Comments to the OECD 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 International Chamber of Commerce (ICC), as the world business organization speaking with authority on behalf of enterprises from all sectors in every part of the world, welcomes the opportunity to provide comments on the Discussion Draft regarding BEPS Action 10 to modify the transfer pricing guidelines relating to low value-adding intra-group services. Many multinational enterprises (MNEs) choose to centralise or regionalise activities for reasons of commercial efficiency, and this inevitably leads to a need to recover costs cross border. ICC therefore welcomes modifications to the transfer pricing guidelines where this will enhance certainty and clarity for taxpayers and tax administrations alike.

No commercial business incurs an expense solely for the purpose of obtaining a tax deduction, as it is a poor strategy returning less than the amount of the initial outlay. For that reason no business would deliberately set out to duplicate costs. On the contrary most multinational businesses need to remain competitive, and are therefore very focussed on reducing costs in real terms year on year through productivity improvements in their supply chain and support costs. For these reasons we believe that:

1. The risk of duplicative costs is low.
2. The risk that an activity would be undertaken that is not needed is also low, with a corresponding impact on the risk that benefits have not been provided.

In ICC's view the key practical challenge facing a taxpayer is to ensure that the costs are properly recharged to the operating businesses that have benefitted overall from the business expenditure. If the expense is a valid business expense, in principle it seems fair that such costs should be able to be recharged and should be able to be deducted considering it is implicit in the arm's length standard that there are two parties to every transaction, and that therefore both the income and the expense are within the charge to tax.

ICC believes that it would be helpful at the beginning of section B to explicitly recognise that a business will not generally incur an expense unless it is necessary, and that due to competition the majority of businesses operate continuous business improvement programmes in order to become more efficient. This is important context in which the benefits test should be evaluated and whether the services being provided are duplicative.

Paragraph 7.12 on duplication does not mention the fact that in a regulated industry such as banking, local regulatory requirements have a strong influence on how certain support functions are organised. Even where branches and subsidiaries are subject to consolidated supervision by the home regulator, local regulators will still expect to see controlling and reporting functions such as compliance, finance, risk and internal audit performed in country. This may result in some inevitable duplication of the control functions.

ICC welcomes the acknowledgement that MNEs may have few alternatives but to use cost allocation and apportionment methods. In practice some tax authorities still expect to audit to the level of individual third party invoices based on the idea of a direct one to one service relationship. We recommend that paragraph 7.27 is strengthened to make it clear that the indirect nature of the service provision should not be a reason by itself for the expense to be denied.

ICC welcomes the opportunity provided by the simplified charge mechanism set out in D.2 to reduce the tax compliance burden for both taxpayers and tax administrations for what should be a low risk area in tax audits. In particular we welcome the comments at D.2.5 which make clear how the benefits test is to be applied in connection with low value-adding services, as this is often one of the most difficult problems experienced by taxpayers in practice seeking to recover costs incurred and to avoid double taxation.

However there are still two common scenarios where double taxation is incurred and which will not be helped by the discussion paper:

1. Even where all the requirements are satisfied, there are a number of countries that impose absolute limits on the amount of services recharged by foreign affiliates – whether low value-adding or not – generally by reference to a percentage of sales. Clearly, this penalises MNE taxpayers that operate a highly centralised business model compared with other MNE taxpayers and compared with domestic taxpayers. Moreover ICC understands that the Discussion Draft does not represent a consensus view and urges member states to reach agreement to reduce double taxation on the issues described. Similarly, ICC encourages the OECD to engage with non-OECD members to obtain further commitment on a common treatment.
2. High withholding taxes (where the services are sourced outside of the country levying the withholding taxes) or irrecoverable indirect taxes levied on the gross amount of services recharged by foreign affiliates may mean that in the case of low value-adding services with a mark-up on costs in the range of 2-5% there may be a net cost to the taxpayer for making the recharge.

In the case of a mark-up on costs of 2-5% applied to an appropriate cost base, it is clear that eroding the tax base to take advantage of differences in corporate income tax rates is not the primary motivation.

The proposal requires that all costs related to providing low-value adding services incurred by any members of the group are pooled, before being allocated to group members. In practical terms, this would have a severe impact on certain taxpayers as it appears that complex allocation processes would have to be combined. In practice, the same result would be achieved if the teams responsible for both sets of charges were simply to apply the same cost mark-up to their low-value adding services. It would be helpful if taxpayers were given the option to set up sub-pools where different categories of costs are handled by different parts of the organization. Furthermore, the proposal should make it clear that there is no requirement for a mark-up to be applied to pass through costs.

In case of divestments it may take some time to reduce the group low value-adding services, e.g. due to legal restraints to laying-off people, etc. Thus, while the charge-out basis is reduced at the time of the divestment, the level of the costs related to low value-adding services is reduced later on. It is important for the taxpayer that also these temporarily higher costs regarding low value-adding services can be deducted from the tax base, in order to prevent double taxation.

Regarding paragraph 7.61 on documentation, it would be helpful if the final version would refer to the paper on Action 13 (i.e. whether this information should be included in the Master File or Local File).

ICC believes that removing these specific impediments and permitting businesses to centralise low value-adding services in the location where it makes most commercial sense (without concerns about double taxation) would make a more positive contribution to global economic growth.

ICC also recommends that the following aspects be covered by OECD in BEPS Action 10:

a) The range of mark-ups could be from 0%-5% to allow for those industry sectors where the charging of a mark-up may not be permitted (e.g. some production sharing arrangements) or where the tax payer is using a 0% mark-up in compliance with the country's cost sharing regulations.
b) The draft guidelines tend to address simplification measures largely from a service provider's perspective. More emphasis should also be given to respecting the election of the simplification measure from the perspective of the service recipient; or the low value-adding intra-group services should be made part of a bilateral safe-harbour.

The International Chamber of Commerce (ICC)

Commission on Taxation

ICC is the world business organization, whose mission is to promote open trade and investment and help business meet the challenges and opportunities of an increasingly integrated world economy. Founded in 1919, and with interests spanning every sector of private enterprise, ICC's global network comprises over 6 million companies, chambers of commerce and business associations in more than 130 countries. ICC members work through national committees in their countries to address business concerns and convey ICC views to their respective governments.

The fundamental mission of ICC is to promote open international trade and investment and help business meet the challenges and opportunities of globalization. ICC conveys international business views and priorities through active engagement with the United Nations, the World Trade Organization, the Organisation for Economic Co-Operation and Development (OECD), the G20 and other intergovernmental forums.

The ICC Commission on Taxation promotes transparent and non-discriminatory treatment of foreign investment and earnings that eliminates tax obstacles to cross-border trade and investment. The Commission is composed of more than 150 tax experts from companies and business associations in approximately 40 countries from different regions of the world and all economic sectors. It analyses developments in international fiscal policy and legislation and puts forward business views on government and intergovernmental projects affecting taxation. Observers include representatives of the International Fiscal Association (IFA), International Bar Association (IBA), Business and Industry Advisory Committee to the OECD (BIAC), Business Europe and the United Nations Committee of Experts on International Cooperation in Tax Matters.