EUROPEAN COMMISSION
DIRECTORATE-GENERAL
TAXATION AND CUSTOMS UNION
Analyses and tax policies
Analysis and coordination of tax policies

Brussels, December 21 2007
Taxud/E1/

DOC: JTPF/014/REV2/BACK/2007/EN/FR

EU JOINT TRANSFER PRICING FORUM

CONTRIBUTIONS ON

CENTRALISED INTRA-GROUP SERVICES

Meeting of 23rd October 2007

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Centralised intra-group services (management fees):

1.French proposals for the Forum

The introduction to Chapter VII of the OECD transfer pricing guidelines[1] states that: "This Chapter discusses issues that arise in determining for transfer pricing purposes whether services have been provided by one member of an MNE group to other members of that group and, if so, in establishing arm's length pricing for those intra-group services."

Thus enterprises which are invoiced for intra-group services or centralised intra-group services by an associated enterprise must demonstrate to their tax authority that:

- i) the services for which invoices are issued have in fact been provided and

- ii) that the amounts charged comply with the arm's length principle.

Compliance with the second condition can under no circumstances be grounds for dispensing with the first condition.

In France, evidence of services received must be provided under Article 39(1)(1) of the CGI (General Tax Code), which covers the deductibility of all charges, including charges for intra-group services. Compliance with the arm's length principle in the context of valuing intra-group services is governed by Article 57 of the CGI (which transposes Article 9 of the OECD Model Tax Convention).

Given the increase of this type of invoicing, authorities and enterprises often face difficulties in categorising this type of charges and accepting or having accepted their deductibility. This is to a great extent because of the differences that sometimes exist in supporting documentation requirements and ways of determining the accepted price. Experience has shown that the difficulties encountered concern both supporting documents for the volume of charges invoiced and compliance with the arm's length pricing principle.

These difficulties have led the EU Transfer Pricing Forum to seek to develop common practices among the EU Member States regarding the supply of services. We set out below some avenues for exploration in seeking practical solutions to these difficulties.

[1] See also paragraph 7.5.

I) *Application of the arm's length principle to intra-group services*

For the amount invoiced for services to be considered to comply with the arm's length principle, the price charged must be deemed to be the price that would have been agreed between independent enterprises in comparable circumstances.

To determine whether this is the case, account must be taken not only of the value of the service to its recipient and the amount that a comparable independent enterprise would have been prepared to pay, but also of the costs borne by the service provider.

The compliance of an invoiced service with the arm's length principle is also assessed on two levels:

- that of the margin on the costs invoiced

Taking into consideration the accumulated experience of EU authorities in this field, one might accept that for standard services a margin of 5 - 8% on costs could be deemed to comply with the arm's length principle. A group applying margins within this range could be assured that it would not have its margin challenged.

"Standard" services would mean services rendered under centralised management of communication, accounting, and human or legal resources. Services that would not be categorised as standard would be those requiring very specific expertise or technology with high added value, which might justify higher margins, for instance strategic services to a subsidiary or research and development services.

Furthermore, where a company does not carry out the service itself, but acts as an agent or broker in the supply of the service, this margin could not be applied to the cost price of the services themselves, but only to the costs incurred by the company in acting as the agent.[2]

- amounts invoiced

The arm's length principle may lead to charges being excluded as shareholders' expenses from the services invoiced. The OECD defines the type of costs involved and cites three categories of examples[3]. Obviously, there is no reason to alter this definition. However, it could be used as the basis for developing other practical examples in the context of the Forum.

[2] OECD Guidelines, paragraph 7.36.
[3] OECD Guidelines, paragraph 7.10.

As has already been pointed out, the volume of charges invoiced, expressed as a percentage of turnover or of the operating margin can itself be assessed in terms of the arm's length principle, but such assessment alone is not enough.[4] The fact that the charges are consistent with general practice in the sector concerned does not mean that the enterprise does not have to prove that the services were in fact rendered. On the other hand, where the charges are fully documented, they cannot be rejected solely because they exceed standard charges in the sector.

The relationship between the volume of charges invoiced by the associated enterprise, expressed as a percentage of turnover or of the operating margin, and the volume of charges invoiced in comparable enterprises could have implications for the level of supporting documentation required to prove that the charges are for services that have in fact been supplied (see above).

II) Supporting documentation for services invoiced

In principle the rules on supporting documents to be provided by enterprises for deductible charges fall under States' national law, and are subject to review by national courts. However, the deduction of intra-group charges cannot be treated in the same way as deductions for other charges, as deduction of external expenditure reduces the group's taxable profit, while deduction of intra-group expenditure is off-set by the entry of a corresponding profit in the accounts of another company in the group. If there is no corresponding adjustment, rejection of an intra-group invoice thus leads to double taxation of the group, which the authorities then have to eliminate by mutual agreement and under the European Arbitration Convention.

Many cases submitted under mutual agreement procedures result from the rejection of charges for intra-group supplies of services on the grounds of inadequate supporting documentation, following checks by a tax authority. The authorities' experience has shown that a great number of these discussions focus on the supporting documentation for such charges. The authority which has made the adjustment generally has more exacting requirements than does the authority asked to make the corresponding adjustment.

It might therefore be worthwhile for the Forum to draw up a European standard for supporting documentation for this type of charges. If this is not done, cases on which States have been unable to reach agreement will be submitted to the advisory commission under the European Arbitration Convention of 23 July 1990 and the arbitration committees will be the ones which have, indirectly, to establish standards through their opinions. It may be that the opinions handed down do not all draw on the same standards. An initiative on the part of the Forum would therefore be desirable.

[4] OECD Guidelines, paragraph 7.29 ff.

We propose that the deduction of charges for intra-group supplies of services be made conditional upon presentation of the following supporting documents proving the nature and scale of the services rendered:

- the service contract;[5]
- details of the operations performed or hours devoted to the service supplied (time sheet);
- method by which the price was set;
- costs incurred by the service provider (salaries, travel costs, fees, other costs);
- method of allocating the charges in the case of indirect allocation of costs (distribution formula and reasons for its use);
- specific examples of operations undertaken under the service rendered.

Presentation of these supporting documents would protect the group from the risk of the charges being questioned by an authority, provided that it had complied with the arm's length principle.

As suggested above, authorities' requirements for supporting documents could then be adjusted according to whether the amount of the charges is comparable to average charges for the services invoiced by comparable companies.

If the volume of invoiced charges, assessed as a percentage of turnover or of earnings before interest and tax, were in line with standard practice in the sector, the enterprise would be required to provide the documentation listed above to show that the services had in fact been supplied.

If the volume of charges were more than 25% higher than standard charges in the sector, deduction of the full amount would only be allowed if the enterprise provided additional evidence justifying and explaining this in detail.

To facilitate verification of the supporting documentation, it might also be useful where possible to allow the auditor auditing the enterprise receiving the services to check directly with the enterprise supplying the services that the services were in fact rendered as claimed. We therefore propose that the Forum invites the tax authorities to facilitate the verification of expenditure by foreign auditors on their territory.

[5] This requirement diverges formally from the formulation in paragraph 7.18 of the OECD Guidelines. However, it seems to be in line with the arm's length principle and legitimate in the context of work aiming to guarantee to enterprises that they can deduct invoiced expenditure.

Services intra groupe centralisés (« management fees ») :
Propositions de la France pour le Forum

Le chapitre VII des Principes directeurs en matière de prix de transfert de l'OCDE précise dans son introduction[6] : « Le présent chapitre examine les problèmes qui se posent en matière de prix de transfert pour déterminer si des services ont été rendus par un membre d'un groupe multinational à d'autres membres de ce groupe et, dans l'affirmative, pour déterminer le prix de pleine concurrence applicable à ces services intra-groupe ».

Ainsi, les entreprises qui se voient facturer des services intra-groupe ou des services centralisés intra-groupe par une entreprise associée doivent justifier auprès de leur administration fiscale :

- i) de la réalité des prestations facturées et,

- ii) de la conformité de leur montant au principe de pleine concurrence.

En aucune manière le respect de la deuxième condition ne peut dispenser l'entreprise du respect de la première.

En France, l'obligation de justifier des prestations reçues résulte de l'article 39-1-1° du CGI qui régit la déductibilité de toute charge, y compris les prestations de services intra-groupe, alors que le respect du principe de pleine concurrence dans le cadre de la valorisation des prestations de services intra-groupe, est encadré par l'article 57 du CGI (qui transpose l'article 9 du Modèle de convention fiscale de l'OCDE).

Face au développement de ce type de facturations, les administrations et les entreprises rencontrent très fréquemment des difficultés pour appréhender ce type de charges et admettre ou faire admettre leur déductibilité, du fait notamment d'exigences parfois divergentes sur les justificatifs requis et des modes de fixation de prix admis. L'expérience montre que les difficultés rencontrées relèvent autant de la justification du volume de charges facturées que de la conformité de leur pricing au principe de pleine concurrence.

Ces difficultés ont conduit le Forum européen sur les prix de transfert à rechercher le développement de pratiques communes entre les Etats de l'Union européenne concernant ces prestations de services. Les développements suivants proposent des pistes de réflexion dans la recherche de solutions pratiques à ces difficultés.

[6] Voir également le § 7.5.

III) Application du principe de pleine concurrence aux services intra-groupe :

L'appréciation de la conformité du montant des prestations de services facturées au principe de pleine concurrence suppose que le prix appliqué est celui qu'auraient convenu entre elles des entreprises indépendantes dans des circonstances comparables.

Ceci suppose de prendre en compte à la fois la valeur du service pour son bénéficiaire et le montant qu'une entreprise indépendante comparable aurait été disposée à payer mais aussi les coûts supportés par le prestataire.

La conformité au principe de pleine concurrence d'une prestation de service facturée s'apprécie ainsi à deux niveaux :

- Le niveau de marge appliqué sur les charges facturées

Compte tenu de l'expérience accumulée par les administrations européennes dans ce domaine, il pourrait être admis que pour les services standards, un niveau de marge appliqué sur les coûts compris entre 5 et 8 % soit considéré comme conforme au principe de pleine concurrence. Un groupe pratiquant des marges comprises dans cette fourchette recevrait l'assurance de ne pas voir cette marge remise en cause.

Par services « standards », on entendrait des prestations rendues dans le cadre des fonctions centralisées de gestion de la communication, de comptabilité, de gestion des ressources humaines ou juridiques. En revanche, ne seraient pas considérées comme standards les prestations facturées pour des fonctions faisant appel à des savoir-faire ou des techniques très spécifiques, à haute valeur ajoutée, qui pourraient justifier des marges supérieures. Tel serait le cas par exemple de prestations de nature stratégique dispensées à une filiale ou de services en matière de recherche et développement.

Il est également précisé que lorsque la société ne réalise pas le service elle-même mais intervient en tant qu'agent ou intermédiaire dans la fourniture du service, cette marge ne pourra pas être appliquée aux prix de revient des services eux-mêmes, mais seulement aux coûts exposés par la société pour l'exercice de ses fonctions d'agent[7].

- Le quantum des charges facturées.

Le principe de pleine concurrence peut conduire à exclure des prestations facturées les charges considérées comme des dépenses d'actionnaires. L'OCDE définit le type de charges

[7] Principes directeurs OCDE, § 7.36

visées et en cite 3 catégories d'exemples[8]. Il n'y a pas lieu, bien évidemment de modifier cette définition. En revanche, celle-ci pourrait donner lieu au développement d'autres exemples pratiques venant l'illustrer dans le cadre du Forum.

Par ailleurs, comme relevé précédemment, l'importance des charges facturées, exprimée en pourcentage du chiffre d'affaires ou de la marge opérationnelle, peut elle-même être appréciée au regard du principe de pleine concurrence, sans pour autant que cette appréciation soit suffisante[9]. Le fait d'avoir un volume de charges conforme à la pratique d'un secteur d'activité ne dispense pas l'entreprise associée de justifier de la réalité de ces prestations. Inversement, des charges pleinement justifiées ne peuvent être écartées au seul motif qu'elles excèdent la pratique du secteur.

Le rapport entre le volume de charges facturées par l'entreprise associée, exprimé en pourcentage du chiffre d'affaires ou de la marge opérationnelle, et le volume de charges facturées dans des entreprises comparables pourrait avoir des conséquences sur le niveau des justificatifs exigibles pour démontrer la réalité de ces charges (voir supra).

IV) La justification des prestations de services facturées :

Si les règles de justification des charges déductibles par les entreprises relèvent, en principe, du droit interne des Etats, sous le contrôle du juge, la déduction de charges intra-groupe ne peut être traitée de manière similaire à la déduction d'une autre charge : la déduction d'une charge externe réduit le bénéfice imposable du groupe alors que la déduction d'une charge intra-groupe est compensée par la comptabilisation d'un bénéfice correspondant dans une autre société du groupe. En l'absence d'ajustement corrélatif, le rejet d'une facturation intra-groupe fait donc supporter au groupe une double imposition, que les administrations doivent éliminer dans le cadre des procédures amiables et de la convention européenne d'arbitrage.

De nombreux cas présentés dans le cadre des procédures amiables font suite au rejet des charges afférentes à des prestations de services intra-groupe, lors d'un contrôle par une administration fiscale, pour défaut de justification suffisante. L'expérience des autorités compétentes montre que de très nombreuses discussions se cristallisent sur le niveau de justification de ces charges. L'administration ayant opéré le redressement a généralement des exigences plus importantes que celle à qui est demandée d'accorder l'ajustement corrélatif.

Dans ce contexte, un standard européen de justificatifs pourrait être développé par le Forum pour ce type de charges. A défaut, les situations où les Etats n'auront pas pu trouver d'accord seront soumis à une commission consultative dans le cadre de la convention européenne d'arbitrage du 23 juillet 1990 et il reviendra aux commissions d'arbitrage d'élaborer

[8] Principes directeurs OCDE, § 7.10
[9] Principes directeurs OCDE, § 7.29 et suivants.

indirectement des standards dans le cadre de leurs avis. Il n'est pas exclu que les avis rendus s'inspirent de standards différents. Une démarche pro-active du Forum est dans ce contexte souhaitable.

Il est proposé de conditionner la déduction des charges de services intra-groupe à la production des justificatifs suivants attestant de la substance et de l'importance des services rendus :

- le contrat de prestation de services[10] ;
- le détail des interventions ou des heures consacrées à la prestation rendue (« time sheet ») ;
- la méthode de fixation du prix ;
- les charges engagées par le prestataire (salaires, frais de déplacement, honoraires, autres charges);
- la méthode d'allocation des charges en cas d'imputation indirecte des coûts (clé de répartition et sa justification notamment);
- des illustrations concrètes des réalisations opérées grâce à la prestation rendue ;

La production de ces justificatifs aurait pour effet de sécuriser le groupe contre une remise en cause de ces charges par une administration, pour autant que la condition relative à la conformité au principe de pleine concurrence, soit respectée.

Comme évoqué ci-dessus, les exigences des administrations en termes de justificatifs pourraient alors être adaptées selon que le quantum s'inscrit ou non dans la moyenne des services facturés par des entreprises comparables.

Si le volume des charges facturées, apprécié en pourcentage du chiffre d'affaires ou du résultat opérationnel, est conforme à la pratique du secteur d'activité, l'entreprise serait tenue de justifier de la réalité des prestations par la production des éléments justificatifs énumérés ci-dessus.

Si le volume des charges est supérieur de plus de 25% à la pratique du secteur, la déduction intégrale ne serait admise que si l'entreprise apporte des éléments de preuve supplémentaires justifiant les raisons pour lesquelles un dépassement existe et explicitant la réalité de celui-ci.

Par ailleurs, afin de faciliter la vérification de ces justificatifs, il pourrait être utile, lorsqu'une telle intervention est possible, de permettre au vérificateur qui audite l'entreprise bénéficiaire des services de s'assurer directement auprès de l'entreprise prestataire de la réalité des prestations rendues. Il est donc proposé que le Forum invite les administrations fiscales à

[10] Cette exigence s'éloigne formellement de la formulation retenue au § 7.18 des Principes directeurs OCDE. Elle paraît toutefois conforme au principe de pleine concurrence et légitime dans le cadre de travaux visant à garantir aux entreprises la déductibilité des charges facturées.

faciliter l'intervention de vérificateurs étrangers sur son territoire aux fins de vérification des charges engagées.

2. Dutch proposals for the Forum

Considerations for intra-group services
Distinction between shareholder costs, direct -and indirect charges and appropriate evidence

One of the topics which is part of the work programme of JTPF for 2007-2008 are intra-group services. It is recognised that differences in treatment of inter-company service fees and charges can result in double taxation or excessive compliance costs. In the Netherlands a substantial part of the MAPs result from different treatment of shareholder activities and inter-company service fees and charges. Most of the time the discussion focus on the labelling of the activities (shareholder activity or intra-group service), and subsequently the appropriate evidence for establishing the appropriateness of a service charge. Therefore the Netherlands welcomes the idea to discuss this issue within the JTPF in order to try and find a common understanding.

As part of the discussion the Netherlands would like the JTPF to take the following approach into consideration.

Extract method
The approach is based on the sum of intra-group services as a sort of intra-group services reservoir and extracts from that reservoir different types of intra-group services in a particular order.

The approach is founded on two general premises:
1. Headquarters generally perform activities in their own interest (as a shareholder) or in the interest of the group as a whole. In other words, costs that are not related to shareholder activities therefore are *generally* [11] made in order to provide the respective group members with economic or commercial value to enhance their commercial position. For direct allocable costs this is obviously true, but also for costs of which the benefit to the respective group members is less obvious, it should be kept in mind that headquarters normally perform such activities with the aim to enhance the commercial position of the group members.
2. Only in exceptional cases a MNE allows for duplication of activities. A company operating in a commercially rational way does not normally allow for duplication of activities; if duplication of services exists (for example after a merger), this duplication will generally be abolished within the minimum time frame necessary to restructure the activities (1 or 2 years maximum).

Shareholder activities

[11] Of course headquarters can also perform services (other than shareholder activities) which are for the full benefit of the headquarters itself.

Costs of shareholder activities should be borne by the group member which has the ownership interest (shareholder). This type of activities does not justify a charge to any other group company (7.9 OECD transfer pricing guidelines, hereinafter referred to as OECD TPG).
The first step in the extract method is therefore to extract the shareholder activities from the reservoir.

Direct-charge method
For intra-group services a fee can be charged, provided that certain requirements are fulfilled. The most important requirements for charging a fee for services are i) the activity provides a respective group with economic or commercial value to enhance its commercial position (7.6 OECD TPG) and ii) there is no duplication (7.11 OECD TPG).The Netherlands endorses the view laid down in 7.20 of the OECD TPG that the direct-charge method is to be preferred to charge intra-group services, because it facilitates the determination of whether the charge is consistent with the arm's length principle. As a second step the direct-charged activities are extracted form the reservoir. In case were the direct-charge method can be applied, evidence is usually readily available.

Indirect-charge method
There are circumstances in which the direct-charge method is too difficult or burdensome to apply and MNE groups choose to apply an indirect charge-method. In such cases some degree of estimation or approximation is often necessitate (7.22 and 7.23 OECD TPG). The indirect-charge method incorporates the idea that the added value of the service for the recipient companies can not be identified for every group company separately. One should bear in mind the reason why the headquarters performs these services.

If there is no rationale for the headquarters performing these services for itself in isolation (and that do not relate to shareholder activities), then one could conclude that they are performed for the benefit of the group as a whole or for a part of the group. This might or might not also benefit the headquarters in its own right, depending on the facts of the case. The fact that the costs can not be individually attributed to the respective group companies, does not mean that these activities have no (indirect) benefit for these group companies

The Netherlands is of the opinion that in these cases the appropriate evidence can be different from those cases where the direct-method can be applied. It should however be clear that the services have been rendered and that it is plausible that the group companies benefit from those services. If so, an indirect-charge method (based on a logical distribution formula) should be acceptable without requiring the proof of a direct benefit for each individual group company.

In practice discussions often focus on the fact whether or not the intra-group services provide economic or commercial value to the recipient group companies (including a formula to divide the costs) and the possible duplication of service activities. In cases were the best effort of companies can be assured and the before mentioned premises are fulfilled, the taxpayer should have the benefit of the doubt when in the "grey area". This means, that the burden of proof for applying the indirect-charge method should be applied with some leniency.

In essence, this means that the assessment of the added value of the services and duplication test are not only tested from the perspective of the entity that receives the charge, but also from the entity that performs the service.

The prior description gives a more theoretical overview of how the extract method works.
Another related issue which could be discussed within the JTPF is when to qualify an activity as a shareholder activity. In our opinion EU based MNE's with activities in multiple EU countries would benefit from a more common understanding on what kind of activities are to be qualified as shareholder activities.
Moreover, we are of the opinion that a multilateral approach to distinguish between low value and high value intra-group services should also be possible. For the low value services, it may be possible to determine some sort of common approach to remunerate these activities.

3. UK proposals for the Forum

This is the UK`s response to the invitation to submit comments on group services which is an item on the JTPF's current work programme.

The item is:

> Group services (Management and HQ expenses, central services, shareholder costs, stewardship expenses etc)
>
> *The JTPF acknowledged that inter-company services are a particularly difficult area for taxpayers and tax administrations alike. With a view to developing approaches to ensure that tax administrations' treatment of inter-company service fees and charges does not result in double taxation or excessive compliance costs, the JTPF will consider in particular:*
>
> *- whether costs incurred by a MNE should be deductible somewhere within the MNE;*
>
> *- the standard of evidence appropriate;*
>
> *- a common approach to evidence for cases in a MAP;*
>
> *- the appropriate re-charges for inter-company services.*

A useful starting point is, of course, the OECD Transfer Pricing Guidelines. These address the issue of whether intra-group services have been provided and distinguish such services from shareholder activity and stewardship activity. They go on to discuss the determination of an arm's length charge for intra-group services. A business might choose either a direct or an indirect charging method. The Guidelines note the practical advantages that indirect methods can often have although these can sometimes obscure the theoretically correct way of arriving at an arm's length result. The Guidelines make clear that the appropriate arm's length result should be considered from the perspective of both the provider and the recipient of the service.

The JTPF will want to consider, in particular, the views of businesses about the problems that can arise in practice in applying these principles. These are likely to include the design of charging systems that are appropriate for the business, and do not impose excessive administrative costs, and the challenge of demonstrating that these systems produce acceptable arm's length results.

The JTPF will also want to explore how tax administrations can be confident about the robustness of the evidence.
A valuable outcome of the exercise might be to identify categories of intra-group services that represent a low risk, both in the provision and in the receipt of the service, in terms of arriving at an arm's length result. Such categories might include services with a high content of transactions of a routine nature and/or services involving high volumes and low unit costs. It might be possible to agree that such services require a less intensive standard of evidence, which could be provided more cheaply, than services where risks were higher.

The JTPF might consider the various forms that intra-group services might take to help to identify lower risk categories. These forms might include administrative services (such as payroll, audit, legal, training), financial services (such as Treasury, debt factoring, foreign exchange management), and procurement services. It would be for consideration whether other services such as contract manufacturing and routine research and development might helpfully be included.

The JTPF might also want to consider what could be learned from tax administrations outside the EU with relevant experience in this area.

4. Latvia comments

Latvia does not have big experience in transfer pricing cases, yet, but during the audit of enterprises which are charged for receiving the intra-group services or centralized intra-group services, tax payers should prove that:

- services in fact have been provided and received;
- remuneration for the services comply with the arm's length principle.

We do agree with French proposal on required documents for proving the nature and scale of the services rendered and would like to add that in situations where centralized services or intra-group services are rendered to all or several members of group, company which receives the service has to be able to show the transparent, verifiable information (comparable data) about the terms of charge for services which are determined for all members of group.

4. Swedish comments

Below are general comments from Sweden concerning the future work by the JTPF on the subject of intra-group services.

Initially, Sweden would like to emphasise that the work in the JTPF should never lead to a separate guidance for the European countries that differs from the OECD guidelines. Therefore our work should focus on the areas that are not covered by the work of the OECD.

This said, we recognise that intra-group services is a difficult area for taxpayers and tax administrations. It might therefore be worthwhile to see if some common standards or best practises could be developed that limit the risk for double taxation and excessive compliance costs.

Since the question of appropriate evidence often comes up in the context of intra-group services, it might be of interest to further explore this subject and possibly to draw up some recommendations or standards for supporting documentation. If such common standards could limit the number of cases of double taxation within the EU, this would benefit both the taxpayers and the tax authorities. In drawing up such standards it should be born in mind that the documentation requirement should be limited to what can be considered as necessary, so as to not create new administrative burdens for the taxpayers. Any recommendation or standard must therefore be carefully considered and not simply be a compilation of the rules and practises of the different member states.

It might also be interesting to discuss whether some categories of intra-group services can be identified as representing low risk or standard services and whether we could develop some approaches that would reduce the administrative burden in these cases. However, our opinion is that the aim should not be the introduction of “safe harbour” rules, such as a certain margin that would always be accepted for standard or low risk services.

As concerns the classification of activities as shareholder activities we recognize that this is a common problem in practise and that the existing guidance in the OECD guidelines is not always sufficient. However we think that work on further guidance on this issue should rather be done within the OECD.