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The thin line between incidental benefits and deliberate concerted group actions

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This article is the last of a series of three posts dealing with non-chargeable intra group services: Shareholder Activities, Duplicate Activities and Incidental Benefits. This post will specifically focus on the delineation of incidental benefits.

To get the bigger picture, transfer pricing rules and the standard on which it relies, the arm's length principle, considers the entities of a same MNE group as being separate entities, "rather than as inseparable parts of a single unified business."^[1]

Nonetheless, by adopting this approach, the current framework does not always take into consideration the degree of integration of the business model, the economies of scale and the profits resulting from group synergies when pricing an intra-group transaction.

Generally speaking, a synergy is "*the combined power of a group of things when they are working together that is greater than the total power achieved by each working separately*".^[2], thus providing an advantage to the associated enterprises compared to independent entities. On the other hand, group synergies can also negatively impact the MNE group, for instance when they result in bureaucratic barriers.^[3]

Group synergies are commonly divided into two groups: incidental benefits, which correspond to passive synergies and deliberated concerted group actions, which coincide with active synergies. This separation is necessary because depending on which category they belong, benefits can be treated differently under transfer pricing rules, although it can be complex to delineate the line between the two categories.

Incidental benefits and passive association.

A definition of incidental benefits is outlined in the TPG: "*There are some cases where an intra-group service performed by a group member such as a shareholder or coordinating centre relates only to some group members but incidentally provides benefits to other group members.*"^[4] Reorganization of the group, acquisition of new members or termination of a division are examples of situations that "*may also produce economic benefits for other group members not directly involved in the potential decision since the analysis could provide useful information about their own*

business operations.”^[5]

In a second paragraph, the TPG deals with the concept of passive association, by providing a definition which differ from the situations described in the first paragraph but still results in incidental benefits: *“Similarly, an associated enterprise should not be considered to receive an intra-group service when it obtains incidental benefits attributable solely to its being part of a larger concern, and not to any specific activity being performed.”*^[6]

An example is consequently provided and describes a situation where an entity of an MNE group has a credit rating higher than the one it would have if it were not affiliated to the group. This credit rating is only due to its passive association to the MNE and is referred to as *“implicit support”*.^[7] The UN TP Manual provides other examples among which: *“independent enterprises transacting with an enterprise that is a member of an MNE group may be willing to provide goods or services to it at prices that are below the prices charged to independent buyers.”*^[8]

Because independent parties would not be willing to pay for such activities and would never be in a situation where they would encounter that type of benefit from belonging to a group, incidental benefits must not lead to the consideration that the other group members received an intra-group service.

On the other hand, for instance, if the higher credit rating was due to a guarantee provided by another associated enterprise, in other words to deliberate concerted actions, the TPG considers that an intra-group service would have been rendered.

As remarked by FieldFisher in the public comments on the future revision of Chapter VII of the TPG on intra-group services, *“Based on our preliminary comments in setting the stage for Chapter VII, we wonder if it is the right place to discuss and provide guidance on passive association or if it needs to be supplemented by a specific (new) Chapter dedicated to financial transfer pricing services.”* ^[9]

Finally, an essential addition is provided by the mentioned Section D.8 in paragraph 2: *“The term incidental does not refer to the quantum of such benefits or suggest that such benefits must be small or relatively insignificant.”*^[10] Rather what is important is whether a third party would be willing to pay for those kind of activities.

The definition used by the US Treasury Regulations is similar to both TPG and UN Manual but it delivers a valuable comment: *“A controlled taxpayer’s status as a member of a controlled group may, however, be taken into account for purposes of evaluating comparability between controlled and uncontrolled transactions.”* This mention is not provided by the TPG along with the definition of passive association, as it is done in the US Regulations, but rather in the Section on group synergies.

To conclude, generally speaking, incidental benefits are derived when one entity renders a service to another associated entity but incidentally this service brings economic or financial benefits to other members of the group.

Similarly, passive association is when an entity derives benefits solely from its association to the MNE group. In this case, there is no specific service rendered and

from which derives benefits, it is just a consequence of being integrated to the MNE group.

Both concepts are opposed to active promotion and deliberate concerted group actions, but the line between them can be thin and complex to establish at times.

Active promotion and deliberate concerted group actions.

The TPG refers to the concept of “*active promotion of the MNE group’s attributes*”^[11], without defining it, but precisizing that it should be opposed to the concept of passive association. It states that the active promotion of the MNE group attributes “*positively enhances the profitmaking potential of particular members of the group.*”^[12] The concern surrounding the meaning of this concept was also highlighted by FieldFisher in the public comments: “*The wording used is vague and leaves room to individual interpretations.*”^[13] In the TP Guidance on Financial Transaction no reference is made to active promotion, nonetheless, the concept of deliberate concerted actions is mentioned several times.

The later concept is defined in the TPG, not in the section on incidental benefits but rather in the one dealing with group synergies: “*In some circumstances, however, synergistic benefits and burdens of group membership may arise because of deliberate concerted group actions and may give an MNE group a material, clearly identifiable structural advantage or disadvantage in the marketplace over market participants that are not part of an MNE group and that are involved in comparable transactions.*”^[14] Those group actions create value and are also labeled as active group synergies.

Benefits or disadvantages derived from this deliberate concerted group actions should be identified and allocated among the associated enterprises based on a thorough functional and comparability analysis.

An example of deliberate concerted group actions can arise in the case of an explicit guarantee provided by a parent company to its subsidiary. Assume that Co A, the parent company, guarantees the loan entered by one of its subsidiary Co B, with an independent bank. Due to this explicit guarantee, Co B benefits from a lower interest rate. In this case, Co B should pay a guarantee fee as it benefited from a deliberate concerted group action.

Another example is developed in the UN TP Manual: “[...] *assume that the MNE Group N decides to implement a policy of cost savings. In this respect, it incorporates Company P in Country L to centralize the procurement function and take advantage of volume discounts that arise solely because of the MNE group’s aggregated purchasing. Assume that Company P does not take title of the raw materials from suppliers. The concerned group members directly acquire the raw materials from the suppliers under the conditions applying to the group. In this scenario, Company P performs a deliberate concerted action which should generally be reflected in the pricing of a procurement fee to be paid by the group members to Company P.*”^[15]

Conclusion

To summarize, incidental benefits are spillover effects derived from the membership of the group. In this case, these benefits cannot be considered intra-group services.

On the other hand, deliberate concerted group actions are the result of wanted and active actions undertaken within the group that may lead to benefits or to disadvantages and are thus deemed as remunerable intra-group services (this said, there could be situations where a deliberate action may not justify a charge).

Whether a benefit is incidental or derived from a deliberate action will be determined on a case-by-case basis, supported by functional and comparability analysis.

While discussing the OECD Guidelines and the distinction between incidental benefits and deliberate concerted group actions, S. Maury highlights that *“they do not go into further detail on the question of how to determine which of these two categories benefits belong to or how to evaluate them in practice. Although the distinction can be understood as an approach to pragmatically distinguishing between synergies that can be clearly identified and those that cannot, the allocation of synergies under this scheme can well be very difficult to make in practice.”*^[16] We agree on the fact that the TPG could be clearer on how to distinguish the two categories, especially for intra-group financing and that further examples are needed. The thin line between the two concepts is also due to the fact that it is a complex task to determine whether incidental benefits exist or not, and whether an additional benefit has been received as a result of a deliberate concerted group action.

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[1] OECD (2017), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2017, OECD Publishing, Para 1.6.

[2] Cambridge Dictionary, “Synergy”, available at: <https://dictionary.cambridge.org/fr/dictionnaire/anglais/synergy>

[3] OECD TPG, *supra* n 1, Para. 1.157.

[4] OECD TPG, *supra* n 1, Para. 7.12.

[5] OECD TPG, *supra* n 1, Para. 7.12.

[6] OECD TPG, *supra* n 1, Para. 7.13.

[7] OECD (2020), Transfer Pricing Guidance on Financial Transactions: Inclusive Framework on BEPS Actions 4, 8-10, OECD, para. 10.77.

[8] United Nations (2017), Practical Manual on Transfer Pricing for Developing Countries, Para. B.4.2.21.

[9] 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. 202.

[10] OECD TPG, *supra* n 1, Para. 1.159.

[11] OECD TPG, *supra* n 1, Para. 7.13.

[12] OECD TPG, *supra* n 1, Para 7.13.

[13] OECD Public Comments, *supra* n 9, p. 202.

[14] OECD TPG, *supra* n 1, Para. 1.159.

[15] UN TP Manual, *supra* n 8, Para. B.5.2.31.

[16] S. Maury, Applying the Arm's Length Principle to Group Synergies, 27 Intl. Transfer Pricing J. 4 (2020), p. 3.

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