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Loyens & Loeff Transfer Pricing Series

Intra-group Services - Charlotte Kiès & Jan-Willem Kunen

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Charlotte Kiès, tax adviser, is a member of the Americas, Energy and Life Sciences practice group of Loyens & Loeff in the Netherlands. She is also a member of the Latin America region team as well as the Spain & Portugal region team, the multilateral instrument (MLI) team and the Digital Taxation team focusing on Pillar Two.

Charlotte specialises in advising internationally operating corporate clients on all areas of taxation. She also advises on international (re)structuring. Among her clients are multinationals in the energy, aviation, oil & gas, construction and financial sector. From 2010 to 2011 she worked at Loyens & Loeff's New York office.

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Jan-Willem advises clients on Dutch and international transfer pricing and tax aspects such as mutual agreement procedures, (bilateral) advance pricing agreements and Pillar One and Pillar Two. Jan-Willem also has broad experience in advising on business restructurings, transfer pricing disputes, financing, IP, acquisitions and the setting up of international structures. He teaches transfer pricing courses at the Dutch Association of Tax Advisers. From 2014 to 2016 he worked at Loyens & Loeff's Zurich office.

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Intra-group services and their benefits

Intra-group services are very common transactions arranged by nearly every MNE group.

The benefits of intra-group services include:

- Reducing costs by benefitting from economies of scale, synergies and by efficient use of resources;
- Being able to create centers of excellence and offering specialized services;
- Developing inhouse expertise, control and coordination (aligning policies and functions on a regional basis);
- Ensuring the quality of services and the availability of services when required;
- Avoiding duplication of work.

Types of in intra-group services

Intra-group services include:

- Services by a group member to another group member(s);
- Services provided by a group member for the benefit of the overall group;
- Services from third parties on behalf of a group member provided to another group member.

Was an intra-group service rendered?

What is an arm's length charge?

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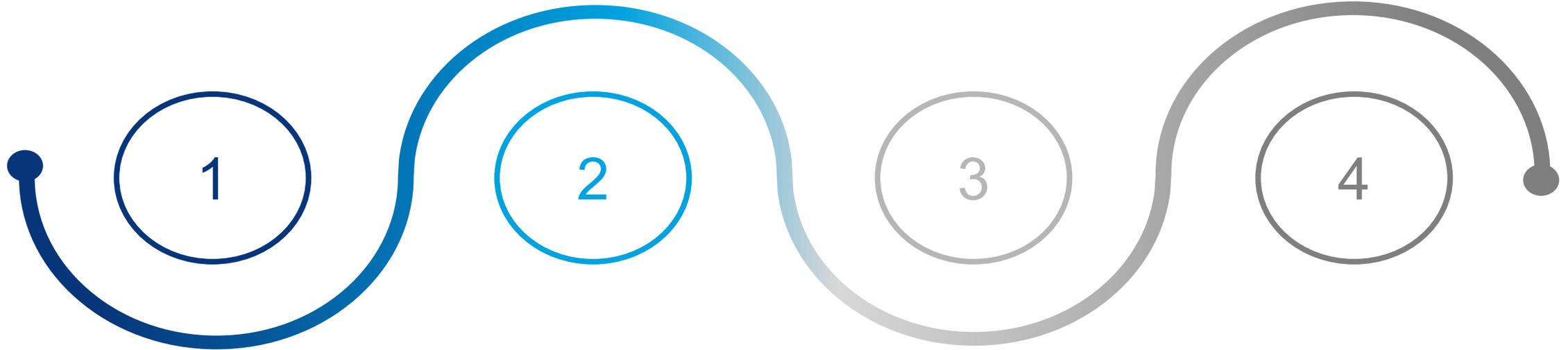
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Benefits test

Willing-to-pay test

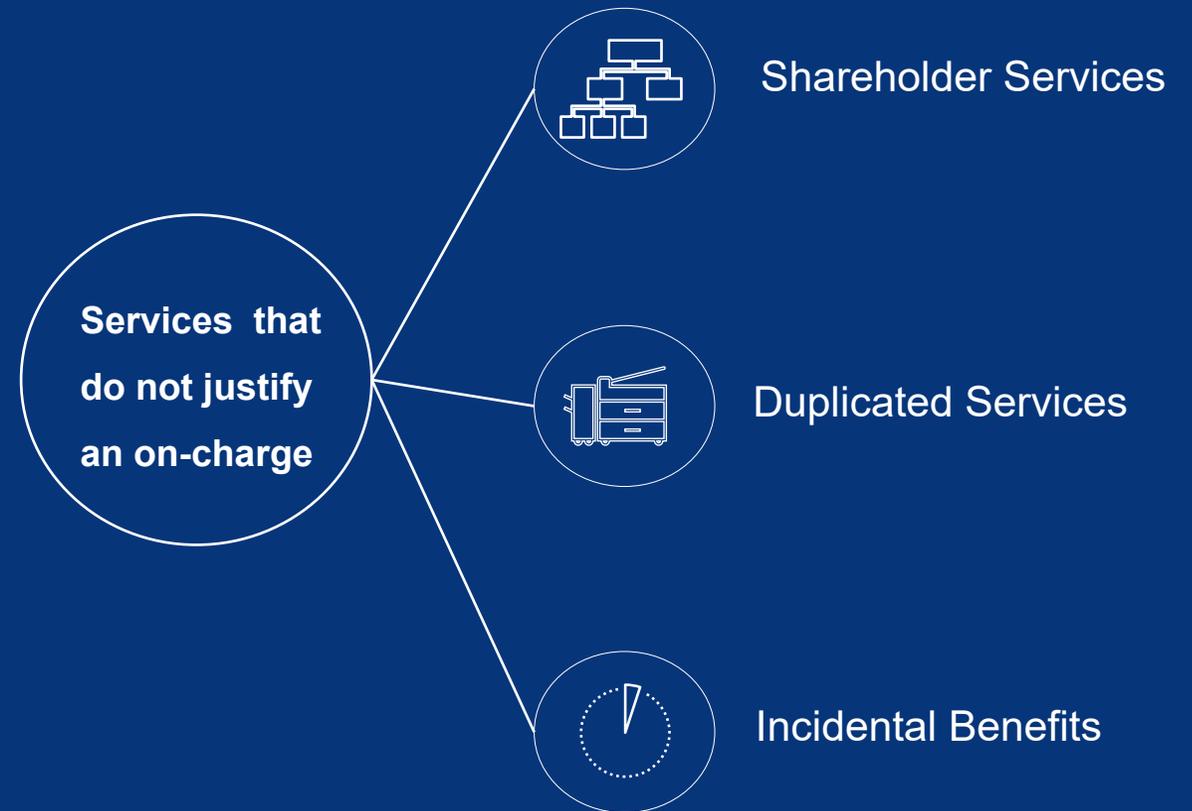
Cost base

Mark-up

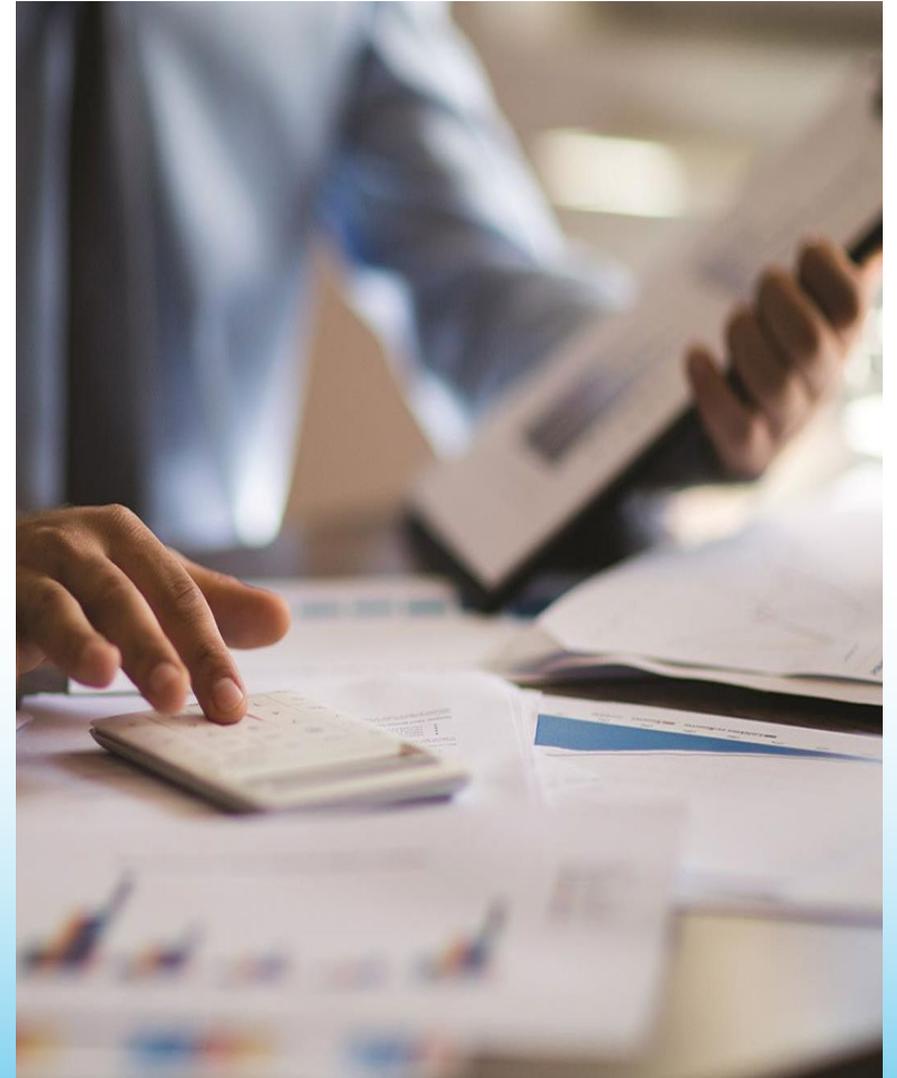


Was an intra-group service rendered?

- The **benefit test** entails that an intercompany service can be acknowledged, when it is expected to benefit the entity receiving the service.
- A service benefits an entity when the **activity performed adds economic or commercial value** for these group member(s) for which an independent enterprise **would have been willing to pay** (to a third party), or in case an independent third party would perform the activity in house. If an entity would not be willing to pay for the activity, or perform the activity itself, the activity should not be considered an intercompany service based on the arm's length principle.
- The benefit test is a factual test that depends on the facts and circumstances of each specific case, therefore intercompany services cannot be predetermined on an abstract basis.



- Transfer prices should reflect charges that would have been paid by an independent party in similar circumstances. **Both perspective of service provider** (costs incurred) **and service recipient** (value of service) are relevant.
- The charges should be based on **functions performed, assets used and risks involved**;
- The selection of a transfer pricing method should be aimed at finding the **most appropriate transfer pricing method** for a particular case.
- **Aggregate analysis is allowed** when separate transactions are so **closely linked or continuous that they cannot be evaluated adequately on a separate basis** (e.g. highly integrated services that are often provided in connection with the transfer of other assets such as the use of IP)
- Often, the application of the transfer pricing guidelines will lead to use of the **(CUP Method)**, the Cost Plus Method **(CPM)** or the Transactional Net Margin Method **(TNMM)** for pricing intra-group services.



CUP

- Compare prices and not cost or mark-up;
- If reliable internal or external comparables available, the preferred method;
- Difficult to apply in practice.



CPM

- One-sided analysis;
- Compare gross services profit mark-up charged between independent parties;
- Cost base includes direct costs and indirect costs.



TNMM

- Alternative when cost plus is difficult to apply;
- Compare net profit margin on costs;
- Cost base includes direct costs and indirect costs.



PSM

- Two-sided analysis;
- Splits profit from a controlled transaction.
- Highly integrated transactions & sharing of risks;
- Unique & valuable contributions to the value chain by more than one entity.



- The direct-charge methods are in principle applied in cases whereby the associated enterprises are charged for **specific services, which can be 'individualized'**.
- This method can be applied **by determining the costs of the services which were directly charged** to the recipient of the services.
- An MNE group may be able to adopt direct charging arrangements, particularly where **services similar to those rendered to associated enterprises are also rendered to independent parties**.
- If the direct-charge method can be applied on a reliable manner, the **direct-charge method is preferred**.

This approach may not always be appropriate if, for example, the services to independent parties are merely occasional or marginal.

Direct-charge method is difficult/unpractical

The indirect-charge methods are applied, when it is difficult or unpractical to use the direct-charge methods. The cost allocation and apportionment through the indirect charge method often necessitates some degree of estimation of the relevant cost base

Service value estimated / analysis burdensome

The Indirect-charge method is often applied in case of services for more than one member of the MNE group and the value of the service attributable to each of them can only be estimated. It is further applied when a separate analysis and record of the service for each recipient would be too burdensome in terms of gathering and keeping documentation to prove the correctness of the charge made.

Charge supported by an identifiable and reasonably foreseeable benefit

Any indirect-charge method should be sensitive to the commercial features of the individual case, 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.

Allocation key

Allocation key should be selected based on the nature of services and the use to which services are put. Examples of allocation keys are turnover, staff employed, assets, etc.

Cost Base Considerations

Consistency

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.

Both actual and budgeted costs may be appropriate to use as cost base depending on the facts and circumstances. Actual costs may raise an issue because the tested party may have no incentive to carefully monitor the costs. Budgeted costs may raise concerns in case of large differences between actual costs and budgeted costs.

Actual vs Budget

Pass-through costs

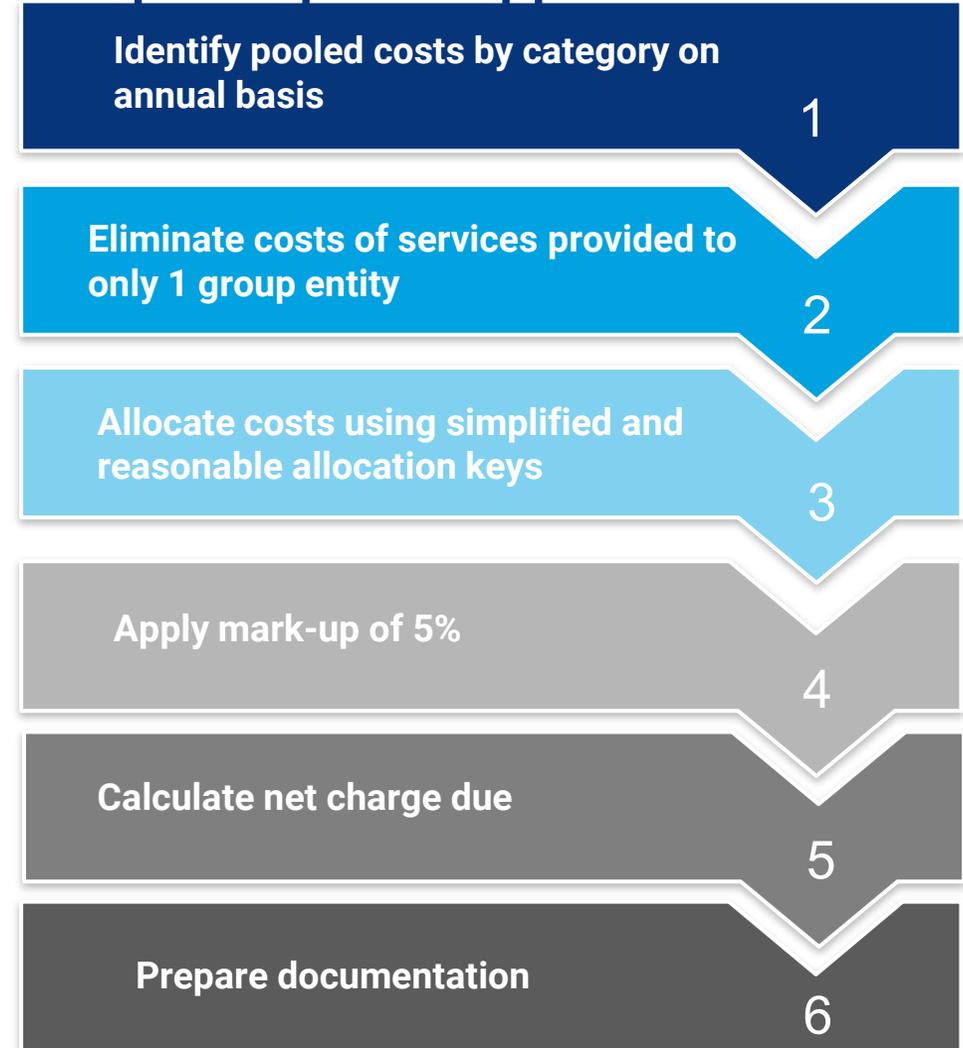
Pass-through costs can generally be on-charged without mark-up. However, mark-up should be on the cost of agency function/added-value by service provider.

- In an arm's length transaction, an independent enterprise normally **would seek to charge for services in such a way as to generate profit**, rather than providing the services merely at cost.
- The **economic alternatives available to the recipient** of the service also need to be **taken into account** in determining the arm's length charge.
- When a group member is only acting as an agent or intermediary in the provision of services, it is important in applying a **cost-based method that the return or mark-up is appropriate for the performance of an agency function rather than for the performance of the services themselves**. In such a case, it may **not be appropriate to determine** arm's length pricing as **a mark-up on the cost of the services but rather on the costs of the agency function itself**.
- An arm's length mark-up is determined based on comparables from a benchmark analysis or internal CUP (exception : safe harbour for low value-adding services).



- The simplified approach is an elective, simple way to document such services.
- Simplified benefit test : demonstrate benefit was received by group members within the specific categories of services.
- Services must be supportive in nature:
 - Not be part of core business;
 - Not require use of / create unique or valuable intangibles;
 - Not involve assumption or control of / create substantial risk.
- Not for services also provided to third party customers.
- The OECD Guidelines prescribe the application of a 'standard' 5% markup on all costs, associated with low value-adding services.

Steps simplified approach



Low Value-adding Services : Simplified Approach

WOULD QUALIFY



Accounting & Auditing

HR

Regulatory issues

Internal & external communications & PR support

IT (when not part of principal activities)

Legal services

Tax support

Administrative & clerical support

WOULD NOT QUALIFY



R & D

Manufacturing

Sales, Marketing & Distribution

Financial transactions

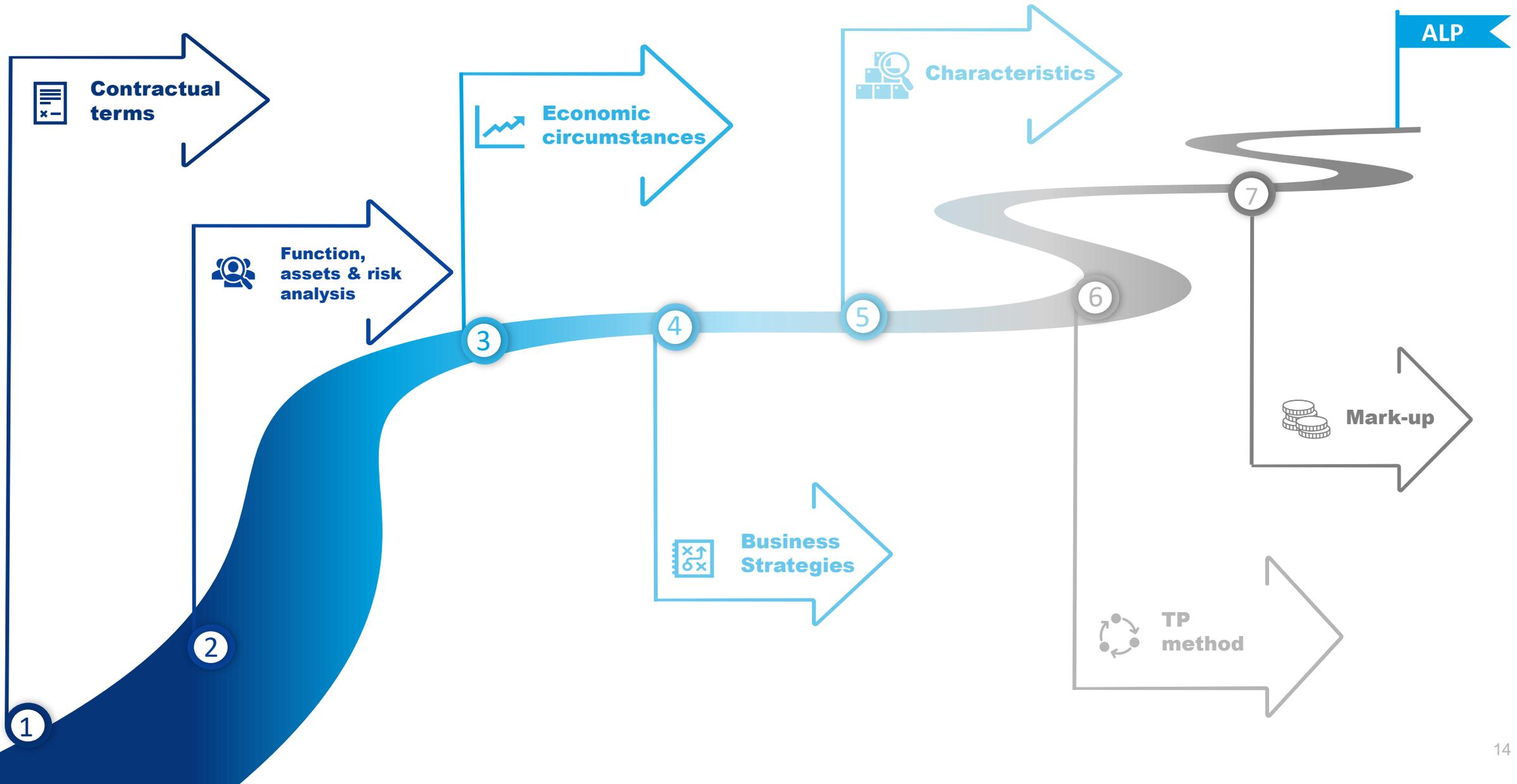
Exploration or extraction

Purchasing of raw materials

Insurance

Corporate senior management

Value Chain: Road to ALP

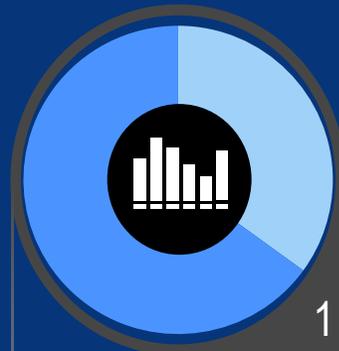


Database

Benchmark analysis starts with the choice of an appropriate database. Choice of the database depends on the relevant region with respect to the transactions and the type of transaction.



Search Process



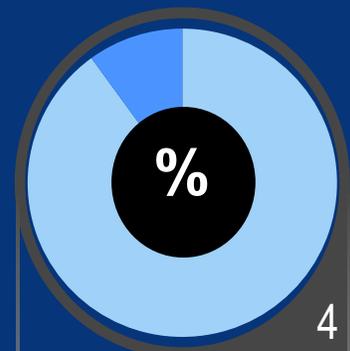
Company selection



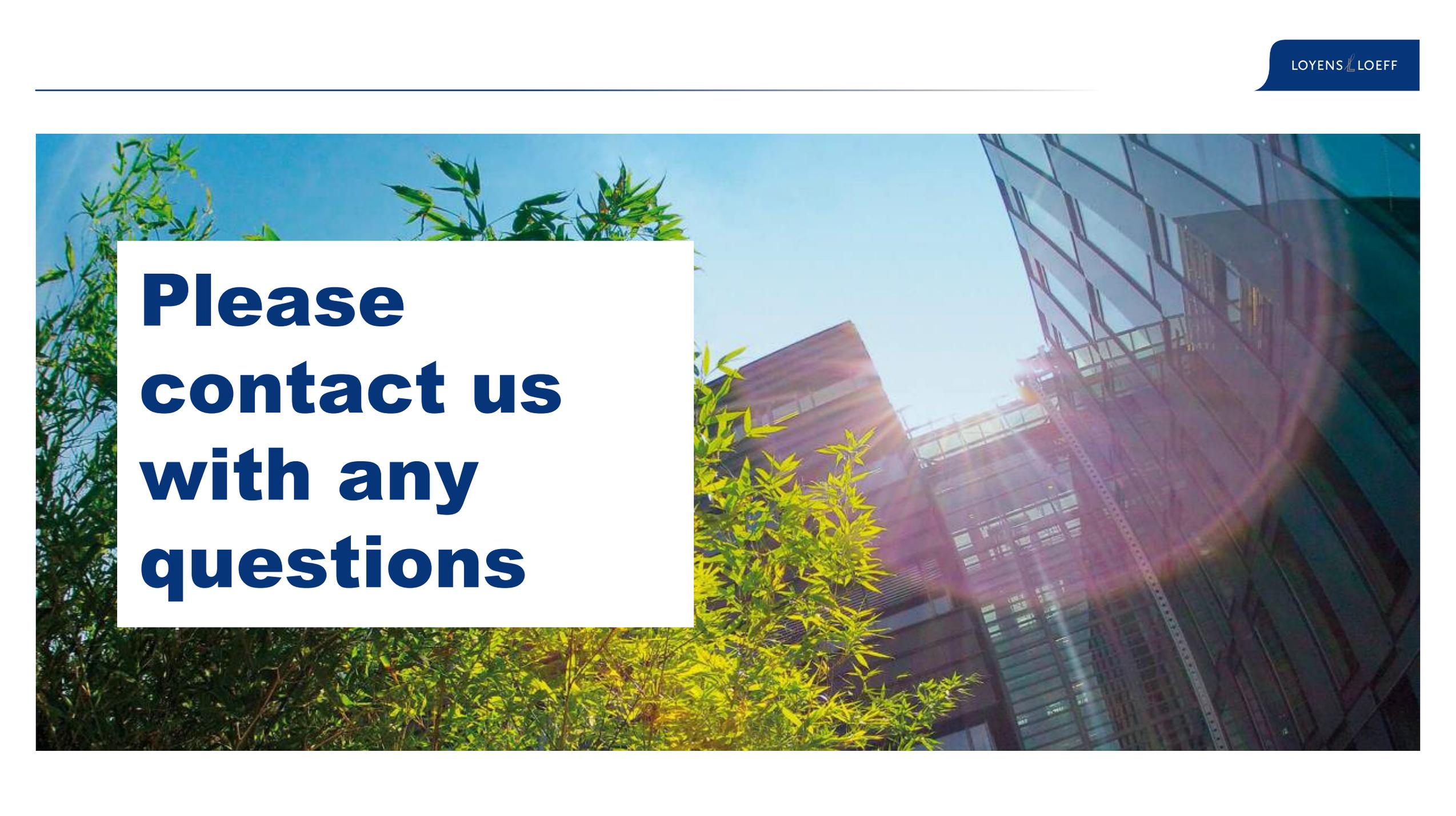
Quantitative screening



Qualitative screening



Statistical analysis



**Please
contact us
with any
questions**