

BEPS
WAKE UP!

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BEPS recommendations on Transfer
Pricing (Actions 8 – 10, 13)

Agenda

Action 1: Address the tax challenges of the digital economy		
“Gaps”	“Frictions”	“Transparency”
i. Establishing international coherence of corporate income taxation	ii. Restoring the full effects and benefits of international standards	iii. Ensuring transparency while promoting increased certainty and predictability
Action 2: Neutralise the effects of hybrid mismatch arrangements	Action 6: Prevent treaty abuse	Action 11: Establish methodologies to collect and analyze data on BEPS and the actions to address it
Action 3: Strengthen controlled foreign company (CFC) rules	Action 7: Prevent the artificial avoidance of PE status	Action 12: Require taxpayers to disclose their aggressive tax planning arrangements
Action 4: Limit base erosion via interest deductions and other financial payments	Assure that transfer pricing outcomes are in line with value creation	Action 13: Re-examine transfer pricing documentation
Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance		
		Action 14: Make dispute resolution mechanisms more effective
		Action 9: Risk and capital
		Action 10: Other high-risk transactions
Action 15: Develop a multilateral instrument		

Ac. 8, 9 & 10: TP Guidelines - Introduction

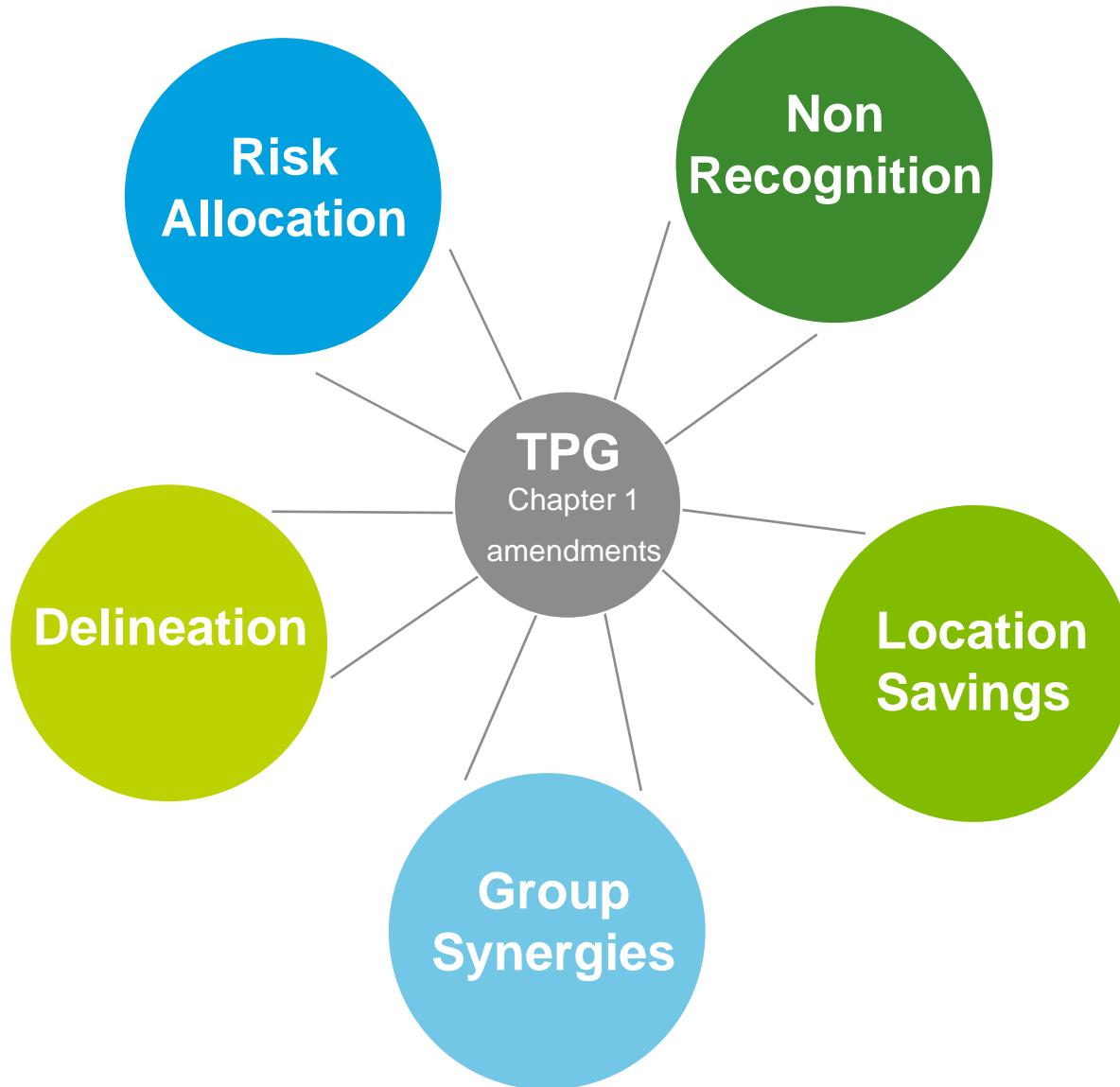
Action 8, 9 and 10 targeted “cash-boxes”

- Capital-rich entities without any other relevant economic activities
- Seen as primary cause of BEPS
- To “defunct” them the OECD WP6 contemplated
 - Measures within the Arm’s Length Standard (“ALS”)
 - “Special Measures” possibly within or outside the ALS

The Final Report asserts

- No “special measures” ended up being used
 - All measures are consistent with the ALS
 - The interpretation of the ALS for purpose of Article 9 of the OECD Model has been modified
- Along with the anti-abuse rules of the non-TP Actions
 - Cash-boxes are likely to be eliminated
 - BEPS should therefore be reduced
- Some additional work remains
 - Global profit splits being probably the most critical

Ac. 8, 9 & 10: TP Guidelines Amendments



Delineation
Delineation of the actual transaction between associated enterprises

Risk Allocation
Risk should be allocated between the parties, using the same “delineation of the actual transaction” approach

Non-Recognition
Non-Recognition of the accurately delineated transaction

Location Savings
Location savings and other local market features

Group Synergies
MNE group synergies

Ac. 8, 9 &10: TP Guidelines Amendments

Amendments to Chapter I, TPG

First point:

Delineation of the actual transaction between associated enterprises

- “written contracts versus conduct” issue
- The amendments say that, in identifying the transaction, you should start with the written contract
- However, the amendments also say that the written contract can be clarified, supplemented or even replaced by the conduct of the parties
- Who won the debate? Conduct!

Ac. 8, 9 & 10: TP Guidelines Amendments

Amendments to Chapter I, TPG (cont.)

Second point:

Risk should be allocated between the parties, using the same “delineation of the actual transaction” approach

- Means that you start with the contractual allocation of risk
- But you then validate (or change) that contractual allocation, by reference to the conduct of the parties
- Specifically, the contractual allocation of risk to a party will be respected only if that party:
 - Controls the risk
 - Has the financial capacity to assume the risk

Ac. 8, 9 & 10: TP Guidelines Amendments

Amendments to Chapter I, TPG (cont.)

Second point (cont.):

Risk should be allocated between the parties, using the same “delineation of the actual transaction” approach (cont’d)

- A party will be considered to **“control a risk”** if it satisfies two requirements:
 - The capability to make decisions to **take on, lay off, or decline a risk-bearing opportunity**, together with the actual performance of that decision-making function
 - The capability to make decisions on **whether and how to respond to the risks associated with the opportunity**, together with the actual performance of that decision-making function

Ac. 8, 9 & 10: TP Guidelines Amendments

Amendments to Chapter I, TPG (cont.)

Third point:

non-recognition of the accurately delineated transaction

- Non-recognition is permitted only if the parties are **not acting in a commercially rational manner**
- Re-characterization can occur when
 - The behaviors of the parties is inconsistent with the contract
 - Control of financial capacity fails on specific risks

Ac. 8, 9 & 10: TP Guidelines Amendments

Amendments to Chapter I, TPG (cont.)

Third point (cont.):

- Contracts have always been important, they are now more than ever
 - Ambiguous, incomplete or not-followed contracts open door to re-characterization
- The level of documentation required to avoid re- characterization is significantly greater than before
 - Granular risk analysis establishing control and financial capacity (local file)
 - Multiple steps process required to “accurately delineate” the transactions

Ac. 8, 9 & 10: TP Guidelines Amendments

Amendments to Chapter I, TPG (cont.)

Fourth point:

location savings and other local market features

- These items are not intangibles - they are comparability factors
- The amendments describe a **4 step analysis** to determine the impact (if any) of these features on the pricing. Consequently, it is necessary to consider:
 - whether location savings exist;
 - the amount of any location savings;
 - the extent to which location savings are either retained by a member or members of the MNE group or are passed on to independent customers or suppliers; and
 - where location savings are not fully passed on to independent customers or suppliers, the manner in which independent enterprises operating under similar circumstances would allocate any retained net location savings.

Ac. 8, 9 & 10: TP Guidelines Amendments

Amendments to Chapter I, TPG (cont.)

Fifth point:

MNE group synergies

- The amendments state that **incidental benefits** from membership of a group (e.g., a supplier offers an entity a discount because the entity is a member of the ABC group) should not be compensated
- However, benefits which are derived from **deliberate concerted group actions** (e.g., establishment of a centralised procurement company in order to obtain volume discounts from suppliers) **should be shared by the group members according to their contribution to the synergy**. In the procurement example, this would suggest that the centralised procurement company would not be able to keep the benefits, other than a return for its functions

Ac. 8, 9 & 10: TP Guidelines Amendments

Amendments to Chapter VI, TPG

- Legal ownership of an intangible does not give rise to a right to the returns from the intangible
- Instead, the returns from intangibles should accrue to:
 - Parties who perform the development, enhancement, maintenance, protection, and exploitation (DEMPE) functions in regard to the intangibles
 - Parties to whom the intangibles risk is allocated (by virtue of performance of control functions and having the financial capacity to assume the risk)
 - Parties who provide the assets (e.g., funding) for the development of the intangibles
- Unfortunately the guidance on how to do that is postponed to 2016-2017



Ac. 8, 9 & 10: TP Guidelines Amendments

Amendments to Chapter VI, TPG (cont.)

- Hard to value intangibles (HTVI) are intangibles for which:
 - No reliable comparables exists; and
 - Financial projections or other assumptions for valuation are highly uncertain
- Regarding hard to value intangibles:
 - The tax authorities are permitted to use “ex post outcomes” (i.e., hindsight) as presumptive evidence of the appropriateness of “ex ante” (upfront) pricing arrangements
 - However, several exemptions are provided, including an “80/20 rule” (the ex post outcomes are within 20%, plus or minus, of the ex ante projections)



Ac. 8, 9 & 10: TP Guidelines Amendments

Amendments to Chapters I & VI, TPG: cash box entities

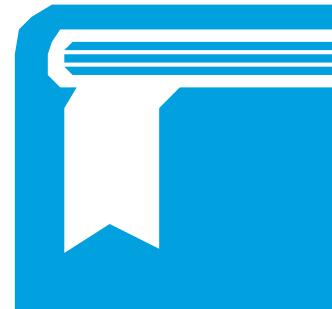
- The cash box entity has been the subject of many thousands of hours of discussion and analysis
- How it will be handled:
 - Definition: a “cash box entity” is an entity with high capital, but low (or no) functionality
 - If the entity does not control its funding risk, then it is entitled to a return no higher than the risk-free return – and it can be lower, if the arrangements are not “recognised”, because they are not commercially rational
 - If the entity does control its funding risk, but nothing more, then it is entitled to a risk-adjusted return – but nothing more
 - In view of these conclusions, the “special measures” which were hotly debated for many months, are not needed



Ac. 8, 9 &10: TP Guidelines Amendments

Amendments to Chapter VII, TPG

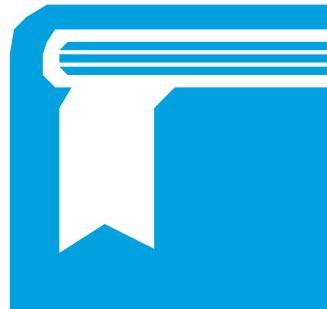
- Chapter VII on intra-group services, has been completely re-written – however, the only substantive changes are regarding the new material on low value-adding intra-group services
- Regarding low value-adding intra-group services:
 - Countries will be free to choose to apply the new material only if payments for low value-adding intra-group services don't exceed a threshold amount.
 - Mark-up has been fixed at 5%



Ac. 8, 9 & 10: TP Guidelines Amendments

Amendments to Chapter VIII, TPG

- Chapter VIII on cost contribution arrangements (CCAs), has been completely re-written
- Two key points:
 - To qualify as a participant in a CCA, a party must exercise control over the risks and have the financial capacity to assume the risks
 - As a rule, contributions to a CCA will generally be valued at “value”



Ac. 8, 9 &10: TP Guidelines Amendments

Profit split method:

Scope of work for preparation of guidance in 2016

- The report sets out a “scope of work” regarding the guidance on the profit split method, to be prepared in 2016
- An interesting point made in the scope is this: the profit split method is not the default method to use when you have no comparables



Ac. 8, 9 &10: TP Guidelines Amendments

Profit split method:

Scope of work for preparation of guidance in 2016 (Cont.)

The report says:

“The sharing of profits or losses under a profit split may in some circumstances reflect a fundamentally different commercial relationship between the parties, in particular concerning risk allocation, to the paying of a fee for goods or services. In cases where the delineation of the actual transaction is such that a share of profits would be unlikely to represent an arm's length outcome, the revised guidance will emphasize the need to use and adjust the best available comparables rather than selecting a profit split method. An appropriate method using inexact comparables is likely to be more reliable in such cases than an inappropriate use of the transactional profit split method.”



Ac. 13: TP Documentation & CbC Reporting

Summary

- The report consists of a complete re-write of chapter V of the Transfer Pricing Guidelines, which concerns documentation.
- The new chapter V describes the three-tier approach to TP documentation:



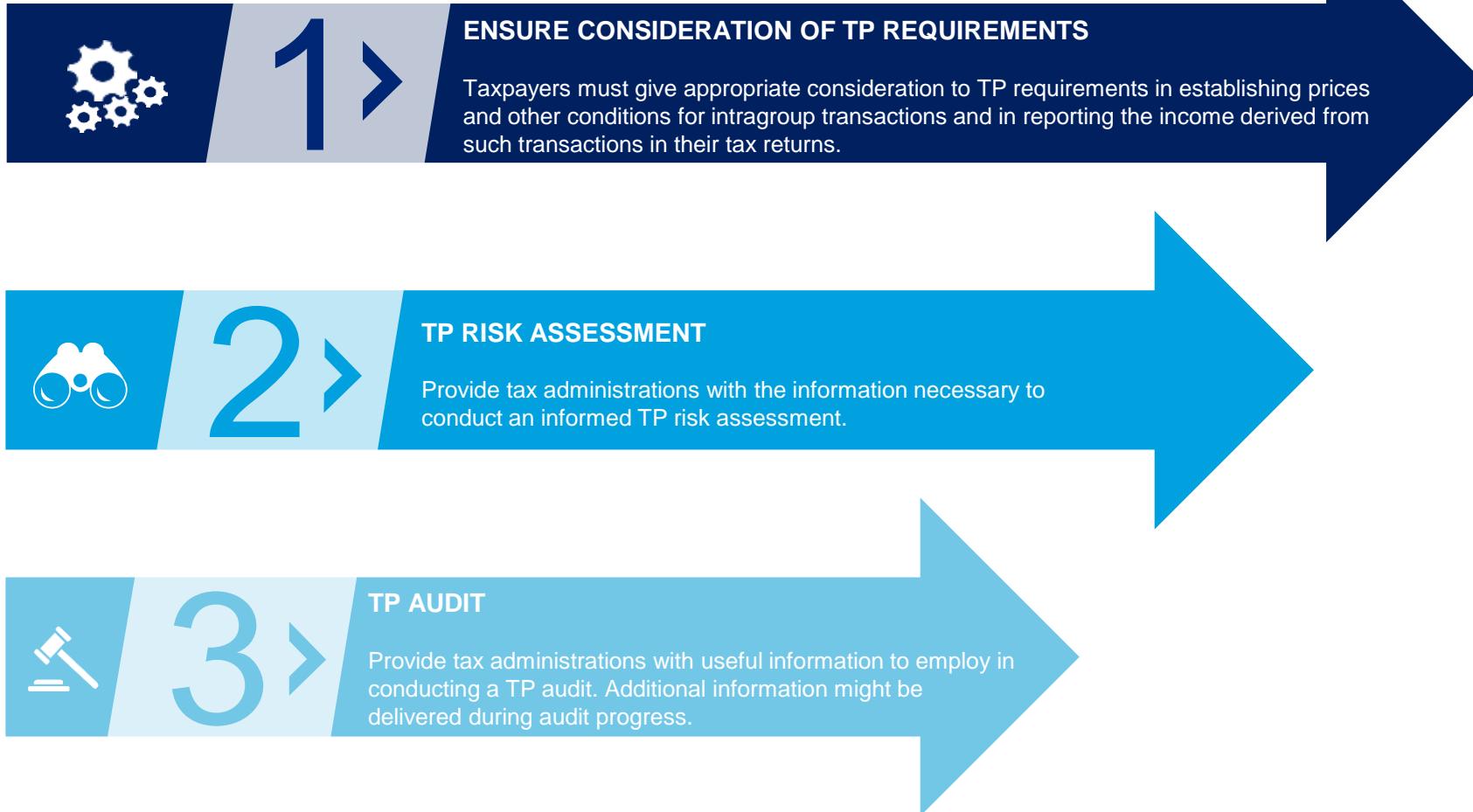
Ac. 13: TP Documentation & CbC Reporting

Summary (Cont.)

- Also included in the new chapter V is the model template for the CbC Report, together with instructions on how to complete it
- Also there is the various elements of the CbC implementation package which were released several months ago - the model legislation and the various forms of competent authority agreement
- In summary, nothing new in the re-written chapter V – it's been covered either in the 2014 report on Action 13 or in the materials which were released earlier this year

Ac. 13: TP Documentation & CbC Reporting

Objectives of TP Documentation - Reminders..



Ac. 13: TP Documentation & CbC Reporting

Country-by-country reporting - Reminders...

Timing

- Applies for periods beginning on or after 1 January 2016.
- Filing 12 months after the accounting period end.

Applicable to

- Entities with turnover of €750m + in the previous accounting period.
- E.g. consolidated turnover > €750m required in FY15 for CbC to be due for FY16

Filing and sharing

- Parent company location
- Automatic exchange mechanism to be developed

Use and other points

- Template only to be used – no extra or reduced info
- Only to be used for risk assessment

Table 1. Overview of allocation of income, taxes and business activities by tax jurisdiction

Name of the MNE group: Fiscal year concerned:										
Tax Jurisdiction	Revenues			Profit (Loss) Before Income Tax	Income Tax Paid (on cash basis)	Income Tax Accrued – Current Year	Stated capital	Accumulated earnings	Number of Employees	Tangible Assets other than Cash and Cash Equivalents
	Unrelated Party	Related Party	Total							

Table 2. List of all the Constituent Entities of the MNE group included in each aggregation per tax jurisdiction

Name of the MNE group: Fiscal year concerned:														
Tax Jurisdiction	Constituent Entities resident in the Tax Jurisdiction	Tax Jurisdiction of organisation or incorporation if different from Tax Jurisdiction of Residence	Main business activity(ies)											
			Research and Development	Holding or Managing intellectual property	Purchasing or Procurement	Manufacturing or Production	Sales, Marketing or Distribution	Administrative, Management or Support Services	Provision of Services to unrelated parties	Internal Group Finance	Regulated Financial Services	Insurance	Holding shares or other equity instruments	Dormant
	1.													
	2.													
	3.													
	1.													

Table 3 – Additional Information

“Please include any further brief information or explanation you consider necessary or that would facilitate the understanding of the compulsory information provided in the country-by-country reporting.”

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