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Shareholder Activities: Taxpayers' Headache?

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Shareholder activities?

As mentioned by the 2017 Transfer Pricing Guidelines (TPG) of the OECD[1], one of the two main issues relating to the analysis of transfer pricing for intra-group services, is to determine whether the service has been rendered or not and to this end, the benefit test is applied. However, in some situations, further scrutiny is needed. Indeed, some activities are rendered in relation with several group members or for the group as a whole and in some specific cases, those activities are received by group members that do not particularly need them and would not necessarily be willing to pay an independent party to perform them. To determine whether these activities are services or shareholder activities, it must be asserted if they were solely performed by a group member in its capacity as shareholder and more generally because of its ownership interest in one or more other group members. If the answer is positive, the activities would be qualified as shareholder activities.

The guidance for this kind of activities is that they are not intra-group services and thus the costs should be incurred by the parent company in its capacity as shareholder and should not be charged out to the other group members. These so-called shareholder activities are detailed through examples in the TPG in Chapter VII, paragraph 7.10 and relate to:

- a) *Costs relating to the juridical structure of the parent company itself;*
- b) *Costs relating to reporting requirements of the parent company;*
- c) *Costs of raising funds for the acquisition of its participations and costs relating to the parent company's investor relations;*
- d) *Costs relating to compliance of the parent company with relevant tax laws;*
- e) *Costs which are ancillary to the corporate governance of the MNE as a whole.* [2]

Compared to the 2010 TPG, the first three examples were detailed and parts d) and e) were added. Shareholder activities have also been mentioned and developed in the UN Practical Manual on Transfer Pricing for Developing Countries, in both 2013 and 2017 editions. The definition of the concept is in line with the TPG and the "sole benefit test" is similar, except for the wording replaced by "benefit only"[3].

The EU Joint Transfer Pricing Forum also made an attempt to clarify the concept by developing an elaborated list, at a time, in 2009, where the OECD one was limited.

In May 2018, the OECD invited public comments from practitioners, academics and tax administrations on the future revision of Chapter VII of the TPG on intra-group services. It indeed considered that this chapter posed several practical challenges and one of them related to shareholder activities.

What is the main issue with these activities?

The main concern regarding shareholder activities is reflected in the public comments and is unanimous: the scope of these activities is unclear and vague.

As a matter of fact, the service provider's tax administration could characterize the activity as being an intra-group service and thus chargeable, while the service recipient's tax administration could consider it as a shareholder activity. In this case it would lead to an unsolved double taxation. A clear definition would allow a diminution of the cases of double taxation as the shareholder activities could be identified more easily by the taxpayer and provoke less controversy among the tax administrations. Finally, clarifying the concept would bring certainty to both taxpayers and tax authorities and would be much needed to smooth tax audits.

It leads to a concrete headache for taxpayers who can be challenged on this point by tax authorities. It is therefore essential to deal with this issue not only to alleviate the taxpayers' headache but also to counteract possible situations of economic double taxation.

Suggestions to Policy Makers

In the public comments on the future revision of Chapter VII, commentators have globally asked for a clarification of the definition of shareholder activities and particularly to differentiate it from the concept of stewardship activities. The latter activities are defined in the TPG as "a range of activities by a shareholder that may include the provision of services to other group members, for example services that would be provided by a coordinating centre."^[4] In our opinion, this notion should simply disappear from the vocabulary employed by the OECD, as the TPG offers no thorough explanation of the concept and therefore, it cannot be seen as serving any practical purpose. Moreover, this concept has a vague legacy from the 1979 Transfer Pricing report and following this reasoning, SwissHoldings, remarked in the OECD public comments that "*We also recommend avoiding reference to the old 1979 Report in paragraph 7.10 and the 1984 Report in paragraph 7.9. These references could give the impression that these old Reports are still applicable legal sources to interpret the arm's length principle and/or "stewardship activities" is still a category taxpayers need to consider.*"^[5]

Additionally, emphasis should be given to the audit activities because both paragraphs on shareholder activities and centralized services in the TPG mention this kind of activities, thus creating an overlap. Indeed, further guidance should be developed because both paragraphs do not have the same conclusion, as centralized services are considered intra-group services.

Currently, a short non-exhaustive list of shareholder activities is cited by the OECD. To define the concept, this list should be detailed through specific examples, such as

in the US regulations and the list developed by the EU JTPF.

Indeed, PwC, in the OECD public comments, remarked that *“Cue can be taken from the US services regulations, which has numerous such examples. Such examples will provide certainty and may facilitate a meaningful dialogue between the taxpayers and tax administrators during a tax audit.”*[6] Indeed, the US regulations on *“Methods to determine taxable income in connection with a controlled services transaction”* [7] are more detailed and complete than the TPG.

First of all, the concept itself is thoroughly defined in the regulations: *“An activity is not considered to provide a benefit if the sole effect of that activity is either to protect the renderer’s capital investment in the recipient or in other members of the controlled group, or to facilitate compliance by the renderer with reporting, legal, or regulatory requirements applicable specifically to the renderer, or both. Activities in the nature of day-to-day management generally do not relate to protection of the renderer’s capital investment. Based on analysis of the facts and circumstances, activities in connection with a corporate reorganization may be considered to provide a benefit to one or more controlled taxpayers.”*[8] This definition does not depart from the one used in the TPG and offers the taxpayer an easier way to delineate the scope of the concept. As a matter of fact, it already comprises all the examples stated in the TPG in the definition itself. Moreover, the US regulations go beyond the TPG and put forward practical examples, eight exactly, of shareholder and non-shareholder activities.

The first and second examples are about reporting activities; the third deals with audit activities; the fourth, fifth and sixth deal with the capital structure of the parent company; the seventh deals with day-to-day management activities; the last example is about strategic activities. Thus, the OECD can refer to the US regulations to develop guidance on Chapter VII.

During the period April 2009 to June 2010, the EU JTPF also addressed the concept of *“shareholder costs”* (note that compared to the OECD, the term *costs* is used and not *activities*) and developed its own non-exhaustive list of shareholder costs. The EU JTPF reminded that the analysis must be done on a case-by-case basis and depending on the facts and circumstances of the situation. It also stated that *“the analysis will always require that the following questions be raised in relation to each cost listed: is it benefiting the whole group, does it benefit the parent company only, should it be allocated out to the subsidiaries, or should it be considered to benefit to a certain subsidiary?”*[9]

The EU JTPF list is composed of examples similar to the ones in the TPG. At the same time other examples were added and are worthy to be highlighted: *“Costs to reorganize the group, to acquire new members or to terminate a division ; Cost of the board of directors of the parent company that is associated with the statutory duties of a director as a member of the board of directors.”*[10] It must be noted that the 2017 UN TP Practical Manual also adds *“the appointment and remuneration of parent company directors”* and *“the meetings of the parent company’s board of directors”*. [11]

Furthermore, it could be suggested that the TPG includes a list of non-shareholder activities for the most controversial cases as it has been done in the US regulations for example, where it was mentioned that *“Activities in the nature of day-to-day management generally do not relate to protection of the renderer’s capital investment.”*[12]

Finally, example e) of shareholder activities in the TPG should be reviewed because it seems more like a catch-it-all category than a valuable and detailed addition. Indeed, Ludovici Piccone & Partners argued in the public comments that *“the economic definition of activities included in corporate governance, encompasses practically every sphere of management: action plans, internal controls, performance measurement and corporate disclosure. In arm’s length conditions, there might be companies willing to pay for such services.”*[13] Therefore, a precise definition of the scope of ancillary activities is necessary to avoid any confusion.

Conclusion

To conclude, the concept of shareholder activities is dear to the OECD that has been using it since 1979. Nonetheless, no valuable guidance on this issue has been developed by the organization and the taxpayers are unanimously asking for a clearer definition and a better delineation of the scope of the notion. But after all, isn’t the underlying question beyond the complex delineation of the concept of shareholder activities and more about the simplification of proof of the benefit test? Indeed, for low value adding services a simplified approach is applied but what about high value adding services? In our opinion, in the future, simplification should also be explored for such services. For instance, as a first step, a list of the most common high value adding services could be developed. Thereafter, safe harbors (pre determined arm’s length margins) could be introduced as a mechanism of simplification for these common high value adding services.

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[1] OECD (2017), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017, OECD Publishing, Chapter VII, Para 7.5.

[2] OECD Transfer Pricing Guidelines, *supra* n 1, Chapter VII, Para 7.10.


[3] United Nations, Practical Manual on Transfer Pricing for Developing Countries (United Nations 2017), Para. B.4.2.13.

[4] OECD Transfer Pricing Guidelines, *supra* n 1, Chapter VII, Para 7.9.

[5] OECD (2018), OECD Scoping of the future revisions of Chapter VII (intra-group services) of the Transfer Pricing Guidelines – Comments Received on the Request for Input, OECD Publishing, p. 217.

- [6] OECD Public Comments, *supra* n 5, p. 175.
- [7] 26 CFR § 1.482-9 - Methods to determine taxable income in connection with a controlled services transaction.
- [8] US Regulations, *supra* n 7.
- [9] European Commission, on the work of the EU Joint Transfer Pricing Forum in the period April 2009 to June 2010 and related proposals, see 1. Guidelines on low value adding intra-group services and 2. Potential approaches to non-EU triangular cases, COM(2011) 16 Final, Annex 2.
- [10] EU JTPF, *supra* n 9, Annex 2.
- [11] United Nations Practical Manual on TP, *supra* Para. B.4.2.14.
- [12] US Regulations, *supra* n 7.
- [13] OECD Public Comments, *supra* n 5, p. 134.

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