SwissBanking

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SBA Submission: OECD Request for Public Comments on Scoping of the Future Revision of Chapter VII (Intra-Group Services) of the Transfer Pricing Guidelines

Dear Sir or Madam,

The Swiss Bankers Association ("SBA") would like to thank you for the opportunity to provide its comments on the new project of Working Party No. 6 ("WP6") to revise the guidance in Chapter VII: Special Considerations for Intra-Group Services of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD TPG").

Our views are based on the extensive experience of our members with respect to designing, implementing, operating, documenting and defending the intra-group services concept in Multinational Enterprises ("MNE") while concentrating its management and administrative services expertise in several regional or one global Shared Services Center ("SSC").

Please find below our comments on the following specific issues:

1. Comments on recent changes to Chapter VII: Special Considerations for Intra-Group Services of OECD TPG incorporating the simplified approach to determine the arm's length charges for low value-adding intra-group services ("LVAIGS") as a concept presented in OECD BEPS Action 10.

The SBA highly appreciates the simplified transfer pricing approach for LVAIGS developed by WP6 under the mandate of BEPS Action 10, which might lead to the revision of Chapter VII of

OECD TPG. It is of high practical relevance that a new guidance is presented on what type of commonly performed intra-group services can benefit from the simplified determination of arm's length charges.[1] Although we agree with the overall logic of the definition, we do not believe that all marketing services should be excluded from LVAIGS. In our view, there should be a distinction made between the group marketing promoting the existence of the whole MNE and product marketing that is closely connected with distribution. The former should be included in the LVAIGS group and benefit from the simplified remuneration approach. In addition, the SBA would welcome guidance on whether delegation of employees could be treated as LVAIGS or not.

The introduction of safe harbor rules for the profit mark-up of 5% on total costs incurred in connection with LVAIGS is for the SBA of the utmost importance. In practice, a high number of MNEs have been charging Cost+ 5% for LVAIGS for years. Therefore, the determination of the arm's length charge was not entirely new. However, the introduction of the Cost+5% as a safe harbor rule enables MNEs (incl. SBA members) not to undertake costly benchmarking studies substantiating that 5% is the arm's length profit mark-up on full costs. The benefit is even accentuated considering BEPS Action 13 requiring that benchmarking studies for at least routine functions should be yearly updated by presenting new financials of the final set of comparable companies.[2]

The SBA would appreciate, if the application of a simplified approach - with safe harbor rules for profit mark-ups – would be more frequent in the OECD TPG. We suggest that the WP6 would present a list of commonly performed routine services[3] with indication of internationally accepted profit mark-ups on full costs. Such a step would significantly reduce the administrative burden for MNEs. Even if prices for benchmarking studies fell in the last five years, their preparation and update absorb resources of the in-house transfer pricing specialists. They spend a significant amount of time on each benchmarking study - if outsourced individually for each function - on:

- identifying the need for the study,
- drafting the request for proposal,
- selecting the most suitable provider (selection of objective criteria, evaluation of individual proposals and communication of results to applicants),
- coordination of benchmarking outputs with Master File ("MF") and Local File ("LF") filing deadlines,
- reviewing the quality of the benchmarking studies, and
- presenting the results of the studies to internal stakeholders.

[1] OECD TPG, Chapter VII, Art. 7.43 et seq.
[2] OECD TPG, Chapter V, Art. 5.38.
[3] E.g. investment funds administration, structured products legal or any other middle-office type of routine functions.

In addition, the SBA would welcome, if additional safe harbor rules would apply for transaction volumes of business related intra-group services. We suggest that any intra-group transaction below USD 50'000 does not have to be documented in MF or LF. Alternatively, we would appreciate, if there would be a relief from benchmarking requirements for them in the new Chapter VII.

2. Comments on scoping of the future changes of Chapter VII: Special Considerations for Intra-Group Services of OECD TPG reflecting the rest of the findings presented in OECD BEPS Actions 8 to 10.

a. Interaction with Chapter I: The Arm's Length Principle

Overall, we believe that the Arm's Length Principle ("ALP") should prevail over formulary apportionment ("FA") when it comes to intra-group services. Our main concern with FA is the difficulty of implementing the system in a manner that would both protect against double taxation and ensure single taxation. To achieve this would require substantial international coordination and consensus on the predetermined formulae to be used and on the composition of the MNE in question.[4]

As the MNEs represented by the SBA exclusively provide financial services – acting in the fields of Asset Management, Investment Banking, Wealth Management and Retail Banking – the transfer pricing methods used for testing the arm's length character of intra-group services are limited to Comparable Uncontrolled Price ("CUP"), Cost Plus ("CPM"), Profit Split ("PSM") and Transactional Net Margin ("TNMM"). In our view, the most recent version of Chapter I presents more examples and guidance for MNEs manufacturing and selling goods than for MNEs providing exclusively services[5]. We would appreciate, if Section D of Chapter I would give more guidance for applying arm's length principles for entities providing only services. More specifically, we would welcome more guidance on the hierarchy of methods that could even be binding for the tax authorities. Furthermore, more examples and explanations on the choice between CPM, TNMM and PSM for intra-group services would be highly appreciated. In addition, the SBA is missing in the current version of OECD TPG any comments on transition issues related to the change of the method. We would welcome, if WP6 would explicitly mention that tax authorities should not change the method for transfer pricing adjustments typically by applying the new method on the previous years or the old method on the future years. Finally, we suggest that WP6 promotes the use of global benchmarking studies and restrict the – still widely spread – tax administration requirements for local or regional benchmarking studies.

[4] OECD TPG, Chapter I, Art. 1.22.
[5] OECD TPG, Art. 1.40 and 1.44.

b. Interaction with Chapter VI: Special Considerations for Intangibles

The SBA believes that there is an interaction between intra-group services and intangibles because of the OECD TPG rules determining who is entitled to the remuneration for the use of the intangible property ("IP"). According to Art. 6.32 OECD TPG, it is the group entity performing development, enhancement, maintenance, protection and exploitation ("DEMPE") of intangibles. In practice, the most common remuneration for the use of IP are royalties determined as a percentage of relevant revenues via application of the CUP method. At the same time, some of the DEMPE functions are intra-group services that are typically remunerated with the CPM, e.g. the legal activities connected with the protection of a brand or the marketing and communication activities related to development, enhancement and maintenance of a brand. The SBA would welcome, if WP6 would make a distinction between the marketing activities and could provide guidance on what are e.g. brand building marketing costs.

c. Interaction with Chapter VIII: Cost Contribution Arrangements

In the financial services business, Cost Contribution Arrangements ("CCA") are used for common cross-border development and maintenance of tools. The SBA believes that there is an interaction between intra-group services and CCA, when one of the participating parties provides intra-group services to other participants and the value of this contribution should be calculated.[6] We would welcome, if the same rules for the determination of the arm's length price would be applied as mentioned in Chapter VII: Special Considerations for Intra-Group Services.

d. Interaction with the OECD work on the use of the PSM

The use of PSM is widely spread in the financial services business. This is because there are commonly used highly integrated business models[7], in which more entities make unique and valuable contributions (i.e. perform non-routine functions, assume substantial risk or own/employ important assets).[8] The SBA believes that LVAIGS do not present any unique and valuable contribution and as such should not trigger any need for the implementation of PSM. They can be remunerated via Cost+5% method according to the simplified determination. In contrary, non-routine and high-value-adding, business related intra-group services could require the application of PSM. The relevance of the distinction between routine and non-routine functions for PSM accentuates the importance of detailed knowledge of business models and their value chains.

[6] OECD TPG, Art. 8.13.
[7] OECD (2017), BEPS ACTION 10, Revised Guidance on Profit Splits, p. 7.
[8] OECD (2017), BEPS ACTION 10, Revised Guidance on Profit Splits, p. 5.

e. Interaction with the OECD work on financial transactions

The OECD BEPS Action 4 focuses on limiting base erosion via interest deductions and other financial payments. The SBA believes that both provisions of intra-group credits and granting of guarantees are non-routine high value adding intra-group services. It would be highly appreciated, if WP6 would elaborate on the application of guarantee and e.g. the necessity to apply PSM because multiple parties make valuable contributions. In other words, there should be more guidance provided in the updated OECD TPG on, how the risk assumption is limited by the receipt of guarantee from another group entity.

3. Comments on the practical challenges - identified by many practitioners, academics and tax administrations - that require further analysis

a. Demonstrating that a service has been rendered and/or that the service rendered provides benefits to the recipient

In general for a MNE operating a global or a regional SSC, the rendering of intra-group management and administrative services for the benefit of group entities is the only activity performed by the specialists (e.g. Group Tax, Group Accounting and Group Treasury) located in the SSC. In most cases, a SSC concentrates a great level of know-how and experience that could be compared with external professional services providers. Many of the in-house experts used to work for external professional services providers (e.g. Big 4 or Law Firms) before going in-house. It tends to be less costly to hire an in-house specialist for e.g. international tax matters than to outsource the service to an external service provider. Simultaneously, the ultimate goal of any SSC is to support the main business lines (e.g. asset management, investment banking, wealth management and retail banking) as a back-office function. There is usually a pro-active collaboration between the front business lines and the SSC in terms or services needed.

All the above arguments demonstrate that - in practice - neither the evidence that service has been rendered nor the provision of benefits to the recipients present a significant issues that WP6 should further elaborate on in the envisaged update of Chapter VII.

b. Drawing a distinction between: (i) activities which do or do not benefit the local affiliates; (ii) benefits that purely arise from group membership and those that arise from a deliberate concerned action; and (iii) shareholder activities and stewardship activities

Ad (i): See our comments on 2 a) above and 2c) below.
Ad (ii): In our view, the distinction between the ways the intra-group services are ordered is not of a practical relevance. Ultimately, both groups have to be classified either as shareholder or as other services and the related costs should be directly or indirectly charged to the benefiting enti-

ties.
Ad (iii): The SBA believes that the distinction between shareholder activities and the rest of the intra-group services was sufficiently described in Art. 7.9 to 7.10 of Chapter VII. We would welcome, if WP6 would mention in the updated of Chapter VII, Art. 7.9 that the category stewardship activities should no longer be used by the tax authorities and the tax payers. Finally, it would be highly appreciated if WP6 would mention that even shareholder costs should be charged to the top holding company at Cost+5%, if performed by SSC.

c. Identifying in practice duplicated activities

In our view, there is such a high-pressure on costs in a MNE – maximizing the shareholder value – that there is no interest to incur costs unnecessarily or provide any intra-group services inefficiently. In a well-organized MNE the local CEOs / COOs regularly discuss the amount and quality of intra-group services provision with the Head of CSS. Therefore, we believe that the duplication of activities is not of practical relevance anymore.

d. Finding an appropriate allocation key for charging intra-group services

The SBA believes that the most suitable allocation key or keys should reflect the underlying need for the particular services.[9] The major problem in practice is that the intra-group services receiving entities cannot usually identify the need for such a service on their own. This is because the recipients of LVAIGS are companies and branches employing business related specialists that do not have any expertise e.g. in accounting, group tax or group legal issues. In our view, the most pragmatic allocation key is the approximation of the time spent by the cost center (e.g. group tax) for individual entities.

e. Determining the costs that should or should not be included in the cost base of the remuneration for the provision of services between associated enterprises

In our view, full costs related to providing the service should be included in the cost base including both direct and indirect costs (e.g. allocations). However, neither the cost base nor the profit mark-up should include VAT/GST or WHT applicable to the service. The arm's length remuneration should present the basis for the determination of the output VAT/GST or the applicable WHT.

Due to the widely spread use of integrated business models, the cost base for intra-group services is frequently built by another intra-group charge remunerated with CPM as well. The SBA would highly appreciate, if WP6 would explicitly mention in the envisaged update of Chapter VII that all intra-group services influencing the cost base for another intra-group service should be remunerated at arm's length. In addition, it would be welcome to mention that netting of intra-group services charges is not allowed from the transfer pricing perspective.

[9] OECD TPG, Chapter VII, Art. 7.59.

	f. Assessing the arm's length conditions for services provided in connection with the use of intangibles; services that are highly integrated with the value creation of the MNE group; and/or involve significant risk.

See the SBA's comments 2 a) to d) above.

We thank you for taking due consideration of our comments

Yours sincerely,
Swiss Bankers Association

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