To	Tax Treaties, Transfer Pricing and Financial Transactions Division, OECD/CTPA	Date	June 20, 2018
From	KPMG International	Ref	KPMG Comments on Services Chapter VII

cc Stephen Blough, KPMG LLP, United States

Comments on the scope of the future revision of Chapter VII (intra-group services) of the Transfer Pricing Guidelines

Professionals in the member firms of KPMG International ("KPMG") welcome the opportunity to engage with the Organisation for Economic Co-operation and Development ("OECD") as it embarks on its project to provide additional guidance on the transfer pricing of services transactions in Chapter VII of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Guidelines"). KPMG commends the OECD for engaging the business community on this project at an early stage.

KPMG agrees with the OECD that the focus of the new guidance should be on the practical application of the underlying principles of Chapter VII. A common hardship faced by taxpayers in regard to services transactions is that while tax authorities might agree on the theoretical principles for the transfer pricing of these transactions, they may have divergent views on the practical application of those principles. The result is often significant uncertainty and compliance burden for taxpayers. Additional guidance from the OECD that reduces some of that uncertainty and compliance burden will be greatly welcomed.

KPMG provides some specific suggestions related to the proposed OECD guidance below.

Recognizing the global aspect of an MNE's business

OECD guidance should recognize that many, if not most, MNEs by their nature incur significant costs centrally in running their global businesses, which are appropriately deductible against income earned either where incurred or in other jurisdictions. Further many functions such as finance, human resources and legal will often have activity at both the headquarter (or other centralized service provider) and local levels. Associated with these structures are transfer pricing payments to the center for beneficial services received. These charges are properly understood as normal transactions associated with typical business structures, not as inherently high-risk transactions.

However, tax authority practices in some jurisdictions with respect to such charges involve very detailed factual assessments with a high burden of proof on the taxpayer to support the charges. While tax authorities are rightly focused on the activities of and benefits received by entities in their jurisdiction, their evaluations often implicitly or explicitly treat the business decisions of taxpayers to adopt centralized structures as subject to challenge under the arm's length principle. For example, tax authorities often require detailed documentation of benefit of activities of the center, when there is some local headcount; in other cases tax authorities deny deduction for services provided by the center on the basis that similar services could be provided locally at lower cost. These practices amount to challenges to the business judgment of the taxpayer regarding efficient operation of its business, while imposing administrative burdens on both tax authorities and MNEs that are far out of line with the risks associated with these transactions.

KPMG believes therefore that the OECD could significantly advance the interests of sound tax administration by providing additional guidance regarding indicators of risk with respect to intercompany services charges, and streamlined procedures where low risk is indicated.

Indicators of Risk

As discussed above, KPMG does not believe that payments of management and related services charges to headquarter or other centralized service centers are inherently high-risk transactions but rather are generally routine transactions inherent in the typical structure of global businesses. KPMG does not dispute that services transactions with elevated risk meriting closer examination exist – for example, services transactions closely intertwined with valuable intangibles or highly integrated with value creation of the group could fall in such category – but believes that the OECD could usefully identify indicators of risk that could assist tax authorities in focusing their efforts and significantly reduce the compliance burden of taxpayers with respect to routine transactions. Such indicators could be based on information contained in the Chapter V documentation package inclusive of master file, local file and country-by-country reports.

One indicator of low risk that KPMG recommends adopting is the existence of a principled and consistently implemented global policy for determining charges for centralized services to group companies. Such a policy would incorporate methods used for distinguishing beneficial from shareholder and other non-beneficial activities, including a description of the division of responsibilities between the center and local organizations, along with identification of reasonable allocation keys and consistent mark-ups. It would also set out the principles applied for determining whether any exception to the policy should be made. In financial services, for example, an exception could arise where the full allocation under the policy to a regulated entity in a particular country would cause that entity to be in breach of local regulatory requirements.

This approach would be documented at the global level, such as in the master file. The OECD could consider providing companies the opportunity to expand the existing section on services arrangements in the master file to document their uniform, global transfer pricing policies for centralized services—with the benefit that such documentation would support low risk treatment of the transactions inclusive of streamlined procedures.

Streamlined procedures

As noted above, taxpayers face very high administrative burdens in responding to tax authority requests for detailed local documentation of the beneficial receipt of centrally provided services, well out of proportion to the risk associated with these transactions. Streamlined procedures for low risk services transactions could include allowing benefits and charging policy (including allocations) to be supported at the group-wide level as described above, with local documentation limited to conformity with the global approach.

Further, the OECD could emphasize that if the taxpayer demonstrates on a global basis that beneficial services were rendered and received, there should not be additional challenges from tax authorities as to who should have provided those services. As discussed above, many MNEs have shared service centers in high cost jurisdictions for perfectly valid business reasons, yet face substantial administrative burdens responding to detailed requests from tax authorities to show that the services were not duplicative or could not have been provided locally at lower cost. The OECD could emphasize that for transfer pricing purposes, tax authorities should not challenge the MNE's business decisions regarding the division of activities and responsibilities between central and local where the taxpayer demonstrates the benefits of the shared services on a global basis.

The addition of low value added services guidance in 2015 touched upon certain aspects of simplification, however local jurisdiction adoption to date is low. KPMG recommends that the OECD encourage greater adoption of the low-value services safe harbor and also expand some of the principles to the rest of the chapter, such as simplifying the demonstration of benefit.

Services provided in connection with the use of intangibles

For services provided in connection with the use of intangibles; services that are highly integrated with value creation of the MNE group; and/or involve significant risks, the general principles for interpreting and applying the arm's length principle should apply in conjunction with specific principles for services such as the benefit test.

In particular, the most appropriate method should be chosen based on the specific facts of the transaction under consideration; for example, the most appropriate method choice should not depend on whether a transaction is characterized as a service, as opposed to some other or mixed character, but rather on the overall facts of the specific case.

With respect to services provided in connection with the use of intangibles, the OECD might observe that such services could variously involve situations where:

- Valuable intangibles are used by and in the jurisdiction of the service provider, in connection with providing the services;
- Services that are provided as part of a bundled transaction in which the service recipient also obtains use of or access to valuable intangibles, and
- Services that may affect a transfer of intangibles from the service provider to the service recipient (e.g. training in proprietary methods) or creation of intangibles by the service provider for the service recipient (contract R&D).

The guidance would benefit from an emphasis that the overall principles of the most appropriate method should be applied to examine such transactions. The most appropriate method evaluation might, depending on the specific facts of the transaction, consider methods commonly used for services and also those for intangible transactions. The most appropriate method should be determined based on all of the facts of the transaction at issue.

For transfer pricing purposes, the facts may indicate that a transaction or bundle involving both services and intangibles may be most appropriately analyzed in aggregate, without the necessity of detailed determination of the character of the transaction as services, intangible transfer, or a combination of both. The OECD should recognize this while also recognizing that for other tax purposes such determination of character may be necessary.

About KPMG International

KPMG is a global network of professional services firms providing Audit, Tax and Advisory services. We operate in 154 countries and territories and have 200,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

KPMG Contacts	Firm	E-mail
Steve Blough	KPMG in the US	sblough@kpmg.com
Brian Cody	KPMG in the US	bcody@kpmg.com
Gianni De Robertis	KPMG in Italy	gianniderobertis@kpmg.it
Komal Dhall	KPMG in the US	kdhall@kpmg.com
Chris Morgan	KPMG in the UK	christopher.morgan@kpmg.co.uk
Teresa Quinones	KPMG in Mexico	teresaquinones@kpmg.com.mx
Robin Saunders	KPMG in the UK	robin.saunders@kpmg.co.uk
Prita Subramanian	KPMG in the US	psubramanian@kpmg.com