activity. Such an economic benefit exists if an independent entity in the same or similar circumstances would be willing to pay for the services or perform the activity itself. This principle is referred to in this chapter as the "benefit test" and is considered in more detail below (paras. 10–13).

B.4.3. A transfer pricing analysis of intra-

d

B.4.11. An examination of the facts and circumstances will be required to determine whether the benefit test has been satisfied for an enterprise receiving an intra-group service. The level of detail covered by such a factual examination, and the amount and nature of documentation required to demonstrate satisfaction of the benefit test, should be based on the materiality of the service charges. ~~The topic of appropriate documentation for intra-group service charges is discussed in greater detail later in this Chapter.~~

B.4.12. 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 anticipated commercial position in an identifiable way. For benefit test is satisfied and a chargeable service has been provided, even though the activity may not always actually result in benefits.

Service activities for the specific needs of an associated enterprise

B.4.14. Associated enterprises may request the provision of specific intra-group services. Services provided specifically to one member of the MNE group and designed specifically to its operations will generally satisfy the benefit test. For example, an associated enterprise which is part of an MNE group involved in telecommunications may suffer reputational damage and a potential loss of business if information technology (IT) problems prevent customers from using its telecommunications system. If an IT problem arises and direct assistance is provided promptly to the associated enterprise by another member of the MNE group specializing in the provision of IT services, the service would satisfy the benefit test as the associated enterprise has received an economic benefit to maintain its business operations.

B.4.15. Similarly, if an associated enterprise seeks assistance in the design of a targeted marketing campaign from a related party which specializes in marketing strategies and practices, the associated enterprise providing the marketing strategy advice is providing a service designed to meet the specific needs of the recipient. The benefit test would generally be satisfied in such a circumstance because the associated enterprise anticipates a commercial benefit from the service, and an independent enterprise in the same or similar circumstances would be willing to pay for the provision of such services.

Centralized services

B.4.16. An MNE group will often ~~will~~ centralize certain business functions within an associated enterprise operating as a service provider to the rest of the group or to a sub-group of associated enterprises, such as a regional sub-group, for their benefit. A wide variety of services may be centralized in this manner, including both low and high-value adding services. Depending on the facts, each associated enterprise benefitting from the services provided by a centralised service provider should be charged an arm"

~~This excludes activities that (are intended to) provide a benefit to a group company and for which an independent party would be willing to buy or perform the service itself. Such activities can be considered a provision of services to the respective MNE group company. Managerial and control activities related to the management, protection and enhancement of a specific investment will be the responsibility of the local operating company and should be allocated accordingly as an intra-group service.~~

~~Other Holding Company activities~~

~~Other shareholder activities undertaken by or on behalf of the ultimate shareholder might include (but are not limited to) group governance activities, corporate structure activities, group treasury activities.]~~

B.4.21. Shareholder activities may include the following:

the preparation and filing of reports required to meet the juridical structure of the parent company;

the appointment and remuneration of parent company directors;

the meetings of the parent company‟s board of directors and of the parent company‟s shareholders;

the parent company‟s preparation and filing of consolidated financial reports, reports for regulatory purposes, and tax returns;

the activities of the parent company for raising funds used to acquire share capital in subsidiary companies; and

the activities of the parent company to protect its capital

Othef1 0 0 1 146.18 384.176P 16789.3GBiperat compb2 Tf1 0 0 1 146.18 384.MC 9916789.3GBd to d3(vit)-3(ies)7(ti)-3 I

and it is required by the stock exchange and securities regulators to report its financial position periodically. The reporting requirements include the group‟s consolidated profit and loss statements and balance sheet prepared in accordance with International Financial Reporting Standards. Subsidiary Co is a subsidiary company resident in Country B and maintains its own accounting function to support the operation of its business. Subsidiary Co is required under the domestic law of Country B to prepare its accounts in accordance with International Financial Reporting Standards and to annually file statutory financial statements. Subsidiary Co‟s chief financial officer provides certain reports and financial statements to Controller Co for inclusion in the group‟s consolidated financial statements. The incorporation of this material into Controller Co‟s consolidated financial statements are actions that Controller Co carries out as a shareholder of Subsidiary Co, Controller Co cannot impose a service charge on Subsidiary Co for reviewing and incorporating its financial statements into the group‟s consolidated financial statements that Controller Co is required to file, as these activities do not provide Subsidiary Co with a benefit. These activities are exclusively attributed to the obligations imposed on Controller Co as a listed company. If Subsidiary Co incurs costs in preparing financial statements for the group‟s consolidated financial statements that exceed ~~the requirements of meeting~~what is necessary to meet the financial reporting requirements in Country B, Controller Co should compensate Subsidiary Co on an arm‟s length basis for the additional activities.

Duplication of activities

B.4.25. Duplication of services occurs when a service is provided to an associated enterprise which has already incurred costs for the same activity performed either by itself or on its behalf by an independent entity. Duplicated activities are usually not chargeable services. The determination of duplication must be made on a case-by-case basis. There are some circumstances in which duplication may provide an associated enterprise with a benefit if an independent party would have been willing to pay for the duplicated services in similar circumstances. For example, this situation may arise

~~Majority locally hosted and supported services delivered to suit local aspirations.~~

- ~~Local hardware costs~~
- ~~Local services costs~~
- ~~Network costs~~
- ~~Local IT staff on-site~~
- ~~3rd party costs charged directly to Company X" operating companies.]~~

B.4.27. When an activity is in the process of being centralized for an MNE group, acceptable duplication may occur during the transition phase. For example, an MNE group may decide to centralize its human resources function for the group and this alteration would require the closure of each associated enterprise"s human resources department after the necessary data has been provided to the centralized human resources database. This process is likely to

the intra-group service. In some cases, the incidental follow-on benefits that an associated enterprise receives may be remote and would fail the benefit test as an independent party would not be willing to pay for the service.

Example 7~~6~~

Motorcycle manufacturing MNE X has an associated enterprise that serves as a distribution company in Country A, which is incurring losses. The Parent company‟s marketing department is asked for assistance and advice as to how to make the associated enterprise in Country A profitable. After studying the Country A consumer market and comparing that market with other markets where MNE X motorcycles are sold, the parent company‟s marketing department develops a marketing campaign for Country A where specifically adorned and highly decorated motorcycle helmets are given away for free together with motorcycles sold in Country A. There is no law requiring the use of motorcycle helmets in country A. The marketing campaign is a success and sales in Country A increase the next year. The helmets are actually quite popular due to their specific designs and adornments. The year after, an independent study shows that motorcycles of MNE X are less likely to be involved in deadly accidents. This study boosts the sales of MNE X‟s motorcycles in Country A. The associated enterprise in Country A is allocated the cost of the marketing campaign developed for it by Parent company. As a result of the independent study on motorcycle safety, however, the sales of MNE X motorcycles go up in countries B, C and D as well. These countries also have no laws that require the use of motorcycle helmets when riding a motorcycle. ~~In~~The issue is whether the marketing campaign cost incurred by the Parent company‟s marketing department perhaps ought to be allocated to associated enterprises in Countries B, C and D as well. The increased sales in Countries B, C, and D appear to be incidental benefits of the marketing campaign developed for Country A specifically.

Example 8~~7~~

Assume that an MNE group has

increasing efficiencies, economies of scale or other synergies. The incidental benefits ordinarily would not cause these other group members to be treated as receiving an intra-group service because the activities producing the benefits would not be ones for which an independent enterprise ordinarily would be willing to pay.

Functional analysis

B.4.31. If chargeable intra-group services have been rendered, the next step is to determine the arm‟s length service charges for transfer pricing purposes. Under the arm‟s length principle, charges for the services should reflect the charges that would be paid by independent entities in the same or similar circumstances.

general, any of the transfer pricing methods identified in the following section may be applied to identify an arm‟s length price under a direct charging method. For example, an overseas subsidiary may be directly charged for a 2-day visit of a software engineer who is employed by the parent company and who may have visited the overseas subsidiary‟s site at the latter‟s request to render certain consultancy services or advisory services. In such a case the parent company can charge the specific costs for these consulting services with or without a mark-up (as the case may be) directly promotion prospectively on the basis of the anticipated economic benefit for group members. Tax administrations of developing countries often find it difficult to verify the validity ~~authenticity~~ of these types of fees. Furthermore, determining whether the applied allocation is in accordance with the arm‟s length principle is another practical difficulty since intra-group services are mostly charged by applying an indirect charge method, utilizing various allocation keys. When the parent company of an MNE is located overseas, the local subsidiary companies can often only provide information regarding their own operations instead of an overall understanding of the entire intra-group services structure. Potential relevant information could be whether associated enterprises in other countries ~~who~~that similarly benefit from the services follow the same methodology to pay the service fees and the actual amount of the service fees charged to the various associated enterprises.

B.4.39. Generally, the direct charge method is preferred over the indirect charge method in cases where the services rendered by an associated enterprise to other group members can be specifically identified and quantified. In many circumstances, MNEs will not have an option but to use indirect cost allocation. In such cases, intra group services charged on an allocation basis will be acceptable if the allocation is a reasonable reflection of the expected benefits (see para 38).

Provision of assets and ancillary services

would be inappropriate for any additional service charges for training to be imposed on the associated enterprise.

B.4.42. For both direct and indirect charging methods, the transfer pricing methods in this Manual (Chapter 6) may be used to determine arm‟s length prices for intra-group services provided that they are reliable. If there is a disagreement between the tax authorities of the service provider and the service recipient on intra-group service charges, double taxation may occur. See Chapter 6 for a detailed discussion of the transfer pricing methods that can be appropriate for intra-group services, i.e. the Comparable Uncontrolled Price (CUP) method, the Cost Plus Method, the Transactional Net Margin Method (TNMM) and, in some circumstances of high value added services providing integrated benefits, the Profit Split Method (PSM).

CUP

B.4.43. The CUP method (see paras. 6.2.1-6.2.5.4.) requires a high degree of comparability between controlled and uncontrolled transactions. If an MNE group‟s service provider renders the same services in comparable circumstances to independent entities as it provides to associated enterprises, uncontrolled transactions should be compared based on the comparability factors discussed in Chapter 5. As the CUP method requires a high degree of comparability, details on the services rendered, functions performed, assets used and the risks borne in controlled and uncontrolled transactions may be needed. In addition, comparability may be affected if provision of the services involves the use of intangible assets. Other comparability factors may have an effect on the prices charged in uncontrolled transactions such as quantity discounts and contractual terms which may provide extended periods for payment of services rendered and associated guarantees.

B.4.45. If there are material differences between controlled and uncontrolled service transactions, reasonably accurate comparability adjustments are required. If such comparability adjustments cannot be made, the reliability of the CUP method will be reduced and the CUP method may not be the most appropriate method. While comparable service transactions between independent parties may take place, it is unlikely that the critical information on these transactions (such as the prices charged, functions performed, assets used and risks borne by the parties) will be available for comparison. This type of information on uncontrolled transactions is often confidential and unlikely to be publicly available.

Example 10~~9~~

Grain Co and Shipper Co are associated enterprises. Grain Co is resident in Country A and produces wheat for export. Shipper Co is resident in Country B and carries on a business of providing grain shipping services. Shipper Co provides grain shipping services to four independent enterprises and approximately 60 per cent of its business is made up of performing shipping services to these independent customers and 40 per cent of its business is performing shipping services for Grain Co. In this situation it is likely that Shipper Co would be able to use the CUP method as it has internal comparables to use in setting its transfer prices for Grain Co. The reliability of the comparables depends on a comparability analysis. Assume that there is a high comparability in terms of the type of service provided, the volume of transactions, the contractual terms and the economic conditions. In this case,

arm‟s length service charges based on the gross profit mark-up on costs earned by comparable independent service providers. The Cost Plus Method is often used for determining transfer prices for services.

B.4.47. Although the Cost Plus Method is less dependent on similarity between the controlled and uncontrolled services under the CUP method, the services in controlled transactions and comparable uncontrolled transactions should be similar. If material differences arise between the controlled transactions and the comparables, Indirect expenses may include the following items: depreciation of equipment and buildings; rent for leased items or immovable property; property taxes; occupancy and other overhead costs; maintenance costs; insurance; personnel costs, accounting~~,~~ and payroll expenses; and other general, administrative and managerial expenses. Total services costs do not include interest expenses, foreign income taxes or domestic income taxes.

Example 12~~11~~

A company that is a member of an MNE group provides an on-call service to its associated enterprises and the service satisfies the economic benefit test. Once it is established that an on-call service provides a benefit to group members the next issue for consideration is the service fee that may be charged. The fee for an on-call service may include part of the capital costs of providing the service, such as business premises and equipment as well as a profit margin. If the premises and equipment are leased, the charge would be a proportion of the annual lease fees. If the premises and equipment are purchased, it would be appropriate to allocate depreciation expenses to the recipients. An independent enterprise providing such services would be expected to include these expenses in the prices it charges its customers.

Transactional Net Margin Method (TNMM)

B.4.51. The TNMM may be used for services. (See 6.3.1.2-12.7. for more details on the TNMM). The TNMM examines the net profit margin of an associated enterprise~~"s~~ (the tested party) ~~net profit margin~~ from the controlled transactions, relative to an appropriate base. ~~that the enterprise makes from controlled transactions.~~ The TNMM focuses on net profit rather than gross profit margins and ~~the TNMM provides~~looks at comparable net profit margins for uncontrolled transactions. The TNMM may be based on internal comparables, such as those from uncontrolled transactions that the associated enterprise enters into. Alternatively, the profit margins may be obtained from transactions by independent parties.

Provider‟s net profit of 5 per cent is within the arm‟s length range of the net profit to the cost of providing the services. The service provider is treated as making a net profit of $5,000 from providing intra-group services to an associated enterprise.

Profit Split Method

B.4.54. The Profit Split Method may in certain circumstances be used for that provides a full range of solution services. In such a situation the profit split method can commonly be used as the most appropriate method for determining the arm‟s length price of the international transactions, based on a residual profit analysis.

Example # [TP example]

Air Express is engaged in the business of a logistics service provider offering a comprehensive portfolio of international, domestic and specified freight handling services. The group of entities ~~are~~is generally involved in international transactions ~~of~~involving freight services provided by associated enterprises. ~~expenses from AE's.~~ The business activities involve~~s~~ entering into contracts with third parties for ~~lifting~~moving their cargo from its source to destinations abroad. The execution of the job involves -lifting ~~of~~ cargo from the ~~place~~location of the customer~~s~~ in one country, ~~and~~ sending it to the country of ~~its~~ destination, collecting it from a port or airport and then supplying it to the ultimate buyer. All such activities are carried out by ~~A~~associated ~~E~~enterprises in various countries. The total expenses incurred in all countries are combined and then ~~reduced~~deducted from gross receipts~~,~~ and the residual amount is shared in the ratio of 50:50 between the entit~~ies~~y of the origin country and the entity of the destination country, based on a Profit Split Method.

Example # [TP example]

An MNE group is ~~involved in~~ operating in a few countries through its associated enterprises and ~~it~~ providing~~es~~ agency services to various re-insurance companies and ceding~~[?]~~ companies, whic~~h~~o places insurance risk ~~undertaken by them~~ by ceding it to re-insurance ~~C~~companies. ~~The e~~Each entity in the group co-ordinates in basis using another Profit Split Method. ~~is another profit split method.~~ Each party bears ~~their~~its own expenses. ~~]~~

Pass-through costs

B.4.55. In some circumstances an MNE group may decide to outsource some services to an independent entity and to use an associated enterprise to act as an agent for the group to pay the accounts and to then allocate the charges to its associated enterprises on an objective basis. These may be called pass through costs. As an agent, its only role may be to pay the independent service provider and to then allocate the total cost of services among group members on an objective basis. In such a case, it may not be appropriate to determine arm‟s length pricing as a mark-up on the cost of ~~-~~th

B.4.61. The following non-exhaustive list contains allocation keys that are commonly used by MNEs for certain types of services:[3]

Information technology: number of personal computers;

Business management software; number of licences;

Human resources: number of employees;

Health and safety: number of employees;

Staff training: number of employees;

Tax and accounting: sales or size of balance sheet;

Marketing services: sales to independent customers; and

Vehicle fleet management: number of cars.

multilateral safe harbour is available, ~~they are~~this is to be preferred as ~~they~~it reduces the risk of double taxation.

B.4.64. This chapter sets out two safe harbours that may be used by tax authorities:

> Low-value services that are unconnected to an associated enterprise‟s main business activity. This safe harbour is usually available for low-margin services. The rationale for a safe harbour is that there may be difficulties in finding comparable transactions for low-margin services; and the administrative costs and compliance costs may be disproportionate to the tax at stake. In addition, the safe harbour provides taxpayers and tax authorities with certainty.

> Safe harbours for ~~M~~minor expenses ~~safe harbours~~ are for situations in which the costs of services provided or received are relatively low, so the tax authority may ~~decide to~~ agree to not adjust the transfer prices provided they fall within the acceptable range. The rationale for this safe harbour is that the cost of a tax authority making adjustments is not commensurate with the tax revenue at stake and therefore the taxpayer cannot be expected to incur compliance costs to determine more precise arm‟s length prices.[4]

Low-margin services safe harbour

B.4.65. Low-margin services are services which are not part of an MNE group‟s main business activities from which it derives its profits. They are low-margin services that support the associated enterprise‟s business operations. A determination of an associated enterprise‟s low-margin services would be based on a functional analysis of the enterprise. The functional analysis would provide evidence of the main business activities of an associated enterprise and the way in which it derives its profits.

[4] These two safe harbours are based on the safe harbours in the Australian Taxation Office‟s Taxation Ruling 1999/1 Income Tax: International transfer pricing for intra-group services, paras. 77–87.

B.4.66. Low value-adding intra-group services are services performed by one member or more than one member of an MNE group on behalf of one or more other group members which :

are of a supportive nature;

are not part of the core business of the MNE group (i.e. not creating the profit-earning activities or contributing to economically significant activities of the MNE group);

do not require the use of unique and valuable intangibles and do not lead to the creation of unique and valuable intangibles, and

do not involve the assumption or control of substantial or significant risk by the service provider and do not give rise to the creation of significant risk for the service provider.

B.4.67. The following services are common examples of low-margin services:

human resources services;

accounting services;

tax compliance services; and

data processing

B.4.68. For an associated enterprise that is a distributor and marketer of an MNE group‟s products, marketing services woukM ai ¸ o _ uek f as e ¸icneʊ ʇ ʊ s ¸ m p ¯ iv¾ se strategic management services.

B.4.70. The determination of whether services qualify as low-margin services may require a case-by-case analysis of the key business activities of an MNE group.

B.4.71. A safe harbour may contain the following requirements:

identification of the service within the scope of the safe~~-~~ harbour;

a fixed profit margin;

an assumption that the same gross profit margin is accepted in the other country; and

the documentation requirements.

Example 16~~15~~

Manufacturing Co, Distributor Co and Services Co are associated enterprises. Manufacturing Co is resident in Country A and carries on the business of manufacturing goods. Distributor Co is resident in Country B and is a distributor of goods purchased from Manufacturing Co. The MNE group decides to centralize its human resources function in Services Co in Country C in order to obtain cost savings through economies of scale and the relatively low labour costs in that country. The total cost of human resources services provided to Distributor Co is $100,000 under a direct charging system and the agreed mark-up for this function is 7.5 per cent in Country C, therefore Distributor Co is charged $107,500 by

ilroadde-6(r:)] TEET(Cithi-12(da)4(ngr)ss p)yf t mar

On the facts, Distributor Co would be entitled to use the administrative services safe harbour as the human resources are less than 15 per cent of its total expenses and the mark-up on services is within the accepted range. On the basis that Distributor Co"s main business activity is distributing goods, human resources services would qualify as administrative services.

Minor expense safe harbour

B.4.72. In the minor expense safe harbour option, a tax authority agrees to refrain from making a transfer pricing adjustment if the total cost of either receiving or providing intra-group services by an associated enterprise is below a fixed threshold based on cost and a fixed profit mark margin is used. The aim is to exclude from transfer pricing examinations, services for which the charge is relatively minor. The rationale is that the costs of complying with the transfer pricing rules would outweigh any revenue at stake. It also considers the potential administrative savings for a tax authority by avoiding transfer pricing examinations of minor expenses. An important requirement is that the same fixed profit margin should be used for in-bound and out-bound intra-group services for a country. The safe harbour provides taxpayers and tax authorities with certainty. The minor safe harbour may contain the following requirements:

a restriction on the relative value of the service expense (e.g. less than X per cent of total expenses of the associated enterprise receiving the services);

a fixed profit margin;

the requirement that the same profit margin is used in the other country, and

the documentation requirements that are expected.

B.4.73. An example of a safe harbour for services is set out below.

For inbound intra-group services:

the total cost of the services provided is less than X per cent of the total deductions of the associated enterprises in a jurisdiction for a tax year;

the transfer price is a fixed profit mark-up on total costs of the services (direct and indirect expenses); and documentation is prepared to establish that

drafting and commissioning legal and tax opinions;
assistance in the fulfilment of legislative obligations;
assistance in the judicial litigation;
centralized management of relationship with insurance companies and brokers;
tax advice;
transfer pricing studies; and
protection of intangible property.

Accounting and administration services:

assistance in the preparation of the budget and operating plans;
keeping of the mandatory books and accounts;
assistance in the preparation of periodical financial statements, annual and extraordinary balance sheets or statements of account (different from the consolidated financial statement);
assistance in compliance with fiscal obligations, such as filing tax returns, computing, and paying taxes, etc.; data processing;
audit of the account of the subsidiary; and management of the invoicing process.

Technical services, for example:

assistance regarding plant, machinery, equipment, processes, etc.
planning and executing ordinary and extraordinary maintenance activities on premises and plant;
planning and executing ordinary and extraordinary restructuring activities on premises and plant;
transfer of technical know-how;
providing guidelines for the products" innovation;
production planning to minimize excess capacity and meet demand efficiently;
assistance in planning and implementing capital expenditure;
efficiency monitoring; and
engineering services.

Quality control services:

providing quality policies and standards of the production and provision of services;
assistance in obtaining quality certifications; and
~~certifications; and~~
development and implementation of client satisfaction programs.

Other services:

strategy and business development services in case there is a connection with an existing (or to be established) subsidiary;

corporate security;
research and development;
real estate and facility management;
logistic services;
inventory management;
advice on transport and distribution strategy;
warehousing services;
purchasing services and sourcing raw materials;
cost reduction management;
packaging services.