

# Shareholder's Activity An Unresolved Saga!

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**Piyush Bafna**

Chartered Accountant

## 1. Introduction

Intragroup services constitute a significant part of cross-border trade. Under the transfer pricing, it is subjected to stricter scrutiny by the Tax Administrations due to its intangible nature. However, intra-group service in the nature of the shareholder's activity is not allowed to be cross-charged by the parent to other group companies. In the Indian Income Tax Act, Regulations or case laws, there is no definition or authoritative exposition about the parameters or examples of activities or services can be regarded as a 'shareholder activity'. Thus, it is relevant to understand the global jurisprudence regarding the concept of a shareholder activity so that suitable guidance can be drawn from it.

## 2. Jurisprudence across the world

### 2.1. OECD Transfer Pricing Guidelines (2017)

**Para 7.9** of Chapter VII of OECD Transfer Pricing Guidelines (2017) observed concerning the shareholder's activity as

*A more complex analysis is necessary where an associated enterprise undertakes activities that relate to more than one member of the group or to the group as a whole. In a narrow range of such cases, an intra-group activity may be performed relating to group members even though those group members do not need the activity (and would not be willing to pay for it were they independent enterprises). Such an activity would be one that a group member (usually the parent company or a regional holding company) performs **solely because of its ownership interest** in one or more other group members, i.e. in its capacity as shareholder. This type of activity would not be considered to be an intra-group service, and thus would not justify a charge to other group members. Instead, the costs associated with this type of activity should be borne and allocated at the level of the shareholder. This type of activity may be referred to as a shareholder activity, distinguishable from the broader term stewardship activity used in the 1979 Report. **Stewardship activities** covered 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. These latter types of non-shareholder activities could include detailed planning services for particular operations, emergency management or technical advice (trouble shooting), or in some cases assistance in day-to-day management.*

**Para 7.10** of said guidelines lists few examples when services can be called as shareholder activity. Amongst others, as regards example (e) in said para which says *costs which are ancillary to the corporate governance of the MNE as a whole*, it is worded very generically and may catch virtually all corporate actions like action plans, internal controls, performance measurement and corporate disclosure etc. A precision in the language would have been more useful.

## 2.2. UN Practical Manual on Transfer Pricing (2017)

*B.4.2.13. Shareholder activities are activities undertaken to provide an economic benefit only to the shareholder company (ultimate parent company or any other shareholder such as an intermediary holding company, depending on the facts of the case) in its capacity of shareholder. Accordingly, the cost of shareholder activities should be borne exclusively by the shareholder. Shareholder activities performed by an associated enterprise on behalf of its parent company should be charged to the parent company on an arm's length basis.*

The 2017 UN Practical Manual also added the appointment and remuneration of parent company directors and the meetings of the parent company's board of directors as shareholder's activity.

## 2.3. USA Regulations

The US Treasury Regulations on Transfer Pricing deals with the provisions of intragroup services. It extensively dealt with the conditions to determine whether there should be a charge for the provision of an intragroup service and with the qualification of shareholder activities. Shareholder activity was defined as

*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.*

In short, activities that primarily benefit the parent shareholder of a group in its capacity as owner, rather than other member companies are considered as shareholder's activity. Section 1.482-9(l)(3)(iv) provides that shareholder activities do not confer a benefit on controlled parties and therefore do not give rise to an arm's length charge. US regulations provide eight practical examples of shareholder and non-shareholder activities.

## 2.4. EU Joint Transfer Pricing Forum Final Report On Shareholder Costs

In this report of 2008, after discussing country practices and examples given by the OECD TP guidelines, provides a non-exhaustive list of expenses treated as shareholder's activity

**A.** Costs of activities relating to the juridical structure of the parent company itself, such as:

- costs for the meeting of shareholders of the parent company including advertising costs;
- costs for the issuing of shares of the parent company;
- costs of the supervisory board of the parent company;
- 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.
- costs for the compliance of the parent company with the tax law (tax returns, bookkeeping, etc.)

**B.** Costs relating to reporting requirements of the parent company including the consolidation of reports:

- costs for the financial reports of the parent company;
- costs for the consolidated financial statements of the group;
- costs for the application and compliance with cross-border tax consolidation. Tax legislations of

some countries provide for cross-border tax consolidation that requires parent company to collect information of subsidiaries.

- costs for the audit of the accounts of the parent company.

**C.** Costs of raising funds for the acquisition of subsidiary by the parent company;

**D.** Costs of managerial and control (monitoring) activities related to the management and protection of the investments as such in participations unless an independent party would have been willing to buy for or to perform for itself;

**E.** Costs to reorganize the group, to acquire new members or to terminate a division unless they produce economic benefit for the subsidiary that is not incidental.

**F.** Costs for initial listing on a stock exchange of the parent company and costs for the activities related to stock market listing of the parent company, in the years after the initial listing.

**G.** Investor relations costs of the parent company: costs for press conferences and other communications with (i) shareholders of the parent company, (ii) financial analysts, (iii) funds and (iv) other stakeholders of the parent company.

### 3. Key aspects of shareholder s activity

From the above discussion, the following principles emerge

#### 3.1. Receipt of direct/indirect benefit

If the activities are producing some direct or indirect effect to the recipient company which consequently results in higher profits by increase in turnover or reduction in the costs or other efficient management to the recipient company and the resultant higher dividends to the renderer or the shareholder company, such activity should not be treated as shareholder s activity.

#### 3.2. Purpose of the activity

If the expenses for the activities that a group member (usually the parent company or a regional holding company) performs **solely** because of its ownership interest in one or more other group members (subsidiaries or sister companies), it is referred to as shareholder s cost. However, if the expenses are incurred not for the sole purpose of serving the interest of shareholders and it results in directly or incidentally benefitting the recipient, it cannot be fully termed as shareholder s activity. Thus, a group company should not be considered to have received an intragroup service to the extent when it obtains incidental benefits attributable solely to its being part of a larger concern and not to any specific activity being performed.

#### 3.3. Stewardship Activities

The OECD TP guidelines state that the shareholder activity should be distinguished from the broader concept of stewardship activities which include 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 coordination centre.

To the extent the services have helped the parent to exercise supervision and control over the group entities, it amounts to stewardship services. Refer **Akzo Nobel India Ltd** [\[TS-379-ITAT-2017\(Kol\)-TP\]](#).

Pune ITAT in the case of **INA Bearings India Pvt Ltd** [\[TS-597-ITAT-2019\(PUN\)-TP\]](#) had occasion to interpret the term stewardship in relation to transfer pricing adjustment in relation to management services. The key observations of the Tribunal are as under

i. *In commercial context, stewardship activities are the activities undertaken by an enterprise to protect one s own interest.*

ii. *If an activity/service of the renderer company produces some effect on the recipient company, whether or not resulting into a tangible benefit to the recipient, the same ceases to be a stewardship activity.*

iii. Stewardship is a broader term and one of the forms of stewardship activities is a shareholder activity.

Thus, it may be noted that, in the case of central coordination and control activities, the focus has changed from the nature of the activity to the willingness to pay in an independent scenario. It follows implicitly from the OECD TP guidelines that coordination activities (stewardship activities) qualify as services unless a particular subsidiary does not need the activity and would not be willing to pay an unrelated party to perform it.

### **3.4. Mixed Activities - Part Shareholder and Part Intra Group Service**

There are certain activities which are mixed activities which are qualifying part as a group service and part as a shareholder activity. Undeniably, these are shareholders' costs. In such cases, these activities/services not only discharges a shareholder's duty but also produces some additional benefits to the recipient company.

In such cases, a question arises on how to deal with such costs? There is no guidance either in the OECD TP Guidelines or the Indian Income Tax Act. But, a discussion on this issue can be found in the EU Joint Transfer Pricing Forum ( JTPF ) in its 2010 report.

In that case, the question arises whether an additional service in the form of benefit has, in fact, been provided? In answering that question following factors are important

- a. Is the additional benefit is distinct & independent?
- b. If yes, is it recognized as such when seen stand-alone?
- c. Does the whole group benefit from such activity?
- d. Is the benefit attributable to specific subsidiary/ies?
- e. If more than one group company is getting benefitted, how costs should be apportioned based on a proper allocation key like time, turnover etc.?
- f. Is a benefit such that a subsidiary would have paid to an independent service provider?
- g. Whether such charge complies with the arm's length method?

The answer to the above questions exists in the just allocation of these costs partly to the parent and partly to the other group subsidiaries. There can be no straight jacket formula and it will depend on facts of each case. The attribution will be determined keeping in mind the type of industry, the type of company and the service provided.

### **4. Useful questionnaire to ascertain shareholder's activity**

From the above, while determining whether a cost/activity is a shareholder's activity, the following questions are useful

- i. Whether the service is actually received by the group company from the activity of the other group company?
- ii. Whether the sole and not primary purpose of the activity is to protect the interest of shareholders of the provider company?
- iii. What would a group company do if it stopped getting the service from the other group company?
- iv. If services are stopped by the one group company, would another group company find out another

independent service provider in the market to do that work?

**v.** Have services been provided to meet the specific needs of the services of the recipient group company?

**vi.** Does the group company has the capacity to absorb the services provided by the other group company?

**vii.** What are the economic and commercial benefits derived by the recipient group company out of such intra-group services?

**viii.** Whether a request for such a service has been raised by the one group company to the service provider group company?

## **5. Conclusion**

At present, there is no guidance available from the Central Board of Direct Taxes ( CBDT ) what constitutes shareholders' activity and it keeps assesseees in a dilemma while planning their tax affairs and taking positions while filing tax returns. A circular from the CBDT giving a more specific outline and examples like US regulations would go a long way in the times to come!