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EU JOINT TRANSFER PRICING FORUM

SUMMARY RECORD OF THE TAX ADMINISTRATIONS SUBGROUP MEETING ON 22 AND 23 SEPTEMBER 2008 IN MALTA.

Meeting of 27-28th November 2008

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Summary record of the tax administrations subgroup meeting on 22 and 23 September 2008 in Malta

Chair: Stefaan De Baets

Participating countries: Austria, Belgium, Czech Republic, Denmark, France, Germany, Italy, Malta, Netherlands, Spain, UK.

EU Secretariat: Peter Finnigan, Jean-Marc Van Leeuw

Considering the fact that the MS tax administration had not yet the opportunity of an in depth discussion of the intra groups services topic, the Secretariat and the Vice-chair "Administration" drafted a specific working document on intra-group central services in order to stimulate the debate. This document was sent to the MS tax administrations for comments and to the business representatives for information in July. The delegate for Sweden sent in written comments on the working document which were taken on board during the discussions.

The document was discussed in the order in which it was drafted and focusing on the questions in the document.

The sub group noted that its deliberations, conclusions or recommendations cannot bind the full forum.

Discussion on the Working document

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

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

Example: a cost of 100 is allocated between MS A and MS B, each for 50 % (at arm's length, i.e. based upon an arm's length functional analysis). However, the domestic law of MS A provides for a limited deduction of the cost under its domestic law of 75 %; whereas the domestic law of MS B allows for full deduction.

Total cost : 100	
Allocated cost : 50	Allocated cost : 50
Limitation under domestic law MS A: 75 %	Limitation under domestic law MS B : 0 %
Deductible : 37,5	Deductible : 50
Total deductible for tax purposes : 87,5	

The subgroup continued with a discussion on the questions in the working document.

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?

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

Q2. Based on the above principles is the SUB-GROUP prepared to recommend that in defining a standard service or routine service the following requirements should be met?

Before examining the different bullet points stated under this question, the subgroup agreed that a flexible approach to guidance would be preferred to a prescriptive one. The bullet points therefore should be seen as guidance and not as strict rules to be applied. The subgroup in expressing its opinion on defining standard services were seeking a win - win situation : improved risk assessment and related audit process for the tax administrations and greater certainty for the business involved and reduced resources for both parties.

Certain participants stated that for "standard" services, it may be possible to find comparable data and if that is the case, then a CUP should be used. It was suggested that an additional bullet point could address the existence of independent comparables in the context of an agreed approach to standard services.

A participant drew attention to the fact that under OECD terminology "basic" or "routine" functions are defined as functions for which independent benchmarks exist.

It was mentioned that a distinction should be made between:

(1) definition requirements of a standard service

(2) application of the arm's length principle to that standard service

Requirements to be met :

- *The inherent nature of a routine service is such that it would not ordinarily attract the attention of tax administration auditors or demand much attention in a risk audit conducted by the tax department of an MNE.*

The subgroup was of the opinion that the issue mentioned under the bullet point is not a requirement but rather a conclusion.

- *The service provided does not generate a significant amount of <u>turnover</u> for the <u>provider</u> nor does it attract a significant cost base compared to the costs of the business <u>as a whole</u>*.

Different views were expressed. There was general agreement that when appraising a particular service it could be set within the context of the MNE as a whole as well as at the

level of the provider and recipient. For example a service provided may not be part of the core business of the group but significant in the context of the business of the provider.

It was suggested that if the bullet point regarding the recipient were merged with this one it would better convey the notion that the provision of a service had to be viewed from different perspectives (provider, recipient, MNE as a whole) in arriving at an accurate assessment of that service.

One participant mentioned the practical problem of finding relevant data at the level of the MNE as a whole.

Although the bullet point refers to a potential valid indicator – turnover - it would be too limiting to consider that to be the only one.

- *The service is not being rewarded on an entrepreneurial basis – i.e. high risk high reward*.

The subgroup was of the opinion that it should be better to rephrase this bullet by making reference to low value added service.

- *The service does not constitute a major cost to the recipient in comparison to its overall administrative operating costs.*

The subgroup agreed to delete the word “administrative” because of its limitative effect in this context.

- *When there is an opportunity for a service to create, further develop or modify an intangible it should always be classified as a non routine service.*

The complex issues around the treatment of intangibles mentioned in this bullet point quickly surfaced in this part of the debate. Views were expressed that even low value services could contribute - at least indirectly - to the creation or modification of a valuable intangible. A distinction was drawn between services which supported or influenced IP that generated profits from third parties and services which supported or influenced IP creation that did not have that impact. However it was felt that any IP issues that arose should be considered in the wider context of the current work of the JTPF.

Another participant was of the view that specific domestic law in another area of tax should always overrule any principle that may be agreed on services. This is particularly true for business restructuring and intangibles.

On drafting another participant stated that the word “always” should be replaced by “in principle”.

- *The service is not part of a bundle of standard services that cumulatively become a significant part of the core business and therefore not be considered any more as at low risk.*

The subgroup saw a clear link with bullet point # 2. Reference should be made to low value added service instead of low risk.

- *The service is not one linked to the core business of the company. (The IRS Regs define that as a service that" would not contribute significantly to key competitive advantages, core capabilities or fundamental risks of success or failure of the*

business". ATO guidelines refer to "non core services which are not integral to the profit earning activities of the multinational group" as do New Zealand guidelines.)

The discussion focused on the scope of the core business : should it be limited to the core business of the provider, or extended to the core business of the MNE ?

Q3. Drawing on an OECD guidelines analysis provided at the annex in the annex of DOC: JTPF/001/2008/EN and written contributions can the SUB-GROUP endorse a list of services that are inherently likely to be standard services?

At this stage of developing an approach to standard services, the subgroup was not yet convinced that producing a list was the most useful way forward but a general agreement was reached to exclude R&D from any "standard" list. Additionally, the subgroup also concluded that contract manufacturing gives rise to issues of definition and “value added” would not be considered a "standard" service in a lot of cases and it would only seek to complicate matters if they were to be included in any definition or list of indicators. Moreover any list complied should only be indicative of the type of services at which the guidance was targeted.

To assist further consideration it would be useful if the business community could provide a list of service activities that they usually consider as "standard" and in which areas in particular there definition of standard was challenged by Member States.

Q4. Finally an important drafting question is agreement in describing a service as "standard". In the future which word do you consider as appropriate to better express the concept: routine service, standard service, basic service, other?

The subgroup did not agree on a final wording. One participant suggested using “qualifying” services. Another suggestion was to use “basic” or “routine” services. However, see comment on OECD terminology under question 2.

It was felt more clarity on the worth of lists and terminology would emerge after further discussions on the issues raised by the above bullet points.

Q5. To clarify the issue of Shareholder activity is the SUB-GROUP prepared to provide commentary to highlight the link between shareholder activity and benefit provided as follows?
" Several shareholder activities are self evident and recognised as inappropriate in charging costs out to associated enterprises. For example activities related to the juridical structure of the parent company itself, such as meeting of shareholders of the parent issuing shares in the parent company and costs of the supervisory board; costs relating to reporting requirements of the parent company including the consolidation of reports, costs of raising funds for the acquisition of its participations. (Would the SUB-GROUP like to invite Business to expand on this list?)
A fundamental test to be applied in considering whether or not an activity may fall within shareholder activity, involving an associated enterprise, is whether or not the activity provides a benefit to that associated enterprise."

The subgroup was of the opinion that this topic is 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.

Q6 Does the sub group wish to address and elucidate when it would be appropriate to charge out costs only or costs and a margin or is it content to rely on existing OECD guidance at 7.29 -7.37.

Some participants indicated that this is a pure OECD topic. The subgroup was of the opinion that the OECD guidelines provide sufficient guidance. The subgroup thinks that this guidance, at this point in time and in view of the time frame available to the JTPF, does not need to be expanded and reference to CUPs will give guidance as to whether or not a mark up is appropriate

Q7 Does the SUB-GROUP wish to record they consider that, wherever possible, a CUP methodology should be used to establish the arm's length charge for a standard service? Further more MNEs should apply a direct charge approach and only in exceptional circumstances apply an indirect charging mechanism.

According to a participant, CUPs are generally available for standard services. Only when these are not available, recourse had to be had to direct charge methods and then indirect charge methods. Other participants, however, stressed the limited and difficult use of a CUP, even for standard services. A reference was made to the minutes of the June 2008 meeting where the latter point of view was confirmed.

The subgroup confirmed the hierarchy of the methods : (1) CUP (wherever possible), (2) Direct charge method and (3) Indirect charge method. However, some participants stressed how burdensome the obligatory use of a direct charge method could be. The burden upon business in applying a direct charge method is an element that also should be taken into consideration.

Q8 Does the SUB-GROUP wish to provide a non exhaustive list of direct and indirect costs that would generally be reflected in make up of a comprehensive cost base or does it prefer to give more general guidance?

Some administrations expressed favour for general guidance through a non exhaustive list of examples.

One participant suggested that the cost base discussion should be linked to the documentation discussion.

Q9. Is the development of some sort of safe harbour rule something that the SUB-GROUP wishes to progress? Would the sub-group suggest avoiding the use of the words "safe harbour"? What words do you consider as appropriate to better express the concept developed in the previous paragraphs?

The subgroup held a tour de table to reflect the subgroups different views.

A range of views were given on the use of safe harbours to include:

- Opposition to the use of safe harbours and abandonment of arm's length principle;

- Further explanation from OECD on their current attitude to safe and the arm's length principle;

- In effect safe harbours were already in place in some Member States;

- Safe harbours encouraged simplification and this was core to the work of JTPF;

- Domestic law issues could arise;

- An acceptance that safe harbours might have a place in discrete areas such as standard intra group services;

- Several interrelated issues such as documentation, audit consequences and comparability issues including mark up and methodology.

- Safe harbours disadvantage Member States not granting the safety of the harbour

After this tour de table Chair noticed that a majority was in favour of the safe harbour approach albeit that some further clarifications and safeguards were needed. The Secretariat suggested the following structure for the future discussion: (1) to whom shall the safe harbour be applied; (2) guidance of the following elements : documentation, range, monitoring, implication for MS upon agreement and disagreement on the range.

Some further discussion revealed that the audience should not be a class of taxpayers, but should be activity driven. The types of activities are the standard services to be defined through the bullet point approach (see above). Standard services will never be high added value profit generating activities (e.g. IP) outside or inside the group. It may be that IP linked only to the creation or modification could be included in a standard service definition. R&D and contract manufacturing should be out of the scope. It is also possible that seemingly standard services may become non standard either through bundling or the particular context in which they are provided.

Q10 Does the SUB-GROUP wish to make any comment on the application of other methodologies in relation to standard services?

This question was covered in the discussion on question 9.

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

On documentation and evidence, further guidance needs to be developed. Two important question 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.

A lively debate, in response to various comments made, demonstrated that the following points would benefit from further discussion whilst not losing sight of the overall goal of simplification:

- Application of the range in one MS and existence of a CUP in the other MS;
- whether some link between the method (and range) used by the provider (or one of the States) and the method (and range) used by the other would be necessary, and the related problematic issue of symmetry (automatic acceptance);
- use of safe harbour in MAP context;
- relationship between safe harbour and CUP.

Summary record (by the tax administration vice Chair) of the Joint Subgroup meeting of Tax administrations and business. Malta – 23 September 2008

Joint Chair: Stefaan de Baets and Theo Keijzer

Participating countries: Austria, Belgium, Czech Republic, Denmark, France, Germany, Italy, Malta, Netherlands, Spain, UK.

Participating Business members : Theo Keijzer, Mike Sufrin, Eduardo Gracia, Werner Stuffer, Monique van Herksen, Sander van der Fluit, Aurelio Massimiano
…

EU Secretariat: Peter Finnigan, Jean-Marc Van Leeuw

The parties met in accordance with the request made by the business members Vice-chair, at the June JTPF meeting, for a limited joint meeting between tax administrations and business representatives, post the tax administration subgroup meeting in Malta.

The document that formed the basis of the tax administration meeting had been sent, in July, to business representatives for information.

No comments were received from the business side on the working document prior to the meeting.

The Business Vice chair was invited to comment on the tax administrations working paper but his preference was to outline a current and sizable problem in the field of services.

The following was presented to the group:

- Costs of an MNE are only ever incurred for commercial reasons. Costs should therefore either be attributed to the place in which they were incurred or allocated out to the appropriate MNE member.

- Once allocated domestic law could influence the amount of costs allocated that would eventually be deductible and that was not a contentious issue for business.

- The debate moved to the bookkeeping consequences of allocation and deductibility but that was not the core issue to be addressed.

- Costs finally allocated often represented costs that were incurred as a result of a long chain and complex matrix of costs from differing providers of differing services. When challenged by Member States on the make up of a particular allocated cost business did not think that enough weight was given to the fact that the cost allocated had already been audited by external third parties. In particular it could be extremely burdensome to unpick a particular aggregated cost often to be traced back through several subsidiaries.

- Commonly service contracts consisted of two parts:

    1. A **general services** part consisting of a call off service wherein identified services were available to be called on as required. This element of the contract would be charged out in accordance with arm's length principles for

example direct charge of use of the service or in accordance with an appropriate allocation key relevant to the type of service provided.

2. A **specific services** part wherein there was the capability to provide services over and above the agreed general call off element. For example the call off element may only provide for a set number of technicians hours when more are needed. Those additional hours service would be an additional cost.

- The interaction of these two elements of a service contract led to some MS not accepting costs were correctly allocated and those costs were left stranded.

- The problem was amplified further by means of the following diagrammatic representation:

Costs can be divided into three categories

Direct services	Mixed	Shareholders' services

- Business wished to examine and define further the differing categories of cost, supported by examples, go on to explain why costs should be deductible somewhere and arrive at a fast track system to ensure all costs allocated and deducted (subject to domestic rules). Attribution to a particular category was not as important to business as the allocation of all costs.

- Furthermore the direct services are allocated to the recipient of the service (direct allocation / direct charge method). The shareholder's services are allocated to the shareholder. The mixed group, is the controversial area (indirect allocation, indirect charge method, …). This group would include the shareholders' services over which the tax administrations did not reach agreement on their allocation. E.g. a service could be considered shareholder service by one MS and a stewardship activity by another, leading to the non allocation and deduction of the costs.

- A proposed solution to the problem was the use of agreed allocation keys. This was an area to be discussed and developed but elements of any agreed approach could include: the internal and individual allocation keys of the group in question or a common EU allocation key, capable of audit;

- Business also wished to present a paper to the forum on shareholder costs

- In conclusion business were interested in how best to take forward their proposal and a written submission was offered.

The proposal by business was a new development for Member States and they asked for a recess in the meeting to discuss the development

After reconvening the administration Vice Chair summarised tax administrations' response

After a brief first discussion amongst MS participants, the tax administration vice chair indicated that the tax administrations are not insensitive to the request for certainty for business. However, in the current situation and in the absence of a full view on the business proposal, it is too early to give a precise opinion.

However, it was also stated that the proposal of the business could be integrated into the standard services / non standard services discussion. As it was observed by some

participants, elements indicated by business could be helpful in the definition of standard services / non standard services. However, it is not yet entirely clear how both approaches can be combined in one single document – if appropriate - in the absence of a written proposal.

Additionally the allocation key issue was not discussed at all during the member states meeting.

In further discussion the majority of attendees felt the two proposals could be worked together and indeed there were some clear areas of communality e.g. share holder costs definition of types of services the work should concentrate on. Some attendees felt however that the work of the forum should concentrate on the new business proposal. In either event Tax Administrations would require further clarity on the proposal in terms of: allocation keys, the services to which those keys should apply in particular clarifying whether business considers a general service – is the same, or wider or narrower than the subgroup's concept of standard service, and clarity on how such allocation would fit into the application of transfer pricing rules allocating profits which may be taxed by the respective States without such allocation resulting in a diversion from the appropriate allocation of profits between the States.