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13 January 2015

Dear Mr Hickman,

Comments on the 'Public Discussion Draft on the Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines relating to Low Value-Adding Intra-Group Services'

Thank you for the opportunity to provide comments on the Public Discussion Draft on BEPS Action 10: *Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines relating to Low Value-Adding Intra-Group Services* (the Discussion Draft) dated 3 November 2014.

PricewaterhouseCoopers LLP (PwC), on behalf of its international network of Member Firms, welcomes the consideration given by the OECD to add a specific section to Chapter VII of the OECD Transfer Pricing Guidelines containing special simplified rules relating to the allocation of low value-adding intra-group services costs among members of an MNE group. Many MNEs have centralised such low value-adding intra-group services activities and it is our experience that the current compliance burden required both to prepare detailed transfer pricing documentation and manage the ensuing tax audits can be significantly out of proportion to the actual profit potential of the intra-group charges or the actual tax risk involved.

PwC believes that, through the inclusion of a specific section on low value-adding intra-group services in Chapter VII that (1) lowers the burden on MNE groups to demonstrate the beneficial nature of those low value-adding activities for other MNE group members; and (2) allows for an elective approach for reducing the administration involved in the pricing of low value-adding services, the OECD is achieving an appropriate balance between theoretical sophistication and practical application that is commensurate with the tax at stake in the countries paying and receiving the charges.

Whilst the OECD is in the process of developing increasingly detailed transfer pricing guidance for complex transactions under some of the other Action Points of the BEPS Action Plan, PwC's view is that it is also essential for the OECD to continue promoting a cost effective use of taxpayers' and tax administrations' resources for improved compliance and enforcement processes. Already in its 2011 report on *Multi-Country Analysis of Existing Transfer Pricing Simplification Measures*, the OECD identified a number of countries (i.e. Australia, Austria, Japan, the Netherlands, New Zealand and the US) applying simplification measures for low value-adding services (i.e. services deemed to carry a limited risk). The simplification measures for those types of services were found to be consistent with

the pragmatic risk assessment strategy adopted by those tax authorities with the aim to keep compliance costs proportionate with the size and complexity of the transactions.

Given the overall strong support for the proposals the Discussion Draft sets forth, the usefulness of the proposed measures will depend on how many countries agree with and adopt the proposed measures. As the OECD is a standard setting organisation, it is hoped that the OECD and G20 countries participating in the drafting of the proposed measures recognize the mutual benefits that would inure to both taxpayers and tax administrations from the widespread adoption of a uniform approach to this issue.

In the remainder of this letter we have identified a number of items for further consideration by the OECD in its next version of the document. We believe that it would be beneficial if the output of the current OECD work results in an updated Chapter VII of the Transfer Pricing Guidelines.

Detailed Comments:

1. Definition of low value-adding intra-group services:

PwC welcomes the inclusion of criteria to determine whether a service could qualify as a 'low value adding service' under the elective approach. In this respect, PwC recommends to the OECD to confirm the following:

- Based on the text of the Discussion Draft, the activities listed in paragraph 7.47 cannot be considered as 'low value-adding intra-group' services but this does not mean that they necessarily add high value to the MNE group. This is a question that must be addressed by each individual MNE through the normal transfer pricing analysis and the functional analysis in particular.

  As such, for those services that do not qualify as a 'low value adding service' under the elective approach, the full transfer pricing analysis performed by MNE groups may still lead to the same or a similar result including a similar level of profit mark-up as for services that do qualify for the elective approach (i.e. between 2% and 5%).
- The definition of 'corporate senior management' should be clarified by means of examples, as a too broad definition is likely to result in discussions between tax authorities and taxpayers. For instance, whereas the head of legal and HR could be part of an MNE's 'corporate senior management' and thus be excluded from the simplified approach based on the current Discussion Draft, legal and HR services are listed as examples of services qualifying for the elective approach. We therefore recommend the OECD to limit in its next version of this document the type of corporate senior management functions that need to be excluded from the elective approach.
- The examples listed in paragraphs 7.47 and 7.48 are not meant to be exhaustive so as to provide sufficient flexibility to taxpayers to demonstrate the low-value adding (or vice versa) nature of activities in their documentation file.

2. Simplified determination of arm's length charges for low-value adding intra-group services:

a) Determination of cost pool:

The OECD should provide more explicit guidance on how the pool of costs needs to be determined as otherwise there could be room for different interpretations by different tax authorities, potentially resulting in increased administration and, in the worst case, increased double taxation.

In order to avoid this, PwC recommends the OECD to consider the following elements:

Cross-charges – It would be helpful if the OECD could make it clear that a cost pool represents a composite service of administration in which all participants (providers and recipients) have agreed to cooperate and delegate tasks in order to improve efficiency. Thus it should be sufficient for each company to engage in a single contract for that composite service or set of services and to issue or receive a single invoice such that each bears the appropriate level of cost.

It would also be helpful if the OECD would reference the indirect charge method of paragraphs 7.24-7.27 of the OECD TP Guidelines which is likely to be appropriate in the case of services to which the new Section D applies. This will make it clearer that at arm's length a company providing such a service can be doing so as part of a general arrangement to a single recipient acting on behalf of a group in the same way that an independent lawyer or an accountant might advise one customer that then shares the advice with other interested parties from whom it might separately recover a part of its costs. In such a case the lawyer or accountant would not need to engage separately with every party or invoice them separately.

The extent of the service – An issue arises where two or more companies cooperate. In a simple example, two companies both employ corporate lawyers engaged in services that fall within para 7.48. Company A incurs costs of 60; Company B costs of 40. The appropriate allocation key suggests each should bear 50. PwC believes that the correct interpretation is that Company A has supplied a service worth 10 to Company B. An alternative view which can be deduced from the current draft is that Company A has supplied a service worth 35 to Company B which has, in turn, supplied one worth 15 to Company A. It would be helpful if the OECD could be clear that the service is of 10.

Similarly, the simplified approach with a single pool and single mark-up for these ‘supportive’ services are probably best characterised as general administration. In the same example, if Company A incurs legal costs of 60 and Company B HR costs of 40, an approach consistent with the OECD's suggested approach is that the correct interpretation is that Company A has actually supplied a composite administrative service of 10 to support the actual business of B. If the OECD intends that each category of activity in the pool retains a specific nature then it would be helpful to say so.

The draft implies that all companies providing services could charge one entity which then charges all those receiving services. Such a company would likely be unable to recover indirect taxes and withholding taxes suffered are likely to be a cost to that company. It would therefore need to include the taxes borne as a cost when making charges to service recipients. The Discussion Draft needs to clarify that these costs are validly included in the cost pool.

Local deductions, duties, assessments or charges – PwC recommends that, by virtue of their low value-adding nature, payment for the services should in principle not be subject to any type of local withholding. Alternatively, we recommend the OECD to make it explicit in its next publication that in case the service recipient’s country requires for any type of deduction or withholding on the service payment, the amount of such a deduction or withholding to be added to the payment to be made to the service recipient. This should allow the latter to receive a payment equal to the actual value of the service rendered as if the local deduction or withholding had not been made.

b) Allocation of low value-adding service costs:

PwC welcomes that the Discussion Draft seeks to strike a balance between theoretical sophistication and practical administration as regards the selection of the most appropriate allocation key(s). In this respect, PwC recommends the OECD to make it (more) explicit that:

- the examples of allocation keys listed in the Discussion Draft for particular services are for illustration purposes only and not intended to be exhaustive or binding in any way; and
- a single allocation key could be applied to the total pool of costs where it best reflects the needs to allocate the pooled costs.

c) Profit mark-up:

Cost cross-charge – A number of countries reported to the OECD in 2011 the availability of simplification measures for low value-adding services. Certain of those countries allow for the charging of costs related to low value-adding services without a profit mark-up whereby the mere cost cross charge is deemed to be arm's length.

The US explicitly mentioned in 2011 that the goal of their simplification measure for low value-adding services is to take them off the audit table so that both taxpayers and tax authorities can devote their attention to more significant transfer pricing or other audit issues.

PwC recommends the OECD to take a similar stance – i.e. allow for a mere cost cross charge - towards the low value-adding intra-group services and go a step further in creating a true low risk environment for low value-adding intra-group services which would also benefit tax authorities in both developed and developing countries through the conservation of audit resources for more important transfer pricing issues.

Safe-harbour range – A literal reading of the current Discussion Draft seems to support the position that taxpayers can select any point within the proposed safe-harbour range of 2% to 5%. It may serve to eliminate all doubt if the OECD could make this point explicit in its next version of this document.

Cost contribution arrangements – Although PwC understands that cost contribution arrangements have not been addressed by the OECD in this Discussion Draft, the OECD should say so where necessary in this Discussion Draft to achieve consistency so that any centralized services related to a cost contribution arrangement can also be cost shared without a profit element even if those relate to low value adding intra-group services.

3. Pass-through costs:

The OECD should address certain inconsistencies between general services versus low-value adding intra-group services such as 'pass-through' costs. Para 7.36 which is a reasonable attempt to allow for pass-through of costs (except for the agency function aspect) should also apply to similar costs even when a taxpayer elects the low-value adding intra-group services treatment. Paragraph 7.57 of the Discussion Draft appears not to allow for pass-through of costs.

4. Documentation and reporting:

PwC welcomes the inclusion of a prescriptive list of documentation that would need to be available within an MNE under the elective approach. In this respect, PwC believes that it would be worthwhile for the OECD to make it explicit in its next version of the document that:

- The level of the transfer pricing documentation to be maintained for the low value-adding intra-group services under the elective approach does not fall within the scope of Action Point 13 of the BEPS Action Plan. As such, a documentation file prepared at group level containing the criteria prescribed by paragraph 7.61 would be sufficient thus not creating the need for a separate local file for each participating MNE group member.
- A single intra-group contract would be sufficient thus creating an additional layer of practical administration and harmonisation in line with the low risk and low profit nature of the services concerned.

On behalf of the global network of PwC Member Firms, with the contribution of our colleagues David Ernick, Patrick Boone, Ian Dykes, Andrew Casley and Jonas Van de Gucht, we respectfully submit our response to the Public Discussion Draft on BEPS Action 10: *Proposed Modifications to Chapter VII of the Transfer Pricing Guidelines relating to Low Value-Adding Intra-Group Services*. For any clarification of this response, please contact the undersigned or any of the contacts below.

Yours faithfully,

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