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Agenda

- Introduction: intragroup contracts
- Intragroup contract drafting
- Distribution and sales transaction
- Production settings
- Dealing with intangibles & IP
- Management of intragroup contracts
- Conclusion
- Questions and answers

Introduction:

Relevance of intragroup contracts

Introduction: intragroup contracts and BEPS

Relevance of intragroup contracts

Intragroup contracts have increased in relevance due to the OECD articles regarding BEPS action items 7 (Permanent Establishment), 8-10 (adaption of transfer prices to added value) and 13 (transfer pricing documentation and Country-by-Country Reporting)

BEPS action items 7, 8-10, 13

Starting points when assessing the appropriateness of a transaction are the contractual relations between affiliated companies and the related assignment of functions and risks

The parties' actual conduct supplements or replaces the contracts in case the agreements are incomplete or the parties do not comply to them

The newly introduced Country File has to comprise all relevant intragroup contracts

The contractual allocation of risks to a party that doesn't control these risks or doesn't have the financial resources for this purpose, is not allowed. In these cases, the allocation must be made to the party that does actually control the risks and is financially able to do so

Relevance for companies

Contracts as a starting point

Actual conduct

Function and risk profile

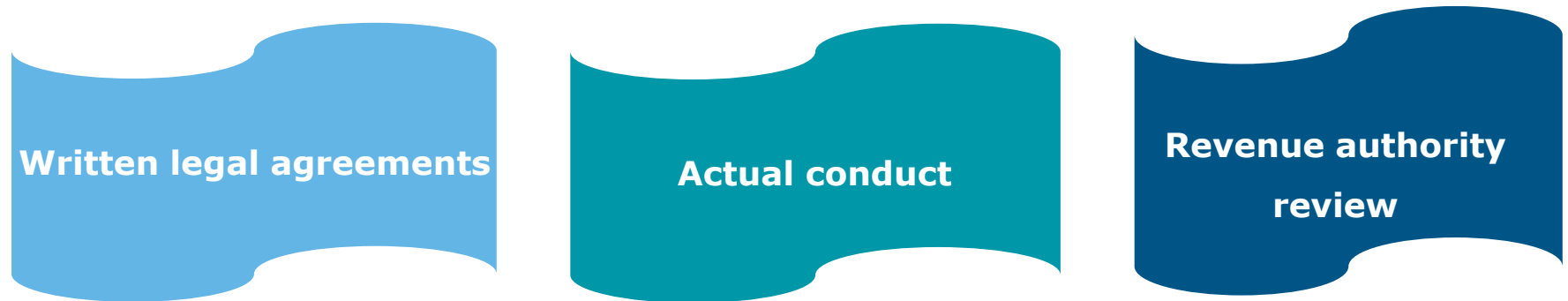
Arm's length prices

Written intragroup contracts should be entered into regularly reviewed and adjusted for all intragroup transactions

Intragroup contracts and BEPS

Relevance of intragroup contracts

Written legal agreements as starting point when a revenue authority considers transfer pricing under new OECD Guidelines:



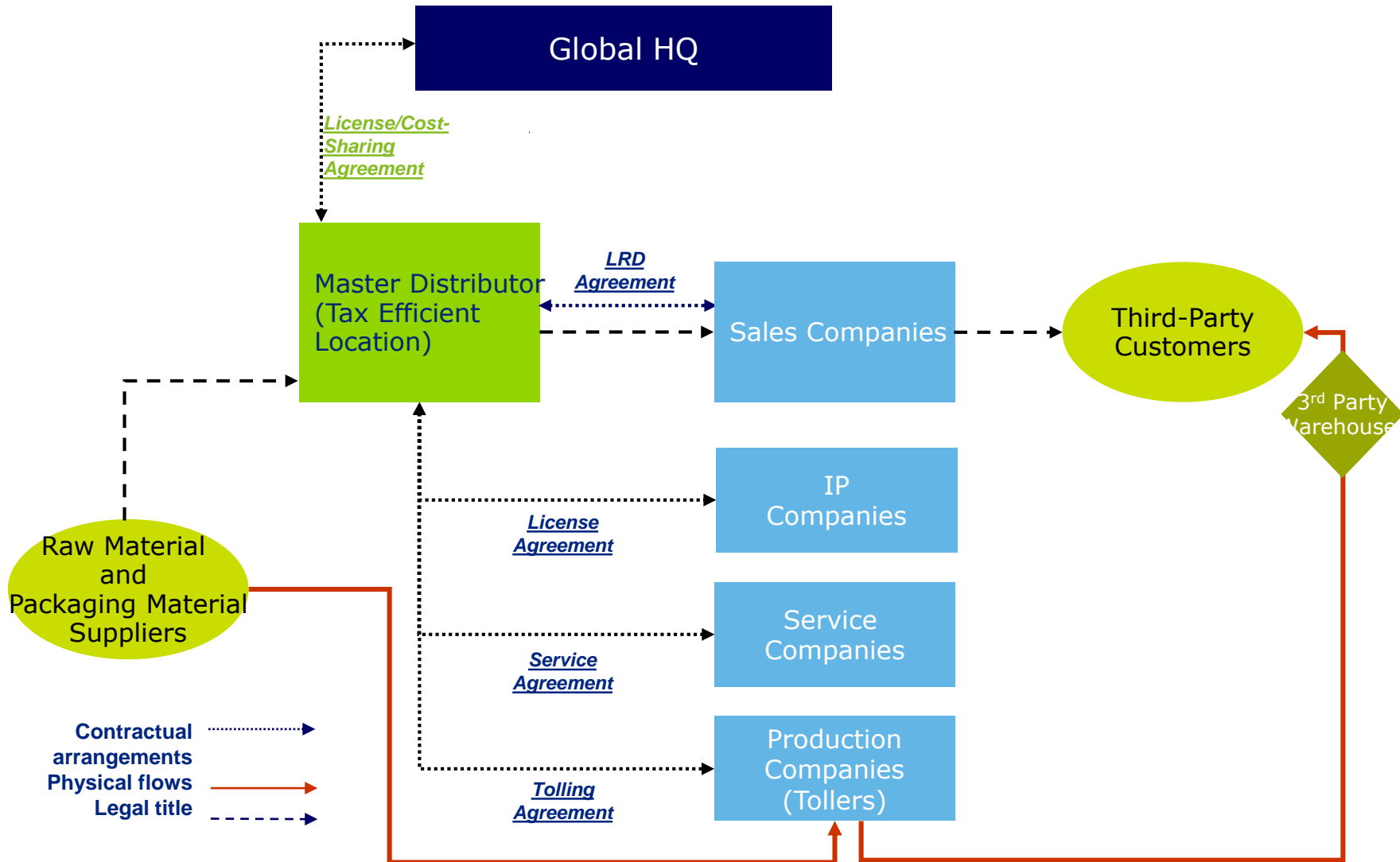
Areas of impact include:

- Recharacterisation
- Risk allocation
- Restructuring
- Intellectual property

Intragroup contract drafting

Intragroup contract drafting

Example: Master Distributor Model and its agreements



Intragroup contract drafting

Substantial provisions

Essentialia negotii

- Definition of contracting parties
- Definition of subject matter
- Description of main rights / obligations
- Agreement on price / remuneration

Standard provisions

- Term / termination
- Confidentiality (post contractual)
- Liability / Limitation of liability
- Change of control
- Choice of law
- Choice of jurisdiction
- Arbitration clause
- Force majeure
- Written form requirements (simple or advanced written form clause? Changes via e-mail?)
- Severability clause

Contract conclusion

- Authorization to sign? Policies?
- Hand written signature vs. electronic signature
- Dates of signature and entry into force
- Retroactive effect for tax purposes?

Distribution and sales transaction

Intragroup contract drafting

Contract types distribution and sales

Authorized dealer / distributor

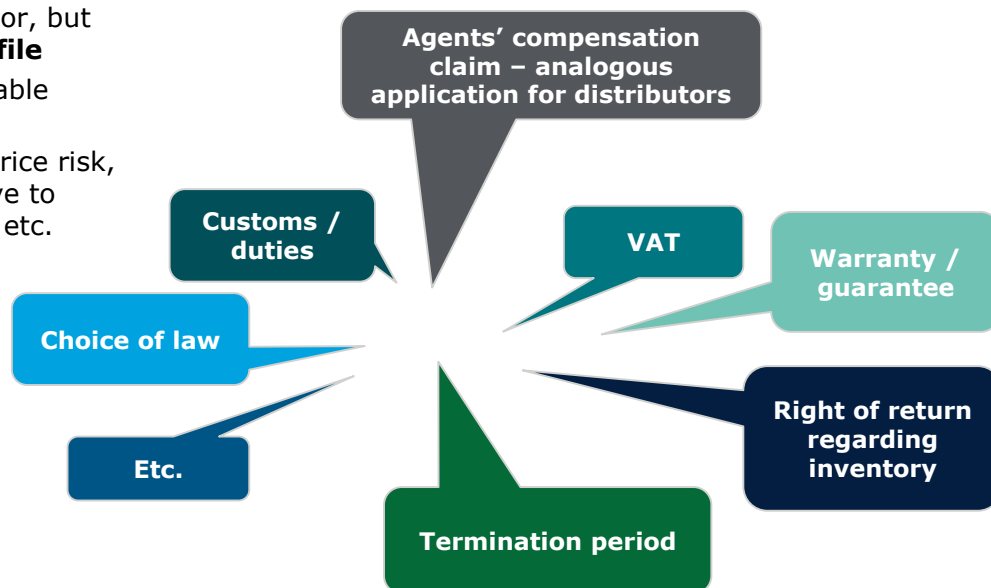
- Acting **on own behalf** for **own account**
 - Dealer agreement serves as framework; sale / delivery of goods under separate sales contracts
 - Analogy to agency law needs to be considered; compensation claims

“Low Risk Distributor”

- Similar to dealer / distributor, but **strongly limited risk profile**
 - Arm’s length questionable
 - In third party scenarios distributors e.g., take price risk, have to keep stock, have to handle warranty claims etc.

Commercial agent

- Acting **on behalf of another** for **account of another**
 - EU Agency Directive grants very similar rights and obligations to agents acting within the EU / EEA
 - Mandatory rules do not apply to agents outside the EU / EEA



Case study 1

Year-end adjustments

Example distribution agreement

- Distribution agreement for a limited risk distributor
- The agreement contains a year-end adjustment clause
 - The limited risk distributor shall receive an arm's length routine return according to Art. 9 of the OECD Model Tax Convention
 - Reference is made to arm's length range of returns (without specifying range)
 - Year-end adjustments (credit / debit notes) are made to median of range

- **Year-end adjustment mechanism has to be detailed in order to duly consider standards of contractual drafting such as the principal of certainty!**
- **Careful drafting of year-end adjustment clause is strongly recommended!**
- **Duly consider potential director's liability and insolvency risks!**

Production settings

Intragroup contract drafting

Contract types production

Manufacturer

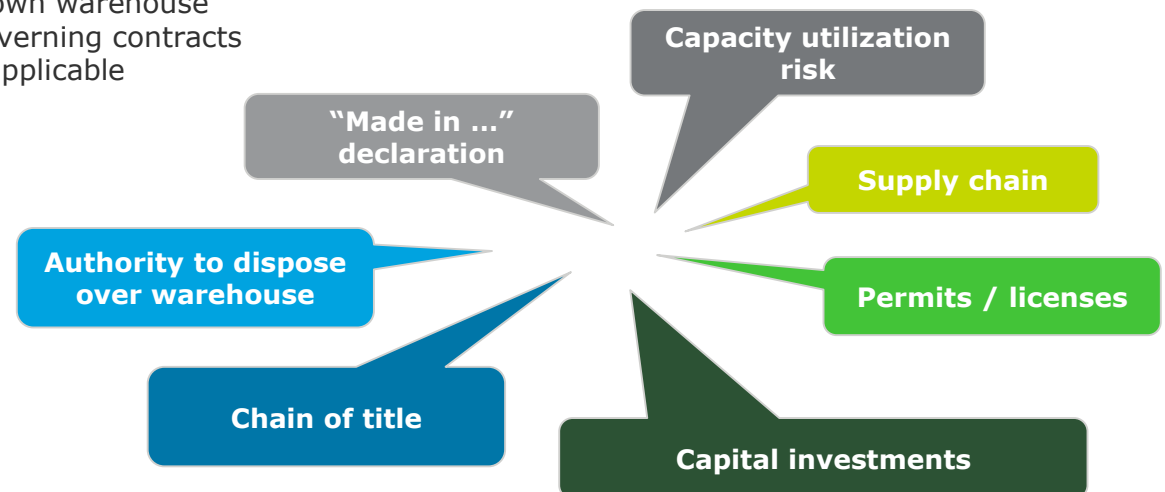
- Production **on own behalf**, on **own account** and **own risk**
- Owned / licensed intangible assets
- Own warehouse

Toll manufacturer

- **Guaranteed purchase**
- Providing of raw materials
- **No / very limited risks and responsibilities**

Contract manufacturer

- **Guaranteed purchase**
- Own procurement of raw materials
- In part own warehouse
- Laws governing contracts of sale applicable



Case study 2

Agreement vs. actual conduct

Example contract manufacturing

- According to the intercompany agreement the principal is responsible for production planning
- Actual conduct
 - Contract manufacturer contacts sales entities for sales budgets / planned sales volumes
 - Contract manufacturer develops a production plan and implements it
 - Contract manufacturer factually decides upon operational planning

- **Regular review and adjustment of agreements to the parties' actual conduct is essential to ensure consistency of contractual agreements, functional and risk profile as well as arm's length prices**

Dealing with intangibles & IP

Intragroup contract drafting

Identify the intangible

Identifying from a legal perspective – the different intangibles involved (trade secrets, intellectual property rights, licenses, etc.) and distinguish them from other issues, such as provision of services

Identify legal owner

Identifying the legal owner of intangibles based on the terms and conditions of legal arrangements, including relevant registrations, license agreements, other relevant contracts, and other indicia of legal ownership

Identify parties re functions, risks, assets

Identifying the parties performing functions (including specifically the important functions), using assets, and assuming risks related to developing, enhancing, maintaining, protecting, and exploiting (“DEMPE”) the intangibles. Use of the “DEMPE tool”

Drafting agreements

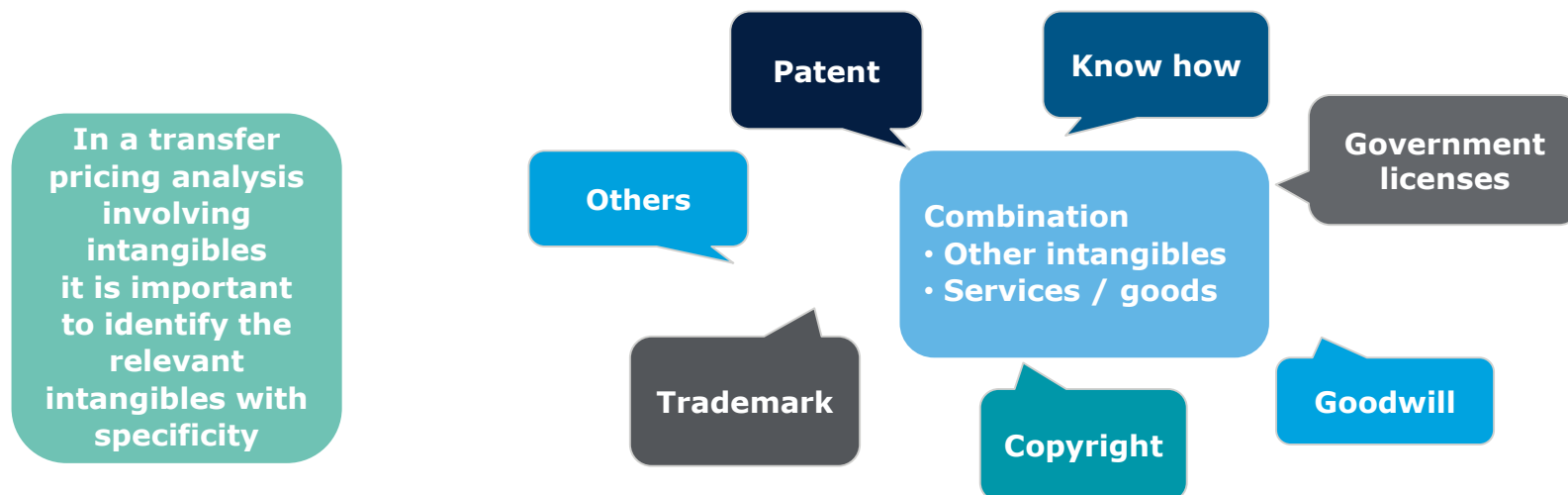
Drafting / modifying existing agreements on arm’s length basis, consistent with the conduct of the parties including their relevant contributions of functions, assets, risks, and other factors contributing to the creation of value

Intragroup contract drafting

Identification of the intangibles

An intangible is something which

- Is not a physical asset or a financial asset
- 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



Intragroup contract drafting

Substantial provisions regarding intangible assets

General provisions

- Detailed description of DEMPE functions
 - **D**evelopment
 - **E**nhancement
 - **M**aintenance
 - **P**rotection
 - **E**xploitation
- Description of intangible assets
- Remuneration – interest for delay
- (If necessary) adjustment of license rate
- Termination clause
- Audit clause

In particular – research & development (contract of service)

- Decisions
- Control
- Providing intangible assets
- Risk assumption
- Allocation of rights regarding research results / enhancements
- Protection / maintenance
- Exploitation
- Etc.

In particular – brands & patent licenses (license agreements)

- Description of affected rights
- Exclusive / non-exclusive use
- Right to sublicense
- Territorial limitation
- Price
- Owed services
- Consequences of termination
- Etc.

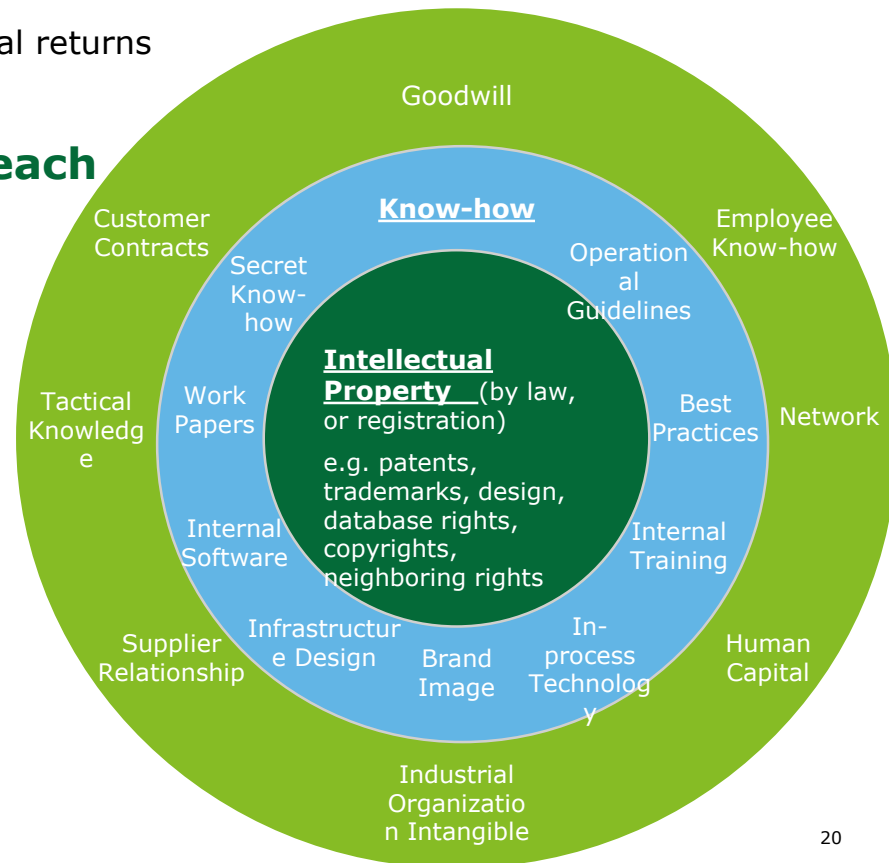
Intragroup contract drafting

To be entitled to IP return:

- Must control **operational** risks
 - Operation means: development, enhancement, maintenance, protection, exploitation (aka **DEMPE** functions)
 - **Thus IP return has shifted from financial capital to people functions (!)**
 - Financial capital gets a projected risk-free return or a risk-adjusted return
 - The OECD has not agreed on what to do with actual returns (who gets the unanticipated upsides)

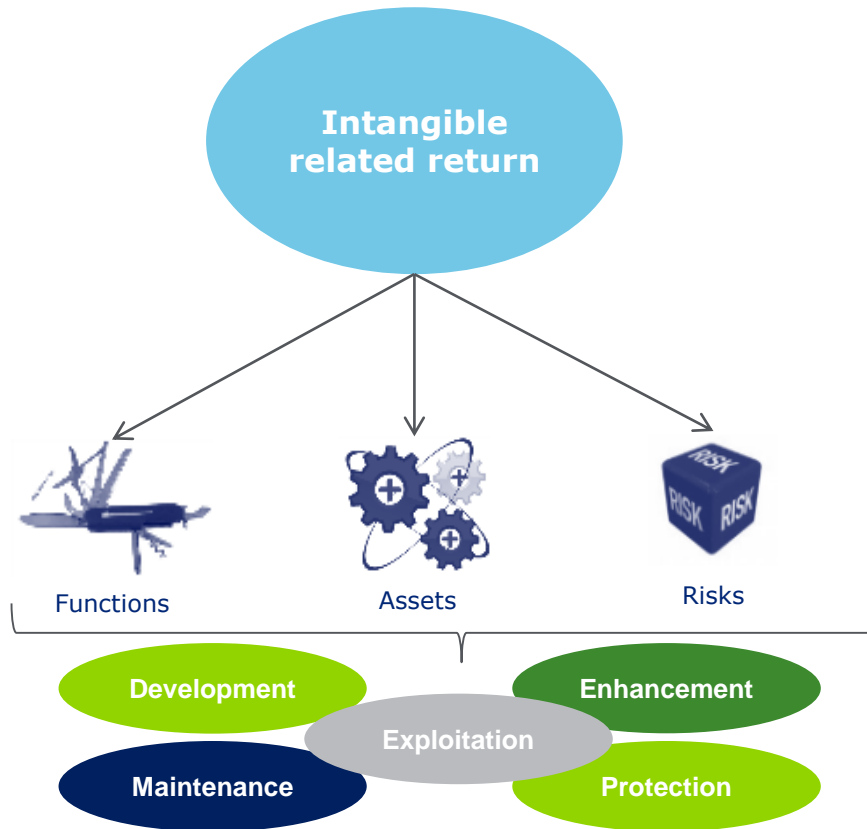
Controlling operational risks requires **for each** operational risk:

- In-location people that:
 - are qualified, have decision-making authority, demonstrate in-location exercise of decision-making authority as it relates to risk mitigate
 - No in-location white lab coat requirement or headcount requirement
- Board meetings are no longer sufficient
- Setting procedures and policies no longer sufficient



Contract Drafting

Intangible related return



Neither **legal ownership** nor **liability for costs** will alone entitle an entity to intangible related return ("IRR").

Consider the functions, assets and risks associated with the development enhancement, maintenance protection and exploitation of intangibles.

Indicators of entitlement to intangible related return

Functions

- Design and control of research and marketing programmes
- Management and control of budgets
- Control over strategic decisions on development
- Decision making on defence and protection
- Ongoing quality control over outsourced functions

Assets

- Intangibles used in research, development or marketing (e.g. know-how, customer relationships)
- Physical assets
- Funding (bearing costs is important, but not in itself sufficient to attribute IRR)

Risks

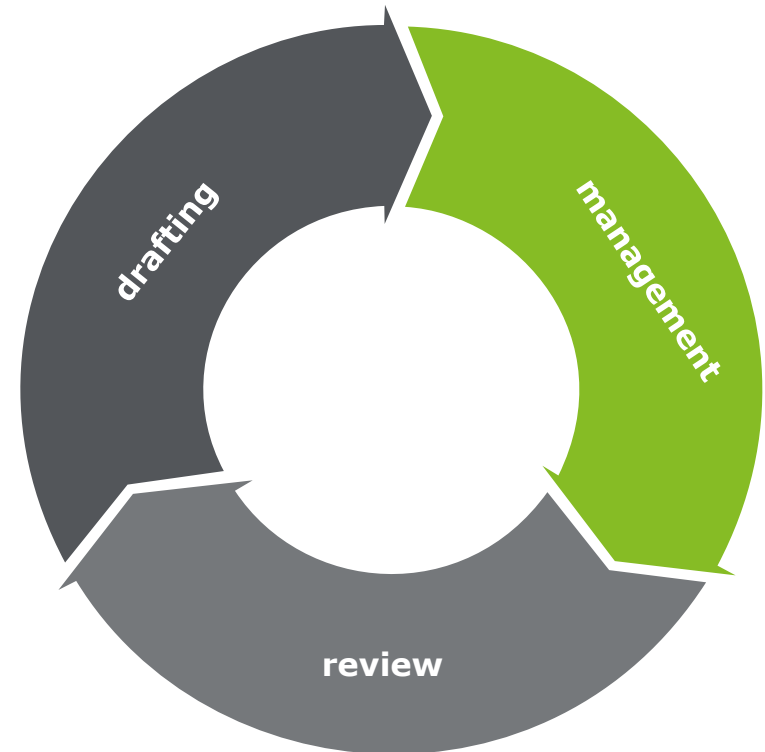
- Costly development of intangibles
- Product obsolescence, or loss of competitiveness
- Infringement/cost of defence
- Product liability

Management of intragroup contracts

Contract management

Challenges

- Drafting of a considerable number of contracts, for example regarding globally present sales companies
- Management and storage of contracts
- Content-related review of coexistence between actual conduct and contractual agreement
- Review regarding contract term
- Adjustment of contracts to current legal developments



Contract management

Contract automation and Information Extraction Tools

Automation – “serial letter 2.0”

- Automation significantly helps reducing the efforts in connection with drafting frequently required documents. We guide the way to “big” and “small” solutions

Information Extraction Tools – efficiency gains by the use of “Machine Learning”

- Information Extraction Tools can be programmed to automatically summarize the content of contracts (e.g., parties, term, provisions governing termination) or to detect particular provisions (e.g., change-of-control-clauses). Here again: The correct tool for your job

Conclusion

Intragroup contracts

Conclusion



Intercompany agreements are crucial for tax purposes

→ **Ensure to have them!**



Drafting intercompany agreements is complicated and requires tax and legal expertise

→ **Team-up between Tax and Legal!**



Intercompany agreements are not only about pricing but about the allocation of functions, responsibilities and risks between the parties

→ **Do not underestimate the complexity**



Intercompany agreements have to be renewed, amended, terminated and finally stored to be found years later

→ **Have a clear process in place!**

Questions and answers

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