40. In national law, administrative procedures and case law there are not many definitions or information about activities that constitute a shareholder cost.
41. The OECD guidelines refer to certain activities that constitute shareholder activities. At annex II is a non exhaustive list that includes existing OECD elements and additional services that the JTPF reviewed and recognised as ones that are regularly classified as shareholder costs. This classification will always depend on the specific facts and circumstances.
42. There is though a fundamental benchmark test that can be applied when deciding if a cost is in fact a shareholder cost.
43. This extract from OECD guidelines 7.9 gives a clear statement on this issue *"In a narrow range of 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 if they were 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 justify a charge to the recipient companies".*

44. Judgment is required when an activity not only discharges a shareholder duty but also produces an additional benefit. A Board Member of a parent company may carry out duties related to the ownership interest of that parent in other group members. That activity would normally be classified as a shareholder cost. Once a shareholder cost is identified it is inappropriate to charge that cost out either directly or through a cost pool.
45. But in the execution of those duties initially for shareholder purposes it may be that the Board Member will discharge the duties in such a way that an additional service is supplied and a benefit received over and above that of the parent company's ownership interest.
46. In that case the question arises has an additional service in fact been provided? Additional considerations include: does the whole group benefit; or is the benefit attributable a certain subsidiary how are costs to be apportioned and the correct arm's length price applied? The answer lies in attribution of the costs partly to the parent and partly to the subsidiaries. That attribution will be informed by the type of industry, the type of company and the service provided leading to the conclusion that a case by case approach can be the only viable approach.

## **7.5 Allocation Keys**

47. Two particularly relevant OECD guidelines comments about allocation keys are:

*"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"(OECD 7.23)*

*"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."(OECD 7.24)*

48. The application of a self evident allocation key for a single service provision should not present the reviewer with any undue problems e.g. payroll service allocated by headcount.
49. The provision of more than one service under a single contract may require the deployment of several different allocation keys. Different rationales will be applied in deciding upon an allocation key depending on the specific circumstances. It would, however, be inconsistent to apply a different allocation key to different recipients of the same services.
50. The touchstone is that any allocation key can be justified and is consistently applied (and is reviewed on a regular basis). A balance is needed between the precision of the key and the burden that would be created if a complex key is insisted upon that only gives a marginal improvement over a key that is operationally more easily applied.
51. The pragmatic approach outlined above is that whatever allocation key is decided upon it must be capable of being justified and applied consistently.

52. Whilst the application of any particular allocation key will depend on the facts and circumstances of a particular case the following keys are in common usage:

IT: number of PC`s  
Business management software (e.g. SAP): Number of licences  
Human Resources: headcount  
Health and safety: headcount  
Management development: headcount  
Tax, Accounting, etc: turnover or size of balance sheet.  
Marketing services: turnover  
Vehicle fleet management: number of cars

53. It may be the case that historically an allocation key has been agreed that reflects arm's length conditions and the consequent price. It is not intend these guidelines require an automatic review of what may already be in place.

*The JTPF could consider providing in annex more examples of commonly accepted allocation keys.*

## **7.6 "On call services". (OECD 7.16-7.17)**

54. One other area that might require some further thought is the treatment of what are known variously as "on call contracts" "call off contracts" or "stand by contracts". In third party situations it is commonplace that arrangements will be made to make use of a service as and when required. The implication of that is threefold. Should a charge be made merely for potential access to a service, what, if any, additional charge should be made if the service is actually called on and what are the ramifications if the service is not used in a particular year?

55. Firstly an infra structure has to be in place to offer and meet the commitments in an on call arrangement. In some cases it may be reasonable a charge is made to cover the infra structure costs and a margin. Equally, in other cases it may be reasonable that a user pays a charge for potential access to that infra structure but no additional fee when the agreed on call service provision is activated. That can be contrasted to the situation where a specific service is requested over and above the standard on call service. In that instance a separate additional fee is appropriate and a direct charge made.

56. A member of the group may not require an on call service in any one year but that fact does not necessarily mean they will not buy into the service the next year. Nor does it automatically mean they will be entitled to a reduction in the annual fee because in one year it was not used. The fee will depend more on the perceived risk by the provider and the user's appetite for risk on a year on year basis.

## **7.7 An arm's length charge.**

57. As has often been said transfer pricing is an art not an exact science and that proposition allows a degree of judgement about the evidential level that is required to evaluate a transfer price and to ascertain that a particular method is reasonable estimation of an arm's length price. (OECD 1.12-1.13 & 1.68-1.69).

### **7.7.1 Methodology:**

58. It may be the case that historically a methodology other than those described in the OECD guidelines has been agreed that reflects arm's length conditions and the consequent price (OECD1.68). It is not intended these guidelines should displace any such method.
59. If a suitable CUP can readily be found for a particular service provision that will be the most expedient route to resolution. For example, the service under review has been supplied to independent third parties or a similar service has been received from a third party.
60. With intra group services, however, it is more often the case that appropriate CUPS cannot be located. Whilst generally any of the other OECD methods may be in point in assessing that a service provision is at arm's length this paper envisages that the cost plus method would be the most appropriate (OECD 2.32 et seq).

### **7.7.2 Margin:**

61. As the services we are concerned with here will typically only attract modest margins establishing an appropriate cost base is relatively more important.
62. Once the cost base of a particular service is determined it is then appropriate to consider what mark up, if any, on those costs should be applied. OECD guidelines recognise that it is not always the case that a mark up should be applied (OECD 7.33 and 7.36). Indeed the guidelines go further in suggesting that although as a matter of principle a margin may be appropriate a cost benefit analysis may be such that a tax administration may not peruse the matter beyond allocating costs. (OECD 7.37).
63. The character of the services that these guidelines address would suggest the in depth analysis of the five comparability factors, including a functional analysis, together with a qualifying benchmarking exercise including a quantitative and qualitative screening of the potential comparables to establish a suitable margin may be a too resource intensive approach. It may be envisaged, therefore, that a reviewer will consider a less prominent search for information to evaluate the margin put forward. However, the less prominent search should of course pass the arm's length test. To a greater or lesser degree the following non exhaustive list may be taken into account by a reviewer in arriving at a final position:
  - The underlying rationale and evidence the service provider relied on in setting the margin.
  - The experience and knowledge of the reviewer in what they have typically encountered as agreed margins for the type of services these guidelines envisage.
  - The wider body of evidence that is available from statistical research.
  - Published practice /experience e.g. by some tax administrations<sup>1</sup>.
64. It is sometimes the case that the same mark up is applied to a range of services provided under a single contract. That may well be an acceptable proposition if it can be judged that the particular services would attract a similar margin and any variance is anticipated to be minimal.

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<sup>1</sup> See UK HMRC Guidelines and French comments in doc. JTPF/014/REV2/BACK/2007

## VIII. Documentation

65. The OECD guidelines (Para.5.4), refers to prudent management principles that would govern the process of considering if transfer pricing is appropriate and the extent of any required level of supporting transfer pricing documentation.

66. This theme is echoed at 2.3.1 of the JTPF on EUTPD report wherein it is recorded:

*"The prudent business management principle, based on economic principles, implies that the sort of evidence that would be appropriate in relation to a transaction of large value might be very different from the sort of evidence that would be appropriate in relation to a transaction where the overall value is significantly smaller".*

67. In applying this principle to the services concentrated on by these guidelines documentation, written agreements may not be available. However, the absence of written documentation should not be the deciding factor in rejecting service provision or benefit but rather should be an element in any overall fact pattern on which a decision is based. (OECD 7.18).

68. It is logical, taking into account the cumulative nature of this approach – addressing routine services, the acceptance of certain working assumptions, provision of a narrative and cost pool explanations -, that the purpose of requesting supporting documentation will already have been met.

69. However it may be useful to reiterate what a useful and a proportionate documentation pack may contain:

- ✓ A narrative -as detailed above.
- ✓ Written agreements.
- ✓ Cost pool –as detailed above.
- ✓ Justification of OECD methodology applied.
- ✓ Verification of arm's length price applied.
- ✓ Invoicing system and invoices – see narrative.

70. It should be noted that information from one source e.g. a written agreement may cover information required from another source e.g. a narrative. The extensive use of computerised systems also provides the opportunity to see summary level detail which may then prevent the need for more extensive primary documentation.

## IX Post review Considerations.

71. It is recommended that for future reference and at the end of this process the narrative becomes a file note in conjunction with some arrangement for regular updates.

72. Continuing the theme of efficient use of resource it would be counter productive to ignore what was established in an earlier review. An exception reporting procedure may be agreed wherein the status quo applies, with perhaps any appropriate pricing realignment being assumed, unless a tax administration is notified to the contrary.

73. A tax administration should consider if an exchange of information would be appropriate and an MNE may consider it worth dedicating a section of any EUTPD policy they may have to this particular area.
74. A review may result in an adjustment. If the adjustment is the consequence of rejecting a particular cost reasons for that decision should be made clear so that the cost may be reallocated and maintain the principle all costs are allocable.
75. An adjustment may then form the basis of a mutual agreement procedure under a DTA and/or the Arbitration Convention. In that case it would be appropriate to draw the attention of the Competent Authorities to the fact that the guidelines have been applied. In the absence of any new evidence acceptance of the adjustment without further enquiry could be a justifiable outcome.

## ANNEXES

### **Annex I: MNE List of commonly provided services**

#### **a. Information technology services, for example:**

- a.1. building, development and management of the information system;
- a.2. study, development, installation and periodic/extraordinary maintenance of software;
- a.3. study, development, installation and periodic/extraordinary maintenance of hardware system;
- a.4. supply and transmission of data;
- and a.5. backup services.

#### **b. Human resource services, for example:**

- b.1. legislative, contractual, administrative, social security and fiscal activities connected to the ordinary and extraordinary management of personnel;
- b.2. selection and hiring of personnel;
- b.3. assistance in defining career paths;
- b.4. assistance in defining compensations and benefit schemes (including stock option plans);
- b.5. definition of personnel evaluation process;
- b.6. training of personnel;
- b.7. supply of staff for limited period;
- b.8. coordination of the sharing of personnel on a temporary or permanent basis; and
- b.9. management of redundancies.

#### **c. Marketing services, for example:**

- c.1. study, development and coordination of the marketing activities;
- c.2. study, development and coordination of the sale promotions;
- c.3. study, development and coordination of the advertising campaigns;
- c.4. market research;
- c.5. development and management of Internet website;
- c.6. publication of magazines handed out to clients of the subsidiary (even if concerning the whole group);

#### **e. Legal services, for example:**

- e.1. assistance drafting and reviewing of contracts and agreements;
- e.2. ongoing legal consultation;
- e.3. drafting and commissioning legal and tax opinions;
- e.4. assistance in the fulfilment of legislative obligations;
- e.5. assistance in the judicial litigation;
- e.6. centralized management of relationship with insurance companies and brokers;
- e.7. tax advice;
- e.8. transfer pricing studies; and
- e.9. protection of intangible property.

**f. Accounting and administration services, for example:**

- f.1. assistance in the drawing up of the accounting procedures;
- f.2. assistance in the preparation of the budget and operating plans;

- f.3. keeping of the mandatory books and accounts;
- f.4. assistance in the preparation of periodical financial statements, annual and extraordinary balance sheets or statements of account (different from the consolidate financial statement);
- f.5. assistance in compliance with fiscal obligations, such as filing tax returns, computing
- f.6. and paying taxes, etc.;
- f.7. data processing;
- f.8. audit of the account of the subsidiary<sup>51</sup>; and management of the invoicing process.

**g. Technical services, for example:**

- g.1. assistance regarding plants, machineries, equipments, processes, etc.;
- g.2. planning and executing ordinary and extraordinary maintenance activities on premises and plants;
- g.3. planning and executing ordinary and extraordinary restructuring activities on premises and plants;
- g.4. transfer of technical know-how;
- g.5. providing guidelines for the products' innovation;
- g.6. production planning to minimize excess capacity and meet demand efficiently;
- g.7. assistance in planning and implementing capital expenditure;
- g.8. efficiency monitoring; and
- g.9. engineering services.

**h. Quality control services, for example:**

- h.1. providing quality policies and standards of the production and provisions of services;
- h.2. assistance in obtaining quality certifications (e.g. ISO 9000); and
- h.3. development and implementation of client satisfaction

programmes;

**Other services:**

- i.1. strategy and business development services in case there is a connection with an existing or to be established subsidiary;
- i.2. corporate security;
- i.3. research and development;
- i.4. real estate and facility management;
- i.5. logistic services;
- i.6. inventory management;

- i.7. advice on transport and distribution strategy;
- i.8. warehousing services;
- i.9. purchasing services and sourcing raw materials;
- i.10 cost reduction management;
- i.11. packaging services; and

## Annex II: Non exhaustive and non prescriptive list of shareholder costs

### Revised table on Shareholder cost

From the discussion held in the JTPF meeting of March 2009 it can be concluded that generally the costs listed in this table can be considered as incurred for the parent company benefit. However the JTPF concluded that the analysis will always request to raise the following questions :is it benefitting the whole group, does it benefit the parent company only, should it be allocated out to the subsidiaries, or should it be considered to benefit to a certain subsidiary?. Therefore only a case by case approach can be taken.

	Description of costs to be considered as shareholder costs.	Comments
<b>1</b>	<i>a. Costs of activities relating to the juridical structure of the parent company itself such as:<sup>2</sup></i>	
2	a.1. <i>costs for the meeting of shareholders of the parent company, including advertising costs</i>	Shareholder costs
3	a.2. <i>costs for the issuing of shares of the parent company</i>	Shareholder costs
4	a.4. cost of the board of directors of the parent company that is associated with the statutory duties of a director as a member of the board of directors.	<p>The 1984 OECD Report admits that board members may perform activities that are to the benefit of the subsidiaries so that only part of the cost relating to the board of directors may be regarded as shareholders' costs. This may be the case when one or more director(s) have qualifications and skills that go beyond the mere holding function and include know-how and skills which are pertinent to the business of the subsidiaries.</p> <p><u>JTPF conclusions:</u></p> <p>A case by case approach is always appropriate because a director or board member could perform activities (partly or</p>

<sup>2</sup> 1995 Guidelines, para 7.10, lett. a.

		totally) for the specific benefit of a (some) subsidiary (ies) and thus could need to be allocated.
5	a.5. costs for the compliance of the parent with the tax law (tax returns, bookkeeping, etc.)	Shareholder costs
6	b. <i>Costs relating to reporting requirements of the parent company including the consolidation of reports:</i> <sup>3</sup>	Shareholder costs
7	b.1. costs for the financial reports of the parent;	Shareholder costs
8	b.2. costs for the consolidated financial statements of the group;	<p><u>JTPF conclusions:</u></p> <p>Targeted costs: all costs that are necessary for consolidation at what ever level.</p> <p>It might be for the parent company or the subsidiary and the question is who benefits.</p> <p>There might be a parallel benefit for the subsidiaries but consolidation is the activity of the group as such.</p> <p>Some members explained that in practise local costs for the subsidiaries are not passed on to the parent because it would be too costly to identify and to isolate those costs</p>
9	b.3. costs for the application and compliance with cross-border tax consolidation. Tax legislations of some Member States provide for cross-border tax consolidation that requires the parent company to collect information from the subsidiaries and comply with formal requirements such as making tax adjustments of the accounts of the foreign	<p>Shareholder costs</p> <p>(although under rare circumstances the subsidiary company may receive a benefit from the consolidation, such as the elimination of withholding taxes that would otherwise apply in the country of the parent company on payments made by the parent company)</p>

<sup>3</sup> 1995 Guidelines, para. 7.10, lett. b.

	<p>subsidiaries to compute the consolidated income for company tax purposes. These costs are incurred <u>to the exclusive benefit of the parent company</u> ;</p>	
10	b.4. costs for the audit of the parent.	Shareholder costs
11	<i>c. Costs of raising funds for the acquisition of its [the parent company's] participations<sup>4</sup></i>	Shareholder costs
12	<i>d. Costs of managerial and control (monitoring) activities related to the management and protection of the investments in participations unless an independent party would have been willing to buy for or to perform for itself:<sup>5</sup></i>	Generally to be considered as Shareholder costs
13	d.1. Costs of the parent company's audit of the accounts of the subsidiary if it is carried out <u>exclusively</u> in the interest of the parent;	Shareholder costs  However, if the audit is also in the interest of the subsidiary the activity is partly an intra-group service: this is the case when the audit is compulsory under the law of the state of incorporation of the subsidiary, when the audit report is published with the financial statement of the subsidiary or published on the website of the subsidiary or, in general, is used by the subsidiary (e.g. provided to a bank when the subsidiary applies for a loan or used by the management of the subsidiary itself).
14	d.2. Costs for the drafting and auditing of the financial statements of the subsidiary in accordance with the accounting	Shareholder costs), unless such activity has a positive effect for the activity of the subsidiary on its own and not simply because it is part of the group. This may be the case where the

<sup>4</sup> 1995 Guidelines, para. 7.10, lett. c. Where the funds are raised by the parent company on behalf of another group member that uses them to acquire a new company, the parent company provides a service to the group member.

<sup>5</sup> 1995 Guidelines, para. 7.10, lett. d.

	principles of the States of the parent (e.g. US GAAP).	financial statement drafted by applying the accounting principles of the parent company is used by the parent company itself to render specific services to the subsidiary, as market analysis, budgeting, etc
15	d.3. <del>Costs of information technology incurred exclusively for the monitoring activity of the parent company over the subsidiary; these costs are shareholders' costs only if such costs are not related to the provision of services from the parent company to the subsidiary; e.g. software that allows the parent company to monitor the sales of the subsidiary is in principle a shareholder cost. If the monitoring is for providing services (as marketing or production planning or stock and inventory management), the cost is an intragroup service.</del>	<u>JTPF conclusions:</u>  Those costs are rarely supported for the benefit of company. Therefore a case by case approach is necessary.
16	d.4. Cost for the general review of the affiliates' performance if not connected to the provisions of consulting services to the subsidiaries	<u>JTPF conclusion:</u>  Those costs can be performed exclusively for the parent and are in that case only shareholder costs however in many cases this can help to improve the subsidiary's management as well and will request an allocation key.
17	e. <i>Costs to reorganize the group, to acquire new members or to terminate a division<sup>6</sup> unless they produce economic benefit for the subsidiary that is not incidental. For</i>	<u>JTPF conclusion</u>

<sup>6</sup> 1995 Guidelines, para. 7.12. The same paragraph points out that such activities, "could constitute intra group services to the particular group member involved, for example those members who will make the acquisition or terminate one of their divisions".

	<p><del>example, such activities could constitute intragroup services to the particular group member involved; e.g. those members who will make the acquisition or terminate one of their divisions.</del></p>	<p><u>JTPF conclusions:</u></p> <p>The OECD is actually discussing Business restructuring and future OECD conclusions could be helpful.</p> <p>A case by case approach was suggested because the restructured entity could also have a direct benefit .</p> <p>OECD comments: The OECD notes that the wording in TPG 7.12 is “costs <u>for analysing the question whether</u> to reorganise the group, to acquire new members, or to terminate a division” and that this is a significantly narrower scope. The OECD view is not to treat restructuring costs such as write off of assets, termination of employment contracts, etc. as shareholder costs or as a service, but rather to examine on a case-by-case basis which entity should bear these costs, depending in particular of the rights and other assets of the parties. There is some discussion in the OECD discussion draft on the transfer pricing aspects of business restructurings about which entity within an MNE group should bear the restructuring costs and the OECD tentatively concludes that depending on the facts and circumstances of the case, it could be the restructured entity, another group entity that benefits from a relocation of activity, the parent company, several group entities, etc</p>
18	<p>f. <b>Costs for initial listing on a stock exchange of the parent and costs for the activities related to stock market listing of the parent, in the years after the initial listing (e.g. preparation of documents required by the stock market supervisory body).</b></p>	<p>Shareholder costs</p>
19	<p>g. <b>Investor relations’ costs of the parent company:</b></p>	<p>Shareholder costs</p>

	<p><b>g.1. costs for press conferences and other communications with (i) shareholders of the parent company, (ii) financial analysts, (iii) funds and (iv) other stakeholders of the parent company;</b></p>	
<b>20</b>	<p><b>h. Study and implementation of the capitalization structure of the subsidiaries. <del>⇒ The capitalization structure of the subsidiary has a direct impact on its capacity to find the financial resources for carrying on its business activity. It is therefore recommended to consider such activity a value added service, attributable to the subsidiary;</del></b></p>	Case by case approach
<b>21</b>	<p><b>i. Costs for the increase of the share capital of the subsidiary <del>⇒ The issuance of new shares aims at collecting new financial resources for the subsidiary itself. For this reason it is recommended to consider such expenses as a service cost attributable to the subsidiary.</del></b></p>	Case by case approach
<b>22</b>	<p><b>Other activity you identify as shareholder activity:</b></p> <p><b>Activities relating to the adoption and enforcement with statutory rules and rules of conduct with regard to “corporate governance” by the parent company itself or the group as a whole</b></p>	Shareholder costs