

TRANSFER PRICING ASPECTS OF INTRA-GROUP SERVICES



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Transfer Pricing Aspects of Intra-Group Services

Many multinational groups have some kind of intra-group services wherein some of the activities are centralized.

OECD Transfer pricing guidelines (“TPG”) focus on below points for the analysis of transfer pricing of intra-group services:

- Determining whether a service has actually been rendered in the context of the intra-group transaction
- Assessment of the pricing for that service provided to related parties in accordance with the arm’s length principle

How to determine whether a service has been rendered?

In order to determine whether an intra-group service has been rendered, it is important to consider whether it provides an economic or commercial benefit to the related party and also whether a third party in comparable circumstances would have been willing to pay for such service or to perform itself.

TPG list some examples of centralized services which benefit the group as a whole:

- Administrative services
- Financial services
- Recruitment and training services
- Procurement, distribution and marketing services

However, TPG also highlight certain activities, which may not qualify as a service to related party because there is no benefit to that party:

- Shareholder activities e.g. cost relating to meeting of shareholders, costs relating to parent company’s investor relations, corporate governance of parent company etc. In analyzing such activities, it should be looked at whether these provide economic value to the group companies and whether they need such activity and would be willing to pay for it if they were independent companies.
- Duplicative activities – Intra-group service will not be considered if the same function is being performed by the company itself or by a third party. However, there can be exceptions and duplicate activity can also sometimes constitute a valid service and need to be analyzed in detail. For example, there can be a charge for marketing services at group level and also the company would be doing this activity itself, however there might not be duplication if its established that the marketing involves different levels of activities.
- Incidental benefits – In some cases, intra-group services performed relate only to some group members but incidentally provide benefits to other group members e.g. reorganization of group, acquisition of new company etc. TPG views that such incidental benefit would not cause the other group member to receive an intra-group service because an independent company would not be willing to pay for it.
- On call services – TPG mentions that it should be analyzed whether just the availability of service (i.e. standby charges) would constitute an intra-group service. The substance of the service and how it has affected the group companies should be looked at.

How to determine an arm's length price?

- Some companies use a direct charge method wherein a specified charge is identified for the service. This is usually on basis of CUP or cost plus method as appropriate.
 - CUP method is likely to be used where there are third party comparables which can be used to determine the price of the transaction
 - In case of cost plus method, TPG implies that a mark-up should be added unless there are special circumstances to justify providing the services at cost or even below cost. Ideally mark-up % should be determined on the basis of mark-up made on comparable uncontrolled transactions.

- In some cases, charge is determined on the basis of apportionment amongst group companies. This is referred to as an indirect charge method. This involves use of allocation criterions relevant to the nature of service being provided. For example, if a group is providing HR services, then headcount may be used as the allocation key for charging the costs of HR department.



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