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Via E-Mail
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Comments of SwissHoldings on the OECD Discussion Draft regarding BEPS Action 10 (Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services) of 3 November 2014

Dear Mr. Hickman

The business federation SwissHoldings represents the interests of 61 Swiss based multinational enterprises from the manufacturing and service sectors (excluding the financial sector). SwissHoldings is pleased to provide comments on the OECD Discussion Draft of the Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines Relating to Low Value-Adding Intra-Group Services (hereafter referred to as "the Draft").

SwissHoldings supports the introduction of a simplified transfer pricing approach for low value-adding services to minimize risks for lengthy disputes and the administrative burden for both taxpayers and tax administrations. The revised Draft should ensure

- that costs are deductible within the group (i.e., double taxation is avoided) and
- the most simple approach to document and support the deductibility of services (i.e. low value-adding services should be excluded from the very extensive documentation requirements as recently codified in the new Chapter 5).

Although clear principles are very important, the Draft should also provide an appropriate level of flexibility for more complex areas such as the definition of services, cost allocation methods and the determination of the profit mark-up.

The key success factor is a consistent application of the new principles by taxpayers and,.more importantly, acceptance by all tax administrations, including those of non-OECD countries.

Further comments on the Draft are provided below.

I. General Comments

1. There is a need to maintain a balance between the level of information requested and the potential compliance and extensive audit management burden for taxpayers.

2. It should be ensured that all (service) **costs are tax deductible** within the group and double taxation is avoided for taxpayers. In contrast to the assumptions in the general BEPS

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discussion, double taxation - as opposed to non-taxation - is one of the main challenges in practice within the context of intragroup service transactions for MNEs. Further clarification and mitigation measures should be added in the Draft (e.g., in section B.1.1., benefits test) and considered in other BEPS actions.

3. Another critical area is the application of **withholding taxes** (WHT) for intragroup services. Application of WHT often leads to double taxation (no full recoverability) and a significant administrative burden for taxpayers and tax administrations. Therefore, we would recommend limiting the application of WHT for service transactions. Specifically, for low value-adding services with a moderate profit margin, application of WHT should not be applied at all.

4. For the transfer pricing analysis (in particular during tax audits) tax administrations must also analyze and consider the **whole transfer pricing model** of the taxpayer (service recipient) and assess whether the service fee is eventually passed on to other members of the group via other intercompany transactions (and not only the services in isolation). For instance, one group entity (beneficiary) might receive "support services" (e.g., finance, accounting, HR or management) from other group members on a regular basis. The main function of this group entity (beneficiary), for example, is to perform distribution activities and provide contract R&D or contract manufacturing services for another group entity and all costs (including the costs related to the "support services") are (indirectly) passed on via transfer prices for other transactions (e.g., contract manufacturing fee) to another group entity. As the received "support services" represent "pass-through costs" for the beneficiary, lower requirements and efforts should be applied to assess the arm's length nature of the received "support services". A tax deduction should always be ensured.

5. We support the clarification in paragraph 7.36 that so called "**pass-through costs**" can be recharged without a mark-up. A clarification or reference in paragraph 7.57 to clarify that the safe-harbor range would not apply to pass-through costs would also be helpful.

II. Specific Comments

Shareholder activities

6. We appreciate the efforts to clarify the definition of shareholder activities. However, we would welcome a clarification that there exist only 2 categories:
    - *Shareholder activities* (where the cost should be borne by the parent company as the ultimate beneficiary) and
    - *Services* (where the costs should be borne by the respective recipients / beneficiaries of the services with the group).

    We also recommend avoiding reference to the old 1979 Report in paragraph 7.10 and the 1984 Report in paragraph 7.11. These references could give the impression that these old Reports are still applicable legal sources to interpret the arm's length principle and/or "stewardship activities" is still a category taxpayers need to consider.

7. The examples mentioned in paragraph 7.11 are helpful to clarify the distinction. However, the examples need to be clear to avoid disputes in the future. Hence, we recommend dropping the new example in paragraph 7.11(e), *"Costs which are ancillary to corporate governance of the MNE as a whole".* At the very least, it needs to be clarified as corporate governance is not defined.

Duplication

8. We welcome the clarification added in paragraph 7.12 that the provided *"intra-group services are different, additional or complementary to the activities performed in-house."* In this regard we would like to highlight that this is the rule and not the exception and should therefore be a leading principle in the top of this paragraph and not at the very end. In the (global) competitive environment in which multinationals operate, no one can afford duplicative activities; or probably the more correct economic term an "inefficient operating model/value chain". Insofar, as this is an "exception" or a more academic topic, taxpayers and tax authorities should apply a simplified approach in the transfer pricing analysis.

Some examples of intra-group services

9. The examples used in section C paragraphs 7.40 to 7.44 have not changed compared to the existing OECD Guidelines. However, given the introduction of a new category of low value-adding services and the examples in paragraph 7.48 we are wondering about the benefits of the examples in section C. As these examples are very general in nature and do not provide further clarity, we recommend to drop section D completely.

III. Low Value Adding Intra-Group Services

Scope of services

10. We recommend clarifying in paragraph 7.48 that the list is not exhaustive and add as a last bullet "other services". In this regard we would like to clarify that – depending on the specific facts and circumstances - the examples mentioned in paragraph 7.47 could fall under the category of low value-adding services (e.g., specific marketing, R&D or manufacturing services). The list provided in Annex I of the EUJTPF guidance from February 4th, 2010 seems to provide a broader and more appropriate qualification. In particular, it covers many other practical examples for low value-adding service such as "(g) technical services; (i5) logistic services, (i6) inventory management, (i8) warehousing services or (i11) packaging services".

11. The inclusion of "services for corporate senior management" in paragraph 7.47 is confusing and should be dropped, as corporate senior managers can also be involved in the performance of low value adding services. Focus should be on the nature and type of services and not on who provides the services.

Determination of cost pools

12. Section 7.52 gives the impression that only one pool of costs for low value-adding services in a group is allowed. In practice, especially in large MNEs, there may be several categories or layers of low value-adding services provided by different service providers located in different countries or regions for different service recipients. The multiple use of the simplified rules described in the Draft must be allowed, and Section 7.52 should be clarified accordingly.

Allocation keys

13. We appreciate the clarification that calls for a balanced approach between "theoretical application and practical administration" in paragraph 7.56 with regard to the determination of allocation keys. However, instead of "one-size fits all" in many cases, flexibility in the

application of the allocation keys is required; in particular if different types of low value-adding services are provided by different service providers in different jurisdictions (as is often the case). In such cases, the business model and functional profile of the service recipients may require the use of different allocation keys for the same category of services. Accordingly, the statement in Section 7.55 "The same allocation key must be used on a consistent basis for all allocations of costs relating to the same category of services" must be clarified. The key element is consistent application (in a transparent manner) from the perspective of the respective service provider (and type of service).

Profit mark-up

14. We appreciate the proposal for a safe-harbor range for low value-adding services. However, for multinationals, flexibility is required to ensure a right balance between the interests of respective service providers and the beneficiaries of the services in order to minimize risks for lengthy disputes. If service providers are located in developing countries, we sometimes see rates higher than 5% (usually, supported by respective benchmarking studies).

15. Hence, one measure to increase flexibility could be to increase the proposed "safe harbor" range to 2-7%. This would also be more consistent with the EUJTPF guidance from February 4th, 2010. However it is important to clarify that in case a mark-up is selected within a proposed "safe harbor" range, that no benchmark study has to be provided. A respective clarification has to be done in clause 7.61 on documentation. Another and important measure is not to force multinationals to apply the "same" rate for all type of services and jurisdictions where the service providers are located. For example, depending on the nature of services and the location of the service provider, different rates could be applied. The key requirement should be to apply for a specific type of service AND service provider the same rate in a consistent manner. Finally, if a specific benchmarking study is available (unfortunately likely to be required if the service provider is located in a non-OECD country and/or service is main function of the service provider) multinationals should optionally be able use this "specific" rate/range - in contrast to the safer harbor range - as a basis to determine the arm's length service fee. At request during a tax audit, a copy of the benchmarking study should be provided to the beneficiaries. Any other solution would most likely lead to double taxation.

Benefit test

16. We appreciate the clarification for the application of the benefit test for low value adding services in paragraph 7.60 (i.e., focusing only on the invoice describing the category of services). However, from our perspective the documentation and reporting requirements described in the first bullet of paragraph 7.61 are not consistent with this statement and too extensive. Clarification and reduction of requirements in paragraph 7.61 are required.

17. It should further be clarified that the "hypothetical cost test" as proposed in paragraph 7.35 is not applicable for low value-adding services. In this regard we would like to clarify that the potential application of this hypothetical test is complex and subjective. Moreover, in most cases doing the services in-house is not really an option within a group. Hence, we recommend deleting the whole paragraph 7.35.

Documentation and reporting

18. Clarification and reduction of requirements in paragraph 7.61 are required in order to be in conformity with the concept provided in that report on low value-adding services and the corresponding low risk profile of profit shifting in that area. Therefore it is proposed to amend

the first bullet of paragraph 7.61 as follows: “A description of the categories of low value value-adding intra-group services provided; the reasons justifying that each category of services constitute low value-adding intra-group services within the definition set out in section D.1 except for services that are already mentioned in clause 7.48; ~~the rationale for the provision of services within the context of the business of the MNE; a description of the benefits or expected benefits of each category of services~~; a description of the selected allocation keys and the reasons justifying ~~that~~ such allocation keys ~~produce outcomes that reasonably reflect the benefits received~~, and confirmation of the mark-up applied, but no benchmark study has to be provided in case a mark-up is selected within the proposed ‘safe harbor’ range”.

19. We appreciate that the documentation and reporting requirements should only be made available upon request. A clarification that there is no requirement to perform a full transfer pricing analysis in the yearly TP documentation (local file) - including penalty protection - would be welcomed. Specifically, additional clarification would also be welcomed on how the proposed documentation package for MNEs which elect the simplified methodology ties in to the work performed under Action 13 on Transfer Pricing Documentation and Country-by-Country reporting.

20. As it would trigger a non-balanced additional compliance burden for multinationals, the requirement for written agreements should be dropped. Focus should be on the determination and allocation of costs (including the applied mark-up) in a consistent and transparent manner. The need for a simplified benefit test is discussed above.

We kindly ask you to take our comments and proposals into due consideration.

Yours sincerely

SwissHoldings
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