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EU JOINT TRANSFER PRICING FORUM

JTPF REPORT: GUIDELINES ON LOW VALUE ADDING INTRA-GROUP SERVICES.

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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 may 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 full audits will be required into the intra group services that fall within the scope of this paper.

II. Overview

5. Underpinning this paper is the assumption that MNEs and tax administrations act in good faith and 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.(see section VI).
7. The key elements or principles of the approach developed by in this paper are:

- (i) All costs are allocable but domestic law will not necessarily allow a full deduction of those costs.
- (ii) Existence of certain important critical assumptions in establishing an agreed starting point for any review.
- (iii) 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.
- (iv) 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 adding to either the provider or recipient. The scope of this paper distinguishes between services that although low value adding could still generate a high turnover and can be included in this approach and services that are high value adding, even if not necessarily generating a high turnover, and would not be within the scope of this paper.
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 adding 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 adding service 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 adding 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 cases that, within the scope of this paper, 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 other's 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 a tax 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 the tax administration to ensure a full understanding of the framework supported as necessary with contemporaneous information. It is also recommended that updates take place through regular meetings. The outcome may be that the tax administration will consider particular facets of the MNE's 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 that 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. Critical assumptions

19. These are:

- ❖ Services concerned are low risk, low value adding business transactions.
- ❖ A service provided meets the OECD arm's length standard in particular the services concerned are rendered and the recipient is provided with economic or commercial value.
- ❖ An MNE will have its own governance system and audit procedures in place and any services provided will be subject to that governance process.
- ❖ Good quality information will be supplied on demand.

It is accepted that some or all of the above critical assumptions may be tested as the process continues.

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 that has been rendered 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 adding 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 the 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 MNE's business in order 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 MNE's 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 provide 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.
- A description of the allocation key (s).
- 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.
- Documentation that can be provided.

23. The above information may be made available and provided in a variety of ways. Clearly a dedicated written narrative could be provided. Some of the information, if appropriate, 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 the 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. 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 subject to the respective domestic law which may not allow a full deduction of those costs.
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 adding of the services coupled with a supporting 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, which will vary depending on the particular circumstances of the case, that all appropriate costs¹ are within the pool and inappropriate costs are excluded. Before addressing the question of mark up and allocation it is necessary to ensure that shareholder costs and costs relating to direct charged services are excluded (i.e. total costs, minus shareholder costs, minus direct charge costs gives the costs to be allocated). It is also important to understand the nature of the costs remaining in the pool. The costs may be made up of direct and indirect costs as well as any appropriate operating expenses of the enterprise as a whole (e.g. supervisory, general and administrative) in as far as they have not already been accounted for in the cost categories.
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

¹ See OECD 2.32 et seq.

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. 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 circumstances 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. 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 without 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 to guarantee that costs allocated are not greater than total 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 is needed 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 sub-contract 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.

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 Para. 7.9 of the OECD guidelines 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 were they 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? In answering that question considerations include: does the whole group benefit; or is the benefit attributable to a certain subsidiary, how are costs to be apportioned and the correct arm's length price applied? The answer lies in the 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 PCs

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

It should be noted that more complex allocation keys might also be used.

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 intended these guidelines require an automatic review of what may already be in place.

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 infrastructure has to be in place to offer and meet the commitments in an on call arrangement. In some cases it may be reasonable that a charge is made to cover the infrastructure costs and a mark up. Equally, in other cases it may be reasonable that a user pays a charge for potential access to that infrastructure 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 level of evidence that is required to evaluate a transfer price and to ascertain that a particular method is a reasonable estimation of an arm's length price (OECD 1.12-1.13 and 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 reviewing that a service provision is at arm's length this paper notes that a cost based method would be the most commonly observed method (OECD 7.31).

7.7.2. Mark Up considerations

61. As the low value adding services we are concerned with in this document will typically only attract a modest mark up, 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 mark up may be appropriate a cost benefit analysis may be such that a tax administration may not pursue the matter beyond allocating costs. (OECD 7.37).
63. In cases where it is appropriate to use a mark up, this will normally be modest and experience shows that typically agreed mark ups fall within a range of 3-10%, often around 5%. However that statement is subject to the facts and circumstances that may support a different mark up.
64. 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 mark up 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 mark up 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 mark up.
 - The experience and knowledge of the reviewer in what they have typically encountered as agreed mark ups 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 administrations².

65. 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 mark up and any variance is anticipated to be minimal.

VIII. Documentation

66. The OECD guidelines (Para.5.4) refer 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.

67. This theme is echoed at 2.3.1 of the JTPF report on EUTPD 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".

68. In applying this principle to the services concentrated on by these guidelines documentation including 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).

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

70. 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.

71. 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.

² See UK HMRC Guidelines and French comments in doc. JTPF/014/REV2/BACK/2007

IX Post review Considerations

72. 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.
73. 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.
74. 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.
75. In line with the Code of Conduct on EUTPD Member States should not impose a documentation related penalty where taxpayers comply in good faith, in a reasonable manner and within a reasonable time in supplying the information outlined above.
76. 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 that all costs are allocable.
77. 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 elements acceptance of the adjustment without further enquiry might be a justifiable outcome.

X Conclusions

78. The JTPF concludes that following these guidelines will facilitate the evaluation and acceptance that the arm's length principle has been applied in the majority of the cases that fall within the scope of these guidelines.
79. The JTPF recognises that this report is specifically targeted at low value adding services but some of the critical assumptions and elements might equally apply to more complex high value adding services. .
80. The JTPF will monitor the effect of these guidelines regularly and in particular to ensure the mark ups referred to remain relevant.

ANNEXES

Annex I: List of intra-group services commonly provided that may or may not be within the scope of this paper.

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 in 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 fulfillment 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 consolidated financial statement);
- f.5. assistance in compliance with fiscal obligations, such as filing tax returns, computing, and paying taxes, etc.;
- f.6. data processing;
- f.7. audit of the account of the subsidiary; and
- f.8. management of the invoicing process.

g. Technical services, for example:

- g.1. Assistance regarding plant, machinery, equipment, processes, etc.;
- g.2. planning and executing ordinary and extraordinary maintenance activities on premises and plant;
- g.3. planning and executing ordinary and extraordinary restructuring activities on premises and plant;
- 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 provision of services;
- h.2. assistance in obtaining quality certifications (e.g. ISO 9000); and
- h.3. development and implementation of client satisfaction programmes.

i. 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.

Annex II: Non exhaustive and non prescriptive list of shareholder costs (text in italic repeats OECD Guidelines).

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 benefit of the parent company. However the JTPF concluded that the analysis will always require that the following questions be raised in relation to each cost listed: 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
1	a. <i>Costs of activities relating to the juridical structure of the parent company itself such as:</i> ³	Generally shareholder cost but see below.
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. 3 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 shareholder 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 totally) for the specific benefit of a (some) subsidiary (ies) and thus could need to be allocated.</p>

³ OECD Guidelines, para 7.10 lett a.

5	a.4. 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> ⁴	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 whatever level.</p> <p>It might be the costs relate to 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 an activity of the group as such.</p> <p>Some members explained that in practice 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 legislation 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	<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>

⁴ OECD Guidelines, para. 7.10, lett. b.

	company tax purposes. These costs are incurred <u>for the exclusive benefit of the parent company</u> ;	
10	b.4. costs for the audit of the parent.	Shareholder costs
11	c. <i>Costs of raising funds for the acquisition of its [the parent company's] participations</i> ⁵	Shareholder costs
12	d. <i>Costs of managerial and control (monitoring) activities related to the management and protection of the investments in participations</i> unless an independent party would have been willing to buy for or to perform for itself: ⁶	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 principles of the States of the parent (e.g. US GAAP).	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 financial statement drafted by applying the accounting principles of the parent company is used by the parent company itself to render specific

⁵ OECD 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.

⁶ 1995 Guidelines, para. 7.10, last para.

		services to the subsidiary, as market analysis, budgeting, etc.
15	d.3. Costs of information technology	<p><u>JTPF conclusions:</u></p> <p>Those costs are rarely supported solely for the benefit of the parent company. Therefore a case by case approach is necessary.</p>
16	d.4. Cost for the general review of the affiliates' performance if not connected to the provisions of consulting services to the subsidiaries	<p><u>JTPF conclusion:</u></p> <p>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 thus require allocation.</p>
17	e. <i>Costs to reorganize the group, to acquire new members or to terminate a division⁷.</i>	<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 on the rights and other assets of the parties. There is some discussion in the OECD discussion draft on the transfer pricing aspects of business</p>

⁷ OECD Guidelines, para. 7.12. The same paragraph points out that such activity “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”.

		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
18	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).	Shareholder costs
19	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;	Shareholder costs
20	h. Study and implementation of the capitalization structure of the subsidiaries.	Case by case approach
21	i. Costs for the increase of the share capital of the subsidiary.	Case by case approach
22	j. Other activity you identify as shareholder activity: 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.	Shareholder costs