

What is your CFO's plan for streamlining intra-group services? (1)

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Let's introduce today's speakers:



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- Reduce the number of intercompany invoices;
- Standardize the costs captured in each invoice;
- Allow for flexibility to capture variations in price and quantity of service delivered;
- Create for a risk management framework for challenges from tax authorities on Share Service Centre costs; **and**
- Automate the complete process.

Services vs Operational cost

Example: How to allocate cost of management board involved in operational decision making?

Direct vs Indirect cost

Example: How to calculate a daily rate for a service engineer?

Full vs Marginal costing methods

Example: When can you apply a marginal costing method where group services run both ways, i.e. all service providers are also service recipients?

Actual cost vs Budget (pre-calculatory vs actuals)

Example: When do you keep the group service provider accountable for budget cost overrun?

How do local tax authorities apply the benefit test vs how can you defend it

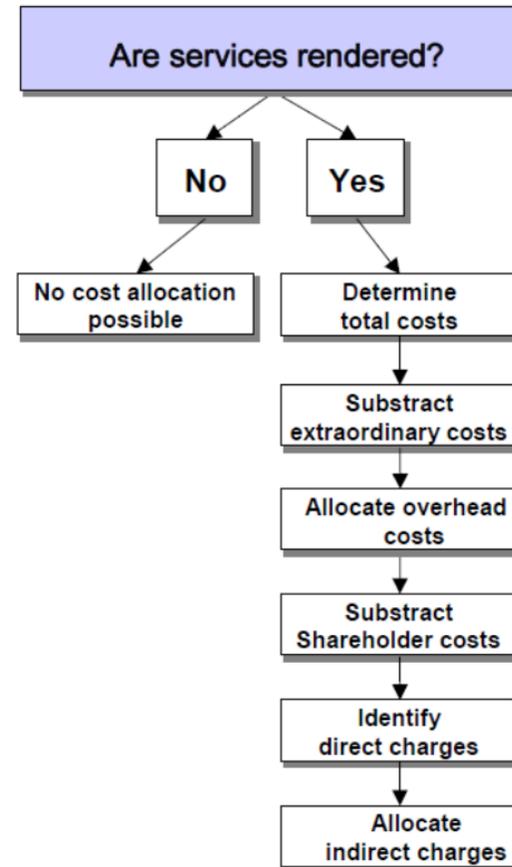
Example: How do you link the services delivered by the “global contract” department to the ultimate service charge?

I/c services as ‘Staff’ vs ‘Line’ functions

Example: If 75% of your HQ is involved in operational and transactional decision making, can you still charge out the HQ cost at “cost plus”?

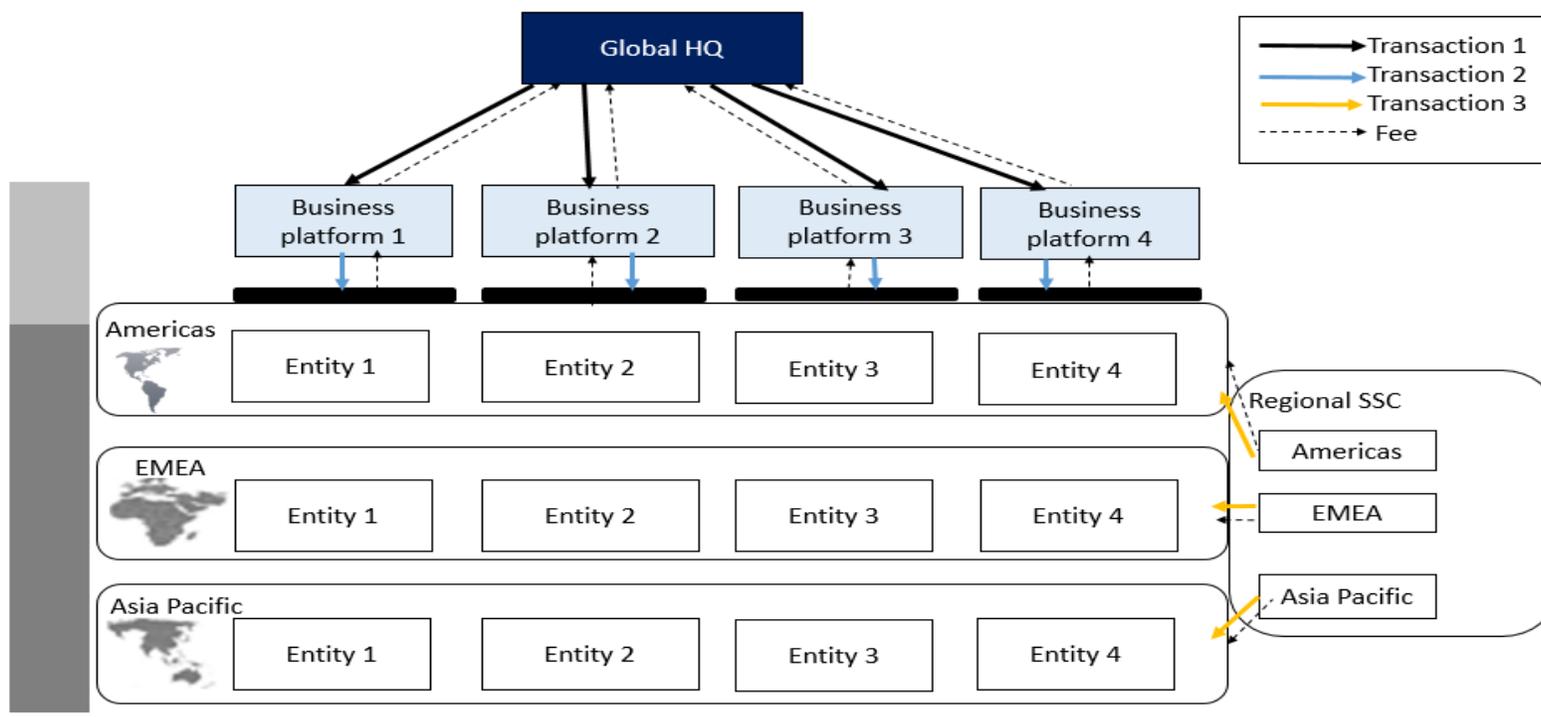
- Allocation of risks on intercompany services - infra-structure and capacity.
Example: How to account for less than 100% utilization of the service providers' capacity, i.e. who is "best placed" to bear the "service" capacity risk?
- Ratio 'imported OPEX' to 'total OPEX' of service recipient - i.e. defining the tipping point.
Example: Is this ratio a reflection of your business model or not?

Practical application - Decision Tree



See appendix A for a list of shareholder costs definitions used by OECD/ EU/ UN

3x3x3 model



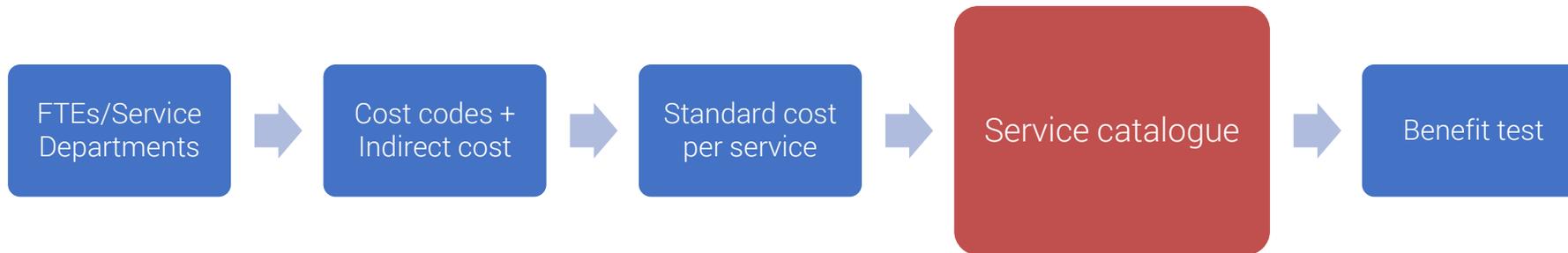
Transaction 1: Provision of Global Support services by Global HQ to the relevant service recipients (“SRs”);

Transaction 2: Provision of Global Business Platforms Support services by four Global Business Platforms (“GBPs”) to the relevant SRs; and

Transaction 3: Provision of Regional Support services by Regional Shared Service Centres (“SSCs”) to the relevant SRs.

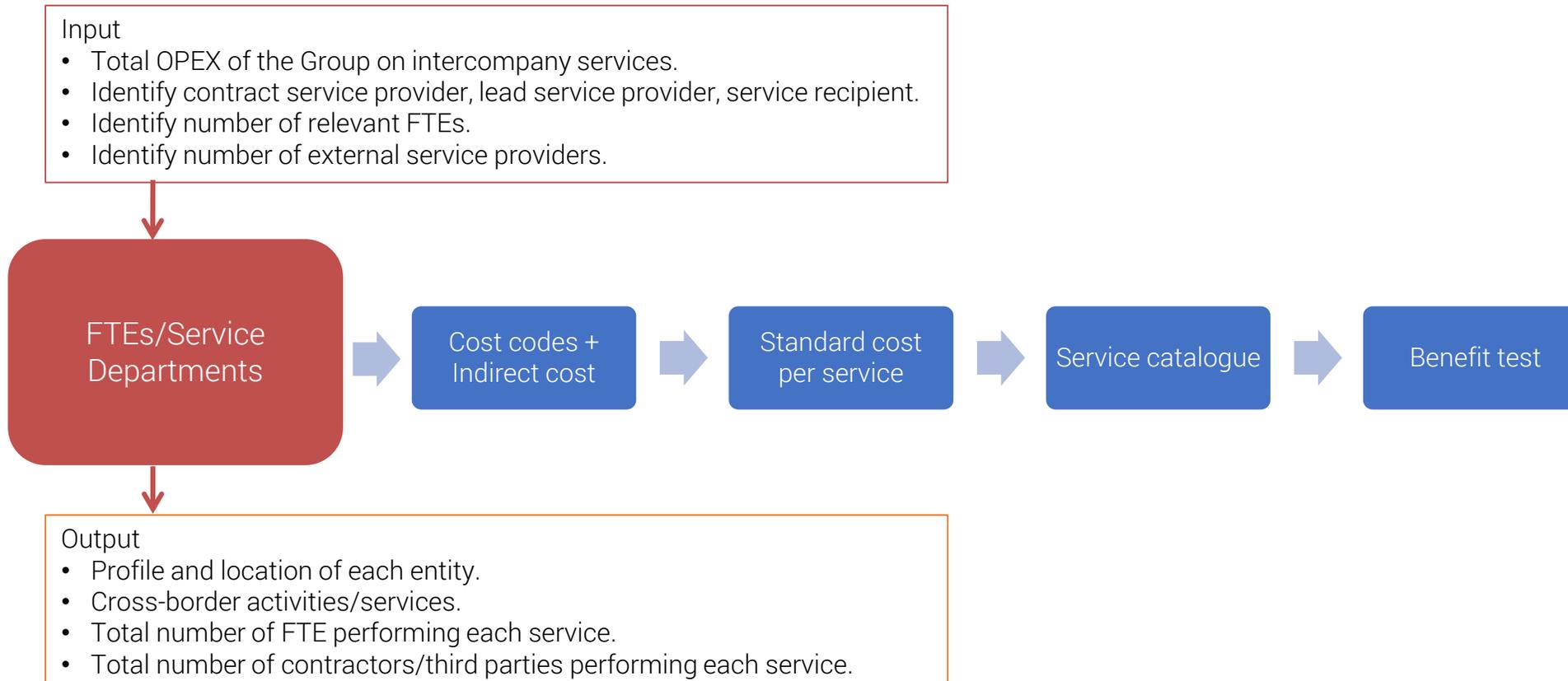
Process mapping on service catalogue

Activity → Cost → Service Catalogue



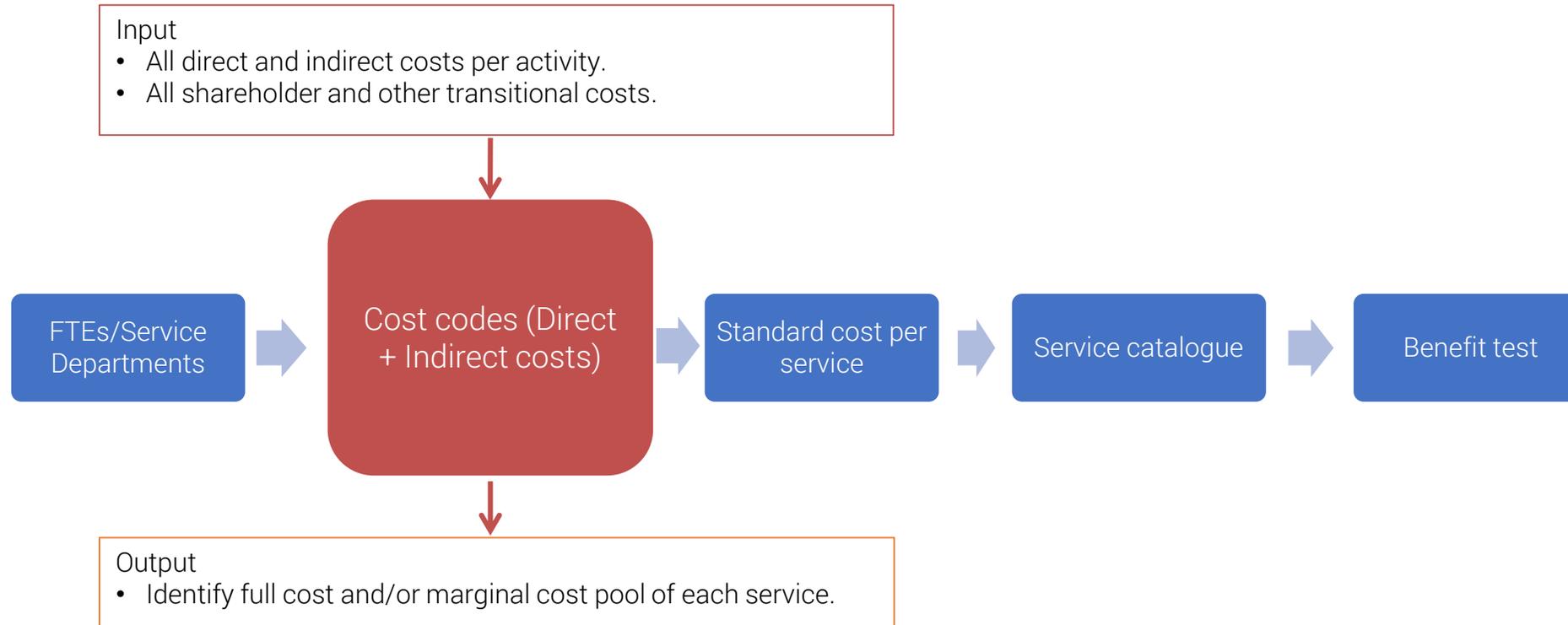
Process mapping on service catalogue

Activity → Cost → Service Catalogue



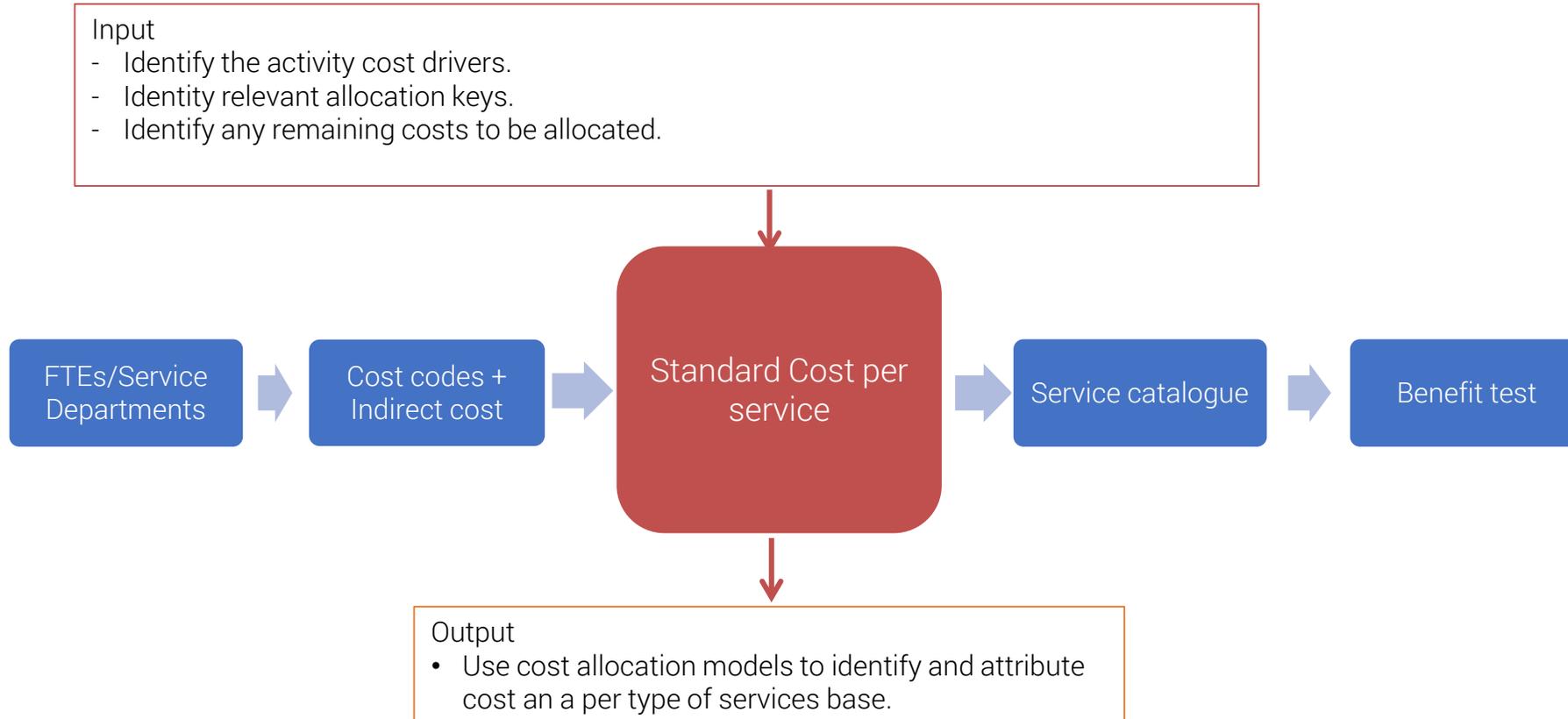
Process mapping on service catalogue

Activity → Cost → Service Catalogue



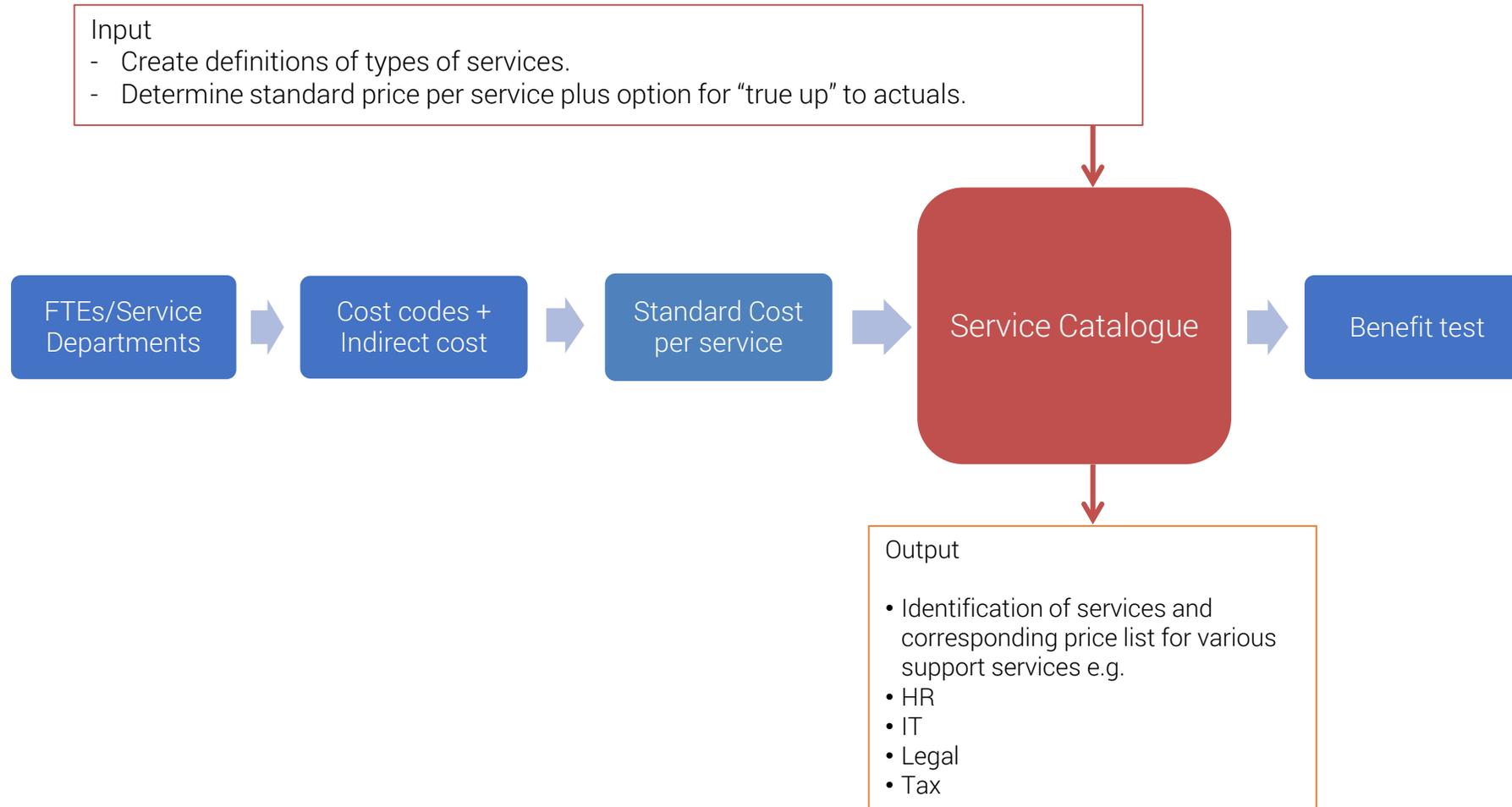
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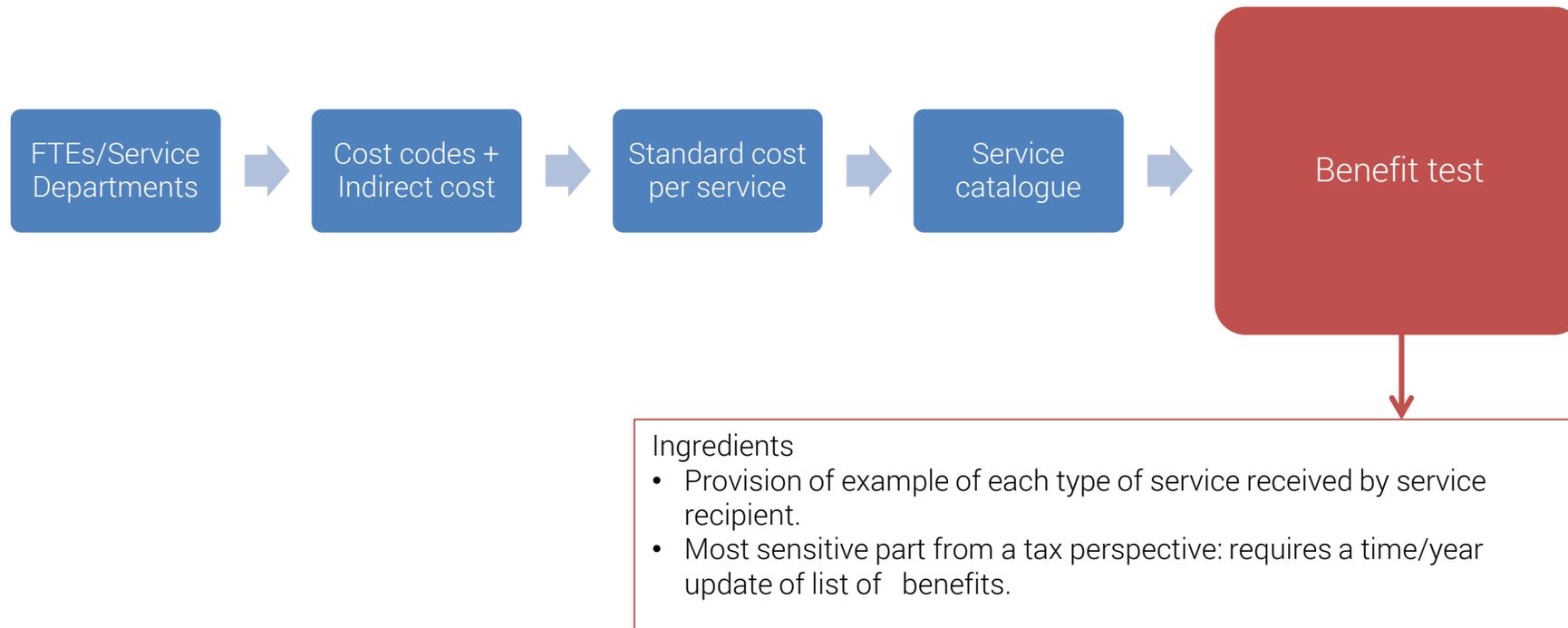
Process mapping on service catalogue

Activity → Cost → Service Catalogue



Process mapping on service catalogue

Activity → Cost → Service Catalogue



Definition Shareholder costs

OECD (2017)	EU JTPF (2010)	UN (2017)
<p>“7.9 [...] an intragroup 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.”¹</p>	<p>“41. The OECD guidelines refer to certain activities that constitute shareholder activities. [...]”²</p> <p>“42. There is though a fundamental benchmark test that can be applied when deciding if a cost is in fact a shareholder cost.”²</p> <p>“44. Judgement 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. [...]”²</p>	<p>“B.4.2.13. Shareholder activities are activities undertaken to provide an economic benefit only to the shareholder company (ultimate parent company or any other shareholder such as an intermediary holding company, depending on the facts of the case) in its capacity of shareholder. Accordingly, the cost of shareholder activities should be borne exclusively by the shareholder. Shareholder activities performed by an associated enterprise on behalf of its parent company should be charged to the parent company on an arm’s length basis.”⁴</p>

¹Organisation for Economic Cooperation and Development; Transfer Pricing Guidelines 2017, Paragraph 7.9.

²EU Joint Transfer Pricing Forum; JTPF Report: Guidelines on Low Value Adding Intra-Group Services, Paragraph 41, 42 and 44.

³German Federal Ministry of Finance (“BMF”); Administrative Guidelines 1983.

⁴United Nations; Practical Manual on Transfer Pricing for Developing Countries (2017), Paragraph B.4.2.13.

Benefit test

OECD (2017)	EU JTPF (2010)	UN (2017)
<p>"7.6 [...] the activity provides a respective group member with economic or commercial value to enhance or maintain its business position. This can be determined by considering whether an independent enterprise in comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise or would have performed the activity in-house for itself. If the activity is not one for which the independent enterprise would have been willing to pay or perform for itself, the activity ordinarily should not be considered as an intra-group service under the arm's length principle."¹</p>	<p>"7.1 Has a Service been provided?"</p> <p>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."²</p>	<p>"B.4.2.3. The benefit test is used to determine whether a member of the MNE group has received a chargeable service from an associated enterprise. The benefit test has two requirements both of which must be satisfied. Secondly, the associated enterprise must demonstrate that an independent entity in the same or similar circumstances would have been prepared to pay for the services or perform the services itself. [...]"⁴</p> <p>"B.4.2.5. The underlying notion of the benefit test is that, in order to be chargeable, the service must provide or be expected to provide the recipient with commercial value to enhance its actual or expected commercial position in an identifiable way. [...]"⁴</p>

¹Organisation for Economic Cooperation and Development; Transfer Pricing Guidelines 2017, Paragraph 7.6.

²EU Joint Transfer Pricing Forum; JTPF Report: Guidelines on Low Value Adding Intra-Group Services, Section 7.1/Paragraph 26.

³German Federal Ministry of Finance ("BMF"); Administrative Guidelines 1983, Section 6.2.

⁴United Nations; Practical Manual on Transfer Pricing for Developing Countries (2017), Paragraph B.4.2.3. and B.4.2.5.

On-call services

OECD (2017)	EU JTPF (2010)	UN (2017)
<p>"7.16 Another issue arises with respect to services provided "on call". The question is whether the availability of such services is itself a separate service for which an arm's length charge (in addition to any charge for services actually rendered) should be determined. A parent company or one or more group service centres may be on hand to provide services such as financial, managerial, technical, legal or tax advice and assistance to members of the group at any time. In that case, a service may be rendered to associated enterprises by having staff, equipment, etc., available. An intragroup service would exist to the extent that it would be reasonable to expect an independent enterprise in comparable circumstances to incur "standby" charges to ensure the availability of the services when the need for them arises. [...]"¹</p>	<p>7.6 "On call services" (OECD 7.16-7.17)</p> <p>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. [...]"²</p> <p>"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."²</p>	<p>"B.4.2.11. Intra-group on-call services apply in a situation where an associated enterprise agrees to provide a particular type of service immediately or within a short period of time. In order to do so it must maintain the staff necessary to provide such services promptly as requested, even though some staff members may not be fully utilized by the MNE group at all times. On-call services may also be called 'call off contracts' and 'stand by contracts'. The expected economic benefit to the recipient of being able to call on such services without delay when needed may be a sufficient business advantage to satisfy the benefit test, even if the contingency requiring the service never arises and actual services are never or infrequently provided. An associated enterprise that is a potential recipient of such on-call services would therefore be expected to pay the service provider for maintaining the necessary staff to provide the service, even during times when the potential recipient does not call on the associated enterprise to provide the service. The existence of an economic benefit for on-call services will need to be considered on a case-by-case basis to ensure that an associated enterprise is actually receiving a benefit from having a service provider on call and that an independent enterprise in the same or similar circumstances would have been willing to pay."³</p>

¹Organisation for Economic Cooperation and Development; Transfer Pricing Guidelines 2017, Paragraph 7.16.

²EU Joint Transfer Pricing Forum; JTPF Report: Guidelines on Low Value Adding Intra-Group Services, Paragraph 54 and 55.

³United Nations; Practical Manual on Transfer Pricing for Developing Countries (2017), Paragraph B.4.2.11.

Profit mark-up

OECD (2017)	EU JTPF (2010)	UN (2017)
<p>"7.31 The method to be used to determine arm's length transfer pricing for intra-group services should be determined according to the guidelines in Chapters I, II, and III. Often, the application of these guidelines will lead to use of the CUP or a cost-based method (cost plus method or cost-based TNMM) for pricing intra-group services."¹</p> <p>"7.61 In determining the arm's length charge for low value-adding intragroup services, the MNE provider of services shall apply a profit mark-up to all costs in the pool with the exception of any pass-through costs as determined under paragraphs 2.99 and 7.34. The same mark-up shall be utilised for all low value-adding services irrespective of the categories of services. The mark-up shall be equal to 5% of the relevant cost as determined in Section D.2.2. The mark-up under the simplified approach does not need to be justified by a benchmarking study. The same mark-up may be applied to low value-adding intra-group services performed by one group member solely on behalf of one other group member, the costs of which are separately identified under the guidance in paragraph 7.57. It should be noted that the low value-adding intra-group services mark-up should not, without further justification and analysis, be used as benchmark for the determination of the arm's length price for services not within the definition of low value-adding intra-group services, nor for similar services not within the elective, simplified scheme."¹</p>	<p>"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."²</p> <p>"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)."²</p> <p>"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."²</p> <p>"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."²</p>	<p>"B.4.2.2. The profit margin which an associated enterprise may derive under the arm's length principle from providing intra-group services varies. A lower profit mark-up is derived from low value-adding services such as administrative services. Such services are necessary for the efficient operation of the international operations of an MNE group but they do not create significant value for the MNE group. On the other hand, services associated with an MNE group's core business activities, which are incurred to maintain or improve the MNE group's profitability, viability or market position, may create greater value and carry a higher profit margin."⁴</p>

¹Organisation for Economic Cooperation and Development; Transfer Pricing Guidelines 2017, Paragraph 7.31 and 7.61.

²EU Joint Transfer Pricing Forum; JTPF Report: Guidelines on Low Value Adding Intra-Group Services, Paragraph 59, 60, 61 and 63.

³German Federal Ministry of Finance ("BMF"); Administrative Guidelines 1983.

⁴United Nations; Practical Manual on Transfer Pricing for Developing Countries (2017), Paragraph B.4.2.2.

Indirect-charge methods (e.g. allocation keys)

OECD (2017)	EU JTPF (2010)	UN (2017)
<p>"7.24 A direct-charge method for charging for intra-group services can be difficult to apply in practice. Consequently, some MNE groups have developed other methods for charging for services provided by parent companies or group service centres. In such cases, MNE groups may find they have few alternatives but to use cost allocation and apportionment methods which often necessitate some degree of estimation or approximation [...]. Such methods are generally referred to as indirect-charge methods and should be allowable provided sufficient regard has been given to the value of the services to recipients and the extent to which comparable services are provided between independent enterprises. [...] 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."¹</p>	<p>"47. Two particularly relevant OECD guidelines comments about allocation keys are:</p> <p><i>"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).</i></p> <p><i>"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)"²</i></p>	<p>"B.4.3.7. A direct charging method may be difficult to apply and the cost of direct charging may be an administrative burden which is disproportionate to the services provided. Many MNEs have developed indirect charging methods using an apportionment method to reflect the relative benefit that each associated enterprise is expected to receive from the provision of intra-group services. Allocation keys used by MNE groups are based on objective factors which are proxy measures for the relative economic benefit an associated enterprise receives from centralized services. [...] Allocation keys are acceptable provided they reasonably comply with the arm's length principle. The main feature of indirect methods is that the allocations are estimates of the relative benefits that associated enterprises expect to receive from services. The allocation may be based on a single factor or several factors used in combination to apportion the expenses."³</p>

¹Organisation for Economic Cooperation and Development; Transfer Pricing Guidelines 2017, Paragraph 7.23.

²EU Joint Transfer Pricing Forum; JTPF Report: Guidelines on Low Value Adding Intra-Group Services, Paragraph 47.

³United Nations; Practical Manual on Transfer Pricing for Developing Countries (2017), Paragraph B.4.3.7.

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