

CIRCULAR
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SUBJECT:

DISCUSSION DRAFT OF THE PROPOSED MODIFICATIONS TO CHAPTER VII OF THE TRANSFER PRICING GUIDELINES RELATING TO LOW VALUE-ADDING INTRA-GROUP SERVICES

BEPS is a tax planning Project developed by OECD to prevent base erosion and profit shifting upon request of G20 finance ministers. In 19 July 2013, OECD was directed to “[d]evelop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to provide protection against common types of base eroding payments, such as management fees and head office expenses.”

Under this mandate, Working Party No. 6 on the Taxation of Multinational Enterprises has developed a simplified transfer pricing approach for low value-adding intra-group services which leads to revisions in Chapter VII of the OECD Transfer Pricing Guidelines. The resulting guidance seeks to achieve the necessary balance between appropriate charges for low value added services and head office expenses and the need to protect the tax base of payor countries.

In particular, the Discussion Draft reduces the scope for erosion of the tax base through excessive management fees and head office expenses by proposing an approach which:

- i. Identifies a wide category of common intra-group services fees which command a very limited profit mark-up on costs;
- ii. Applies a consistent allocation key for all recipients; and
- iii. Provides greater transparency through specific reporting requirements including documentation showing the determination of the specific cost pool.

The main aspects of this additional guidance include:

- a) A standard definition of low value-adding intra-group services;

- b) Clarifications of the meaning of shareholder activities and duplicative costs, specifically in the context of low value-adding intra-group services;
- c) Guidance on appropriate mark-ups for low value-adding intra-group services;
- d) Guidance on appropriate cost allocation methodologies to be applied in the context of low value-adding intra-group services;
- e) Guidance on the satisfaction of a simplified benefit test with regard to low value-adding services; and
- f) Guidance on documentation that taxpayers should prepare and submit in order to qualify for the simplified approach.

Important additions to Chapter VII of the Guidelines are as below;

❖ **Paragraph 7.46-7.47: Definition of low value-adding intra-group services**

- are of a supportive nature;
- are not part of the core business 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 and do not give rise to the creation of significant risk.

The following activities would not be considered as qualifying for the simplified approach outlined in this section:

- Services constituting the core business of the MNE group;
- Research and development services;
- Manufacturing and production services;
- Sales, marketing and distribution activities;
- Financial transactions;
- Extraction, exploration, or processing of natural resources;
- Insurance and reinsurance;
- Services of corporate senior management.

❖ **Paragraph 7.57: Profit mark-up**

In determining the arm's length charge for low value-adding intra-group services, the MNE provider of services shall apply a profit mark-up to all costs in the pool. The same mark-up shall be utilised for all low value-adding services irrespective of the categories of services. The mark-up selected by the taxpayer should be no less than 2% of the relevant cost and should be no greater than 5% of the relevant cost. It should be noted that these intra-group services mark-ups should not, without further justification and analysis, be used as benchmarks for the determination of the arm's length price for services not within the definition of low value-adding services, nor for similar services not within the elective, simplified scheme.

❖ **Paragraph 7.61: Documentation and reporting**

An MNE group electing for application of this simplified methodology shall prepare the following information and documentation and make it available upon request to the tax administration of any entity within the group either making or receiving a payment for low value-adding intra-group services

1. A description of the categories of low value value-adding intra-group services provided
2. Written contracts or agreements
3. Calculations showing the determination of the cost pool
4. Calculations showing the application of the specified allocation keys.

This Discussion Draft is submitted for comment by interested parties. Comments should be submitted by **14 January 2015**

For details of the discussion draft, please refer to <http://www.oecd.org/tax/transfer-pricing/>

Best Regards,

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