EUROPEAN COMMISSION
DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
Analyses and tax policies
Analysis and coordination of tax policies

Brussels, November 2008
Taxud/E1/

DOC: JTPF/025/2008/EN

EU JOINT TRANSFER PRICING FORUM

SECRETARIAT DRAFT PAPER OUTLINING A PROPOSAL TO DEAL WITH INTRAGROUP SERVICES DRAWING ON CONTRIBUTIONS FOLLOWING JUNE 2008 JTPF MEETING

Meeting of 27-28th November 2008

Centre de Conférences Albert Borschette
Rue Froissart 36 - 1040 Brussels

Contact:
Jean-Marc Van Leeuw, Telephone (32-2) 295.89.36 E-mail: Jean-Marc.Van-Leeuw@ec.europa.eu
Peter Finnigan Telephone (32-2) 29 Peter.finnigan@ec.europa.eu

Introduction

1. Latest developments:

Following the meeting of the 5th June 2008 the Member States convened a sub group meeting to develop their thinking in this area. The working paper that formed the agenda of that meeting is doc. JTPF 021/2008/EN and the agreed summary record is contained in Doc JTPF 022/BACK/2008/EN.

The business Members, following sub-group meeting in Malta, have produced a document on cost allocation (Doc. JTPF 023/BACK/2008/EN).

Finally, Professor Maisto has submitted a report on shareholder costs, based on the views of tax practitioners from 22 MS (Doc. JTPF 024/BACK/2008).

2. Aim of the document:

The purpose of this paper is to draw together the work done on this subject since the June 2008 meeting, agree the next steps and if possible reach some tentative conclusions/recommendations.

3. Secretariat's approach:

Considering the latest contributions and discussions the Secretariat is of the opinion that a six stage approach is maybe the most consistent way to examine the intra-group services topic.

1. Firstly, a headline statement of principle to encapsulate the definition and treatment of intra group central services.
2. Secondly, some guidance on the area of "Shareholder Activity".
3. Thirdly, exploring the potential of a lighter touch audit/risk assessment approach to low value add services (also called standard or basic services).
4. Fourthly, guidance on how to deal with centralised service contracts (costs allocation).
5. Fifthly, documentation and evidence required.
6. Sixth interaction with MAP /AC

The subject matter and relative complexity of each of the issues almost suggest the order in which they could be dealt with.

The JTPF may agree during its November meeting some conclusions on the overarching OECD general principles and on shareholder costs. The third and fourth stages (after the presentations made by the vice Chairs during the November meeting) could attract further comments for the March meeting.

Building on that the Forum could then decide to develop and agree an approach to deal with basic singleton service provision then move on to centralised service contracts.

Documentation requirements are a generic theme that could probably be better addressed on the basis of the JTPF conclusions on the first stages.

Stage One: OECD general principles

This chapter was prepared on the basis of the working paper prepared for the tax administration sub group meeting in Malta (doc. JTPF 021/2008/EN) and the related agreed summary record (Doc JTPF 022/BACK/2008/EN).

Conclusions on : (i) when a service is provided and (ii) allocation and deductibility of costs.

(i) when a service is provided

Doc. JTPF 021/2008/EN mentions:

> *Q1. Does the SUB-GROUP wish to approach the issue of definition by*
> *1. agreeing what they consider to be the criteria in deciding when any service, standard or non standard, has been provided at an arm's length charge*
> *2. refining that definition to focus on the criteria in recognising when a standard service has been provided at an arm's length charge*?
> *If the SUB-GROUP can agree the above approach can the following be agreed (essential a reaffirmation of the overarching OECD guidelines in recognising an arm's length service) in terms of the overarching principles to be applied when generally considering if a service has been provided?*

- [*In accordance with OECD guidelines a service is recognised to be at arm's length when a service* ***has in fact been provided and the charge for that service is in accordance with the arm's length principle****.*
- *An arm's length service has been* ***provided*** *when the recipient of the service anticipates deriving economic or commercial value from the provision of the service and the service is one that the recipient would be willing to pay a third party for or perform the service itself.*
- *once it is determined that an arm's length service has been rendered* ***the arm's length charge*** *for that service should be that which would have been made and accepted between independent enterprises in comparable circumstances.]*

The overarching OECD principles were examined and reconfirmed by the subgroup and no further guidance was considered necessary.

If BUSINESS MEMBERS also agree this statement the following conclusion may be capable of agreement

Potential JTPF conclusion:

The Forum gives its full support to the OECD guidance provided in 7.6 in determining when intra- group services have been rendered and in particular the clear reference to the application of the arm's length principle.

(ii) allocation and deductibility of costs.

The latest BM paper proposes the following principles in relation to MNE costs incurred:

A. An MNE is a commercial enterprise with the objective to realise a profit. As such a MNE will incur costs to carry on its business; including rendering intragroup central services[1]. It is not in the interest of the MNE to incur any costs that do not directly or indirectly provide a benefit to the MNE. It is a key principle that all costs incurred by a MNE are incurred for business or commercial purposes.

B. Following the first principle, these costs are incurred for the benefit of one, many or possibly all of the entities within the MNE and it is ultimately only a question of determining which specific entity should bear which costs and how these costs should be attributed

C. If costs are attributed within an MNE (i.e. attributed to the entity where the benefit of the costs resides), it should be accepted that these costs are for the account of that particular entity. The fact that the costs are attributable to an entity should in no way affect the qualification of the local legislation on the general deductibility of the costs.

Member States (if Malta minutes supported by all Member States) concur with those principles:

A preliminary discussion took place and the basic principle that business costs must be allocable somewhere in an MNE group, subject to domestic rules that may disallow some of those allocated costs, was confirmed. So within the context of the EU when considering relevant business costs those costs should be :

(1) ***allocated*** amongst the group entities (within the EU MS) and

[1] Services that are often performed at various levels of the organization, but also routinely and commonly performed at the head office level for the benefit of the entities within the MNE."

(2) ***deducted*** in accordance with domestic law of the EU MS concerned.

Potential JTPF conclusion:

Within the context of intra group services the Forum considers that all commercial costs incurred by an MNE must be allocable somewhere in the MNE. Equally the Forum recognises that costs so allocated are deducted based on domestic rules.(The JTPF may also wish to provide a simple example?)

Stage 2 Shareholder Activity.

This chapter was mainly prepared on the basis of Prof. Maisto report (doc. JTPF 024/BACK/2008/EN.

1) The original discussion paper JTPF001/2008/EN introduced the subject of shareholder costs as follows:

1. *Costs incurred in the pursuit of **shareholder activities** (OECD definition in annex) are not considered by the OECD to represent a service (7.9 and 7.10). The following examples are described:*

    - *Costs relating to the juridical structure of the parent company*
    - *Costs relating to the reporting requirements of the parent company*
    - *Costs of raising funds for the acquisition of it's participants*

    - *Furthermore, costs of managerial and control activities related to the management and protection of the investment in participations may also constitute shareholder expenses.*

Discussion point:

5. Does the Forum consider it worthwhile updating and/or developing a longer list of examples of shareholder expenses (which therefore would not constitute a service)?

2) Business members contribution in Doc. JTPF 023/BACK/2008/EN is as follows :

i.) Identification and attribution of Shareholder Costs

Identification

To help define whether an activity is a pure shareholder activity, the following questions should be considered:

> *"Is the performed activity designed to benefit the operating unit(s) and would an independent company have been willing to pay for it or perform it themselves?"*

- *If yes: the costs will be allocated to benefiting operating company; or*

- *If **no**, this would likely constitute a shareholder activity.*

Shareholder costs are, according to the OECD Guidelines, those costs incurred because of a Holding Company's ownership interest in one or more other group members (i.e. in its capacity as shareholder). Shareholder Costs include but are not limited to costs of managerial and control activities related to the management and the protection of the investment, compliance costs, portfolio management and new Business decisions, investment decisions, monitoring investments, reporting requirements of the parent company and other Holding Company Activities.

Further details on the different types of shareholder costs will be provided in Appendix A to this proposal[appendix a to be provided at a later stage] and includes a further refinement by way of discussing examples.

3) Member States latest position (if sub group summary record is supported by all Member States)

The subgroup was of the opinion that this topic [shareholder costs] was not about standard services and should therefore be addressed separately. One opinion expressed is that this is a pure OECD topic. However, it was clear from the discussion that shareholder's services were unlikely to be considered standard services but the subject did raise issues. According to the subgroup, the business community should be invited to comment on what are their daily problems vis-à-vis the issue of shareholder's activities; in particular tax administration challenges made in the grey area of shareholder/stewardship activity and when a stewardship activity fell within standard or non standard activity.

4) Views from independent tax practitioners on shareholder costs

Prof. Maisto has provided a report (doc. JTPF 024/2008/EN) based on 22 EU tax practitioners' contributions. This report describes the development of the recommendation issued on the subject matter by the OECD as from 1979 through the 1995 Guidelines; provides a survey on the interpretation of the concept of shareholders costs in EU Member States; highlights the discrepancies that may be found in the legislature or practice of such Member States; illustrates the guidance given by the US tax authorities on the features of shareholder costs; provides a list of examples coming from the reconciliation of the OECD reports and Guidelines; and formulates several conclusions/ recommendations.

The country survey provides the following overview:

1.DEFINITION OF SHAREHOLDER COSTS IN NATIONAL LEGISLATIONS

Most EU MS have no specific provisions in their respective internal legislations dealing expressly with the deduction of shareholder costs (see Annex 1 in the report). Specific rules are set forth only by the Greek and Romanian income tax codes and by the Slovenian transfer pricing regulation. Nevertheless, even in such countries the provisions are quite generic.

2. TAX AUTHORITIES' GUIDANCE FOR IDENTIFICATION OF SHAREHOLDER COSTS

Tax authorities have issued guidelines on the deduction of shareholder costs in Denmark, Germany, Italy, The Netherlands, Sweden and the United Kingdom (see Annex 2 of the report).

Guidance provided by the Danish, Swedish and UK tax authorities are very limited. The guidelines merely state that shareholder costs cannot be charged to the subsidiaries and provide limited examples of shareholder costs drawn from the 1995 OECD.

Statements of practice issued by the German, Dutch and Italian tax authorities list some criteria for the identification of shareholder costs and add some examples to those provided by the 1995 Guidelines.

Austria, Greece, Lithuania and Spain have issued no guidance on the tax treatment of shareholder costs but some rulings have specifically dealt with the subject matter or related issues. It's worthwhile to note that certain cases are not addressed by the OECD Guidelines.

In other countries, such as Estonia, France, Ireland, Luxembourg, Poland, Portugal, Slovak Republic and Slovenia no guidance on this topic has been issued by the tax authorities.

3.CASE LAW

Specific case law dealing with the deductibility of shareholder costs could be found in Austria, France, Greece, Italy, the Netherlands, Spain and Sweden

(see Annex 3 in the report). However the number of decisions issued in such States is quite limited and most of them express very generic principles.

Potential JTPF conclusions:

Defining shareholder activity:

The Forum aligns itself with the OECD transfer pricing guidelines at 7.9 wherein "shareholder activity" is recognised as an activity performed solely because of ownership interest. The Forum recognises the link between this commentary and the guidance at 7.6 in that the only benefit arising from the activity falls to the shareholder company (usually the parent company) and as such the costs should fall only to the company that holds that ownership interest.

The Forum, however, thinks that it would be of benefit to both Member States and Business if a more extended list of examples than that provided by current OECD guidelines could be agreed upon.

The Forum may agree the following is a non exhaustive list of activities that constitute shareholder activity (italics reflect existing references in OECD)

a. *Costs of activities relating to the juridical structure of the parent company itself such as*:[2]

   a.1. *costs for the meeting of shareholders of the parent company*, including advertising costs

   a.2. *costs for the issuing of shares of the parent company*

   a.3. *costs of the supervisory board of the parent company*

   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. The 1984 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. It is current practice that

[2] 1995 Guidelines, para 7.10, lett. a.

board members of a parent company have performed duties in the managing of the business of subsidiaries companies for several years and thus gained experience that also continues to be used by the subsidiaries when the manager has moved to the headquarters and attained the position of a member of the board of the parent company. This could be also the case of the groups with a divisional organization: the directors of the parent company are often responsible of the entire division and therefore their activities have a direct benefit also for the subsidiaries.

a.5. costs for the compliance of the parent with the tax law (tax returns, bookkeeping, etc.)

b. *Costs relating to reporting requirements of the parent company including the consolidation of reports*:[3]

b.1. costs for the financial reports of the parent;

b.2. costs for the consolidated financial statements of the group;

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 subsidiaries to compute the consolidated income for company tax purposes. These costs are incurred to the exclusive benefit of the parent company (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);

b.4. costs for the audit of the parent.

c. *Costs of raising funds for the acquisition of its [the parent company's] participations*[4]

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:[5]

d.1. Costs of the parent company's audit of the accounts of the subsidiary if it is carried out exclusively in the interest of the parent; by contrast, if the

[3] 1995 Guidelines, para. 7.10, lett. b.
[4] 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.
[5] 1995 Guidelines, para. 7.10, lett. d.

audit is also in the interest of the subsidiary the activity is an intragroup 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).

d.2. Costs for the drafting and auditing of the financial statements of the subsidiary in accordance with the accounting principles of the States of the parent (e.g. US GAAP), 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 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.

d.3. 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.

d.4. Cost for the general review of the affiliates' performance if not connected to the provisions of consulting services to the subsidiaries

e. *Costs to reorganize the group, to acquire new members or to terminate a division*[6] unless they produce economic benefit for the subsidiary that is not incidental. For 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.

[6] 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".

The Forum may also agree to consider the costs listed hereafter are also shareholder costs:

List of additional shareholders' costs potentially identifiable by applying the principles set forth by the OECD Guidelines:

The following list is drafted taking into account the indication provided by the tax authorities and of the Courts of some Member States – described in the country survey – and the experience of the authors of the Report.

f. 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).
g. Investor relations' costs of the parent company:
   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;

The Forum may also consider valuable to seek clarification on the following services.

List of services for which clarification could be sought by the JTPF

On the basis of the principles set forth by the 1995 Guidelines, in the view of the authors of the report the following expenses should be regarded as service costs and not as shareholders' costs:

h. Study and implementation of the capitalization structure of the subsidiaries. => 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;
i. Costs for the increase of the share capital of the subsidiary => 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.

j. Activities and costs for the initial listing on stock exchange of the subsidiary. => As noted above, expenses for the issuance of new shares should not be considered shareholder costs because they are aimed at collecting new financial resources. For this reason it is recommended to consider such expenses as a service cost attributable to the subsidiary.

k. Costs for the activity related to stock market quotation of the subsidiary in the years after the initial listing. => Considering that the listing is an opportunity for the subsidiary to collect when necessary – new financial resources, these expenses should not be considered shareholder costs.

l. e. Costs for the credit rating of the parent company or of the group as a whole. => Considering that the credit rating of the parent company or of the group as a whole have a direct effect on the cost of financing of the subsidiary, these expenses should not be considered shareholder costs, unless only the parent borrows externally.

Stage 3: low value add intra group central services

This chapter was prepared on the basis of the working paper prepared for tax administration sub group meeting in Malta (doc. JTPF 021/2008/EN) and the related agreed summary record (Doc JTPF 022/BACK/2008/EN).

During the November meeting the tax administration vice chair will make a presentation based on the working paper prepared for tax administration sub group meeting in Malta (doc. JTPF 021/2008/EN) and the agreed summary record (Doc JTPF 022/BACK/2008/EN).

Member States proposals to deal with certain types of intra group central services might be summarised as follows:

A) Member States may wish to lay down criteria which will distinguish the types of services that would enable to facilitate the risk assessment and to simplify the audit stage. The overarching aim could be to identify, either in a risk assessment analysis or as part of an audit, low value add intra group central services. Once the low risk nature of a service is established by reference to an agreed set of criteria it will be inherent in the approach that: (i) if part of a risk assessment process the service will not ordinarily be subject to audit or (ii) if already part of an audit process that audit will be determined by reference to the agreed set of criteria.

To date the emerging criteria identified to define low value add intra group central services appear to be:

- To determine whether or not a service has been provided the overarching principle outlined in Stage One should be applied.

- The nature of a service needs to be considered from the sometimes differing perspectives of provider, recipient, MNE. Such considerations may include:

  - The service is not in fact the core business of the MNE.
  - The service provided will be very much ancillary to the delivery of the core business of the recipient.

- The service does not constitute a major cost to the recipient in comparison to its overall operating costs.
- The service although constituting the bulk of the turnover of the provider is nonetheless low value add.

- The service is not part of a bundle of standard services that cumulatively become a significant part of the recipients core business and therefore not low value add.
- The service is not that of contract manufacturing in recognition that an additional layer of complexity could arise in defining the type of manufacturing to which the approach should be targeted.
- The service will not be linked to the creation, further development or modification of intangibles. A distinction is drawn between services which support or influence IP that generates, directly or indirectly, profits from third parties and those that do not. (example patent registration as opposed to legal defence of patent infringement).
- The service is not a financial transaction in the nature of the provision of finance or financial instruments. A distinction is drawn between that type of service and a low value add function such as accounts administration for group members.

Does the JTPF recommend that in defining a low add value service the above requirements should be met?

B) Once an intra group central service has been identified as low value adding and not presenting a high risk how can the tax treatment of that service differ from a high risk scenario: the following consequences may be capable of agreement:

- The service provider may supply the service in question both within the group and out with the group the independent third parties. In that case the CUP approach will provide a speedy resolution- see later re documentation and evidential level.
- In the absence of a CUP the basic **(*decide term*)???** and low value add nature of the service both strongly support the application of a cost plus methodology (OECD Guidelines 2.32)

- The agreement to the application of the cost plus methodology, in arriving at an arm's length price, will require a specific evidential standard of documentation- see documentation regarding cost base and appropriate mark up.
- Member States may wish to provide a range of marks up typical for such services. Later it could be envisaged that a basic service matching the other agreed criteria and with a mark up within this range would enable the tax administrations the service provided replicates an arm's length transaction.
- The service in question will continue to be regarded as low risk the responsibility for advising changes to the nature of the service provided falling to the service provider or recipient ***(some sort of exception report system) ???***

Does the JTPF endorse the described approach?

C) Member States are not yet convinced of the worth of non exhaustive indicative list of services that may be regarded as inherently likely to be basic in nature and lend themselves to the above approach. Member States seek Business Members views on the compilation of such a list and what assistance they can give in providing clear examples of basic services.

Could/should the JTPF endorse a list of services that are inherently likely to be low value add services based on the list of 'commonly provided services' included in Prof. Maisto report?

D) The measure of successful outcome of such an approach would be fewer audits (and consequently less risk of double taxation) of low value add basic services because of increased confidence of tax administrations that such services comply with the above criteria and the arm's length price has been returned. Business Members will benefit from the mirror image of that in that they will have more certainty that such services will not be subject to audit and evidential documentation is in line with risk. Both will benefit from reduced resource requirement.

Stage Four Costs allocation

This chapter was prepared on the basis of Doc JTPF 023/BACK/2008/EN.

During the November meeting the Business vice chair will make a presentation based Doc JTPF 023/BACK/2008/EN.

Business Members concerns that costs relating to intra group services become "trapped" and so fail to be allocated in conflict with the principle agreed at stage one.

The following background narrative is provided by BUSINESS MEMBERS in their contribution on cost allocations (doc. JTPF 023/BACK/2008/EN).

- An MNE is defined as a group of companies, which are tax resident in several different countries. Mainly, the objective of an MNE is to be economically active and to achieve profits for its shareholders.

- In order to achieve profits, both external transactions (transactions with suppliers, customers, financial institutes, etc.) as well as internal transactions (between the group members) are required.

- An MNE structure will typically involve centralised services functions, which provide a benefit to a number of group companies and in rendering these services an MNE incurs costs. Within an MNE these costs are to be attributed to the beneficiaries of the services rendered. An MNE makes a best effort to match the attribution of the costs incurred to the benefits received by the entities of an MNE.

  If a particular country does not agree to the proposed attribution, a potential double taxation issue arises. This is the main concern raised by the business members.

2.2. Issues raised by business members - Potential double taxation

- As indicated, in attributing costs related to services rendered, an MNE generally makes a best effort to attribute the costs to the beneficiary of the associated service rendered.
- To the extent the tax authority in a country disagrees with the benefit of a particular service rendered and therefore with the associated attribution of the costs, these costs will not be included in the annual tax return of that particular

entity. Therefore these costs will not be treated as business costs for the purpose of calculating the taxable income.

- The MNE is left with no alternative than to re-attribute the costs (i.e. deem another beneficiary) either to another entity within the MNE or to bear the costs itself.
- It is unlikely that the country that gets the costs re-attributed will accept the attribution of these costs since it was the MNE itself that at a first instance indicated a different entity as the benefiting entity for the service rendered. The same applies if the costs remain at the service providing level.
- As a consequence it is likely that the costs get "trapped" between the country that has rejected the initial attribution and the country to which the costs are re-attributed.
- This leads to non-attribution of costs that should be treated as appropriate business costs. This will lead to double taxation.
- In practice the attribution of costs will include multiple entities in a large variety of countries. The issue described above will be compounded by the number countries involved, thus becoming a major issue.

Conclusion:

In accordance with the conclusions at stage one "trapped costs" should be eradicated.

To ensure comprehensive allocation of costs only (i.e rate of mark up not addressed but that will eventually be addressed attached as it is to the cost base) the following process is proposed by BUSINESS MEMBERS:

a) Identification of all costs related to intragroup central services rendered (total cost base);
b) Identification and attribution of the total cost base to different pools of costs:
    i. Identification and attribution of "Shareholder Costs";
    ii. Identification and attribution of "Costs directly attributable";
    iii. Identification and attribution of cost to be allocated to a group of entities using an allocation key.

These steps are discussed further below.

a) Identification of all costs related to intragroup central services rendered

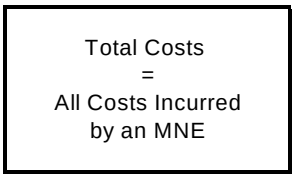
This step involves the identification of all costs incurred in relation to intragroup central services rendered.

An MNE does not incur costs unless these costs will provide benefits. The benefit will be either at the shareholder level (benefit due to the participation) or at the local entity/operating company level (commercial benefit).

This proposal includes cost related to activities that are typically performed at a central (head) office such as (but not limited to):

- Compliance activities
- Finance activities (treasury, tax, finance& controlling)
- Human Resources
- Information technology activities
- Legal services
- Strategy and Business Development Services
- Contracting and Procurement
- Investor relations
- Insurance department
- Marketing/ Public Relations/Corporate Communications
- Engineering
- Technical Services
- Corporate affairs
- Internal Audit
- Accounting
- IP management
- Global Property Services
- Quality Services
- Corporate Security
- Company Secretary Services

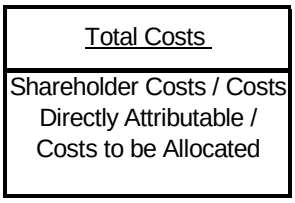
As a result of this step the total amount of costs to be attributed is defined.



b) Identification and attribution to different pools of costs

Once all cost related to the intragroup central services rendered are identified the costs will be further analysed and divided into three pools of costs:

i. Shareholder Costs,
ii. Costs directly attributable, and
iii. Cost to be allocated to a group of entities using an allocation key.



We outline below the identification and attribution of these separate pools of costs.

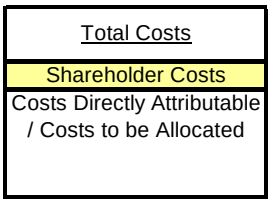
i.) Identification and attribution of Shareholder Costs

Identification

To help define whether an activity is a pure shareholder activity, the following questions should be considered:

> *"Is the performed activity potentially of benefit to the operating unit(s) and would an independent company have been willing to pay for it or perform it themselves?"*

- If yes: the costs will be attributed to the benefiting operating company/(ies); or
- If **no**, this would likely constitute a shareholder activity.



Shareholder costs are, according to the OECD Guidelines, those costs incurred solely because of a Holding Company's ownership interest in one or more other group members (i.e. in its capacity as shareholder). Shareholder Costs include but are not limited to costs of managerial and control activities related to the management and the protection of the investment, compliance costs, portfolio management and new Business decisions, investment decisions, monitoring investments, reporting requirements of the parent company and other Holding Company Activities.

Further details on the different types of shareholder costs will be provided in Appendix A to this proposal[7] and includes a further refinement by way of discussing examples.

Cost of a mixed nature

[7] Appendix A will be provided at a later stage

In certain instances, the costs incurred relating to a service rendered can be of a mixed nature, i.e. the costs are partly attributable to the shareholder and partly attributable to other entities of the MNE.

In applying this procedure the shareholder costs related to that activity would be identified under step 1. The remainder of the costs related to that activity would be identified under the two following steps (Identification of Costs Directly Attributable and Identification of Costs to be allocated). Subsequently, the costs will be allocated as identified and outlined in this proposal.

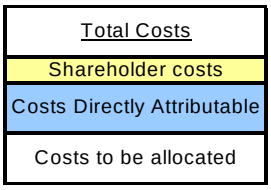
Attribution:

Shareholder costs are to be attributed to the benefiting Shareholder.

ii.) Identification and attribution of costs that are directly attributable

Identification

Costs that can directly be attributed (also referred to as costs for specific services) are costs incurred in relation to services undertaken for the specific benefit of an entity.



Examples:

- An example is the request by an entity of the MNE for a specific piece of software on the local server. The price of the software is directly attributable to the service recipient (the requesting entity).
- A further example is the attribution of costs related to IP Registrations. An IP registration is handled centrally at the Head Office however the associated costs can be directly attributed to the entity for which the IP is registered.

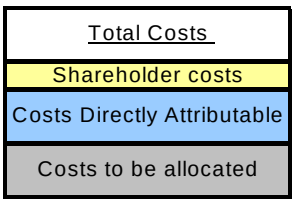
Attribution

- Costs that fall in this cost-pool are to be attributed directly to the beneficiary of the related services.

iii.) Identification and attribution of costs to be allocated to a group of entities

Identification

Costs to be allocated to a group of entities (also referred to as costs for general services) by default are all costs that do not fall in either of the previous cost categories, i.e. costs that are not identified as shareholder costs or costs that are not identified as costs that can be directly attributed to a specific beneficiary (i.e. there is a group of entities that benefit from the service).



In order to allocate these costs the first step is to identify the group of entities that benefit from these services. Once the beneficiaries are identified, the indirect costs will be allocated between these entities using an allocation key. As such the allocation key forms the basis for calculating and determining the volume of cost allocation per beneficiary. The allocation key selected represents the best estimate of the benefits received by the entities for the services rendered and associated costs.

In the allocation of costs related to services rendered a distinction could be made between standard and non-standard services rendered.

From the three identification and attribution steps, as described under b, all costs incurred related to the intragroup central services rendered are attributed between the entities of the MNE:

- Either to the shareholder as "Shareholder Costs";
- To Specific Beneficiaries as "Cost directly attributable"; or
- Costs allocated between beneficiaries based on an allocation key.

In addressing stage four issue does the Forum discern the need to distinguish between basic services and other type of services in either direct attributable costs or costs to be allocated to a group of entities?

The description of this process does not address the issue of how the bona fides of the quantum of costs allocated are ascertained (or in other words how the figures presented are audited) or , if appropriate, what mark up is required to ascertain an arm`s length price.

Potential conclusion: The Forum endorses the process described above as the blueprint by which all costs should be allocated within an MNE

Stage five: Documentation and evidence.

This stage will be better completed at a later stage on the basis of the JTPF conclusions on the first chapters. However we have already included a first state of play in order to facilitate future discussions.

The Discussion paper JTPF/001/2008/EN had the following commentary on documentation and evidence:

Chapter 4 Documentation and evidence (SECTION 4 PARA53-59)

§53 In general, also in the case of intra group services reasonable efforts should be made by the taxpayer at the time when the services are performed in order to justify, whether the transfer pricing is appropriate for tax purposes in accordance with the arm's length principles. This should go together with the corresponding right of the tax administrations to obtain the related documentation prepared by or referred to by the taxpayer in this process as an evidence for the verification of compliance with the arm's length principles.

§54 However, the need for documentation should take into account the requirements for similar cases and be balanced by the compliance costs and administrative burdens, especially, when documents are solely prepared for compliance with tax provisions. Against this background, the Forum is invited to have a closer look at specific issues and potential considerations to questions outlined in earlier chapters.

§55 Once categorised as low risk services it seems sensible for both taxpayers and tax administrations to be able to seek appropriate comfort and evidence that such a service is charged on an arm's length basis for tax purposes.

§56 Evidence would need to establish that a service had in fact been carried out and that the price of the service was recorded at arm's length for tax purposes. But the evidence necessary to do this should be set and construed in the light of the low risk nature of the service. Auditing small amounts is extremely unlikely to result in a large amount of extra tax payable. With this in mind, a useful bundle of evidence could be:

- The service contract
- The transfer pricing method used for setting the price and the invoicing method (direct or indirect charge including the allocation formula and the reasons for its use)
- Cost incurred by the service provider(s) (salaries, travel, third party fees etc)
- Specific examples of the expected or actual service rendered
- Details of the operations performed or time devoted to the provision of the service.

§57 The last bullet point is worthy of expansion. Having to produce new evidence only for the purposes of transfer pricing rules is very resource consuming for taxpayers. It is less costly to use what information already exists.

§58 Pre-existing information (which by definition has not been produced for tax purposes) is also less compromised by any suspicion that it may have been assembled to influence the outcome of the exercise. For these reasons, the time sheets for internal management purposes of employees who help to provide the service under review might prove useful as details of the operations performed.

§59 Within the context of requirements for documentation and evidence for transfer pricing purposes it appears to be appropriate to mention that the US apply a specific approach in this regard.

The above paper also contained contribution by France, supported by Latvia, is as follows:

1. **Documentation:** the relationship between the volume of charges invoiced by the associated enterprise, expressed as a percentage of turnover or of the operating margin, and the volume of charges invoiced in comparable enterprises could have implications for the level of supporting documentation required to prove that the charges are for services that have in fact been supplied
2. **MAPS:** Many cases submitted under mutual agreement procedures result from the rejection of charges for intra-group supplies of services on the grounds of inadequate supporting documentation, following checks by a tax authority. It might therefore be worthwhile for the Forum to draw up **a European standard for supporting documentation**
3. We propose that the deduction of charges for intra-group supplies of services be made conditional upon presentation of the **following supporting documents** proving the nature and scale of the services rendered:

    - the service contract;[8]
    - details of the operations performed or hours devoted to the service supplied (time sheet);
    - method by which the price was set;
    - costs incurred by the service provider (salaries, travel costs, fees, other costs);
    - method of allocating the charges in the case of indirect allocation of costs (distribution formula and reasons for its use);
    - specific examples of operations undertaken under the service rendered.

Presentation of these supporting documents would protect the group from the risk of the charges being questioned by an authority, provided that it had complied with the arm's length principle.
As suggested above, authorities' requirements for supporting documents could then be adjusted according to whether the amount of the charges is comparable to average charges for the services invoiced by comparable companies.
If the volume of invoiced charges, assessed as a percentage of turnover or of earnings before interest and tax, were in line with standard practice in the sector, the

[8] This requirement diverges formally from the formulation in paragraph 7.18 of the OECD Guidelines. However, it seems to be in line with the arm's length principle and legitimate in the context of work aiming to guarantee to enterprises that they can deduct invoiced expenditure.

enterprise would be required to provide the documentation listed above to show that the services had in fact been supplied.
If the volume of charges were more than 25% higher than standard charges in the sector, deduction of the full amount would only be allowed if the enterprise provided additional evidence justifying and explaining this in detail.

The summary record of the JTPF meeting on 5th June 2008 details the following:

2) Documentation and Evidence

A second important passage of discussion was on which kind of documentation could be requested for these standard services in establishing the provision of a service at an arm's length price. The discussions focused on paragraphs 56 to 58.

One tax administration supported that a requirement to provide the service contract could be replaced by the provision of any document that provided evidence of an agreement or commitment to provide a service. Additionally, his experience showed the worth of timesheets as an evidential base was limited. A better source may be an analysis based on cost accounting evidence. These views were supported by Business members.

A consensus emerged to examine in the working document to what extent the EUTPD already sufficiently dealt with the specific documentation requirements for intra group central services.

The Secretariat would reflect these contributions in the forum's working document

In the Member States sub group meeting in Malta the working document proposed the following discussion point:

Documentation and Evidence/ standard service

§29. Once an agreed approach to standard services has been developed and subsequently applied by the taxpayer the need to call for documentation or other evidence would be greatly reduced. A result of classifying a service as standard should mean that the tax administration does not need to audit this particular aspect of the taxpayer's affairs: the tax administration could still audit whether the services charged qualify for the safe harbour rule and whether the safe harbour rule was correctly applied (e.g. whether the cost base and allocation keys are correct). On the other hand, for service charges that qualify for the safe harbour rule, there would be no need to discuss whether the transfer pricing method is the right method (to the extent the method applied is consistent with the one in the safe harbour rule) and there would be no need to make a search for comparables (to the extent the profit element applied is consistent with the one in the safe harbour rule).Of course, a tax administration would not give up any of its usual rights under such a system. But a significant amount of compliance effort will have been saved for both parties.

§30. The taxpayer does though have a responsibility to be able to demonstrate, when services are provided, that arm's length principles have been complied with, either in accordance with any safe harbour rule, or under wider transfer pricing rules.

§31. However, the need for documentation should take into account any risk assessment approach and be balanced by the compliance costs and administrative burdens, especially, when documents are solely prepared for compliance with tax provisions.

§32. Evidence would need to establish that a service had in fact been carried out and that the price of the service was recorded at arm's length for tax purposes. But the evidence necessary to do this should be set and construed in the light of the low risk and routine nature of the service.

§33.The SUB-GROUP will be aware that by resolution of the Council, on the 27 June 2006, adopted a code of conduct on transfer pricing documentation. That resolution may provide some guidance of the standard of evidence required and supporting documentation needed to support the proposition that a standard service has been supplied.

§34. The code does not specifically mention services but does set down certain principles on which SUB-GROUP may wish to draw. Inter alia those principles are:

- A risk assessment approach to documentation i.e. Breadth and depth of documentation commensurate with complexity of transaction and potential tax at risk.
- It is optional to keep documentation in format described
- The extent of documentation required differs between MNE and SMEs
- Compliance cost and administrative burden to be guarded against
- No likelihood of penalty if good faith record kept

§35. Documentation needs to address the following fundamental topics.

- References to any relevant EUTPD filings.
- A narrative to give some overall context of the nature of the service provided from the perspective of the provider and the benefit of the service from the perspective of the recipient.
- Description of all intra group service transactions with the associated enterprise concerned to include details of the service provider, the anticipated benefit and price. This description to be based on a functional analysis at an appropriate level of detail.
- Copy of all formal and informal agreements relating to the service provided. If no documentation a description of what each of the parties understands is to be provided at what cost.
- Details of any evidence that is relied on in setting an arm's length charge including: OECD methodology applied; the composition of any cost base; if allocation keys are used a description of on what they are based and why they are considered appropriate; evidence or documentation that is relied on in setting any mark up on costs; evidence of the billing arrangements

- alternatively if service provided but no cost charge out or costs charged out with out mark up the reasons for that
- if a safe harbour rule applied a reconciliation of the service to the requirements of that rule
- Description of and reasons for any amendment to prior tax treatment of intra group services.

Q11 Does the SUB-GROUP wish to recommend a prescriptive list of documentation required or alternatively give some guidance and non exhaustive examples?

The summary record of the sub group meeting reads:

On documentation and evidence, further guidance needs to be developed. Two important questions arise:

(1) Does the development of a standard service approach in fact demand more or less documentation and if more documentation is required is that a transitory issue?

(2) What is the standard of proof required

The participants were asked whether the elements cited in § 35 of the working document represent an adequate set of documentation for standard services. Business could be invited to suggest on the list. It was felt the Paragraph 35 was a starting point. Cross reference to EUTPD could also be useful.

One participant stated that documenting the comparability analysis could be simplified, but the documentation related to whether the service has been rendered should not be simplified, rather further developed as a stipulation if one wants to benefit from the simplified documentation requirements as regards the comparability analysis. The idea developed that there could be two areas of documentation requirement. The first one relates to the rendering of the service and to the costs incurred by the supplier of services, i.e. to the determination of the cost base. The second one refers to the margin. The extent of the documentation may also vary for each of these two areas. The documentation to evidence the provision of a service that complies to the arm's length principle may be more extensive than that required to support that make up of a cost base and mark up margin on the assumption that’s the provision of a standard service has been provided.

In discussing mark ups it was explored whether or not it would be useful to have some sort of range within which a "safe harbour" approach would exist or should a service specific mark up apply. In case of a range, should the taxpayer document where they should be pin pointed on a particular range. The subgroup noted that several ranges could be considered, e.g. national range, European range, service sector range. To inform the thinking on this it was explored if it would be useful to get a feel for the sort of range that generally applies to standard services within each Member State. It was suggested that the countries present would try to collect information concerning possible ranges for standard services.

The EU code of conduct on transfer pricing documentation (EUTPD) is a basic set of information for the assessment of an MNE`s transfer prices. The adoption of the code is optional for MNEs. The code itself is quite a short document that makes only general references to services.

However the underpinning JTPF report provides the following possibly helpful commentary

2.2. Purpose of good and effective documentation

2.2.1. Business point of view
For taxpayers, the intended benefit of good and effective documentation is less time and expense spent on preparing documentation and a substantially reduced risk of penalties. Businesses are, therefore, looking for pragmatic, user friendly solutions, preferably not exceeding the documents available from the ongoing own company reporting; not least, because staff applying documentation rules are not normally tax experts but operational staff.
2.2.2. Tax administration's point of view
For tax administrations the purpose of good and effective documentation is to ensure that the tax administration has sufficient information to identify the relevant inter-company transactions and allow the tax administration to determine whether a taxpayer's transfer pricing is in accordance with the arm's length principle. The main benefit of good documentation is less complicated and time-consuming transfer pricing examinations.
2.2.3. Benefit of risk assessment
A taxpayer's own risk assessment could help companies focus on necessary improvements in their transfer pricing system and make the tax audit process more efficient. Such a process should mirror that followed by a diligent and prudent business manager acting according to economic principles, who will be concerned to follow the arm's length principle. The existing procedures gather data for the tax administration to evaluate. By focusing directly on risk areas, the whole process could become much more efficient.
For tax administrations, which do not normally have the resources to check everything, making a risk assessment may be helpful in deciding which company to audit or which transactions of a business to examine. One of the factors that a tax administration may take into account in selecting a case for transfer pricing examination is its own knowledge about the nature of the documentation produced by the enterprise.
An effective risk assessment may be beneficial for both tax administrations and taxpayers.
However, to achieve this, tax administrations must be prepared to give due consideration to the facts and analysis in the taxpayer's documentation and taxpayers must be prepared to produce documentation in good faith.
2.3. Content of good and effective documentation

As far as both enterprises and tax administrations are concerned, it is necessary to establish whether the pricing of any particular transaction satisfies the arm's length principle. There has to be evidence of this.

Chapter 5 of the OECD Guidelines contains a general discussion of documentation. The critical role of comparability (looking at comparable transactions that have taken place between independent enterprises) in applying the arm's length principle from Article 9 of the OECD Model Tax Convention is stated in Chapter I of the Guidelines and developed in Chapters II and III with respect to each of the traditional and profit methods.

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. It is not possible to prescribe detailed rules on this point. Given the nature of controlled transactions, it may be necessary for the taxpayer in applying the prudent business management principle to prepare or refer to written materials that would not otherwise be prepared or referred to in the absence of tax considerations. When requesting submission of these types of documents, the tax administration should take great care to balance its need for the documents against the cost and administrative burden to the taxpayer of creating or obtaining them. (cf. paragraph 5.6 of the OECD Guidelines).

In order to establish whether transfer pricing is at arm's length, many Member States, including Member States where the burden of proof is on the tax administration, oblige enterprises to identify comparable uncontrolled transactions. Internal comparables where they exist should be preferred to external comparables when applying traditional methods and the TNMM (see paragraphs 2.15, 2.33 and 3.26 of the Guidelines). However, it is not always the case that the taxpayer has internal comparables and because of the difficulties in locating adequate external uncontrolled transactions for which the comparability analysis can be satisfied, in practice taxpayers as well as some tax administrations frequently rely on publicly available data, e.g. net profit data from commercial databases (although the use of such commercial database is neither prescribed by the OECD Guidelines, nor by EU countries domestic legislations). Some special questions concerning the use of database searches for comparables are addressed in more detail in Chapter 5 below.

However, a coherent and transparent approach in identifying comparable uncontrolled transactions is important in ensuring, for example, that there is no "cherry picking" to suit either the taxpayer or the tax administration. Moreover, the issue of transparency with respect to identifying such comparable transactions is equally important in MAPs between competent authorities.

2.3.2. Documentation

Taxpayers are obliged to determine transfer prices for tax purposes according to the arm's length principle and are expected to prepare and keep documentation concerning how prices and conditions for the controlled transactions are set. The documentation must - on request - be presented to the tax administration and must be of a nature that enables the tax administration to assess whether the prices and conditions are those which would have existed had the transactions been concluded between independent parties.

A key issue for transfer pricing is, therefore, the question of what kind of documentation an enterprise needs to prepare as evidence to demonstrate it has applied the arm's length principle.

The OECD Guidelines say that the need for documentation should be balanced by the costs and administrative burdens and that documentation requirements should not impose on taxpayers costs and burdens disproportionate to the circumstances. In

other words, the amount and type of documentation required should be in proportion to the circumstances of each case and the amounts at issue. For instance, especially for small and medium sized enterprises, the documentation requirements potentially impose an extra burden; this may be increased in the start up phase of their international expansion. Documentation requirements should keep this in mind.

The OECD Guidelines go on to say that it is not possible to define in any generalised way the precise extent and nature of the evidence or documentation that it would be reasonable for the tax administration to require or for the enterprise to produce for the purpose of an enquiry.

It could be argued that Member States should avoid developing rules that are very prescriptive, specifying long lists of material to be produced by all companies affected by transfer pricing regardless of individual circumstances. This prevents flexibility that could otherwise take account of the specific facts and circumstances of a case. For businesses, the growing array of prescriptive transfer pricing rules may result in an onerous compliance burden which is felt to be particularly frustrating within the Internal Market but reflects the different systems and understanding of direct taxation in the Member States.

A flexible approach taken by tax administrations also allows the taxpayer to avoid the preparation and collection of data that may not be necessary in the situation of the specific taxpayer. This leaves some uncertainty but allows a company the flexibility to make reasonable decisions on what is relevant under the facts and circumstances that prevail in their particular business. On the other hand, tax administrations have to assess whether the decisions taken by the taxpayer reflect the arm's length standard. A prescriptive approach might appear to offer greater clarity and certainty for both taxpayers and tax administrations but at a significant cost to companies or those with relatively straightforward and transparent transfer pricing issues.

Each of the documentation approaches as presented in Chapter 3 below has its own merits as regards flexibility and pragmatism on one hand and certainty and reduced compliance costs on the other hand. It is obvious that there is some tension between these two opposing main objectives and some Member States prefer to be more flexible whereas others tend to be more prescriptive.

Chapter 5 of the OECD Guidelines discuss (in a way that is intended to be illustrative; that is to say it is neither compulsory nor exhaustive) what documentation might be expected. The information relevant to an individual transfer pricing enquiry depends on the facts and circumstances of the case. Chapter 5 of the OECD Guidelines outlines the information that could be relevant, depending on the individual circumstances.

From the above the following conclusion may be reached:

Extent of documentation should be commensurate with a prudent assessment of the risk the particular service transaction presents.

There is a distinction between the level of documentation required for a basic service and a non basic service.

In either case evidence will be two stepped. One has a service been provided and two is the price arm's length.

A sub division of those steps in addressing BUSINESS MEMBERS costs allocation issues may be how have cost to be allocated been certified as appropriate and if indirect charging is appropriate how is the allocation key constructed

Penalty avoidance

By endorsing the EUTPD MS have already taken the following commitment:

Member States should not impose a documentation-related penalty where taxpayers comply in good faith, in a reasonable manner and within a reasonable time with standardized and consistent documentation as described in the Annex or with a Member State's domestic documentation requirements and apply their documentation properly to determine their arm's length transfer prices.

Stage 6: MAP/AC

This chapter will be completed at a later stage on the basis of the JTPF conclusions on the first chapters