

Presentation & panel discussion:
Cross border businesses after BEPS - will they have to realign?
Patents & intangibles, digital economy (equalization levy) &
hybrid mismatches

International Fiscal Association

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Action 8 - Transfer pricing of Intangibles

- Assure that TP outcomes are in line with value creation
 - Adopting a broad and clearly delineated definition of intangibles
 - Creating special guidelines for transfers of hard-to-value intangibles
 - Revisiting guidance on cost contribution arrangements

Legal ownership alone not sufficient

- Question of legal ownership separate from question of arm's length remuneration
- Legal ownership does not confer any right ultimately to retain returns from exploiting intangibles
- Return linked to functions, assets and risks for the MNE group
- Mere funding but no control over functions deserve a "risk adjusted return on invested capital"

Activities where intangibles returns attributable

- Functions – development, enhancement, maintenance, protection and exploitation (DEMPE)
- Above may be outsourced but can claim a return on exploitation of intangibles
- If legal owner is to retain returns from exploitation, it must show
 - Control over such functions
 - Assets including funding and contribution of assets to the above functions
 - Risk control of such functions

Action 8 - Transfer pricing of Intangibles

- Broad definition of intangibles: assets that are not physical or financial if transfer would be compensated in arm's length transactions
- Goodwill and going concern included
- Location specific advantages and group synergies are not intangibles
- Definition is specific to transfer pricing and does not control definition under other provisions (accounting)

*Steps in
determining
intangible
returns*

Identify legal
owner

Identify party
performing
important
functions

Confirm
conduct of
the parties
consistent
with
contracts

Identify the
controlled
transaction
related to the
important
functions

Determine
the arm's
length price
for the
important
functions

Action 8 - Transfer pricing of Intangibles

- Realistic alternatives of the buyer and seller
- Should not assume the entire residual is attributable to intangibles
- Useful life of intangible may extend beyond the current generation product if the intangible can be used to create the next generation product
- Specified methods:



Action 8 - Transfer pricing of Intangibles

Definitional aspects

“something which is not a physical asset or a financial asset, and which is capable of being owned or controlled for use in commercial activities and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances”

Examples	
Intangibles for TP Purposes	Not Intangibles for TP Purposes
Patents	Group synergies
Know-how and trade secrets	Market specific advantages
Trademarks, trade names and brands	Assembled workforce
Rights under contracts and government license	
Licenses and similar limited rights in intangibles	

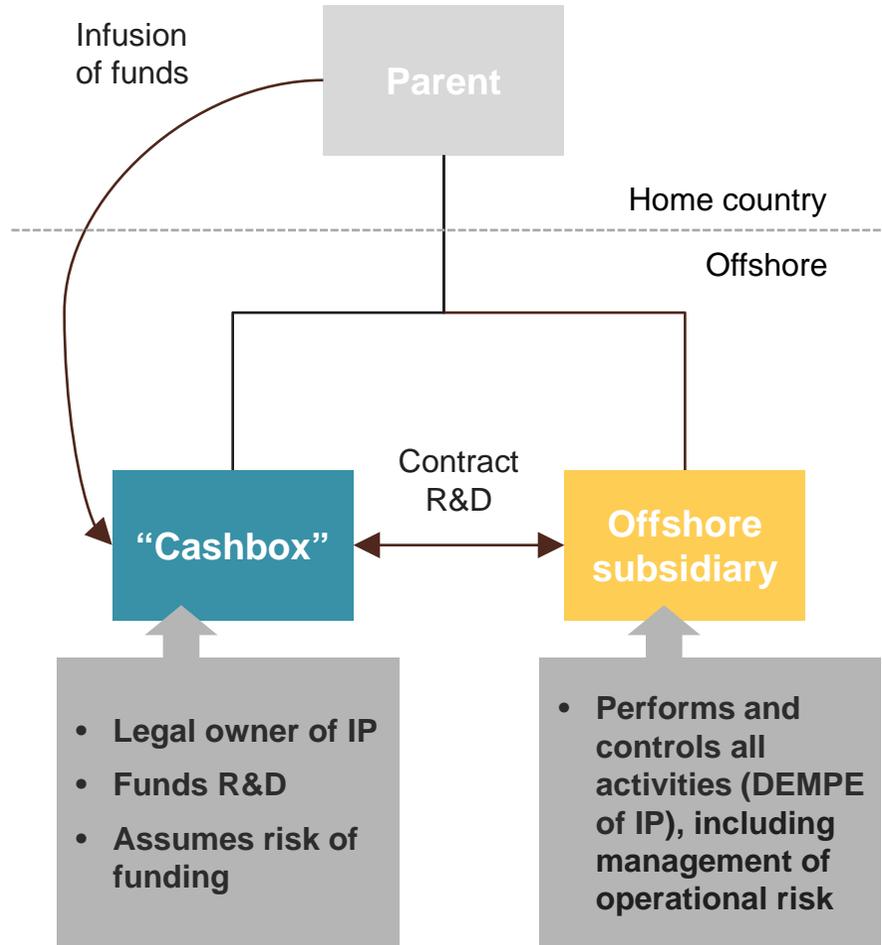
Action 8 - Transfer pricing of Intangibles

Marketing Intangible

- OECD guidance - Focuses on the functional profile /rights of the distributor to evaluate payment required if any. Also provides that such remuneration could take different forms (such as decrease in the purchase price of the product, a reduction in royalty rate etc or separate compensation for advertisement and promotion.)
- India perspective: Indian company with high AMP spend, even if not the “legal owner”, held to be local “developer” of tradename /trademarks
 - Brightline test applied by the tax authorities to determine the “routine” marketing spend of Indian company
 - Any excess spend expected to be reimbursed by the overseas company to Indian company in form of service fee irrespective of the functional profile
- View of the Hon’ble Court aligned with OECD guidance

Action 8 - Transfer pricing of Intangibles

Cashbox controversy



Final BEPS recommendations

- Rejection of special measures and CFC suggestions
- Affirmation that capital-rich entities without relevant economic activities (cash boxes) will not be entitled to any excess profits
- Three scenarios possible
 - No management of funding risk: entitlement to no more than risk-free return
 - Management of funding risk: entitlement to risk adjusted return
 - Management of funding risk and operational risk: not a cash box!

Action 10 - Low value adding services

- Are supportive in nature
- Are not part of the core business of the MNE
- Do not require the use or creation of unique and valuable intangibles
- Do not involve the assumption or creation of substantial or significant risk

What are “low value-adding”	What are not “low value-adding”
Accounting and auditing, accounts receivable / payable, human resources, legal, tax	R&D, manufacturing, sales, marketing, distribution, corporate senior management

- Cautions that if a company’s activities do not qualify for the simplified method, you should not assume that it should generate high returns



Action 13 - CbC Reporting and Documentation

FAQ

TIMEFRAME No harmonized practices for the CbC implementation	MATERIALITY Materiality standards are defined locally with deviation	RETENTION OF DOCUMENTS In line with local domestic legislation	FILING PROCESS CbC in HQ country Master File to be maintained
FREQUENCY OF DOCUMENTATION UPDATES In principle annually but option to update benchmarking every 3 years	LANGUAGE To be clarified locally. Encourage filing in commonly used languages	PENALTIES Fixed vs. proport. penalties. India has defined	SEQUENCE If country of subsidiary implements CbC before country of HQ? Alternate reporting entity argument
CONFIDENTIALITY No public disclosure of information contained in the package	SHARING MECHANISM Several countries have signed exchange of information agreement	REVIEW Proposed documentation requirement to be reassessed no latter than end of 2020	ANALYTICS Are companies considering (IT) solutions to address CbC reporting requirements?



New TPD Documentation BEPS Action Item 13

BEPS/ New TP Documentation

- Masterfile – *Business macro blue-print*
- Local File – *Description of local operations*
- CbC Reporting – *Quantitative reporting on specific tax and non-tax information*

Background

- OECD Transfer Pricing Discussion Draft (“DD”) meant to **replace** existing TP documentation guidelines
- Significant **overhaul** of TP documentation requirements
- Significant **new burdens**

- **3 main objectives:**
 - Helps tax authorities conduct **TP risk assessment**
 - Ensure **taxpayer vigilance** regarding TP compliance
 - Speed tax authority **audits**

New paradigm in TPD – More data and compliance

Areas to look out for

- New Country-by-Country reporting
- New master file concept
- Timing
- Penalties
- Updates
- Local comparables
- Language
- Materiality
- Additional forms
- Access to foreign documents



Country by Country Reporting

13 items of information required organized on country-by-country basis:

- Name of entity
- Place of effective management
- Important business activity codes(s)
- Revenues
- Earnings before income tax
- Income tax paid on cash basis
 - To country of organization
 - To all other countries
- Total withholding tax paid
- Stated capital and accumulated earnings
- Number of employees
- Total employee expense
- Tangible assets other than cash and cash equivalents
- Royalties paid to constituent entities
- Royalties received from constituent entities
- Interest paid to constituent entities
- Interest received from constituent entities
- Service fees paid to constituent entities
- Service fees received from constituent entities



Data will have to be gathered from / compiled for 100+ countries annually for a large MNC, Need to gear up IT and other internal resources

2. New Master File Concept

A Master File provides comprehensive information about the global operations of the MNC group. **This is different from the 'master file' concept as it is known today.** The list of required information includes 21 different items under 5 categories.

Description of businesses:

- *Chart showing supply chain for material products and services*
- *Chart showing important service arrangements between members of the MNE group other than R&D services*
- ~~*Title & country of 25 most highly compensated employees in business lines*~~

Intercompany financing activities:

- *Description of how group is financed; identification of important funding arrangements with unrelated parties*

Intangibles:

- *List of material intangibles and which entities own them, strategy for R&D, location of principal R&D facilities/management*

Creating this kind of documentation it and updating it annually would be a new and major undertaking for transfer pricing, and other tax and non tax teams

Discussion Points

- Data required by CbC report... scaling up of current reporting systems
- Look out for when the local country tax announces requirements for new BEPS TP documentation
- Need partnership with many stakeholders within the business to complete this documentation
- Detailed requirements of Master file such as value chain, principle contributors to value creation, important financing arrangement, etc.

Proactive internal preparation needed to respond to these requirements

Appendices

Annex I-III To Chapter V

Annex I to Chapter V: TP Documentation - Master file

The following information should be included in the master file:

Organisational structure

- Chart illustrating the MNE's legal and ownership structure and geographical location of operating entities

Description of MNE's business(es)

For each of the MNE's major business lines: General **written description** of the MNE's business including:

- Important drivers of business profit
- Chart showing supply chain for material products and services
- Chart showing important service arrangements between members of the MNE group other than R&D services
- A description of the main geographic markets for material products and services
- A written functional analysis describing the principal contributions to value creation by individual entities within the group, i.e. key functions performed, important risks assumed, and important assets used
- A description of important business restructuring transactions, acquisitions and divestitures occurring during the fiscal year
- The title and country of the principal office of each of the 25 most highly compensated employees in the business line (note: names of such individuals should not be included)

MNE's intangibles

- A description of the MNE's overall strategy for the development, ownership and exploitation of intangibles, including location of principal R&D facilities and location of R&D management
- A list of material intangibles or groups of intangibles of the MNE group and which entities own them
- A list of important related party agreements related to intangibles, including cost contribution arrangements, principal research service agreements and license agreements.
- A description of the group's transfer pricing policies related to R&D and intangibles
- A description of any material transfers of interests in intangibles among associated enterprises during the fiscal year concerned, including the entities, countries, and compensation involved

Annex I to Chapter V: TP Documentation - Master file

MNE's intercompany financial activities

- A description of how the group is financed, including identification of important financing arrangements with unrelated lenders.
- The identification of any members of the MNE group that provide a central financing function for the group, including the country under whose laws the entity is organised and place of effective management of such entities.
- A description of the MNE's general transfer pricing policies related to financing arrangements between associated enterprises.

MNE's financial and tax positions

- MNE's annual consolidated financial statement for the fiscal year concerned
- A list and brief description of the MNE group's applicable unilateral and bilateral/multilateral APAs and Advance rulings
- A list and brief description of other relevant tax rulings related to the allocation of income to particular jurisdictions
- A list and brief description of transfer pricing matters pending under treaty MAP or resolved in MAP during the last two years
- Country-by-country reporting template according to Annex III.

Annex II to Chapter V: TP Documentation - Local file

The following information should be included in the local file:

Local entity

- A description of the management structure of the local entity, a local organization chart and a description of the individuals to whom local management reports and the country(ies) in which such individuals maintain their principal offices.
- An indication whether the local entity has been involved in or affected by business restructurings or intangibles transfers in the present or immediately past year and an explanation of those aspects of such transactions affecting the local entity.

Controlled transactions

For each material category of controlled transactions in which the entity is involved, provide the following information:

- Description of the controlled transactions (e.g. procurement of manufacturing services, purchase of goods, provision of services, loans, licenses of intangibles, etc.) and the context in which it takes place (e.g. business activity, financial activities of the MNE group, cost contribution arrangement).
- Aggregate amount of intercompany charges for each category of transactions.
- Identification of associated enterprises involved in each category of controlled transactions, and the relationship amongst them.
- A detailed functional analysis of the taxpayer and relevant associated enterprises with respect to each documented category of controlled transactions, i.e. functions performed, assets used and/or contributed (including intangibles) and risks borne, including any changes compared to prior years.¹
- Identification and description of other controlled transactions of the taxpayer that can directly or indirectly affect the pricing of the controlled transaction being documented.
- Indicate the most appropriate transfer pricing method with regard to the category of transaction and the reasons for selecting that method.
- Indicate which associated enterprise is selected as the tested party, if applicable, and explain why.

Annex II to Chapter V: TP Documentation - Local file

- Summarise the important assumptions made in applying the transfer pricing methodology.
- If relevant, explain the reasons for performing a multi-year analysis.
- List and description of selected comparable uncontrolled transactions (internal or external), if any, and information on relevant financial indicators for independent enterprises relied on in the transfer pricing analysis, including a description of the comparable search methodology and the source of such information.
- Describe any comparability adjustments performed, and indicate whether adjustments have been made to the results of the tested party, the comparable uncontrolled transactions, or both.
- Describe the reasons for concluding that relevant transactions were conducted on an arm's length basis based on the application of the selected transfer pricing method.
- A summary of financial information used in applying the transfer pricing methodology.

Financial information

- Annual local entity financial accounts for the fiscal year concerned. If audited statements exist they should be supplied and if they do not existing unaudited statements should be supplied.
- Information and allocation schedules showing how the financial data used in applying the transfer pricing method may be tied to the annual financial statements.
- Summary schedules of relevant financial data for comparables used in the analysis and the sources from which that data was obtained.

Annex III to Chapter V: A Model Template of Country-by-Country Reporting

CONFIDENTIAL

CTPA/CFA/NOE2(2014)4/REV1/CONF

Annex III to Chapter V: A Model Template of Country-by-Country Reporting

Overview of allocation of income, taxes and business activities on a country-by-country basis



Country	Constituent Entities Organised in the Country	Place of effective Management	Important business activity code(s)	Revenues	Earnings Before Income Tax	Income Tax Paid (on Cash Basis)		Total Withholding Tax Paid	Stated capital and accumulated earnings	Number of Employees	Total Employee Expense	Tangible Assets other than Cash and Cash Equivalents	Royalties Paid to Constituent Entities	Royalties Received from Constituent Entities	Interest Paid to Constituent Entities	Interest Received from Constituent Entities	Service Fees Paid to Constituent Entities	Service Fees Received from Constituent Entities	
						(a) To Country of Organisation	(b) To All Other Countries												
	1.																		
	2.																		
	3.																		
	4.																		
	Total:																		
	1.																		
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Moving forward

- **Follow up work and next steps**
 - Hard-to-Value Intangibles (HTVI)
 - The application of the transactional profit split method
- **BEPS Implementation**
 - Inclusive framework

Hard-to-Value Intangibles (HTVI)

- Work mandated by Action 8 to prevent BEPS by moving HTVI among group members.
- The outcome of this work is found in Section D.4 of Revised Chapter VI TPG:
 - Under this approach, tax administrations can consider *ex post* outcomes as presumptive evidence about the appropriateness of the *ex ante* pricing arrangements if the taxpayer cannot demonstrate that the uncertainty has been properly taken into account in the pricing methodology adopted.
- BEPS Report for Actions 8-10 mandates the development of guidance on the implementation of the HTVI approach during 2016. This is being undertaken by WP6

Hard-to-Value Intangibles (HTVI)

- The implementation guidance is likely to focus on when and how to make an adjustment under the HTVI approach
- The aim of the HTVI guidance will be to:
 - allow the taxpayers to demonstrate that pricing for transfers of HTVI is based on a thorough transfer pricing analysis and leads to an arm's length outcome;
 - protect the tax administration from the negative effects of information asymmetry
- At this stage a decision has not been made as to the format of this implementation guidance or in relation to the timing of its release

Application of transactional profit split method

- Action 10 mandated work will aim to clarify the application of the transactional profit split method in the context of global value chains
- The proposed scope of this work was set out in the BEPS Report for Actions 8-10
- A discussion draft is likely to be released inviting public comments shortly
- A public consultation with commentators is likely to take place in last quarter of 2016

Application of transactional profit split method

- The discussion draft will:
 - clarify when a profit split is likely to be the most appropriate method
 - address the use of profit splits for certain features (e.g. integration, unique and valuable contributions) and when comparables cannot be found
 - provide guidance on profit splitting factors
 - invite commentators to provide examples of situations where a transactional profit split is the most appropriate method
- The tentative deadline for completion of this project in mid-2017

BEPS inclusive framework

What is the inclusive framework?

- Opening up of the Committee on Fiscal Affairs (CFA) to interested and committed countries and jurisdictions
- Members participate on an equal footing in the decision-making body (CFA) and the technical working groups
- The inclusive framework:
 - standard-setting
 - review and monitor the implementation of the BEPS package
 - support implementation
 - 8 toolkits are being developed
 - Further guidance on CBCR implementation
- First meeting in Kyoto: 30 June – 1 July

Conclusion
