

 **UN-ATAF Workshop on Transfer Pricing
Administrative Aspects and Recent Developments**
Ezulwini, Swaziland
4-8 December 2017

 **AFRICAN TAX
ADMINISTRATION FORUM**

**TRANSFER PRICING FOR
INTRAGROUP SERVICES
TRANSACTIONS**

**Wednesday, 6 December 2017
9.00am – 1.00pm**



Sources of Guidance on Services

- UN Manual Section B.4.
- OECD Guidelines Chapter 7

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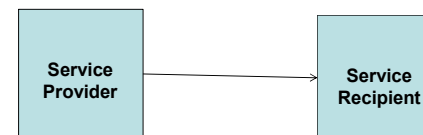
Company to Company Services

Service Transactions Can Include

- Marketing services
- Management and administrative services
- IT services
- Personnel services
- Research and development services
- Many other types of service transactions

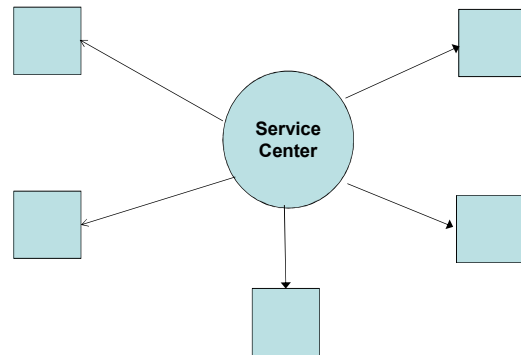
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Structure of Service Transaction



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Structure of Service Transaction



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Key TP Issues for Service Transactions

Key questions include:

- Has a compensable service been provided?
- Are there reasons that the recipient should make no payment for services it receives?
- How can arm's length compensation be determined in a case involving services?
- Can simplified safe-harbour approaches be applied?

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The Benefit Test

The benefit test guides determinations of whether compensable services have been provided

The benefit test is satisfied if:

- The recipient of the service receives a commercial benefit, and
- It can be determined that if the related party had not provided the service, the recipient would have undertaken the activity on its own account or would have hired a third party to perform the service activity.

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Shareholder Services

Even if the benefit test is satisfied, no compensation is required if the services constitute shareholder services, i.e. the primary benefit of the service activity accrues to the service provider in its role as a shareholder of the service recipient.

For example:

- Preparation of parent's regulatory reports, financial statements
- Meetings of parent's board of directors
- Cost of raising funds used for investment in share capital
- Protection of capital investments in service recipient

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Duplication of Services

Occurs when the service provider's service duplicates something the recipient already does for itself

- Are the services in fact duplicated
- Is there a business reason for the duplication of activities, such as reducing the risk of improper decisions
- Is the duplication a temporary consequence of centralizing operations or increasing efficiency

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Incidental Benefits of Group Membership

No compensation is required:

- If a member of an MNE group receives a benefit that is incidental to the rendition of services to another group member
 - Example: Manufacturing sub increases production because of marketing study performed by parent for a marketing sub
- If a member of an MNE group obtains benefits solely because of its membership in the group
 - Example: Reduced borrowing costs without a formal guarantee

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Summary of Rules on Compensable Services

An intragroup service activity must be compensated (paid for) if:

- The benefit test is satisfied
- The activity is not a shareholder service or shareholder activity
- The activity is not a duplicated service
- The benefit is not merely incidental to membership in the group or to a service provided to another group member

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Determining an Arm's Length Price for Service Transactions

- General transfer pricing principles are applied to determine the arm's length price for service activities
- This includes all of the principles discussed in Zambia and in Madagascar
 - Delineating transactions
 - Functional analysis
 - Selecting the most appropriate method
 - Identifying comparables
 - Applying approved transfer pricing methods

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Functional Analysis

The functional analysis in a case involving services must:

- Be sufficiently detailed to support the comparability analysis
- Identify composite transactions
 - Sales of tangible property and services in tandem
 - Use of intangibles in conjunction with the provision of services
- Must cover both the tested transaction and potential comparables

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Comparables

- The same principles on comparability discussed in Madagascar apply to services transactions
 - Transactions engaged in between unrelated parties
 - Either internal or external comparables acceptable for analysis
 - Close similarity to the tested transaction
 - Material differences susceptible to quantification and comparability adjustments
- The unique nature of service transactions makes close comparables difficult to identify

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On Call Services

Difficult comparability issues arise in connection with so-called “on call services”

- MNE group may maintain a global or regional team to address particular issues on a global or regional basis for all group members
- Team is cheaper than outsourcing, but in some periods the team may not be fully utilized
- Questions arise as to which entities should pay for “down” time of the team
- Similar issues arise when uneconomic local market is served for global group advantage even though local businesses may not be profitable. Who bears net losses?

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Transfer Pricing Methods

- Any of the approved transfer pricing methods can be applied to analyze services transactions
- CUP method may be preferred if necessary data is available, but it usually is not possible to apply the CUP method because services tend to be unique
 - Famous US case involving transport of iron ore
- Most service related cases are resolved using the Cost Plus Method, or a TNMM method using a cost based Profit Level Indicator

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Direct Charge Methods

Elements of a Direct Charge Method

- Accurate delineation of the service transaction in question
- Functional analysis
- Selecting the most appropriate transfer pricing method for the facts of the case
- Calculating the proper service fee, including any profit or markup elements

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Indirect Charge or Apportionment Methods

Elements of an indirect charge method

- Identification of the relevant service
- Assembling all relevant services costs in the cost pool
- Identifying appropriate allocation keys
- Determining proper markups, if any
- Calculating and assessing service fees

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Challenges in Applying Indirect Charge Methods

Particular challenges with an indirect charge method include:

- Ascertaining that the benefits test is satisfied for all pooled service costs
- Dealing with pass through costs
- Making sure that multiple markups are not present in the allocation system

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Management Fees

Issues often arise in connection with intragroup management fees

- Difficult issues can arise when intragroup management fees are charged for a group of corporate wide services
- Careful attention should be given by tax authorities to management fee arrangements that are calculated as a percentage of revenues
 - The services provided in connection with such arrangements are often not well described
 - Application of the benefit test for aggregated pools of services is very challenging
 - Comparable arrangements are unlikely to be identified

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Safe Harbour Approaches

- Some countries have adopted safe harbour approaches for some classes of services transactions
- The OECD, the EU, and the United States have all adopted simplifying safe harbour approaches for transactions involving “low value adding” services
- Some countries have adopted safe harbours for minor expenses falling below some defined threshold
- Many developing countries have been reluctant to adopt these types of safe harbour provisions because of the potential for service transactions to be used to erode the local tax base and because of the difficulty of auditing global service arrangements

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Case Study

Case Study #1

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