



Doing your Duty: Transfer Pricing - Tax & Beyond

DLA Piper

2019 Transfer Pricing Masterclass Series



Presenters



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Background & Experience

- Transfer Pricing Technical Lead at World Bank
- Provided transfer pricing technical assistance to African & Asian tax authorities
- OECD/World Customs Organisation TP/Customs interface
- Transfer Pricing Lecturer at IBFD, UK, Swiss, Swedish universities
- EY Australia | Qualified lawyer



Randall Fox
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Co-Head Transfer Pricing
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Background & Experience

- Economist
- APA Team Leader at US IRS
- Led all US/Swiss APA negotiations on intangibles issues
- World Bank transfer pricing technical training to developing countries worldwide
- Independent expert witness in Transfer Pricing Arbitration



Vicki Bales
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Background & Experience

- 18 years in-house tax and transfer pricing experience
- SABMiller / AB InBev Global Head of Transfer Pricing
- Extensive operating model planning, implementation and review
- Africa, Latam, Europe transfer pricing audits
- Chartered Accountant



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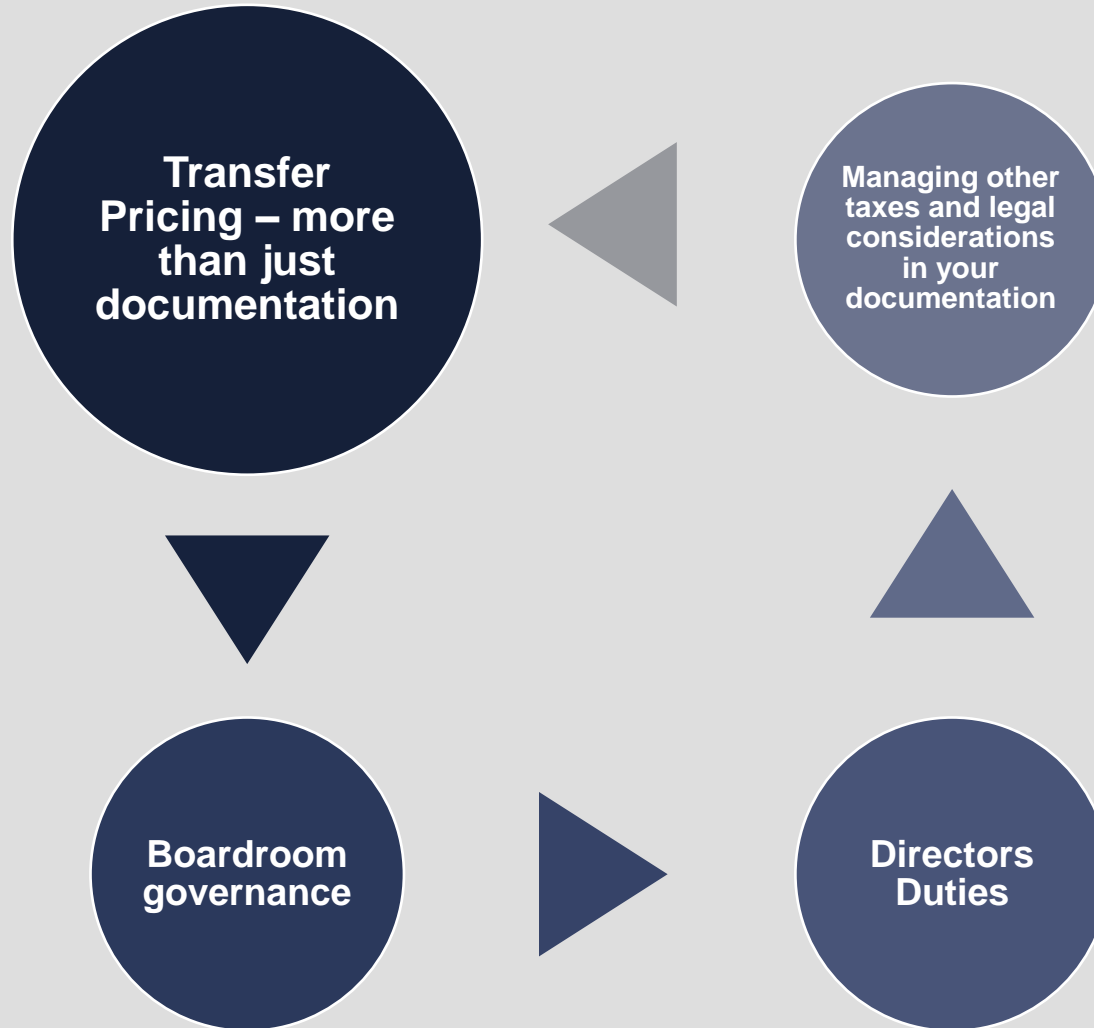
Background & Experience

- 23 years Corporate Partner
- Public equity and private equity
- Corporate M&A
- Multi-jurisdictional transactions

Agenda

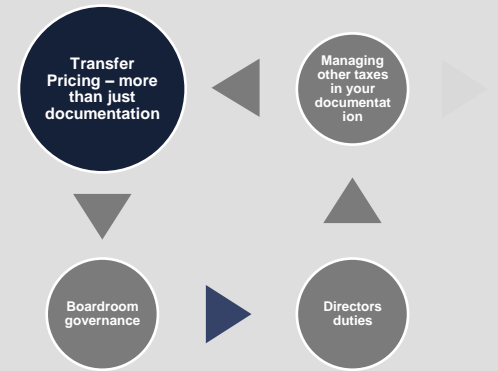
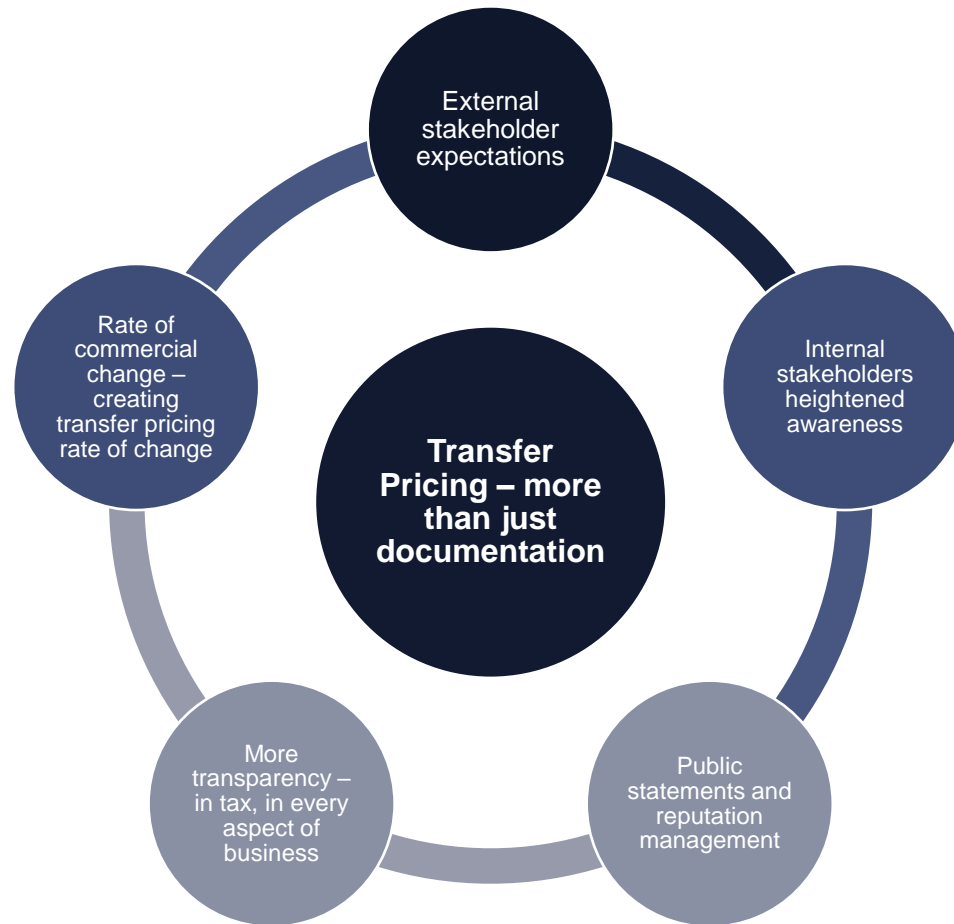
- Doing your Duty: Transfer Pricing - Tax and Beyond
 - Directors duties, boardroom governance and transfer pricing
 - Intra-group agreements
 - TP Documentation *beyond* transfer pricing

Doing your duty: Transfer Pricing, Tax & Beyond



Introduction

Why this topic is important, today more than ever before



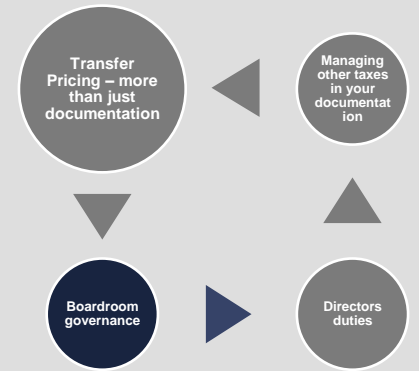
Whilst predominately thought of as a direct taxation issue, transfer pricing arrangements can have a significant commercial, regulatory and legal impact.

Boardroom Governance and Directors Duties

Boardroom governance

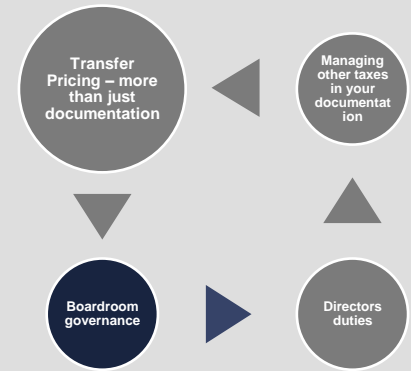
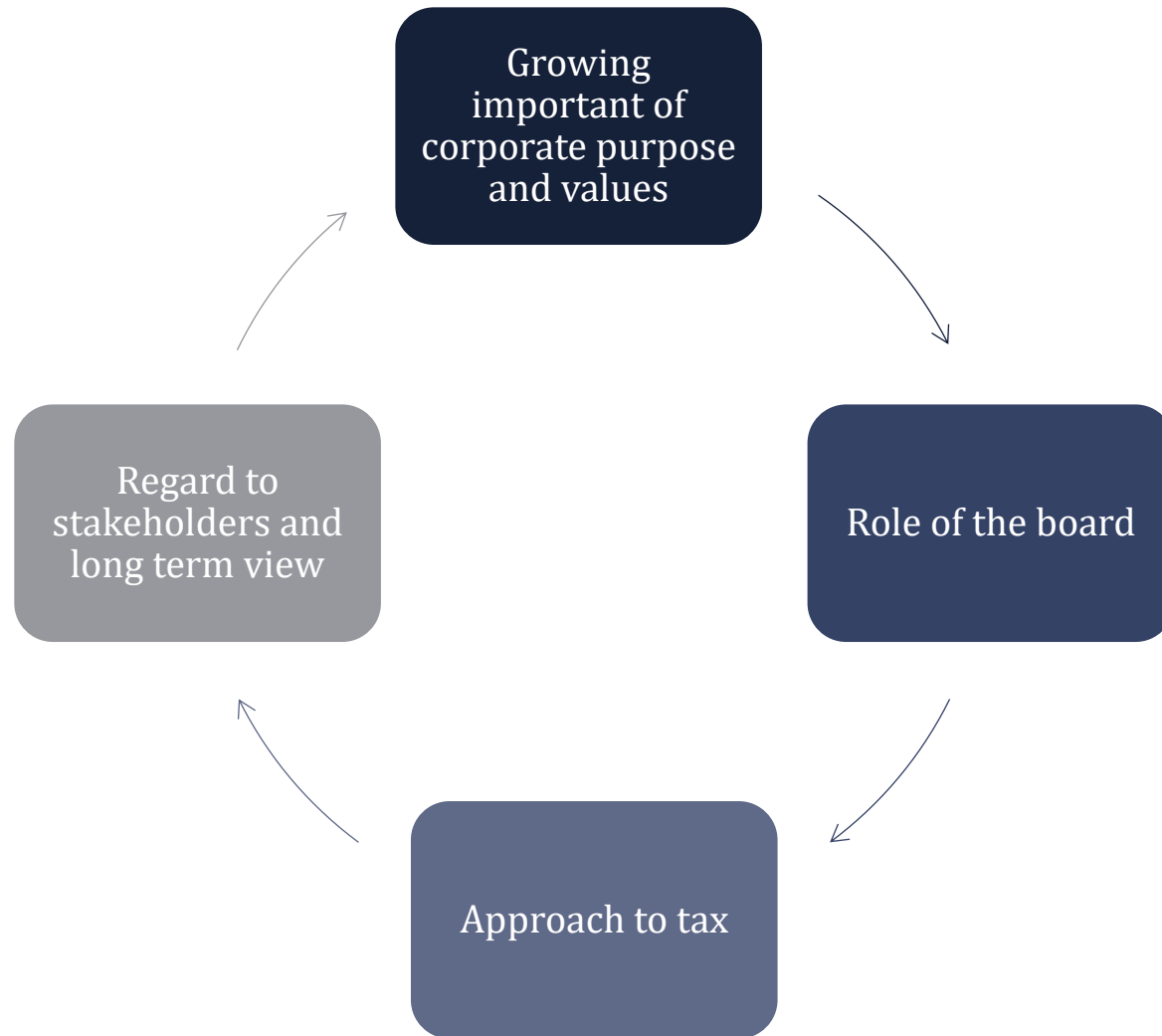
Trends we are observing

- Fracturing relationship between society and business
- Tax is not just a business issue, tax is a social and fairness issue
- Attacks on tax avoidance
- Tax and structuring – simplicity/cost



Boardroom governance

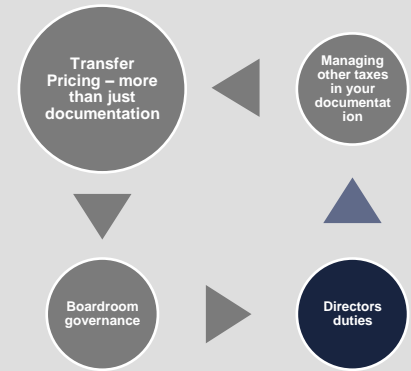
Best practices



Director's duties

At the subsidiary level

- Governance must be embedded throughout the structure
- Results in poor functionality and sometime corporate failure
- Post-acquisition integration
- Managing conflicts of interest – joint ventures



Directors Duties

Business Restructuring Example

	Belgium	France	United Kingdom	Spain	Russia	Germany
Information required by Board Directors in making decisions	All relevant documents (or a summary thereof) relating to the restructuring and the (financial) impact	Legal, tax, financial and strategy impact of the action If wholly owned subsidiary, no legal risk but risk of tax and other transfer pricing issues.	The new agreements, understand the changes and P&L impact. Otherwise, they should request whatever information they believe they need to understand the transaction.	Board of Directors have to request, review and analyse any information that they deem necessary and/or convenient to be sufficiently informed. This includes, for example, copies of the relevant agreements to be terminated, drafts of the new agreements to be signed, any financial and/or legal report that may be relevant.	Draft agreements, financial information of the company (balance sheets, P&L, auditors' reports, etc.)	This depends, inter alia, on the legal form of the subsidiary. Assuming that the subsidiary is a GmbH, the managing directors of the GmbH should have sufficient information to assess the effects of the restructuring on the GmbH itself (ie. copies of any agreements which need to be signed by the GmbH), but would - in light of the right of instruction (see below) - generally not need to see the full documentation for the entire group-wide restructuring.
If the proposed transaction is in the benefit of the entity shareholders (i.e. the rest of the Group), but does not benefit the local entity - are the Directors able to approve such a transaction?	Members of the Board should always act in the interest of the Company. The Board may also take the interest of the group into account but there must also be an (indirect) benefit for the Belgian company.	Board member should act in the interest of the local company. If wholly owned subsidiary, there should be no issue, nobody should "complain".	Directors must act in the way they consider would be most likely to promote the success of the company for the benefit of its members as a whole (s 172(1) of the Companies Act); and a UK subsidiary can therefore consider the benefit to its shareholders from undertaking a transaction. However, in circumstances where the subsidiary receives no benefit, directors may ask for the parent company to pass a special resolution: (i) approving the act; and (ii) requiring the directors to implement it.	Directors of a Spanish entity may agree to proceed with a certain transaction that is in the benefit of the company's shareholders but does not benefit the company itself, if such a decision benefits the company in the long term, understanding that being a subsidiary of a group of companies means that the directors may be obliged to take decisions in the sole benefit of the group at a certain moment, but that those decisions are compensated by the advantages of forming part of that group of companies. We would recommend that such decisions of the Board of Directors be ratified by the General Shareholders' meeting / Sole shareholder of the Spanish entity.	Yes, they can approve any transaction. However, for completeness, please be aware that in case there are any shareholders that do not belong to the beneficiary group, for example, they may challenge a Board resolution, which does not benefit the company. Based on the brief background of your question we understand that this is not the case.	As above, this depends, inter alia, on the legal form of the subsidiary. Assuming that the subsidiary is a GmbH, the shareholders of the company have a right of direction/instruction which may be used to instruct the managing directors of the GmbH to approve a transaction which is not in the best interest of the individual company, but of the overall group. Certain limits exist (eg. if the instruction would lead to an insolvency of the relevant company or would be incompatible with applicable law). If the subsidiary has a different legal form (eg. an Aktiengesellschaft/AG), stricter requirements may apply.

DISCLAIMER: The above table is for informational purposes only and should not be relied upon as legal advice. Please seek advice specific to your facts and circumstances.

Intra-group agreements

Intra-group Agreements

Why are well drafted and up-to-date agreements necessary?

Subsidiary Governance

- Point of reference for Directors in deciding whether to approve and arrangement/transaction
- Agreements, coupled with corporate resolutions and supporting materials help to demonstrate that a Director has fulfilled Directors Duties

Regulatory, IP, HR and Compliance

- Industry specific regulatory considerations (e.g. financial services industry requirements, medical device tracking)
- IP rights enforcement (demonstrating connection)
- Currency control

Other Tax Considerations

- Deductibility
- Indirect taxes

Transfer Pricing Positions

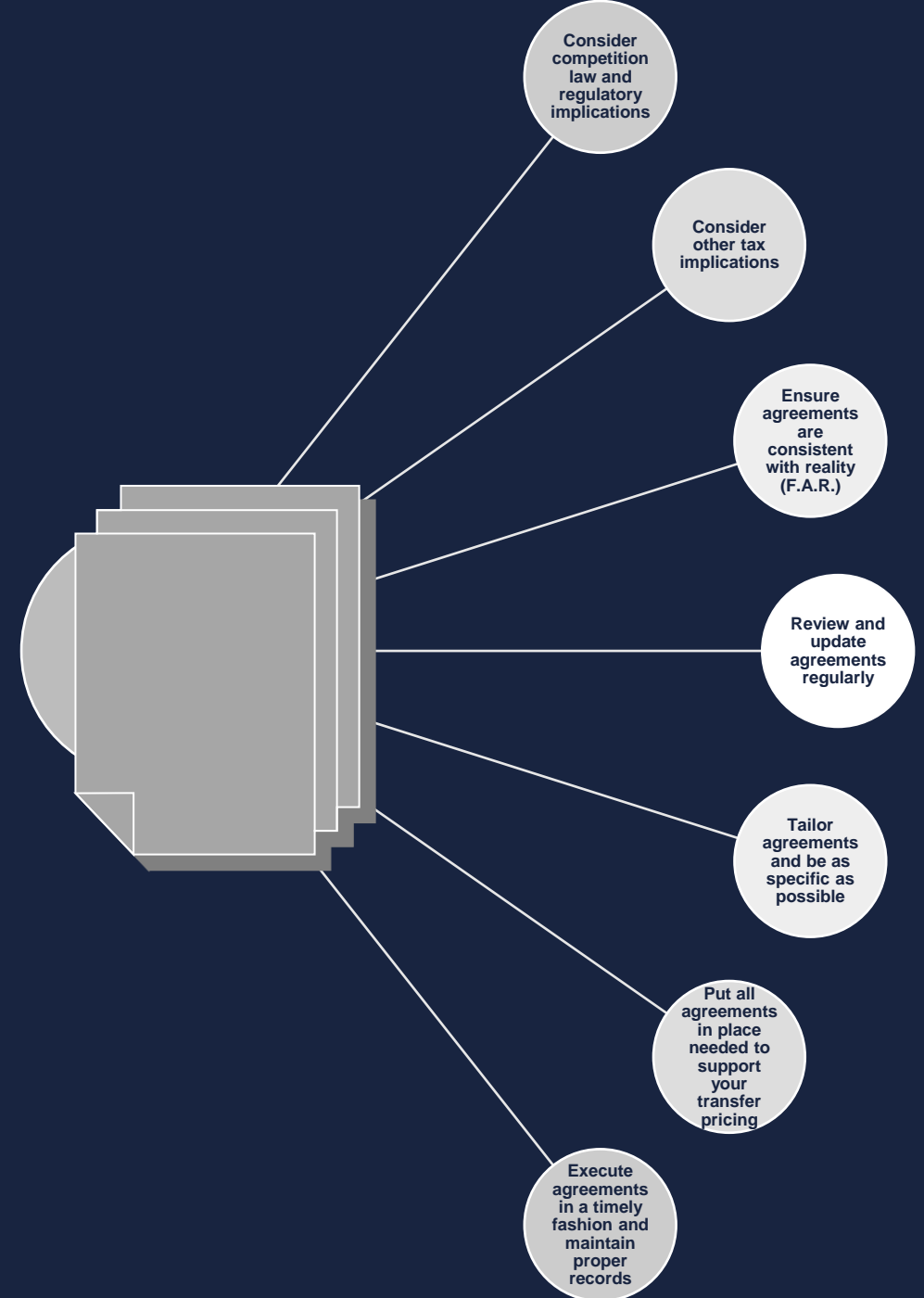
- Part of compliance requirements (MF/LF)
- Starting point for analysis

Intra-group Agreements

Tips and Lessons from the field

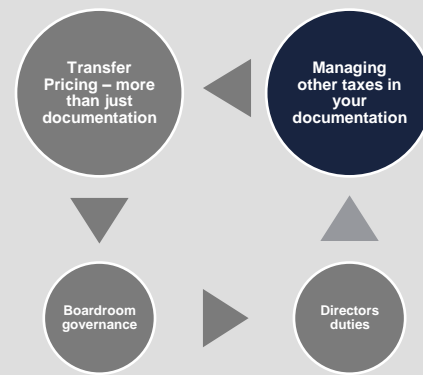
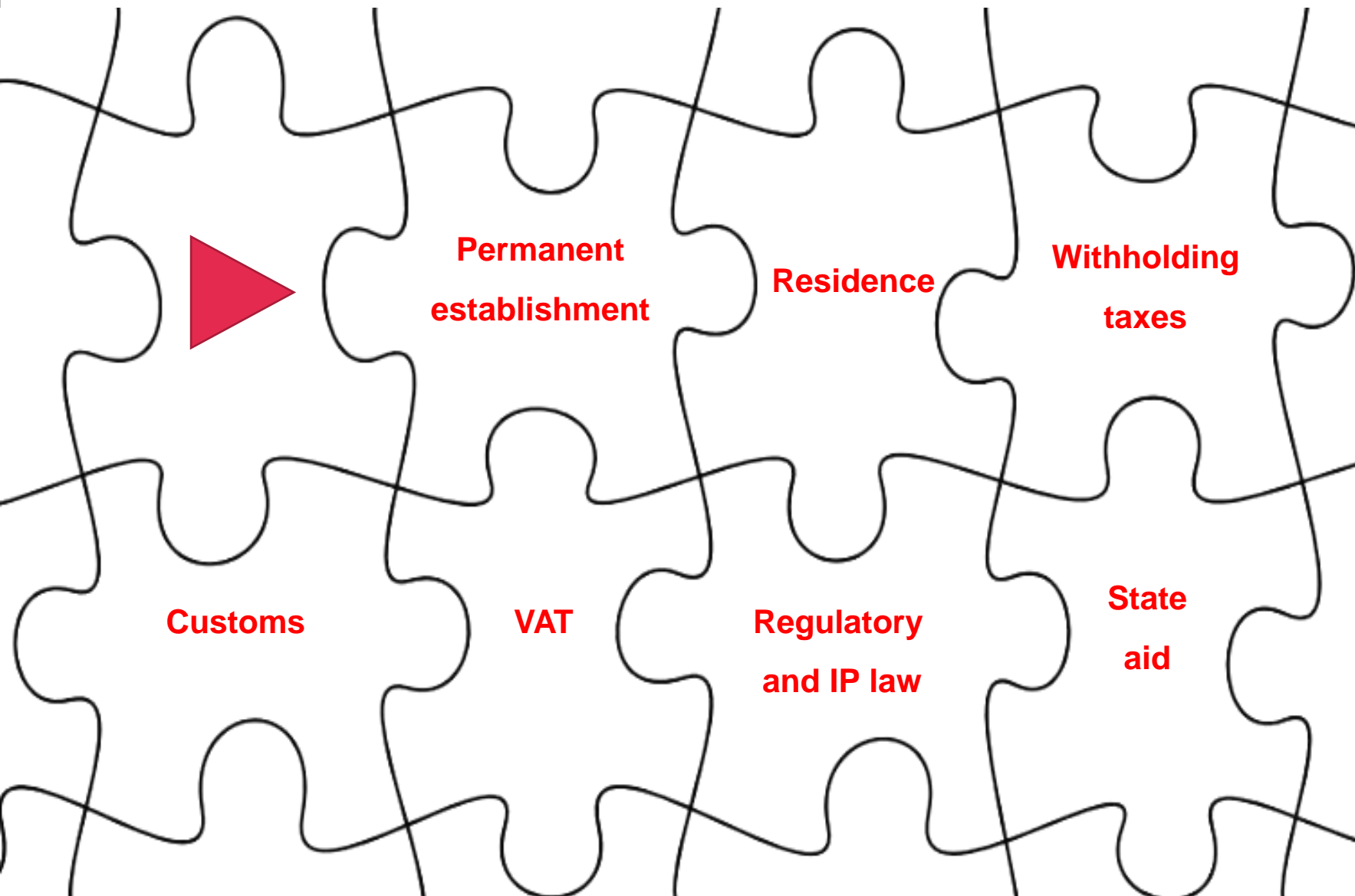
Drafting Transfer Pricing Controversy Ready Agreements:

- Commit and amend as needed:
 - Define the services, IP etc. clearly
 - Where possible, specify the remuneration, as opposed to deferring to "arm's length consideration"
- Carefully consider the term of the agreement and termination rights of the parties
- Include what is necessary, and nothing more
- Draft agreements that are easy to read



Transfer pricing documentation *beyond* transfer pricing

TP Documentation *beyond* Transfer Pricing



TP Documentation *beyond* Transfer Pricing

Permanent Establishment (PE)

Re-cap

A **fixed place of business PE** can arise where an enterprise has a fixed place in another territory, specific exemptions may apply if it is preparatory, auxiliary or warehousing

A **dependent agent PE** can arise where a person is acting on its behalf, and habitually exercises an authority to conclude contracts* in its name, in that other territory

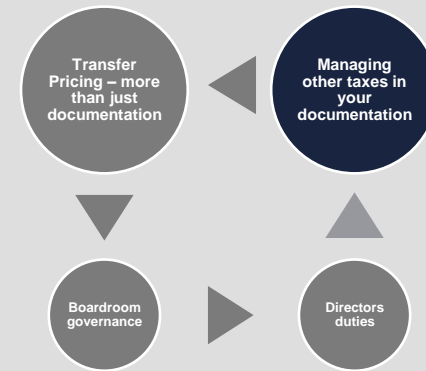
And, in some treaties, a **services PE** may arise where an enterprise performs services in another territory through one or more individuals over a defined period of time

BEPS has sought to lower the PE threshold, which is now a high risk area in tax audits, in addition various countries have **lowered thresholds in their domestic laws or treaties**, or introduced targeted rules

What to keep in mind

TP documentation, interviews and evidence of who does what where – make sure that these do not inadvertently create PE exposures, and if exposures identified, proactively address them

Even if the "profit" of an undeclared PE is low or nil, the penalties (and personal liabilities of Directors) can be significant



"Permanent establishment risks are increasingly considered by tax auditors looking at transfer pricing."

TP Documentation *beyond* Transfer Pricing

Residence

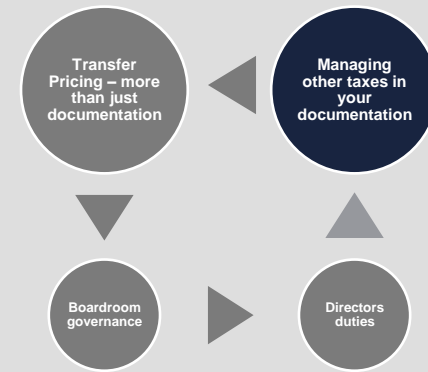
Re-cap

Corporate tax residence definition varies by country. Typically place of incorporation or location of central management and control, the latter being the highest level of decision making, and not necessarily operational control

What to keep in mind

Be mindful of how certain activities are described in transfer pricing documentation. Don't undermine position concerning "management and control" with broad sweeping statements about functionality of entities.

If issues concerning management and control are identified during functional analysis interview, flag and address them asap.



"A strongly worded TP position can have drastic consequences!"

TP Documentation *beyond* Transfer Pricing

Withholding taxes

Re-cap

Under many countries domestic tax laws there may be a requirement to withhold tax in relation to certain payments (e.g. interest, royalties, services or dividends)

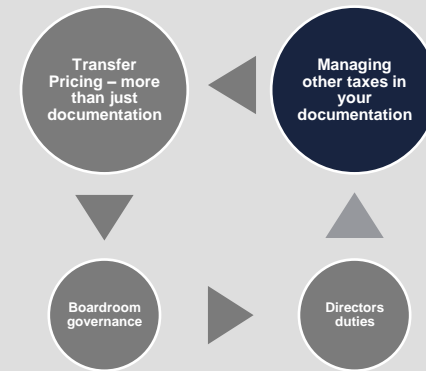
Double tax treaties may reduce the headline withholding tax, but application of a treaty is a not a given. It needs to be confirmed that the treaty and the relevant article applies, which may require looking at whether:

- the recipient is the "beneficial owner"
- the payment meets the specific definition in the article
- the amount of the payment has been impact by a special relationship between the parties

What to keep in mind

Keep in mind how transactions and the activities of recipients are described in transfer pricing documentation, so as not to create withholding tax issues.

The special relationship provision of most tax treaty articles dealing with interest and royalties is another key reason to make sure that transfer pricing is correct on all transactions.



TP Documentation *beyond* Transfer Pricing

Customs Duties

Re-cap

"Related party transactions" → is the declared price "influenced" by the group relationship? If yes, you are outside of transaction value and transfer pricing and customs values start to disconnect

Customs Valuation vs Transfer Pricing

- A low customs import value will mean lower customs duty but a lower deduction, and vice versa
- Include all appropriate elements or exclude inappropriate elements

A transfer pricing report alone (without considering customs specifically) won't typically be acceptable for showing that values are acceptable for customs purposes.

Also consider: single product vs. product range prices, date range of transactions

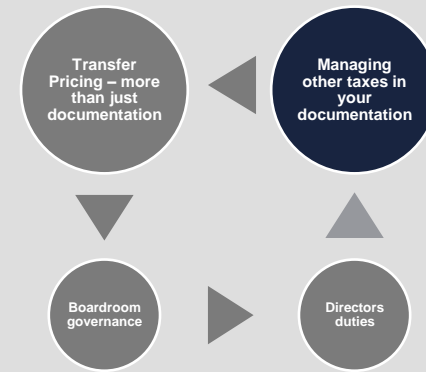
What to keep in mind

Technical Committee on Customs Valuation (TCCV) Commentary 23.1: a transfer pricing study may be of use in the examination of related party transactions for Customs value purpose; on a case by case basis to examine "the circumstances surrounding the sale"

WCO Case Studies: 14.1 TNMM and 14.2 resale price method

How to deal with (retroactive) TP adjustments – Can the transaction value method be applied?

- ECoJ Case Hamamatsu C-529/161: a restrictive or broad interpretation – customs authorities have different views on impact of retro-active price corrections
- Impact of APA's and advance ruling on customs valuation



"Don't assume that the customs values and transfer pricing will always result in the same value."

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Regulatory and IP Law

Re-cap

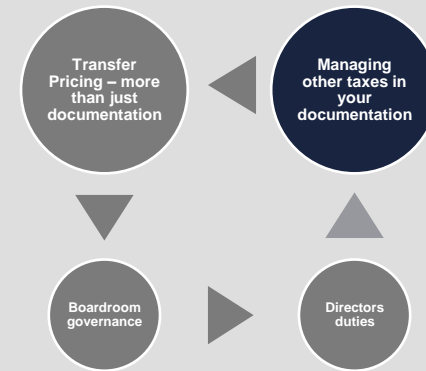
Specific industries have certain regulatory requirements (financial services, insurance, telecoms, broadcasting, education etc.) that may dictate how operations are structured

Intellectual property law governs the ownership and accessibility of ideas and inventions on tangible and intangible concepts. The importance of protecting a companies IP cannot be understated. Intra-group agreements put in place for transfer pricing can have impacts on ease of protection. And ensuring adequate protection may give rise to intra-group licenses inconsistent with TP model

What to keep in mind

If you are operating in a regulated industry, ensure that you have an in-depth understanding of the regulatory requirements and the sensitive areas. Loop in your regulatory lawyers, and get them to review your transfer pricing documentation.

Make sure your liaise with your IP lawyers before setting up and implementing a new structure. Be careful in allowing group entities to use IP without an agreement in place.



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State Aid

Re-cap

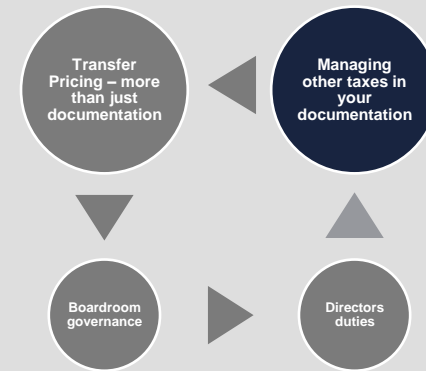
State aid is any advantage granted by public authorities through state resources on a selective basis to any organisations that could potentially distort competition and trade in the EU.

The European Commission has taken a proactive and largely "untested" approach toward state aid and tax rulings in the last few years, even indicating that measures giving rise to state aid can extend beyond rulings to settlements and other agreements.

What to keep in mind

Consider carefully how you document and present any interactions with tax authorities.

Review any rulings and settlement agreements with a member state through a "state aid lens"



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