

The TAXAND logo features a stylized icon of four white dots arranged in a 2x2 grid to the left of the word "TAXAND" in a bold, white, sans-serif font. The background is a photograph of a city square with the Duomo di Milano and the Galleria Vittorio Emanuele II.

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GLOBAL TP CONFERENCE 2017

MILAN

16 NOVEMBER

Your global tax partner

**NEW OECD
GUIDANCE ON
PERMANENT
ESTABLISHMENTS**

**– PRACTICAL
CONSIDERATIONS &
RECENT TAX DISPUTES**

PAOLO RUGGIERO

16 NOVEMBER 2017

INTRODUCTION



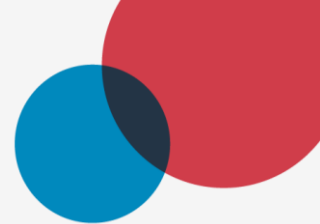
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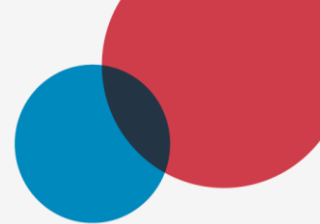


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BRIEF HISTORY OF BEPS ACTION 7



- ❖ Three changes to PE rules of Art. 5 OECD to counter strategies to avoid PE in source state:
 - Agency PE (*para.s 5-6*)
 - PE exception for listed activities (*para 4*)
 - PE exception for short-term projects (*para 3*)
- ❖ No action against fundamental change in balance between source and residence states in taxing rights re cross-border business income (Action 1)

BRIEF HISTORY OF BEPS ACTION 7

Issue 1: Agency PE

Action 7 targets certain structures and arrangements aimed at avoiding para.s 5-6 thresholds in particular:

- Commissionaire arrangements;
- Sales contracts are substantially negotiated in State S but are concluded in the principal's residence state;
- The intermediary acts in a way meeting the conditions of the exceptions for "independent agent".

Issue 2: PE exception for listed activities

Action 7 targets the fragmentation of a cohesive business operation into several small operations in order to (i) claim that each of them is merely engaged in a preparatory and auxiliary activity and (ii) benefit of the Art. 5(4) exemption.

Issue 3: PE exception for short-term projects

Action 7 – in combination with Action 6 – targets the abusive splitting-up of contracts into several parts, each of them covering a period less than twelve months and attributed to a different company of the same group in order to fall outside the construction PE definition - Art. 5(3).

BRIEF HISTORY OF BEPS ACTION 7

Solution 1: Agency PE

1. New Agency PE requirements (Art. 5.5).
2. New Independent Agent exception (Art. 5.6).

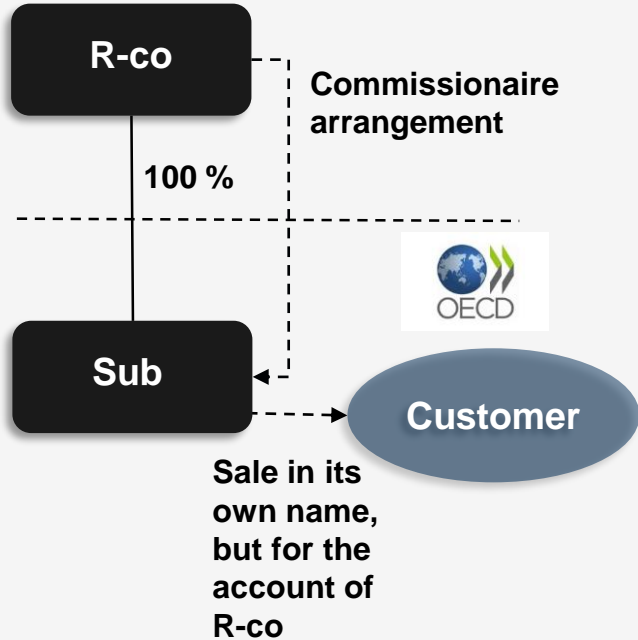
Solution 2: PE exception for listed activities

1. The proposed new wording of Art. 5.4 adds a catch-all requirement that each specific activity (or combination of activities) must be of a “preparatory or auxiliary character”.
2. Anti-fragmentation rule: if a second activity is carried on in the same state by the same enterprise or by a “closely” related enterprise, the exception of para. 4 is not applicable when the business activities constitute complementary functions that are part of a cohesive business).

Solution 3: PE exception for short-term projects

1. Principal Purpose Test introduced by Action 6 is aimed to prevent granting treaty benefit in inappropriate circumstances (Specific example in Action 6: Example J).
2. New Commentary on Art. 5.3: introduction of an optional insertion of a deeming rule to Art. 5.3 -> automatic addition of periods of “connected” activities by “closely related” enterprises.

AGENCY PE PRE BEPS



- ❖ Pursuant to Art. 5(5) OECD-MTC 2010 an **Agency PE** is created
 - if a person is **acting on behalf of the enterprise**,
 - **concludes contracts** in the **name of the enterprise**, and
 - performs these activities **habitually**.
- ❖ Pursuant to Art. 5(6) OECD-MTC 2010 an enterprise shall **not** be deemed to have a PE if it carries on business
 - through a broker, general **commission agent** or any other agent of independent status,
 - provided that such persons are acting in the **ordinary course of their business**.

AGENCY PE PRE BEPS



❖ Based on the current definition of Agency PE, 4 conditions have to be fulfilled:

- the existence of a person (the agent) that is not an independent agent from the enterprise (the principal);
- the agent acts on behalf of the principal;
- the agent has and habitually exercise an authority to conclude contracts in the name of the principal

The dependency of the agent is assessed by verifying the legal and economic independence (inter alia “extent of obligation” of the agent towards the principal, “detailed instruction “or “comprehensive control” exercised by the principal, the allocation of the “entrepreneurial risk” borne by the agent and by the principal, “number of principal” represented by the agent)

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AGENCY PE PRE BEPS



- ❖ The Agent by “Acting on behalf of the principal” and “habitually exercising an authority to conclude contract” involves the principal to a particular extent in the business activity of the state in which the agent is acting (i.e. the agent should have sufficient “authority” to bind the principal’s participation in the business activity of the state).
- ❖ “Habitually exercising” implies that the economic nexus with the source state must not to be an isolated case (*longa manus*)
- ❖ the “authority to conclude contracts” must be “in the name of” the principal. In principle it has to be verified whether the contracts conclude by the agent are “binding” on the principal.

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CURRENT PROBLEM WITH THE AGENCY PE PROVISION



- ❖ The nature of the agent in the different legal system
- ❖ Civil law countries: it can be identified two kind of representation direct and indirect representation. Direct representation implies that the agent acts in the name of the principal and legally binds the latter in relation to third party customer. Indirect representation implies that the agent is acting in its own name and binds itself in relation to third party customer (i.e. the concluded contract is not enforceable against the principal).
- ❖ Common law countries: Two kind of agents namely disclosed and undisclosed agent. Disclosed agent legally binds the principal in relation to third party customer whereas the undisclosed agent binds himself in relation to third party customer (although the principal can also be held liable by the third party customer)

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CURRENT PROBLEM WITH THE AGENCY PE PROVISION



- ❖ The independent agent concept

		Acting in the ordinary course of the business	
		YES	NO
Legal and economic independence	YES	NO PE	PE if art. 5(5)?
	NO	PE if art. 5(5)	PE if art. 5(5)

CURRENT PROBLEM WITH THE AGENCY PE PROVISION



- ❖ The interpretation of the requirement “authority to conclude contract” – legalistic vs economic approach

Economic approach	Legalistic approach
Legal binding of the contract is not decisive. An active participation in the legal arrangement can create the necessary “economic link” in the source state	The wording “in the name of” requires a contracts that legally binds the principal towards the third party client
Agency relationship (direct and indirect) binds the principal towards the third party client	Not every dependent agent will lead to an agency PE (distinction among direct and indirect representation)
Supported by Italian Philippe Morris case	Supported by the French Zimmer case, Norwegian Dell case

THE SOLUTION PROPOSED BY THE OECD WORKING PARTY



- ❖ Economic vs legal approach in the commissionaire arrangement new par. 32.1 on article 5
“ For example, in some countries an enterprise would be bound, in certain cases, by a contract concluded with a third party by a person acting on behalf of the enterprise even if the person did not formally disclose that it was acting for the enterprise and the name of the enterprise was not referred to the contract”
- ❖ Par. 5 is not restricted to the sale of goods “the paragraph would cover, for example, a situation where a person has and habitually exercise an authority to conclude leasing contracts or contracts for services.
- ❖ Does par. 6 apply only to the agents who do not conclude contracts in the name of the principal ?
- ❖ Assumption of entrepreneurial risk as a factor indicating independence
“the working party concluded that whilst there was no doubt that bearing the entrepreneurial risk was an important criterion to identify an independent agent the clarification proposed in par. 38,7 raised a number of questions that should be more fully examined in particular in light of the OECD TPG”.

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BEPS ACTION 7



- ❖ The action n. 7 of the BEPS Project is specifically aimed at preventing the “artificial avoidance of the PE status” and at updating the definition of PE “to prevent abuses” More specifically the aim of the action 7 is:

“develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Works on these issues will also address related profit attribution issue”

“in many countries, the interpretation of the treaty rules on agency PE allows contracts for the sale of goods belonging to foreign enterprise to be negotiated and concluded in a country by the sales force of a local subsidiary of that foreign enterprise without the profit from these sales being taxable to the same extent as they would be if the sales were made by a distributor. In many cases, this has led enterprises to replace arrangements under which the local subsidiary traditionally acted as distributor by “commissionaire arrangements” with a resulting in shift of profit out of the country where the sale take place without a substantive change in the functions performed in that country”

BEPS ACTION 7 – PROPOSED SOLUTIONS



❖ The first discussion draft

	Options			
	A	B	C	D
"conclude contracts"				
replace "conclude contracts" by "engages with specific persons in a way that results in the conclusions of contracts"	X		X	
replace "conclude contracts" by "concludes contracts or, or negotiates material elements of contracts"		X		X
"contracts in the name of"				
add reference to contracts for the provision of property or services by the enterprise	X	X		
replace "contracts in the name of the enterprise" by "contracts which, by virtue of the legal relationship between that person and the enterprise, are on the account and risk of the enterprise"			X	X
"non independency"				
strengthen the requirements of "independence"	X	X	X	X

BEPS ACTION 7 – NEW ART. 5(5)



❖ Option B, so called “material negotiation standard”, was chosen as preferred option:

“Notwithstanding the provision of paragraph 1 and 2 but subject to the provisions of paragraph 6, where a person is acting in a contracting State on behalf of an enterprise and , in doing so, habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise and these contracts are:

- a) In the name of the enterprise, or*
- b) For the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that enterprise has the right to use, or*
- c) For the provision of services by that enterprise,*

That enterprise shall be deemed to have a permanent establishment in that state in respect of any activities which that person undertakes for the enterprise, unless, the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this place of business a permanent establishment under the provision of that paragraph”

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BEPS ACTION 7 – NEW ART. 5(6)



❖ *“a) Paragraph 5 shall not apply where person acting in a contracting state on behalf of an enterprise of the other contracting state carries on business in the first mentioned state as an independent agent and acts for the enterprise in the ordinary course of business. Where however a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent within the meaning of this paragraph with respect to any such enterprise.*

b) for the purpose of this article, a person is closely related to an enterprise if, based on all the relevant facts and circumstances, one has control of the other or both are under the control of the same persons or enterprises. In any case, a person shall be considered to be closely related to an enterprise if one possesses directly or indirectly more than 50 per cent of the beneficial ownership interest in the other (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company’s share or of the beneficial equity interest in the company) or if another person possesses directly or indirectly more than 50 per cent of the beneficial interest (or, in the case of a company, more than 50 per cent of the aggregate vote and value of the company’s share or of the beneficial equity interest in the company) in the person and the enterprise”

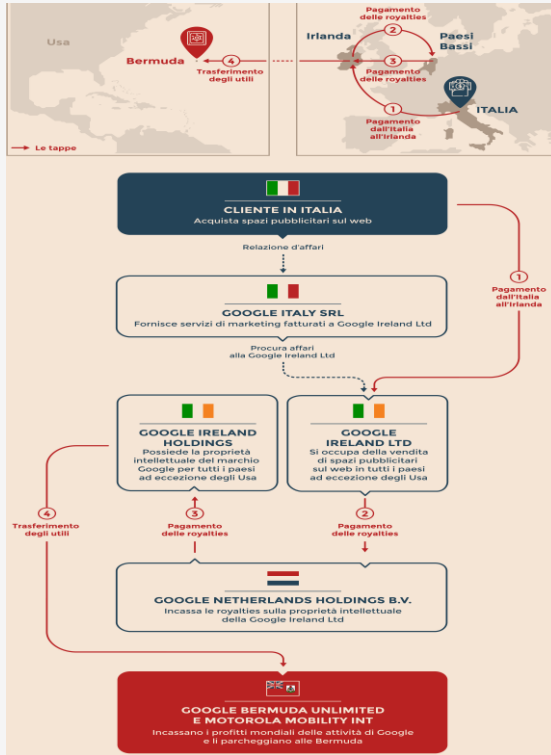
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SMALL REMARKS ON THE NEW DEFINITION



- ❖ the amendments to the commentary should not have any impact on existing tax treaties
- ❖ The Agency PE threshold is “lowered” thus generating more source based taxation but also more uncertainty surrounding the definition of Agency PE with probably a stronger need for an improvement of dispute avoidance mechanism (Rulings APA) and dispute resolution mechanism (MAP arbitrations)
- ❖ it is necessary to have a better clarification on whether the wider scope of the Agency PE provision would include only commissionaire arrangements or also other distribution model
- ❖ The economic approach is prevailing over the legalistic one. It would be sufficient that the agent acts on behalf of the principal and sells good or services belonging to the principal in order for the agent to constitute an agency PE of the Principal.

ITALIAN RECENT CASE: GOOGLE



Case

- ❖ Google Italy is 100% owned by Google Int. LLS (USA company)
- ❖ Google Italy provides supporting selling activity for the benefit of Google Ireland and was remunerated with a cost plus
- ❖ Google Ireland is in charge for online advertising sale for the world (except USA)
- ❖ Italian client was invoiced by Google Ireland
- ❖ Google Ireland paid royalties to Google Netherlands Holding BV
- ❖ The total Italian revenues were 637 million euro but only 67 million euro have been declared to be attributable to the Italian territory while the remaining 570 million were attributed to the Irish company
- ❖ The total amount of taxes declared and paid in Italy were 3,4 million equal to 0,5% on the Italian total revenues compared to a 24% statutory corporate income tax rate

ITALIAN RECENT CASE: GOOGLE



The Italian tax authority position

- ❖ Google Italy has to be considered as an Agency PE of Google Ireland (principal) mainly because the Italian client had a direct contact with the Italian company thus participating in the negotiation of the contracts (economic approach)
- ❖ Google Italy has to be considered not having an independent status (being the agent of only one principle) and not acting in the “ordinary course of its business”.

Google position

- ❖ Google Italy was not performing any sales activities toward the Italian client.
- ❖ Google Italy was not actively participating in the negotiation of the contracts because the contracts details (included pricing) were mainly established using algorithms provided by the same google search engine. The functions performed by the Google Italian employees were supposed to be minimal.

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ITALIAN RECENT CASE: GOOGLE



The settlement

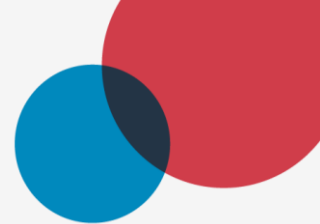
- ❖ According to the press release issued by the Italian tax authorities the main tax impact was referred to Google Italy (303 Million)
- ❖ The profit attributable to the deemed Agency PE were only minimal (3 Million)
- ❖ It can be inferred that during the negotiations the parties agreed to move the case from an Agency PE issue to a pure TP issue most likely by applying new benchmark analysis or a new remuneration method to settle the arm's length fees to be paid by Google Ireland to Google Italy.
- ❖ The claim concerning withholding tax not applied by the Italian agency PE on the royalties paid to Google Netherlands Holding BV seems to be dismissed.

TP VS AGENCY PE



- ❖ Do we really need to lower the PE threshold in order to increase the source state taxation?
- ❖ A proper TP analysis on the “Source State” controlled entity can be the most effective and simple way to increase the source state taxation (see Italian Google case)?
- ❖ A proper TP documentation can eliminate or at least mitigate the risk of having an hidden agency PE in the Source State?
- ❖ It is possible to apply the same economic TP approach to tackle the “artificial avoidance of permanent establishment status” not only in the Agency PE case but every time there is an existing economic nexus in the source state represented by a “controlled entity” therein established?

SPEAKER PROFILE



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TP PANEL DISCUSSION

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16 NOVEMBER 2017

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INTRODUCTION



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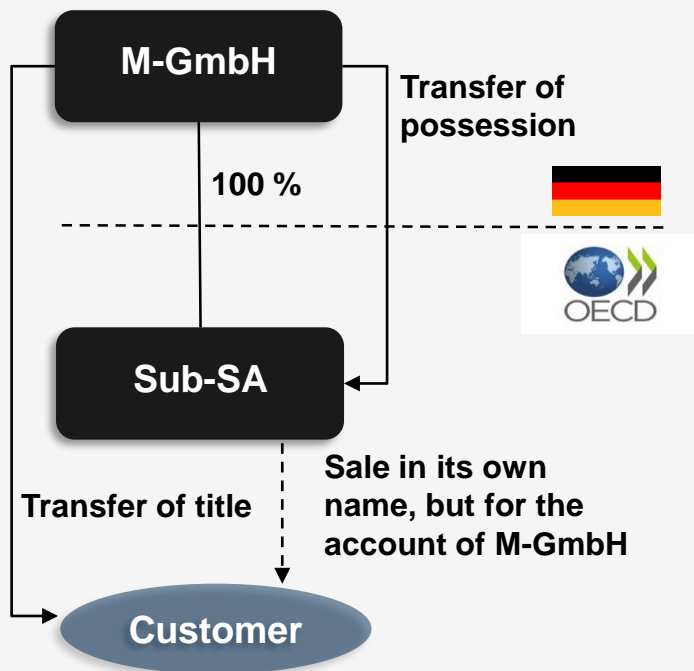
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1. Agency PE
2. Auxiliary & preparatory activities
3. Profit allocation
4. Splitting up contracts



AGENCY PE

CASE 1 - COMMISSIONAIRE PE



Case

- ❖ M specialises in production and distribution of jewelry.
- ❖ Sub sells the products of M in its own name but for the account of M in its state of residence.
- ❖ Sub is responsible for identifying customers, soliciting, placing and processing customer orders with M.
- ❖ M transfers possession, but not the title to the goods to Sub. The latter is directly transferred from M to the customer.
- ❖ M invoices customers and bears credit risk with respect to customers receivables.
- ❖ Sub receives a commission from M for its activities.

Questions

- ❖ Does the activity performed by Sub create a PE of M in Sub's residence state?
- ❖ Which profits should be allocated to the PE of M?

AGENCY PE - GERMAN POSITION



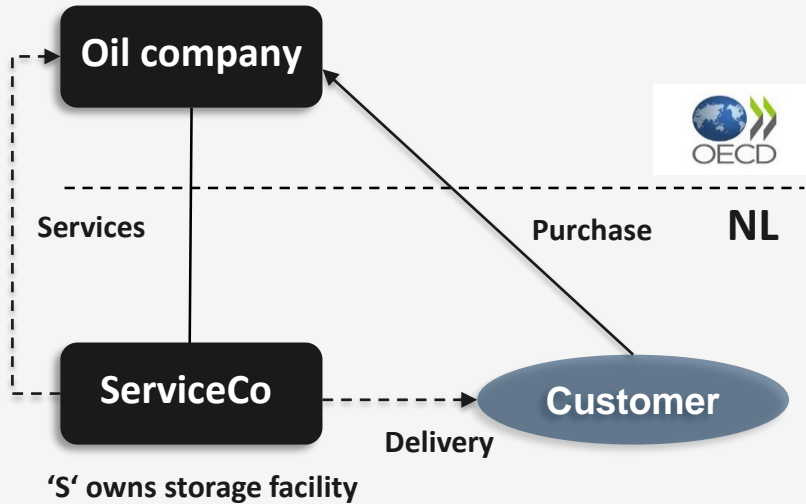
- ❖ Tendency to **blur and broaden the definition of what constitutes a PE** for tax treaty purposes has always been **widely rejected**.
 - Prevailing view: commission agent does not constitute an agency PE in the meaning of Art. 5 (5) OECD-MTC, as he **lacks an authority to legally bind the principal**.
 - But: Tax authorities decree dating December 24, 1999, no. 1.2.2: “*Where a person is authorised to **negotiate all details** of a contract in a way that is **binding** on the enterprise, the **enterprise may be** assumed to be **bound economically**.”*”
- ❖ Germany’s position to the **MLI**:
 - **35 treaties** covered by the convention.
 - **Reservation** not to apply, among others, Art. 12 of the MLI (Commissionnaire Arrangements).

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**AUXILIARY
ACTIVITIES**

AUXILIARY & PREPARATORY ACTIVITIES – PRE BEPS



- ❖ Art. 5 (4) of the OECD-MTC 2010 includes a list of exceptions according to which a permanent establishment is deemed not to exist where a place of business is used solely for activities that are listed in that paragraph.
- ❖ Amongst others the following activities are excluded:
 - Storage;
 - Display;
 - Delivery;
 - Specified activities with a preparatory or auxiliary character.



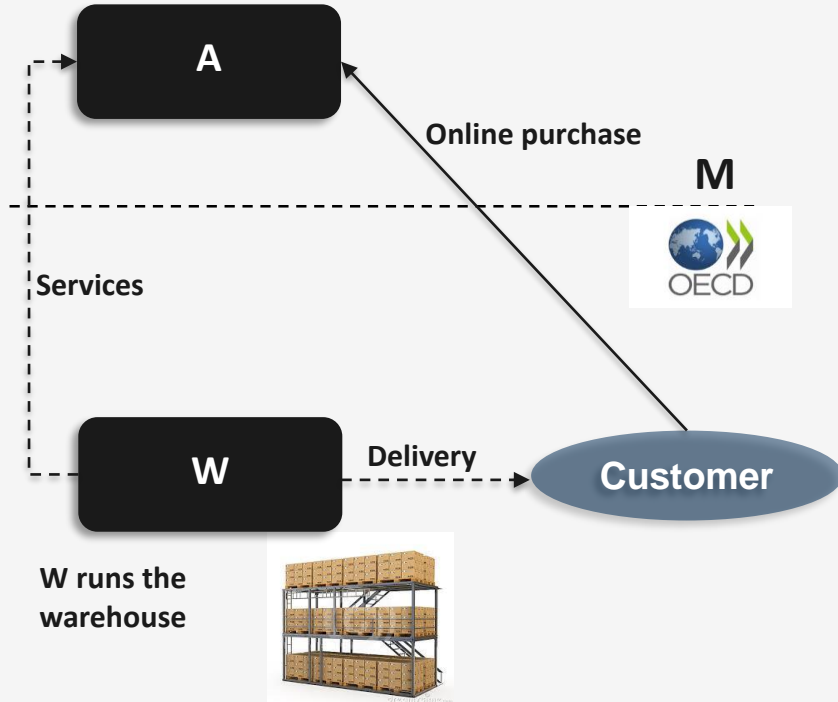
AUXILIARY & PREPARATORY ACTIVITIES – BEPS ACTION NO.7



- ❖ BEPS Action Plan 7 is intended to prevent artificial avoidance of a PE where there is significant activity in a country.
- ❖ The changes to the auxiliary and preparatory clause were deemed necessary to adapt to the digital economy.
- ❖ Activities previously considered to be merely preparatory or auxiliary in nature nowadays correspond to core business activities.
- ❖ In Action 7 it is agreed to modify Art. 5 (4) so that **each of the exceptions** included in that provision is restricted to activities that are otherwise of a **“preparatory or auxiliary” character**.

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CASE 1 – PREPARATORY & AUXILIARY ACTIVITIES?



Case

❖ Facts and circumstances:

- W, an **unrelated enterprise** resident of an OECD country, operates the warehouse on behalf of A.
- W has the **right to use and access** to the warehouse.
- W runs the warehouse under a **service agreement** where it uses specialised **know-how and software** developed by A.
- A has **no employees** in the OECD country.
- The warehouse is **accessible and at the disposal** of A.

Question

- ❖ Does A create a PE in the OECD country?

AUXILIARY ACTIVITIES - DUTCH POSITION



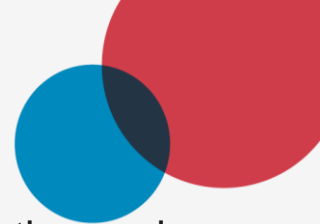
- ❖ The Netherlands' position to BEPS Action 7:
 - The Netherlands chose option A, Art. 13 (1) MLI, stating explicitly that the exceptions of Art. 5 (4) MTC should all be of auxiliary or preparatory nature.
 - Applicable with approx. 30 countries based on the MLI.
 - For specific bilateral situations you need to check the MLI Matching Database.
- ❖ In the Netherlands this set up would not constitute a PE under the new PE definition. Just having access is insufficient to trigger a PE.
- ❖ If W would be a related party, the profit allocation becomes relevant. The Dutch authorities would not adopt a PE for A as long as W would report sufficient profit.
- ❖ This would be different if A **operates the warehouse** with its **own software** and **employees**. The Dutch authorities would analyse how relevant the warehouse function is compared to the overall business.

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**PROFIT
ALLOCATION**

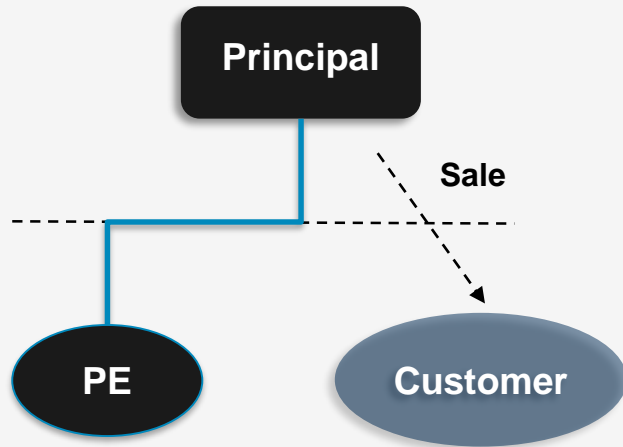
PROFIT ATTRIBUTION



- ❖ **BEPS Action Plan (Action 7)** recognises that 2010 guidance on profit attribution and Authorised OECD Approach (“AOA”) remain valid
- ❖ AOA requires:
 - PE treated as a separate enterprise with its own local functions
 - Risks and assets allocated by analysing significant people functions managing them
 - Transfer pricing applied to the resulting allocation of functions, risks and assets to determine the profit or loss allocable to the PE
- ❖ NB “branch accounts” prepared for accounting purposes are not relevant in determining the appropriate profit attribution for tax purposes
- ❖ Discussion draft published July 2017 explores interaction of transfer pricing and profit attribution. Public OECD consultation was held on 7 November 2017.

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PROFIT ATTRIBUTION – CASE 1

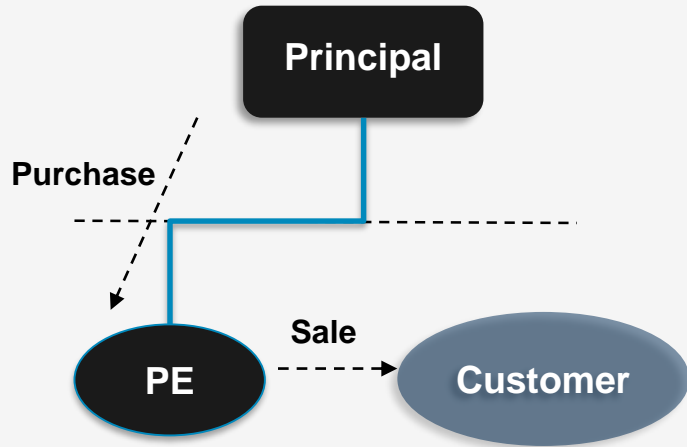


Case

- ❖ PE undertakes all sales, marketing, distribution and customer support functions in local market
- ❖ Sales are made in the name of the Principal

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PROFIT ATTRIBUTION – CASE 1 CONT'D

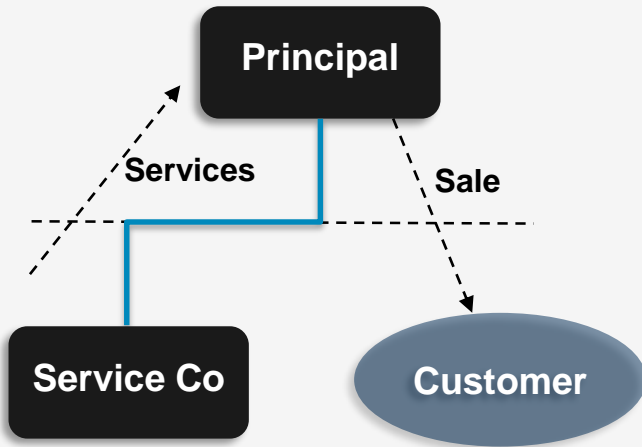


- ❖ AOA deems PE to be a separate enterprise owning local intangibles and making the sales
- ❖ PE's profit is determined by giving it an arm's length return for its functions assets and risks

Questions

- ❖ Would you expect the same characterisation?
- ❖ How would you anticipate the profit should be determined?

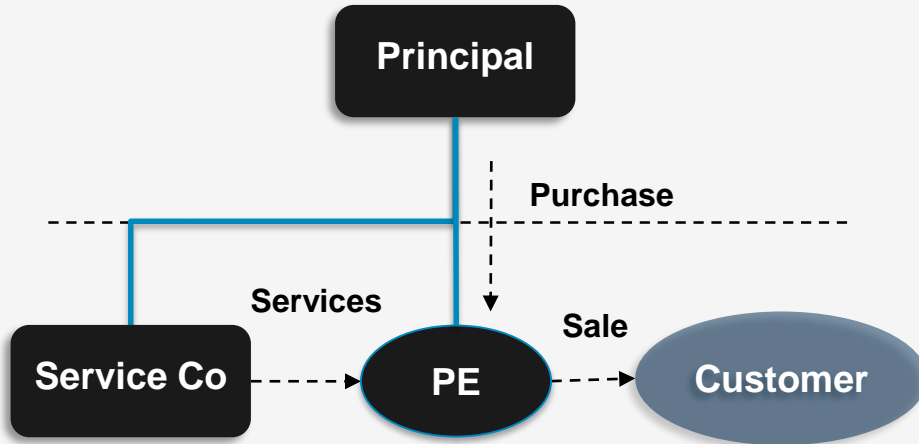
PROFIT ATTRIBUTION – CASE 2



Case

- ❖ Services co undertakes all sales, marketing, distribution and customer support functions in local market
- ❖ Sales are made in the name of the Principal

PROFIT ATTRIBUTION – CASE 2 CONT'D



- ❖ DAPE analysis
- ❖ AOA deems PE to be a separate enterprise owning local intangibles and making the sales
- ❖ PE's profit is determined by giving it an arm's length return for its functions assets and risks

Questions

- ❖ How do you anticipate the profits would be allocated?



**SPLITTING
CONTRACTS**

SPLITTING CONTRACTS



- ❖ projects with significant cross-border elements
- ❖ documentation split into two or more contracts
- ❖ to reduce local tax liabilities by avoid local corporate taxes on offshore work
- ❖ result in lower overall price for the contract works
- ❖ also split onshore contracts to mitigate indirect taxes
- ❖ offshore contract allows for fixed price contracts in harder currency

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CLASSIC SPLITS



- ❖ split into:
 - offshore contract
 - onshore contract
 - With different contracting entities

- ❖ offshore contract for:
 - design
 - engineering
 - out-of-country procurement

CLASSIC SPLITS



- ❖ onshore contract for:
 - managing import process
 - in-country transport
 - onshore procurement
 - installation and erection
 - testing and commissioning
- ❖ consider splitting supply of training and spare parts
- ❖ may require Umbrella Agreement with parent guarantees

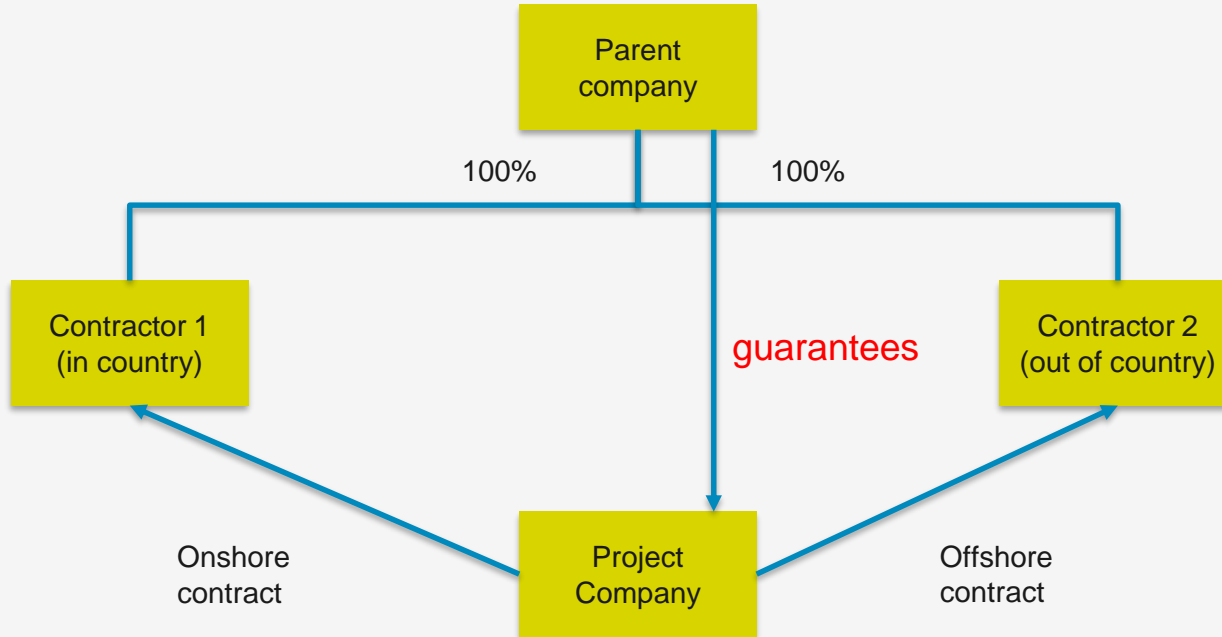
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LEGAL ASPECTS



- ❖ tax efficiency must consider the legal mechanics - not create risks
- ❖ splitting of contracts driven by specific tax circumstances
- ❖ all key contractual issues must still be addressed by both contracts
- ❖ splitting must be sensitive to:
 - underlying local tax risks
 - drafting complexities

CLASSIC SPLIT



APPLICATION IN SA / AFRICA



- ❖ employing someone in SA under offshore contract will require registration of a branch
 - is this a PE?
- ❖ Revenue will try to link it to the in-country building site
- ❖ if services are provided in country
 - sourced there?
 - PE under the services clause?
- ❖ many rely on preparatory or auxiliary services exclusion
 - but new definition may create PE now

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**SPEAKER
PROFILES**

SPEAKER PROFILE



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SPEAKER PROFILE



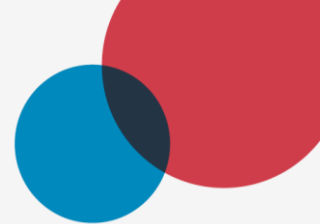
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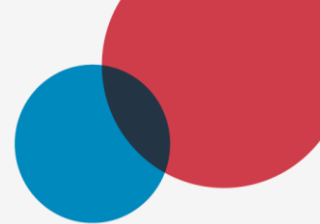
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Richard Syratt is a Managing Director with Alvarez & Marsal Taxand in London, with more than 20 years of corporate and international tax and transfer pricing experience. He focuses on international tax structuring.

Richard's clients include a number of the U.K.'s top-listed multinationals, with projects ranging from "boxes-and-lines" planning such as large debt restructuring projects, tax efficient financing, acquisition structures, mergers, demergers and JV structuring, to substance-based business changes, including intellectual property centralisation, structuring into tonnage tax and implementing franchise arrangements.

SPEAKER PROFILE



Okkie Kellerman

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Okkie is based in Taxand South Africa where he is an executive at ENSAfrica. He is a qualified CA (SA) and specialises in international tax (with special emphasis on inward and outward investments and the funding of transactions such as restructurings, take-overs and merger and acquisition), transfer pricing, thin capitalisation, the application of international double tax agreements and exchange control regulations.

Okkie has gained commercial experience working as a group tax advisor for a South African manufacturer, and has worked for a leading international firm of auditors, advising multinational companies on cross-border tax implication.

**IMPLEMENTATION
OF NEW TP
DOCUMENTATION
REQUIREMENTS**

**CONSEQUENCES
FOR TAX DISPUTES**

**STEFANO BOGNANDI
XAVIER DITZ
EVE XIAO
KIERAN TAYLOR
FELIPE GONZALEZ
HENDRIK BLANKENSTEIN**

16 NOVEMBER 2017



**OVERVIEW OF
THE NEW
REQUIREMENTS**

NEW DOCUMENTATION REQUIREMENTS



- ❖ Final Report on BEPS Action 13 published October 5, 2015 resulted in the revised chapter V of the OECD Transfer Pricing Guidelines.
- ❖ Changes aim at **increasing transparency** of transfer prices of multinational enterprises and an **elimination of information asymmetries between taxpayer and tax authorities**.
- ❖ Additionally automatic exchange of information procedures have been implemented (e.g. CbCR, APA)
- ❖ As of today
 - 60+ jurisdictions have already implemented a CbC filing obligation
 - 65+ CbC MCAA signatories
 - 1.000+ bilateral exchange relations active

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NEW DOCUMENTATION REQUIREMENTS



Master file

Organisational structure

Description of MNE's business

Important Drivers of Business profit
Supply Chain
Service Arrangements
Main Geographical Market
Functional Analysis
BR Transactions

MNE's intangibles

Intangible strategy
R&D activity
List of intangibles relevant for TP
I/C arrangements involving intangibles
TP policy for intangibles and R&D
Transfer of interests in intangibles

MNE's I/C financial activities

External financing arrangements
Internal financing arrangements
TP policy

MNE's financial and tax position

Annual consolidated financial statements
APAs and rulings

Local file

Local entity

Local Management structure/
org chart/reporting lines
Local Business strategy
BR and transfer of intangibles
Key competitors

Controlled Transactions

Information required

- Controlled Transaction description
- Amounts
- Related parties to the transaction
- I/C agreements
- Comparability and functional analysis with respect to the I/C transaction
- TP method applied
- Comparable searches
- APAs and ruling

Financial information

Annual local entity financial accounts
Application of the TP method to the transactions – a financial analysis

CbC Report

Tax jurisdiction

Revenues

Profit (Loss) before Income Tax

Income tax paid (cash basis)

Income tax accrued - current year

Stated capital

Accumulated earnings

Number of employees

Tangible assets (other than cash and cash equivalents)

Information for tax jurisdiction

1. Constituent entities resident in the tax jurisdiction
2. Tax jurisdiction of organisation or incorporation if different from tax jurisdiction of residence
3. Main business activity/ies

NEW DOCUMENTATION REQUIREMENTS



Master file:

“A **list and brief description** of the MNE group’s existing unilateral advance pricing agreements (APAs) and other tax rulings relating to the allocation of income among countries.”

Local file:

“A **copy** of existing unilateral and bilateral/multilateral APAs and other tax rulings to which the local tax jurisdiction is not a party and which are related to controlled transactions described above.”

- ❖ List and brief descriptions of all unilateral APAs and other tax rulings will be available to tax authorities in all countries where the Master file has to be filed => taxpayer is in charge of providing that information.
- ❖ A copy of all APAs and other tax rulings pertaining to documented transaction that the local jurisdiction is not a party to has to be provided.
 - Tax authorities will get access to further information on transaction and pricing in other countries.
 - Inconsistencies in pricing in defense of same transaction will immediately become obvious
=> **consistency is key!**



**TRANSFER
PRICING RISK
MANAGEMENT**

TRANSFER PRICING RISKS



- ❖ Transfer pricing on the top of Tax authorities' agenda
- ❖ All MNEs are targeted
 - How many tax audits have been concluded successfully for the taxpayer?
- ❖ Unlike many other tax areas, transfer pricing position safety is (almost) unpredictable. For example:
 - TP is always a matter of facts and interpretation: “same facts, different interpretation”
 - Comparable are very rarely 100% comparable
 - TP is all about proxies for, not the truth of value creation

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TRANSFER PRICING RISKS



❖ Sources of risks

- **Regulatory:** uncertain regulations and their application by tax authorities, tax authority aggressiveness.
- **Technical:** transfer pricing positions, such as a lack of coherence between structural attributes (for example functions, assets and risks of individual entities) and remuneration.
- **System:** reliability/functionality of ERP systems and internal controls that interact with transfer pricing.

TRANSFER PRICING RISKS



Documentation is the first step in the process of mitigating TP risks

Tax audit and tax dispute management will follow

This process requires skilled and trained tax and business people

- ❖ Knowing the business context
- ❖ Acknowledging risks areas
- ❖ Communicating internally
- ❖ Reporting consistently
- ❖ Anticipating tax authorities expectations
- ❖ Developing proper negotiation arguments
- ❖ Learning from experience

CONSEQUENCES OF THE NEW REQUIREMENTS

Increase the risks of potential double taxation and the need for dispute resolution mechanism

- Appropriate use of CbCR
- Uncertainty about local implementation and enforcement
- Existing diverging views on certain topics (e.g. location specific advantages)

Raise concerns regarding compliance costs

- Increased importance of efficient analysis and extraction of data
- Centralisation of disputes management and global documentation preparation

CONSEQUENCES OF THE NEW REQUIREMENTS



Mitigate risks of tax disputes

- New documentation requires to present consistent TP positions across jurisdictions
- Tax administrations will have information enhancing their risk assessment capabilities and their understanding of supply chain analyses

Confidentiality of data

- Proposed Directive on public CbCR approved by European Parliament in July 2017 – next steps very difficult to predict
- Uncertainty regarding the jurisdictions' ability to ensure the required level of confidentiality

CBCR - THREE EXAMPLES

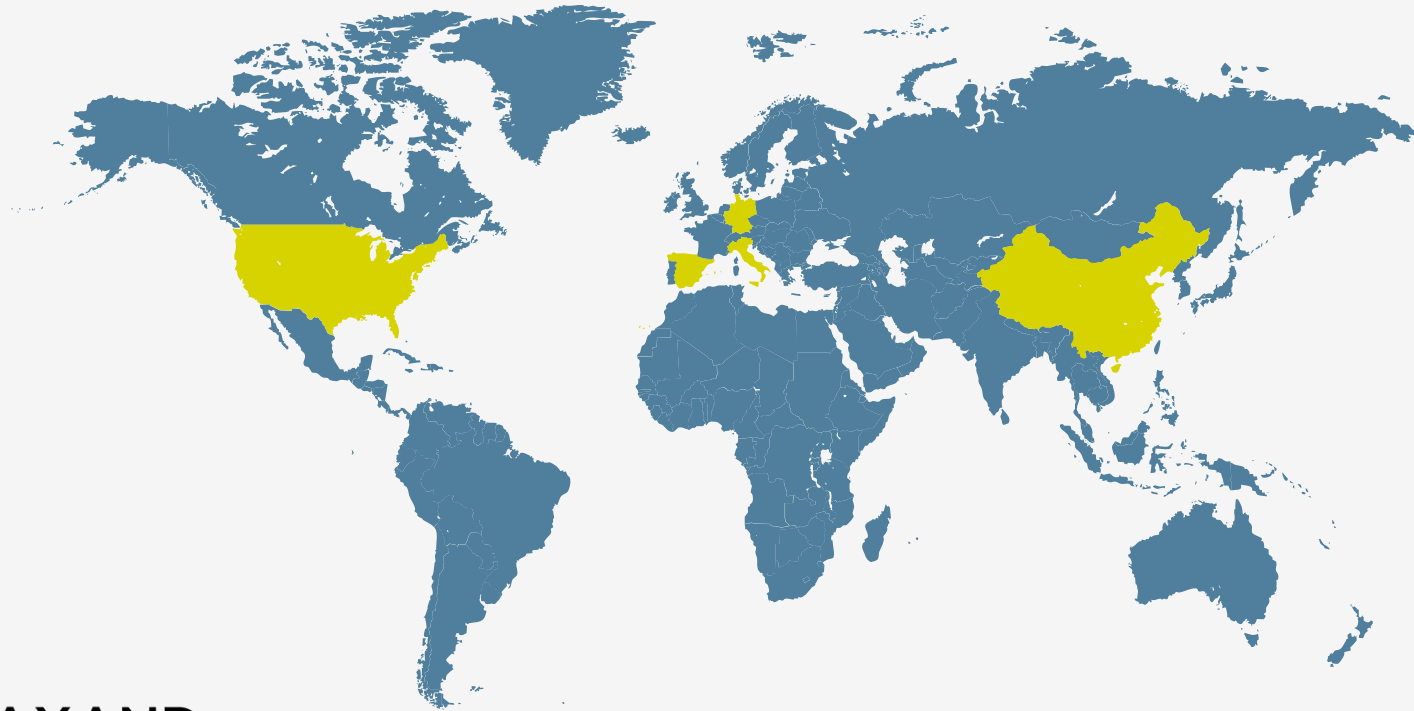


QUESTION	CASE 1 – EU PARENT	CASE 2 – US PARENT	CASE 3 – US PARENT
Performed tests on 2015 data	Yes	No	Yes
Estimated time for 2016 reporting	3 months	12 months	2 months
Resources dedicated	Tax, Accounting	2 global project leaders 30+ Local tax team	Accounting, HR, Tax and Finance
Sources of information	IFRS reporting for consolidation	Tests being performed Global roadshow to decide	Consolidating ERP system (Form 10K)
Critical issues in the process	Manual adjustments (taxes paid; PE data)	Consistency with local TP documentation	Manual adjustments (no single ERP system allows to pull data)
Identified tax risks	No	Possible	Possible
Qualitative information provided	Difficult to manage because figures are aggregated	Will be provided in case of tax audit	Master File will explain to minimise tax controversy



**LOCAL
PERSPECTIVES**

LOCAL TAXAND PERSPECTIVES





**STATUS OF
IMPLEMENTATION:
GERMANY**

GERMAN TAX LAW CHANGES FOLLOWING BEPS ACTION 13



❖ **Changes relating to transfer price documentation** comprised amendments to or the implementation of the following sections:

- Sec. 90(3) General Tax Code (GTC) relating to local and master file (amended).
- Sec. 162(3)/(4) GTC relating to the estimation of transfer prices by tax authorities and penalties in case of non-compliance with Sec. 90(3) GTC (amended).
- Sec. 138a GTC relating to CbCR (implemented).
- Sec. 379(2) no. 1c GTC on sanctions in case of non-compliance with Sec. 138a GTC (implemented).

GERMAN TAX LAW CHANGES FOLLOWING BEPS ACTION 13



- ❖ German legislator implemented changes into the domestic law through so-called **“Anti-BEPS Implementation Act” of December 20, 2016.**
- ❖ **Date of application** of changes:
 - Local/Master file: fiscal years beginning after December 31, 2016.
 - CbCR: fiscal years beginning after December 31, 2015.

LOCAL FILE (SEC. 90(3) SENT. 2 GTC)



- ❖ Includes **documentation of international business transactions with related companies** and PEs according to Sec. 1(4) Foreign Tax Act (FTA).
- ❖ Local file comprises two parts:
 - **Documentation of facts:** Records of type and substance of business transactions with related parties.
 - **Arm's length documentation:** Records of legal and economic basis for the arm's length prices and other business conditions with related parties.

LOCAL FILE (SEC. 90(3) SENT. 2 GTC)



- ❖ Local file requirements altogether **correspond to previous documentation requirements of Sec. 90(3) GTC** in combination with the Profit Allocation Documentation Regulation (GAufzV).
- ❖ Recent revision of the GAufzV published July 12, 2017 implemented only minor changes in comparison to the previous version. E.g., as part of the arm's length documentation the tax payer is now obligated to provide information on the point in time of the determination of a transfer price.

MASTER FILE (SEC. 90 (3) SENT. 3 GTC)



❖ Obligation to prepare a Master file:

- Obligation to prepare a documentation following Sec. 90(1) sent. 1 GTC (= a **local file**).
- **Business income** according to Sec. 15(1) no. 1 Income Tax Act (ITA).
- At least **one business transaction** according to **Sec. 1(4) Foreign Tax Act** (FTA) (= preparing entity is part of a multinational group according to Sec. 90(3) sent. 4 GTC)
- (Unconsolidated) **Turnover** of the preparing entity **exceeds EUR 100 million**.

MASTER FILE (SEC. 90 (3) SENT. 3 GTC)



❖ Master file provides tax authorities with an **overview over worldwide business activities and the transfer pricing system**. Information includes:

- Graphical depiction of organisational structure.
- Short description of business activities.
- Outline of the strategy for the use of immaterial assets within the value chain.
- Description of the company's financing.

COUNTRY-BY-COUNTRY REPORTING (SEC. 138A GTC)



- ❖ Aim of CbCR: **assessment of transfer pricing risks and other BEPS risks**. CbCR **not intended...**
 - ... as a basis to prove the inappropriateness of transfer prices.
 - ... for global formulary apportionment of income.
- ❖ **Base Case** according to Sec. 138a(1) GTC:
 - Domestic company obligated to prepare group financial statements.
 - Group financial statement includes **at least one non-domestic company or PE**.
 - Consolidated group turnover (previous fiscal year) **exceeds EUR 750 million**.

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COUNTRY-BY-COUNTRY REPORTING (SEC. 138A GTC)



- ❖ Two elements of CbCR (+ information necessary for their understanding (Sec. 138a(2) no. 3 GTC)):
 - Overview including ten key figures (turnover, EBT, no. of employees,...) showing the **distribution of business activities** over different countries (Sec. 138(2) no. 1 GTC).
 - Overview over **core activities** (R&D, Production, Distribution, Management,...) **of all companies** for their respective resident country (Sec. 138a(2) no. 2 GTC).

EXCHANGE OF TAX RULING



- ❖ Final report on BEPS Action 5 proposed – inter alia – an **automated exchange mechanism for tax rulings between tax authorities**. The Council of the EU amended the directive on administrative cooperation in the field of taxation (2011/16/EU) through directive 2015/2376 of December 8, 2015 to transpose the provisions into European (secondary) law. Beginning January 1, 2017, **EU member states are obligated to exchange tax rulings on a six monthly basis**.

EXCHANGE OF TAX RULING



❖ German legislator implemented changes through amendment of Sec. 2, 3, 5, 6 and 7 EU Administrative Cooperation Act (EUAHiG) by the Anti-BEPS Implementation Act of December 20, 2016.

❖ **Exchange includes:**

- Binding Assessments (Sec. 89(2) GTC).
- Binding Commitments (Sec. 204 GTC).
- APAs (Sec. 178a(1) GTC).



**STATUS OF
IMPLEMENTATION:
CHINA**

STATUS OF IMPLEMENTATION



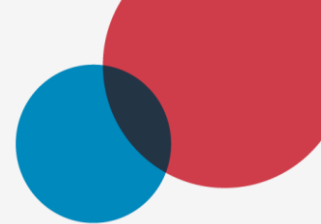
❖ New Form & CbCR

Public Notice No.42 includes the formal templates and filing instruction for the Annual Related Party Transactions Reporting Forms (the "New Forms"). These New Forms entirely replace the previous "nine forms", and increase the total number of forms to fourteen. Overall the information disclosure requirement is increased and the New Forms also include the Country-by-Country reporting form (CbCR).

The CbC Report discloses the allocation of worldwide income, tax payment and location of economic transactions of the entire group.

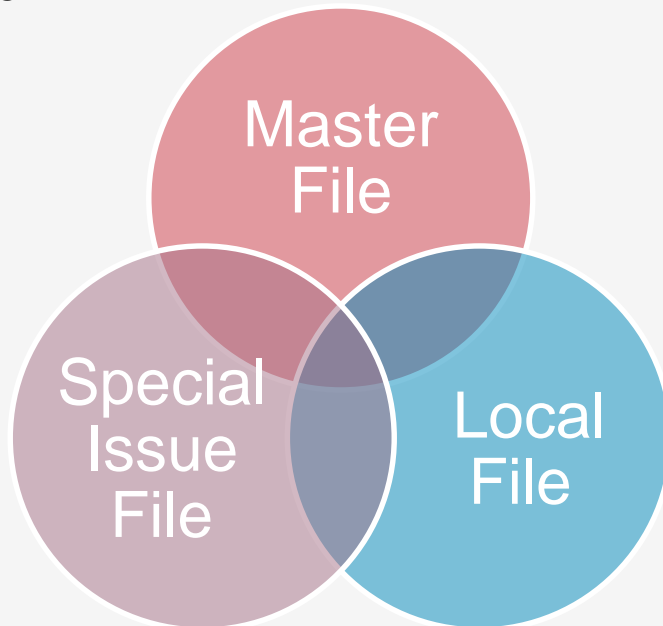
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STATUS OF IMPLEMENTATION



❖ Contemporaneous Documentation

Public Notice No.42 introduces a three tier documentation framework, as set out in the OECD's framework in BEPS Action 13:

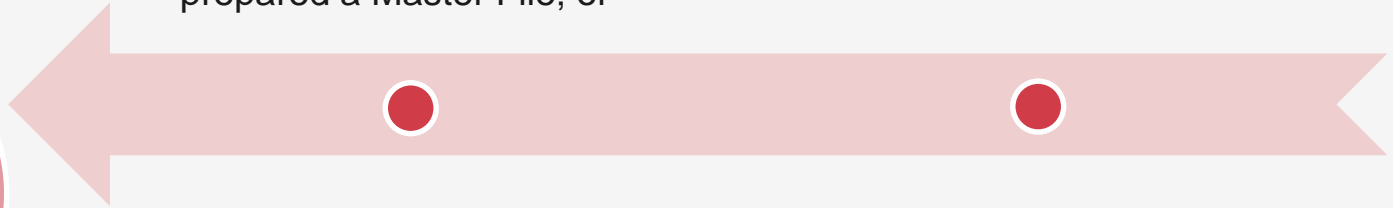


STATUS OF IMPLEMENTATION



The local entity has overseas related party transactions, and the group's ultimate holding company has prepared a Master File; or

The local entity has related party transactions exceeding RMB 1 billion during the year.



Master
File

Organisational chart

Global business

Intangibles, especially R&D facilities

Intercompany activities

Financial and tax positions

Group's existing bilateral APA

Business restructuring

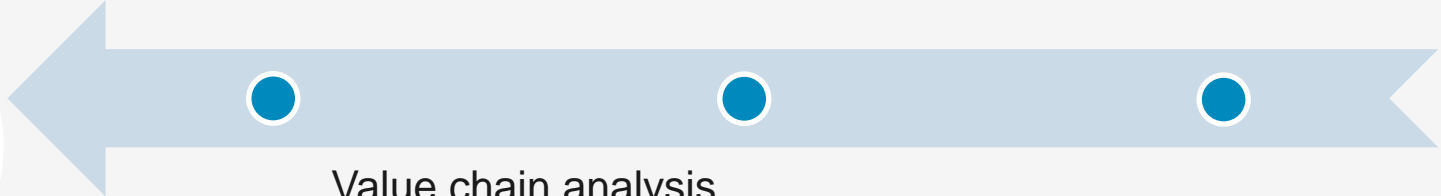
STATUS OF IMPLEMENTATION



The annual sum of related party purchases/sales is exceeding RMB 200 million

The annual sum of related party purchase/sales of financial assets or intangible assets is exceeding RMB 100 million; or

The annual sum of other related party transactions is exceeding RMB 40 million.



Value chain analysis

Financial data of each type of business

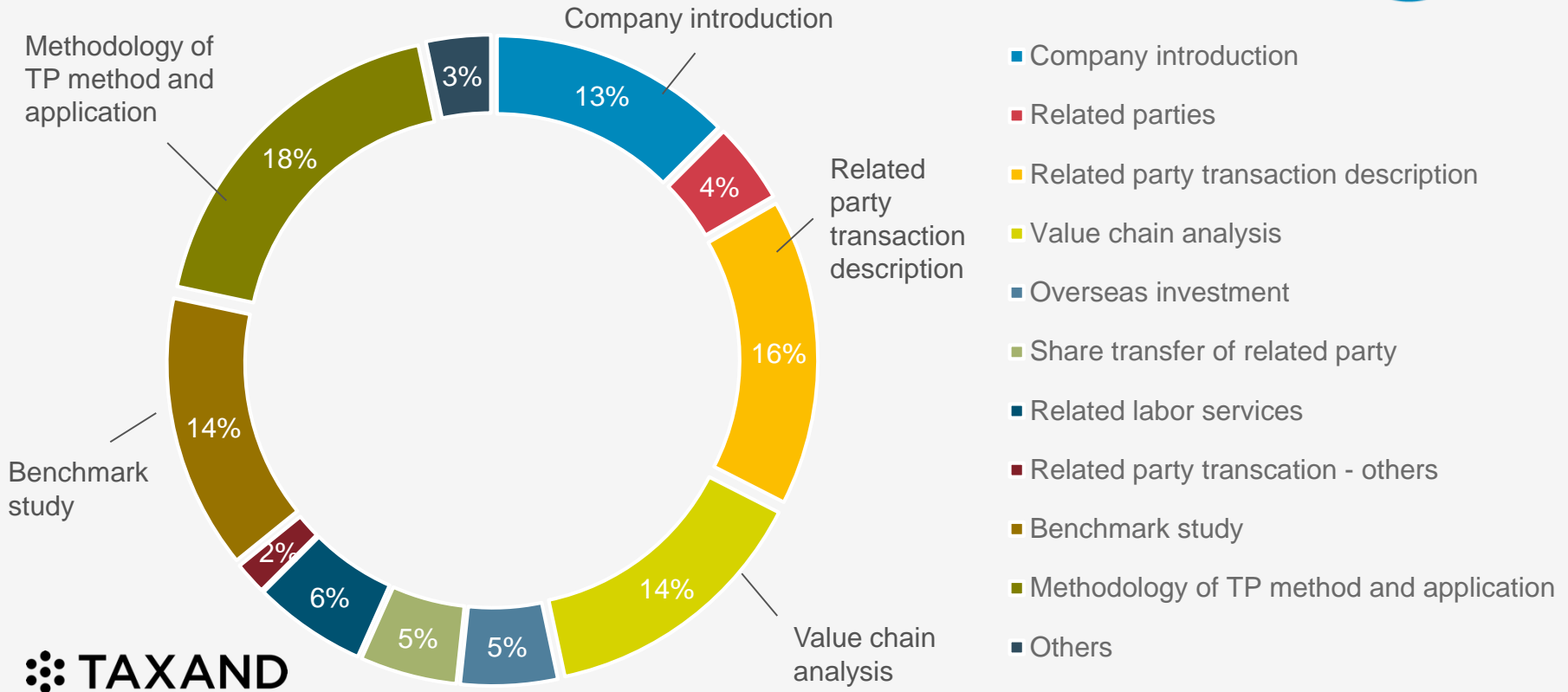
Equity transfer analysis

Related party services analysis

Location specific factors

Global advanced pricing agreements and tax ruling

STATUS OF IMPLEMENTATION

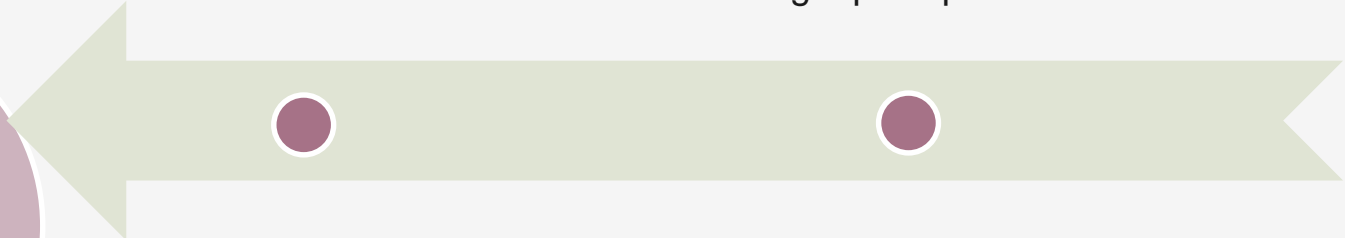


STATUS OF IMPLEMENTATION



The local entity enters or implements CSAs; or

The local entity with debt-to-equity ratio exceeding the threshold need to prove its related party financing's compliance with the arm's length principle



Cost sharing agreement(CSA)

Thin capitalisation

STATUS OF IMPLEMENTATION



Transfer pricing investigations should focus on enterprises with the following situations:

Involves related party transactions with large transaction amount, or varied types of related party transactions;

Incurs long-term losses, low profits or non-linear profits;

Profit is lower than the industry's level;

The profit level does not match the functional risks borne, or the earnings shared do not match the costs shared;

Carries out related party transactions with related parties located at low tax countries (regions);

Fails to declare related party transactions or prepare contemporaneous documentation pursuant to the provisions;

The ratios of debt investments and equity investments accepted from the related parties exceed the stipulated standards;

An enterprise which is established in a country (region) with actual tax burden lower than 12.5% does not distribute profit or reduces profit distribution without reasonable business needs

Implements other tax planning or arrangements which do not have a reasonable business objective.



**STATUS OF
IMPLEMENTATION:
SPAIN**

STATUS OF IMPLEMENTATION



- ❖ Master File and Country-Specific Documentation were already compulsory in Spain
- ❖ From FY 2016, Master File and Local File are fully adapted to BEPS Action 13
- ❖ Now Master File requires relevant Group information (e.g. intangibles, financing information, etc.), irrespective if it does not have any connection with Spanish I/C transactions
- ❖ CbCR is applicable in Spain from 2016. Only for groups which net revenues over EUR 750 million

❖ TAXAND

STATUS OF IMPLEMENTATION



- ❖ All I/C transactions shall be documented in Local File, except for transactions performed below EUR 250 k and transactions between companies of the same Spanish tax consolidation group.
- ❖ Groups with net incomes below EUR 45 million: Simplified Local File and No Master File required
- ❖ New Form 232 describing the I/C transactions applicable from 2016. First deadline next Nov. 30, 2017.

STATUS OF IMPLEMENTATION



- ❖ Local File and Master File shall be produced annually. They shall be delivered to the Tax Authority only upon express request.
- ❖ CbCR: there are two main scenarios:
 - The Spanish company files the CbCR in Spain: 12 months from fiscal YE
 - The Spanish company does not file the CbCR in Spain: it shall be notified to the Tax Agency the group company in charge of producing the CbCR and the jurisdiction where it will be filed as parent or surrogate. Deadline December 31 of each fiscal year.

STATUS OF IMPLEMENTATION



- ❖ Full penalty protection for TP adjustments if TP documentation obligations have been met.
- ❖ Severe penalties just for not having Local File and Master File.
- ❖ As of now no specific penalty regime for CbCR and 232 Form. General penalty regime applicable.



**STATUS OF
IMPLEMENTATION:
USA**

STATUS OF IMPLEMENTATION



❖ Not yet implemented in the USA

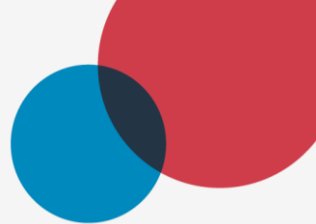
- Clients can choose to draft U.S. documentation in the OECD format.
- OECD format documentation will often contain the ‘ten principal documents’ which are required under Internal Revenue Code Section 6662.
- OECD format documentation generally provides U.S. penalty protection to potential transfer pricing adjustments.

❖ Documentation prepared strictly under the U.S. requirements may not contain all elements required by the OECD Guidelines.

- From a U.S. perspective, a decision should be made on a case by case basis to determine which format a Company’s documentation should take.

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IMPACTS OF SUCCESSFUL DOCUMENTATION



❖ **Penalty Protection**

- Complete, compliant transfer pricing documentation provides protection against penalties, should the IRS impose a transfer pricing adjustment.

❖ **Global consistency**

- Producing consistent global documentation forces a multinational to evaluate its transfer pricing policies to generate greater global consistency.

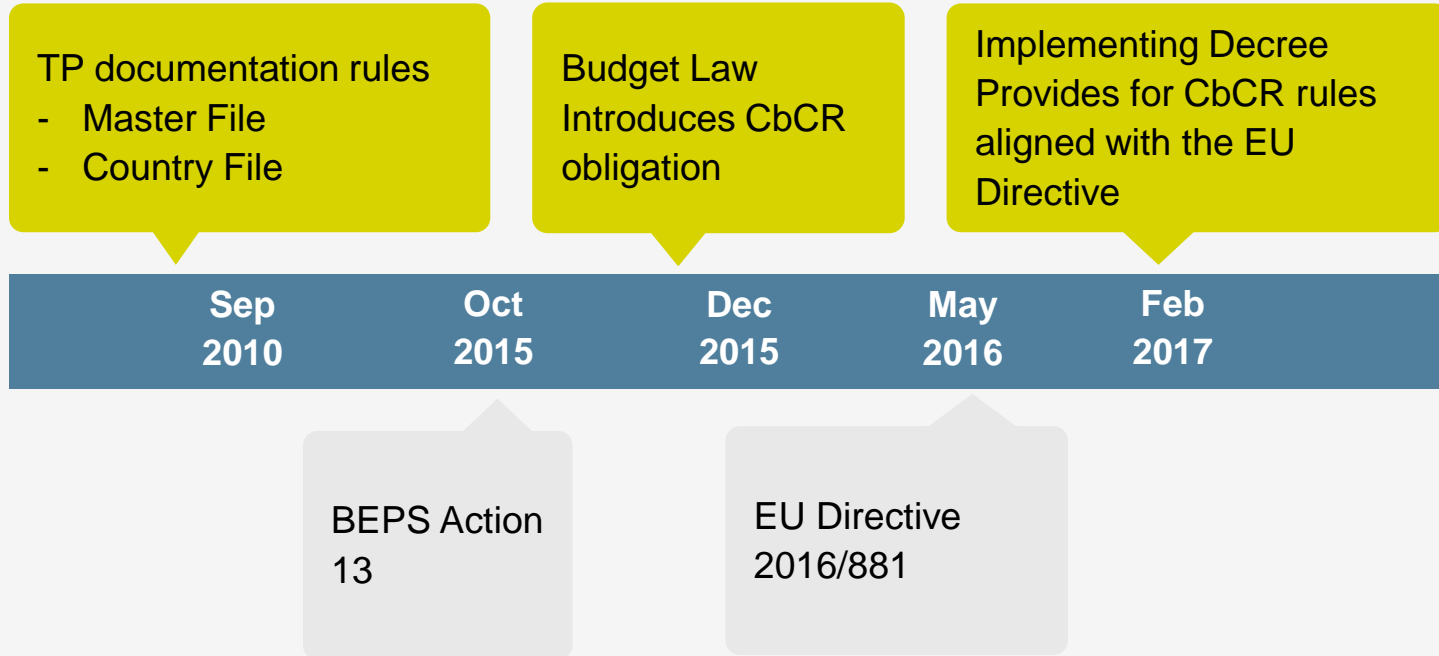
❖ **M&A Diligence**

- Producing timely, coherent and well drafted transfer pricing documentation significantly aids any diligence process, and may increase ultimate sale price achieved.



**STATUS OF
IMPLEMENTATION:
ITALY**

STATUS OF IMPLEMENTATION



STATUS OF IMPLEMENTATION



- ❖ Master File and Country File approach introduced since 2010, in line with the EU Transfer Pricing Documentation standards
 - Optional regime with disclosure in the tax return
 - Minimum content requirements
 - No threshold
 - Penalty protection if TP documentation is properly prepared and timely notice provided in the tax return
- ❖ Endorsement of revised Chapter V requires a new resolution but, in practice, Italian MNEs are already including in the 2016 documentation certain additional information not formally imposed by the existing regulations

STATUS OF IMPLEMENTATION



Country by country reporting

- ❖ Starting from January 1, 2016 - due by
 - Resident parent company if consolidated revenue exceeds €750m
 - Resident subsidiary, if the CbCR due by the foreign parent company is not automatically available for ITA
- ❖ Procedure
 - Communication of the obligation within the tax return filing date
 - Filing of reporting within 12 months after the year end
- ❖ Penalties
 - €10,000-50,000 range (no filing, incomplete or untrue data)

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STATUS OF IMPLEMENTATION



Country by country reporting

❖ Use of information

- Solely for risk assessment purposes
- Economic and statistic analysis
- TP adjustments cannot be based solely on CbCR data

❖ Jurisdictions involved in the exchange of information

- All EU countries (art 8bisbis Directive 2011/16 as introduced in May 2016 by the Directive 2016/881) and
- Countries with qualified agreements in place (Multilateral Competent Authority Agreement on the Exchange of CbC Reports (the "CbC MCAA"))

❖ TAXAND



**REAL CASES:
GERMANY**

REAL CASES



- ❖ **F GmbH** is resident for tax purposes in Frankfurt and operates in the **automotive industry**.
- ❖ The **goods and products** produced by F GmbH are **distributed in Italy, Spain, the UK and China via local distributors (V Ltd.)**, which are subsidiaries of F GmbH.
- ❖ Transfer prices for the goods and products are based on the resale price method. The gross margins are calculated on the basis of a benchmark study.
- ❖ The automotive industry in Europe and Asia is booming, so V Ltd. has grown exceptionally well. **Having overcome start-up losses** from 2005 to 2009 the **return on sales ratio** – based on the EBIT – is between **15% and 22%**.

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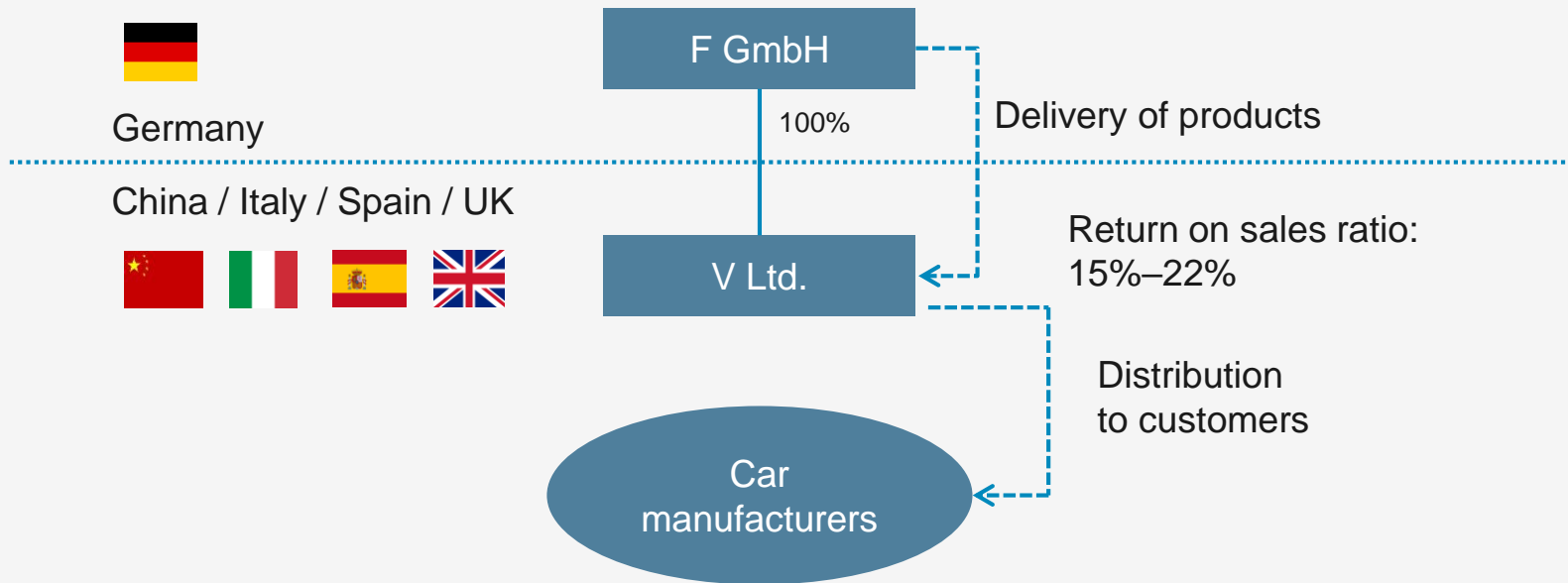
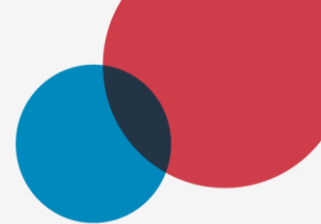
REAL CASES



- ❖ The high return on sales ratios can be explained by enormous **sales growth**, the **excellent local management**, and the **high prices** on the local markets.
- ❖ The **major clients** of V Ltd. are **local car manufacturers** and **large German car manufacturers**.
- ❖ The German **tax audit** challenges the transfer prices for the product delivery to the distribution companies. The auditors' main argument is that **V Ltd. "earns too much"**.
- ❖ The **adjustments** in income are **based on Sec. 1 Foreign Tax Act**, justified by the **return on sales** which is supposedly **too high** at the level of **V Ltd. in each country**.

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REAL CASES



REAL CASES



- ❖ The income adjustment **targets the profit** (return on sales) of V Ltd. Does **Sec. 1 Foreign Tax Act** cover such an **income-orientated adjustment** (note: Sec. 1 Foreign Tax Act refers to a concrete business relationship)?
- ❖ Is it possible to **avoid double taxation** by filing a **mutual agreement procedure** between Germany and China/Italy/Spain/UK if the German tax audit adjusts the income?
- ❖ Is it more reasonable to bring the case before **a tax court** instead of a mutual agreement procedure?
- ❖ Is a MAP possible even if the taxpayer did not cooperate with the tax auditors and the tp documentation was not sufficient?

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**REAL CASES:
CHINA**

REAL CASES



- ❖ The transfer pricing audit process is generally initiated by a request for financial and management information such as statutory accounts, tax computation, pricing information, management accounts and transfer pricing documentation. Based on this information, the tax authority will carry out a review of the documents and decide if a more detailed review is required.
- ❖ TP audit is conducted by the local tax bureau.
- ❖ Due to the foreign exchange control, overseas payment will be rejected if the company triggers TP audit.
- ❖ In China, tax authority is very likely to conduct tax investigation on detailed taxes, such as Enterprise Income Tax, Withholding Tax, VAT, even Individual Income Tax.

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**REAL CASES:
SPAIN**

REAL CASES:

ZERAIN (SPANISH HIGH COURT 19 OCT 2016)



- Ruled in favor of the Spanish Tax Authority
- Relevance of internal comparable even if the volume is not relevant. Lesson: internal comparables are generally better than results obtained from databases (3.27 TP Guidelines). To avoid direct adjustment, it is important to clearly evidence the lack of comparability of these transactions in the Local File.
- “Secret” comparables used by the Tax Agency were accepted.
- The APA agreed between third countries as regards similar I/C transaction audited was not considered.
- The transition from one TP policy to another is always an issue for the jurisdiction losing tax incomes. Comment: A non-tax event should ideally be the triggering event to carry out the transition. APA can be a very useful tool in these cases.
- TP Guidelines do not bind the Spanish Courts. Comment: The TP Guidelines are recognized by the Preamble of the current CIT Act as a source of interpretation of the internal TP legislation provided that they do not conflict with the domestic regulations.

REAL CASES:

MCDONALDS (SPANISH HIGH COURT 2 MAR 2017)



- Ruled in favor of the Spanish Tax Authority
- Spanish Tax Agency consulted Banks on whether the provisions included in the I/C term loans would have been agreed in market conditions.
- The TP adjustment was made using the IR applied to the credit facility granted by a third party to the Company. This internal comparable was considered as the best reference despite the Tax Agency admitted that it had comparability weaknesses.
- The lack of economical rationale of the Company's behavior (it used I/C financing instead using third party financing which IR was lower) was critical to support the TP adjustment. **Lesson: Factual substance is key for TP purposes.**
- I/C financing transactions: general interest rates references (e.g. Spanish legal IR, Euribor, ECB, etc.) are not reliable references. **Lesson: specific benchmarks shall be done to determine I/C IR**

REAL CASES:

PEUGEOT (SPANISH HIGH COURT 31 MAY 2016)



- ❖ Ruled in favor of Peugeot
- ❖ It is not possible to fully disregard I/C transactions based upon TP rules. If the Tax Authority considered that the transaction had not taken place between third parties, it should have used general anti-abuse figures, instead of the TP rules.

Comments:

- New TP Guidelines (post Action 8-10 BEPS) include some cases where I/C transactions should not be disregarded for TP purposes. They may only be disregarded in exceptional circumstances when the I/C arrangement is not commercially rational
- The Spanish context is uncertain. The new Spanish TP regulation seems to open the door to the Tax Authority to be able to re-characterize a I/C transaction (in the past the law referred to the capacity of the Tax Authority to review the TP value, but now this has been reworded establishing that the Tax Agency can generally review whether the I/C transactions)



**REAL CASES:
USA**

REAL CASES



- ❖ Our team was recently engaged to modify a company's transfer pricing documentation in order to defend its intangible development position in multiple jurisdictions.
- ❖ The company engaged Taxand USA to modify the testing mechanism from a traditional TNMM / CPM methodology to a profit split, globally.
- ❖ A key issue (which we ultimately leveraged) is the distinction between the U.S. and OECD DEMPE considerations for intangible returns.
- ❖ Taxand USA implemented OECD - compliant documentation, including a master file, U.S. local file, and other local country files. Given the company's extensive global footprint, OECD - compliant documentation seemed the most appropriate and can be used to defend the companies transfer pricing policy globally.

❖ **TAXAND**



**REAL CASES:
ITALY**

REAL CASE



- ❖ **A** is resident in Italy and operates as a manufacturer of semi-finished products for the fashion industry. Its main reference market is Europe.
- ❖ To serve the Far East market, **A** acquired in prior years a Chinese manufacturer, **B**, that produces the same type of products.
- ❖ **A** provides to **B** (i) semi-finished goods that are subsequently employed for further processing and (ii) product development services.
- ❖ Transfer prices for the goods and services are based on the cost plus method. The margins are calculated on the basis of a benchmark study.

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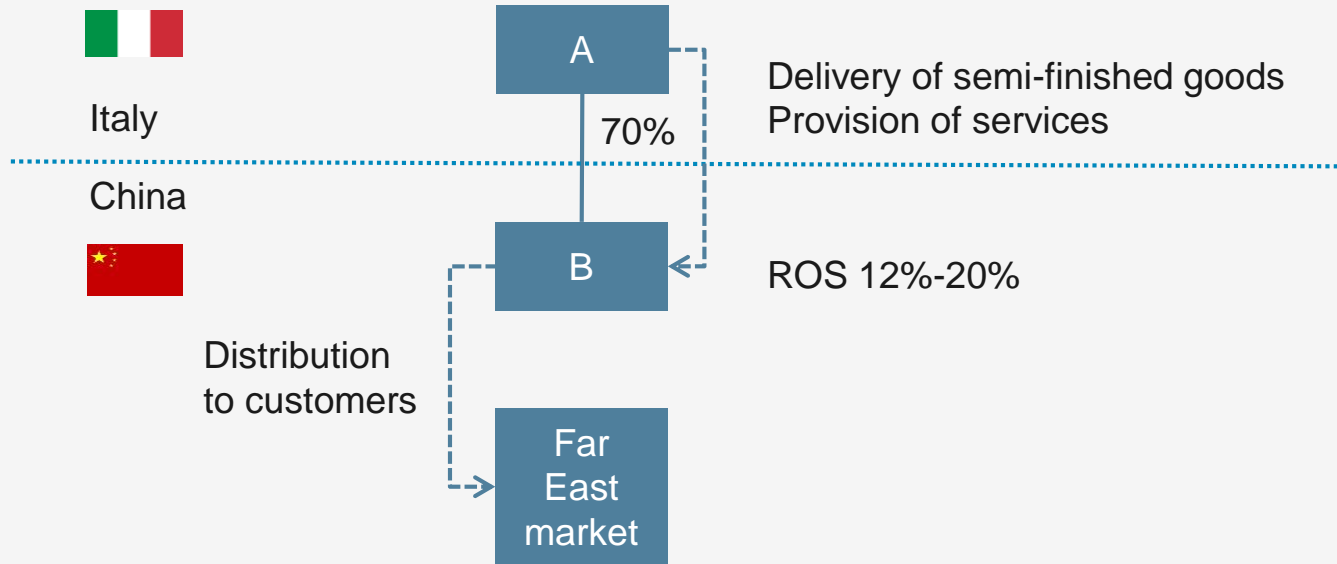
REAL CASE



- ❖ Both **A** and **B** characterise for a similar functional profile (i.e. fully fledged manufacturers):
 - **A** operates a R&D facility mostly for its own benefit
 - **B** historically owns its manufacturing know (local partner)
- ❖ The acquisition of a local manufacturer in China was driven by the need to serve the Far East market with a competitive pricing
- ❖ The Far East market is expanding so that **B** has become exceptionally profitable and the return on sales ratio – based on the EBIT – is between 12% and 20%.

❖ TAXAND

REAL CASE



REAL CASE



- ❖ The Italian tax administration challenges the transfer prices for the product delivery and the service provision.
- ❖ The auditors' main argument is that the competitive advantage of B in the Far East market (and its high profitability) is mainly due to the value added by the products and services provided by A, which in turn is generated by the R&D activity carried out in Italy.
- ❖ The **adjustment** is based on the **attribution of the entire residual profit of B to the price of goods supplied and services rendered by A.**

❖ TAXAND

REAL CASE



- ❖ The tax adjustment refers to the **provision of services and delivery of goods** or to the **licensed use of intangibles**?
- ❖ In case of filing for a **mutual agreement procedure** between Italy and China, the competent authorities would decide the case based on the UN or the OECD Guidelines? Would the Chinese competent authority apply his view on location specific advantages?
- ❖ What would have happened if the TP documentation were drafted according to the BEPS Action 13?



**SPEAKER
PROFILES**

SPEAKER PROFILE



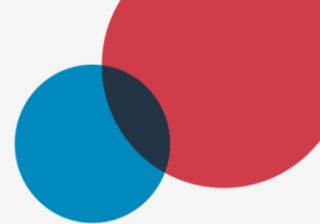
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Eve commences her career as a tax consultant in Hendersen and now has 13 years of professional experience in China tax and business advisory. In addition to her strong tax background, Eve has been specialised in transfer pricing for the last 9 years and has helped many multinational companies in different industries dealing with their PRC transfer pricing issues. Eve has build up valuable experience in the Chinese transfer pricing practice.

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Xaver is a tax advisor and partner with Flick Gocke Schaumburg in Bonn, Germany since 2004. His practice area covers the taxation of companies and groups in both a national and international context, and he specialises in transfer pricing. Specifically, his work focuses on the defence of TP mechanisms in tax audits, litigation, the documentation of TP systems, the planning and implementation of new TP approaches in existing group organisations, Advance Pricing Agreements (APAs), mutual agreement procedures, and EU Arbitration Convention procedures.

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He is a member of the Institute of Chartered Accountants and Auditors of Milan, and has more than 20 years of experience providing tax advice on both Italian and international tax issues, specialising in transfer pricing and business restructuring.

SPEAKER PROFILE



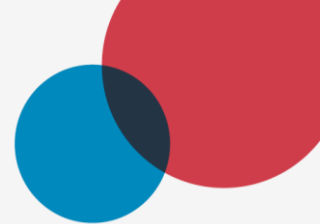
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Felipe is a tax partner with Garrigues in Spain since 2009. Tax law expert with nearly 20 years of experience in advising multinationals and foreign investors with interest in Spain. He is specialised in transfer pricing. Specifically, he focuses on advising clients in the designing of their TP policy, producing TP documentation and assisting them on TP disputes. He has been involved in several unilateral and bilateral APAs, as well as in many mutual agreement procedures on the grounds of the double tax treaties and the EU Arbitration Convention.

SPEAKER PROFILE



Hendrik Blankenstein

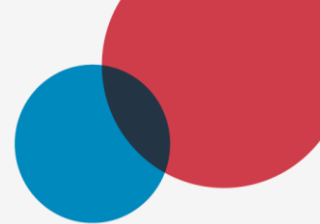
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Hendrik is a partner and head of the Transfer Pricing team in Taxand Switzerland which is Tax Partner AG.

Hendrik Blankenstein is a partner of Tax Partner AG and leads its transfer pricing team. From 1989 to 1995, Hendrik was an international tax consultant at Big 4 firms in both the US and The Netherlands, from 1996-2004 he worked as an in-house international tax and transfer pricing counsel at Nestlé's HQ in Switzerland and from 2005 to 2015 as a Swiss based partner in globally operating transfer pricing boutique consultancy firms.

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Kieran Taylor is a Director with Alvarez & Marsal Taxand in New York. Kieran works within the Transfer Pricing and Tax Efficient Supply Chain Management (TESCM) teams.

Kieran specialises in supply chain restructurings, M&A due diligence, transfer pricing benchmarking and documentation and intellectual property planning and migration.

He received an Bachelor of Laws (Honours) degree from the University of Edinburgh, and is ATT qualified. Kieran is a British National, having grown up splitting time between South Africa and Oxfordshire.



**MITIGATION OF
DOUBLE TAXATION IN
TRANSFER PRICING:
EFFECTIVE APA &
MAP PROCEDURES**

**BENOIT BEC
MARC ALMS
MARIO ORTEGA CALLE**

16 NOVEMBER 2017

Your global tax partner



INTRODUCTIONS

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THE MLI

MLI SNAPSHOT

Purpose & Scope

- ❖ A Single instrument to address treaty related BEPS measures
- ❖ Avoid renegotiation of bi-lateral tax treaties
- ❖ Arbitration provision developed as part of MLI negotiation
- ❖ Enforce the minimum standards

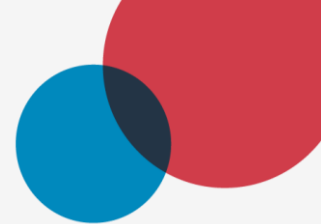
Key features





- ❖ Selectivity with respect to covered tax agreements
- ❖ Applies alongside existing treaties and modifies their application
- ❖ Swift, effective and flexible : reservations and options

Status

- ❖ 71 jurisdictions have now signed + 6 intention to sign
- ❖ Only Austria and Isle of Man has deposited its instrument for ratification
- ❖ Non-signing countries : Unites states, Brazil, Qatar ...

MLI : APPLICATION



	Verify entry into force of the MLI	<ul style="list-style-type: none">❖ Check if your MLI entered into force (i.e. 5 countries including your jurisdiction should have notified the ratification to the OECD)❖ Check if MLI is in force in the other jurisdiction
	Verify if the tax agreement is covered	<ul style="list-style-type: none">❖ Check if both contracting states list the tax agreement in their MLI position❖ Check if the Tax agreement is in force - three months after MLI ratification
	Identify the position taken in the MLI for a the specific provision	<ul style="list-style-type: none">❖ Check if a Reservation has been made by one of the contracting state on specific provision❖ Check if both contracting jurisdictions to the covered tax agreement choose to apply an optional provision of the MLI
	Identify if the existing provision is effectively modified → does the notifications match or not?	<ul style="list-style-type: none">❖ Check if the notification matches : “in place of”, “in the absence of”, in place of or in absence of”, or “to or in modification to” an existing tax treaty provision.

MLI : TIMELINE



❖ MLI Entry into effect:

- **Withholding tax:** takes effect for the first day of the year after both parties to a covered tax agreement have MLI enter into force
- **All other taxes:** taxes levied with respect to taxable periods beginning on or after six months after the MLI enters into force for the two parties

Example:



MLI : IMPLEMENTATION OF BEPS ACTION 14



- ❖ Mutual Agreement Procedure (Part V, Art 16) – OECD Minimum standard
- ❖ Arbitration (Part VI, Articles 18-26)

Mutual Agreement Procedure

Present

- ❖ No mandatory access
- ❖ Strict complaints process
- ❖ No guarantee for solution

Post MLI

- ❖ Access is a minimum standard
- ❖ Complaints submitted to either tax authorities
- ❖ MAP can be extended indefinitely
- ❖ No guarantee for solution

Arbitration

Present

- ❖ No mandatory arbitration clause in double tax treaties

Post MLI

- ❖ Optional provision
- ❖ Supplement to MAP in a second phase
- ❖ If opted, no time limit defined for making a decision
- ❖ Strengthen guidance for arbitration



OVERVIEW OF
MAP/APA



**STATISTICS &
COMPARATIVE
ANALYSIS**

Advance Pricing Agreements Statistics



❖ Statistics in the EU

	Total Number of APAs in force at the end of 2015		Number of APAs granted in 2015		Number of APA applications rejected in 2015		Number of APA applications withdrawn in 2015		Average time in months to negotiate bi-or multilateral APAs	
	EU	NON-EU	EU	NON-EU	EU	NON-EU	EU	NON-EU	EU	NON-EU
Total EU Countries	1 190	254	978	200	60	4	102	15		
France	22	33	7	11	2	1	1	-	25	28
Spain	45	15	12	4	3		4	1	32	69

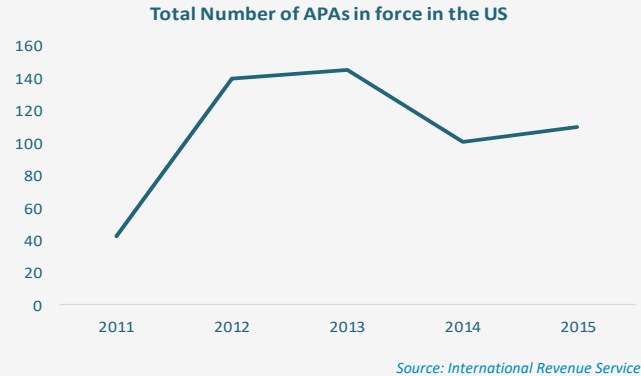
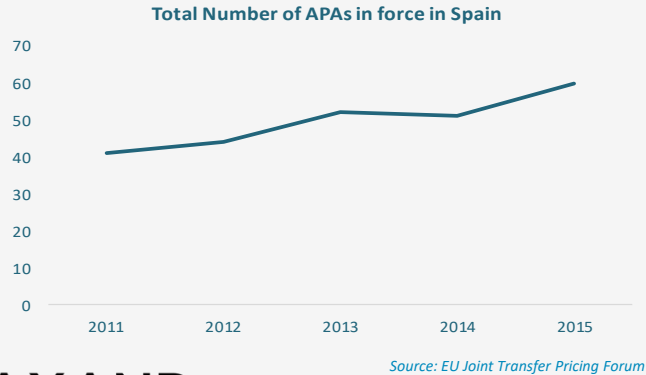
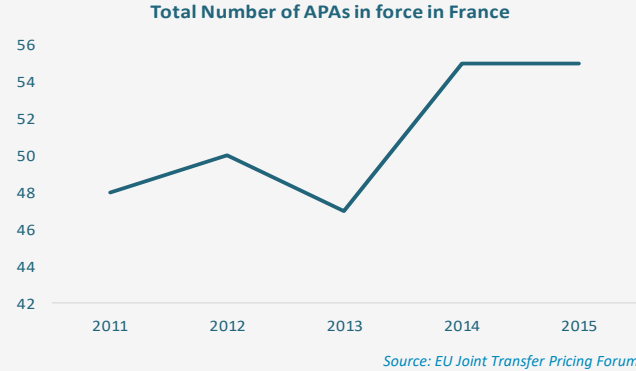
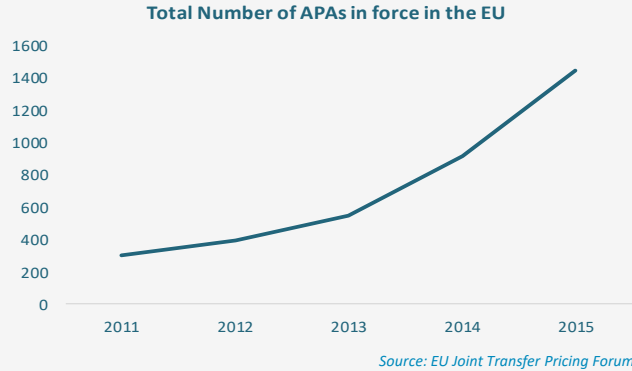
Source: EU Joint Transfer Pricing Forum

❖ Statistics in the US

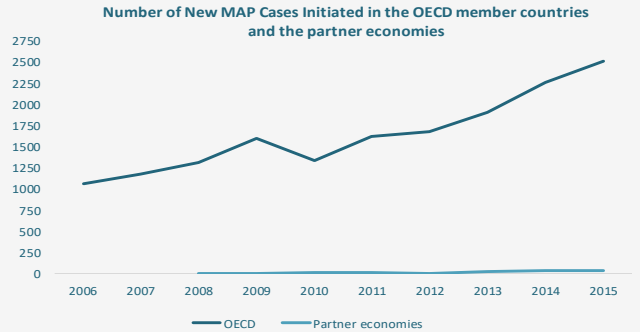
	Total Filed in 2015	Total Executed in 2015	Revoked or Cancelled in 2015	Application withdrawn in 2015	Average months to complete new and renewal APAs executed in 2015
United States	183	110	11	10	36.7

Source: International Revenue Service

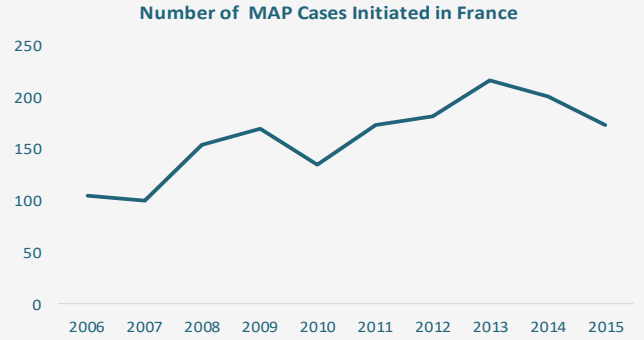
Advance Pricing Agreements Statistics



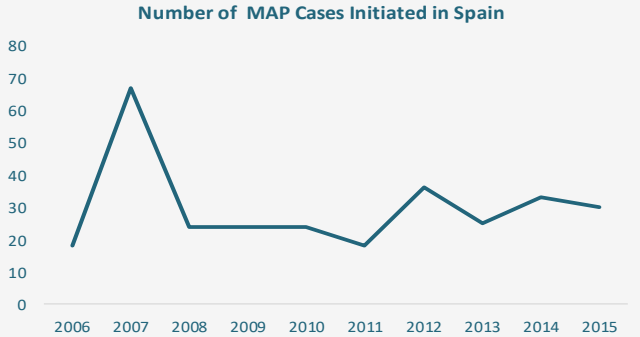
Mutual Agreement Procedure Statistics



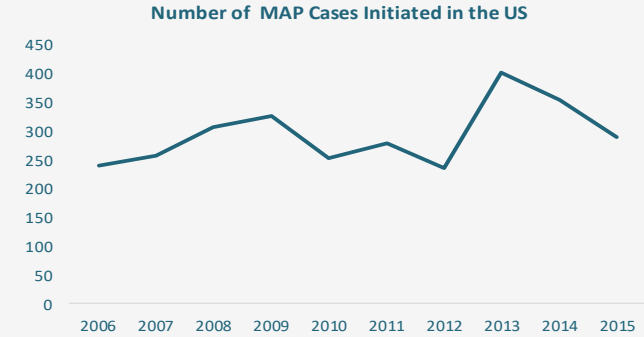
Source: OECD



Source: OECD



Source: OECD



Source: OECD



SPAIN

SPANISH EXPERIENCE: APAS



- ❖ Post – BEPS situation:
 - Increased interest to provide tax certainty
 - Focus on transparency raised concerns on its use
- ❖ STA: specialised team dealing with APAs
 - Limited resources, lengthy process
 - Very BEPS-oriented: value chain and value creation analysis rather than traditional approaches for one-sided methods
- ❖ Preference for bilateral APAs: length and complexity
- ❖ Interaction with tax audits
 - APA vs. audit: which prevails?
 - Joint requests after tax assessments: MAP to eliminate double taxation and “preventive” bilateral APA

❖ TAXAND

SPANISH MAP PROCEDURES



- ❖ Main concerns so far
 - Denied access / effect of assessments signed on agreement
 - Time limits / length of procedure
 - Limited role of the taxpayer
 - Interaction with domestic procedures: suspension
 - No guarantee for solution: difficulties to reach arbitration phase

 TAXAND



U.S.A.

U.S. OVERVIEW



- ❖ The Advance Pricing and Mutual agreement program (“APMA”) was formed through the combination of the APA program and the U.S. Competent Authority staff.
- ❖ The APMA program is made of team leaders, economists, and senior managers which are organised into 10 groups (7 team leader groups and 3 economist groups).
 - Each group will typically be responsible for a cases with a certain number of countries (depending on the volume of cases).
- ❖ The guidance on the process of requesting and obtaining an APA from the APMA is set out in Rev. Proc. 2015-41.
- ❖ The process for MAP cases is set in Rev. Proc. 2015-40.

❖ TAXAND

TRANSFER PRICING METHODS USED IN APMA & LENGTH OF TIME FOR COMPLETION



- ❖ Transfer Pricing Method (“TPM”) used for sale of tangible property and use of intangible property:
 - Comparable Profits Method (“CPM”) : 89%
 - All other methods combined : 11%

- ❖ When the CPM is used for transfers of tangible and intangible property, the most common Profit Level Indicators (“PLI”) used to benchmark results were:
 - Operating Margin : 67%
 - Other PLIs (Berry Ratio and Return on Assets or Capital Employed) : 33%

- ❖ TPM used for service transactions:
 - CPM : 76%
 - All other methods combined : 24%

- ❖ When the CPM is used for services transactions, the most common Profit Level Indicators (“PLI”) used to benchmark results were:
 - Operating Margin : 43%
 - All other PLIs combined : 57%

Months to Complete New and Renewal APAs Executed: 2016						
	Unilateral		Bilateral		Unilateral and Bilateral	
	Average	Median	Average	Median	Average	Median
New	33.9	23.4	50.5	48.8	48.7	46.7
Renewal	21.8	12.0	34.2	32.1	29.9	23.2
New & Renewal	24.1	15.4	42.4	35.6	37.9	32.8



FRANCE

FRENCH EXPERIENCE: APAS



- ❖ APAs remain an “extra-ordinary” option
 - Number of APAs in France remain limited as compared to tax audits volume
 - Lack of dedicated resources
 - Case law culture – resilience to commit in advance
 - Implementation of the method often challenged during tax audits
- ❖ APAs procedures raise multiple constraints and difficulties
 - The delay to obtain a decision is prohibitive
 - Competent authorities are not proactive
 - Not possible to apply for unilateral APA – only renewal
- ❖ Best practice
 - Analysis of opportunity on a case-by-case basis
 - Potentially after a tax audit or MAP
 - To secure unilateral APA concluded in another jurisdiction
 - In any case, consult first the tax authorities on an anonymous basis

Conclusion = APAs cannot be considered as an efficient day-to-day tax-management tool in France

FRENCH EXPERIENCE: MAPS



- ❖ More efficient procedure
 - Tax authorities are very proactive to help the taxpayer
 - Positive behavior
 - Involvement of taxpayer in the procedure
 - Double taxation resolved in most cases even if the delay is still very long
 - Limited utilization of the arbitration process
 - Independence
- ❖ Best practice
 - Working very well in the EU
 - Successful cases with Canada and Australia
 - Frequently used in the negotiation with the tax authorities during a tax audit
 - Enforcing transparency : BEPS – opted for arbitration
 - It is advised to support the tax authorities during the procedure

Conclusion = MAPs can be considered an efficient dispute resolution tool in France



**LATEST EU
DEVELOPMENTS**

MAP: EU DIRECTIVE ON TAX DISPUTE RESOLUTION MECHANISMS

INTRODUCTION



- ❖ DTT and EU Arbitration Convention MAPs do not resolve in some cases tax disputes effectively and/or in a reasonable period of time.
- ❖ This new Directive extends the required and binding arbitration to areas not currently covered by the EU Arbitration Convention → application to all cross-border situations subject to double taxation of business profits and, as the case may be, of wealth.
- ❖ Not applicable to income or capital that qualify for a tax exemption or to those subject to a zero tax rate.
- ❖ Transposition period: until 30 June 2019.

MAP: EU DIRECTIVE ON TAX DISPUTE RESOLUTION MECHANISMS

COMPLAINT PHASE



- ❖ Submission period = 3 years following the first notification of the action resulting in double taxation.
- ❖ Submission to the tax authorities of both States affected.
- ❖ Acknowledgement of receipt → 2 months following receipt of the complaint.
- ❖ The complaint must be accepted or rejected within 6 months following the receipt thereof.
- ❖ Administrative silence = acceptance.
- ❖ Appeal against rejection available in cases where the complaint is rejected by both States.
- ❖ If the complaint is rejected only by one MS, the taxpayer may request the creation of an Advisory Commission.

❖ TAXAND

MAP: EU DIRECTIVE ON TAX DISPUTE RESOLUTION MECHANISMS

MUTUAL AGREEMENT PROCEDURE PHASE



- ❖ Starts if:
 - Both MSs have accepted the complaint.
 - At least one of the MS requests it after the Advisory Commission has decided to accept the complaint.
- ❖ 2-year period to reach an agreement, with the possibility of 1-year extension.
- ❖ Agreement is binding on the Authorities and enforceable by the taxpayer, provided acceptance by the latter and refusal to any other remedy.

MAP: EU DIRECTIVE ON TAX DISPUTE RESOLUTION MECHANISMS THE ADVISORY COMMISSION



- ❖ Set up at the request of the interested party when:
 - The complaint is rejected by just one or some of the MSs.
 - No agreement is reached through the MAP.
 - And provided that:
 - No possibility of domestic appealing exists.
 - There is no appeal pending resolution.
 - Rights of appeal have been waived.
- ❖ 50 days as of notification of complaint's rejection or failure to reach an agreement through the MAP to file application.
- ❖ 120 days to set up the AC, otherwise taxpayer may apply to national courts asking them to set it up.

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MAP: EU DIRECTIVE ON TAX DISPUTE RESOLUTION MECHANISMS THE ADVISORY COMMISSION



- ❖ 6 months period to reach a decision on the acceptance or rejection of the complaint.
- ❖ If accepted by the AC, the mutual agreement procedure shall commence at the request of any of the competent authorities of the Member States
 - 60 days to present the application to the AC and the other MSs affected.
 - Where such a request is not made, the AC shall issue an opinion on how to resolve the question in dispute.

MAP: EU DIRECTIVE ON TAX DISPUTE RESOLUTION MECHANISMS THE ADVISORY COMMISSION AND THE FINAL DECISION



- ❖ If AC set up because no agreement was reached through the MAP => 6 months (plus further 3 if complex nature of the matter) to deliver opinion on the resolution mechanism.
- ❖ Once the opinion of the AC has been notified, the competent authorities of the MSs have a period of 6 months to reach an agreement regarding the mechanism to resolve the dispute.
 - Such agreement may deviate from the AC opinion.
- ❖ If no agreement is reached, however, the opinion of the Commission becomes binding.

❖ TAXAND

MAP: EU DIRECTIVE ON TAX DISPUTE RESOLUTION MECHANISMS INTERACTION WITH DOMESTIC PROCEEDINGS



- ❖ Action of a MS becoming final under national law does not prevent the affected persons from having recourse to the Directive procedures (Domestic conflict?)
- ❖ Submission to the MAP or the dispute resolution procedure does not prevent a MS from initiating or continuing proceedings for administrative and criminal penalties in relation to the same matters.
- ❖ Affected persons have recourse to the judicial remedies available to them under domestic law of the MSs concerned.
- ❖ MSs may deny access to dispute resolution procedure where penalties were imposed in relation to the adjusted income or capital for tax fraud, willful default or gross negligence.
- ❖ Where judicial or administrative proceedings have been commenced in respect of such cases, a competent authority may suspend the proceedings under the Directive.

APA: DIRECTIVE 2015/2376/EU, ON MANDATORY AUTOMATIC EXCHANGE OF INFORMATION IN THE FIELD OF TAXATION



- ❖ Automatic exchange between MSs of information related to issuing, amending and renewing of advance cross-border rulings or advance pricing agreements.
 - Starting on 31 Dec 2016 and the precedent 5 years.
- ❖ No obligation to communicate agreements made in 2012 or 2013 if they were no longer valid on 1 Jan 2014.
- ❖ Possible exclusion of agreements prior to 1 Apr 2016 for non financial or investment-related entities if annual net turnover does not exceed 40 million euros.
- ❖ Bilateral or multilateral TP agreements with third countries will only be communicated if treaty permits their disclosure.
- ❖ Period for the exchange of information:
 - If dated after 31 Dec 2016: 3 months following the quarter of the calendar year in which it took place.
 - If prior 1 Jan 2017: before 1 Jan 2018.



**SPEAKER
PROFILES**

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SPEAKER PROFILE



Marc Alms

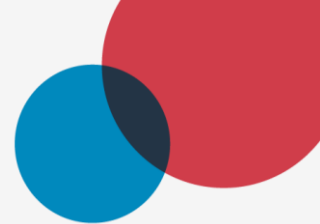
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Marc Alms is based in Taxand USA where he is a managing director with Alvarez & Marsal Taxand in New York, focusing on transfer pricing. He has over 16 years of experience as a transfer pricing specialist.

Marc works with clients on complex IP and tax efficient supply chain planning & support and has assisted clients on obtaining several dozen APAs between the IRS and various foreign tax authorities.

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Loubna is a manager with Arsene Taxand in France, specialised in Transfer Pricing.

Loubna has acquired a strong professional experience in structuring, implementation and securing of transfer pricing policies for various international groups. She has been recently involved in business restructuring issues, value chain analysis, transfer and valuation of intangible assets as well as intra-group financing. Loubna has also assisted corporate groups during tax audits, Advance Pricing Agreements and negotiation with tax authorities in many countries in Europe, Asia and Africa.

She fluently speaks English, Arabic and French.

The logo for TAXAND, featuring a stylized icon of four dots in a 2x2 grid to the left of the word "TAXAND" in a bold, white, sans-serif font.

TAXAND

The text "THANK YOU!" in a bold, white, sans-serif font, centered within a large red circle that overlaps a blue circle. The background of the entire image is a photograph of the Piazza del Duomo in Milan, Italy, with the Duomo di Milano cathedral and the Galleria Vittorio Emanuele II visible.

THANK YOU!

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