



# MANAGING TRANSFER PRICING ISSUES IN AN EVOLVING BEPS ENVIRONMENT

ANTON HUME / DAN MCGEOWN / VEENA PARRIKAR / RICHARD VAN DER POEL / JAY TANG  
2 JUNE 2015

# AGENDA

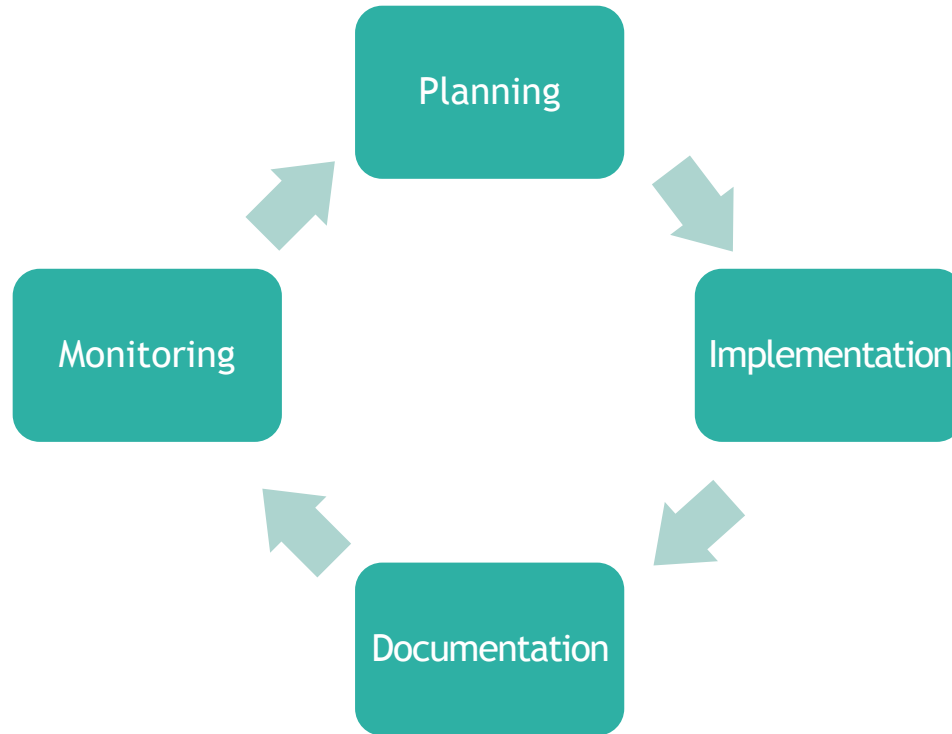


Control Over Transfer Pricing Policies and Procedures	3
Strategies for Effective Transfer Pricing Planning	10
Effective Implementation and Monitoring Strategies	23
Managing Expectations Globally	31
Closing remarks	39

# CONTROL OVER TRANSFER PRICING POLICIES AND PROCEDURES

Dan McGeown, Canada

# FOUR STAGES OF THE TRANSFER PRICING LIFE CYCLE



# PLANNING

## Planning strategies will take into account the OECD's recent guidance while considering:

- Intangibles creation, ownership, maintenance and use
- Robust analyses of functions and risks
- Economic substance required to underpin the desired commercial (and anticipated tax) outcome
- Value chain strengths, weaknesses, areas for improvement and areas of focus framed by the realities of the business
- A review of the potential for appropriate management of the effective tax rate in the context of all of the above.

# IMPLEMENTATION

## Implementation efforts should include:

- Transfer Pricing Policies and Procedures Manual
- Communication of policies and procedures to all entities within the group
- Training to ensure that the policies and procedures, and the expected outcomes in each jurisdiction, are understood in order to facilitate proper implementation in each entity
- Controls over the implementation process
- Ongoing monitoring procedures
- Procedures for taking corrective action, when required.

# DOCUMENTATION

Documentation should incorporate the recent revisions to Chapter V of the OECD Transfer Pricing Guidelines which will require:

- Preparing a robust Masterfile - by the Parent of the group
- Determining which entities require a Local file, based on whether the country has specific transfer pricing penalties to take into consideration and/or the risk of an adjustment
- Considering whether the group is required to file Country-by-Country Reporting and, if so, where
- Incorporating procedures for local and central review of all documentation studies.

# REVISED CHAPTER V OF THE OECD GUIDELINES

## INCLUDES A NEW THREE-TIERED APPROACH TO TRANSFER PRICING DOCUMENTATION

### 1. Masterfile

- High-level overview of the group business
- The Masterfile will be filed directly with the tax administrations in each relevant jurisdiction as required by those administrations .

### 2. Local file

- Provide individual jurisdictions with detailed information on specific group transactions that are considered material under the local country's tax system
- The local files are meant to show the taxpayer has complied with the arm's length principle
- To be filed in the local tax jurisdictions.

### 3. Country by country report

- Aggregate, jurisdiction-wide information on global allocation of income, taxes paid, indicators of economic activity
- Designed for transfer pricing risk assessment and for evaluating other BEPS-related risks
- To be filed with the parent company's tax authority, which may then share with the other tax authorities.





# MONITORING

## Effective monitoring of the MNE's transfer pricing policies and procedures will require:

- Delegating review responsibilities to key individuals at the local entities and parent entity
- Having those individual report in to a central leader within the parent
- Identifying issues encountered during the monitoring process
- Taking corrective actions
- Reporting back to the central leader.

# EFFECTIVE TRANSFER PRICING PLANNING

Veena Parrikar, United States

# THE VALUE CHAIN

WHAT IS IT?

How and where a business creates value, income and profit

STRATEGIC MANAGEMENT

DAY-TO-DAY ADMINISTRATION

R&D

Procurement

Manufacturing

Logistics

Distribution

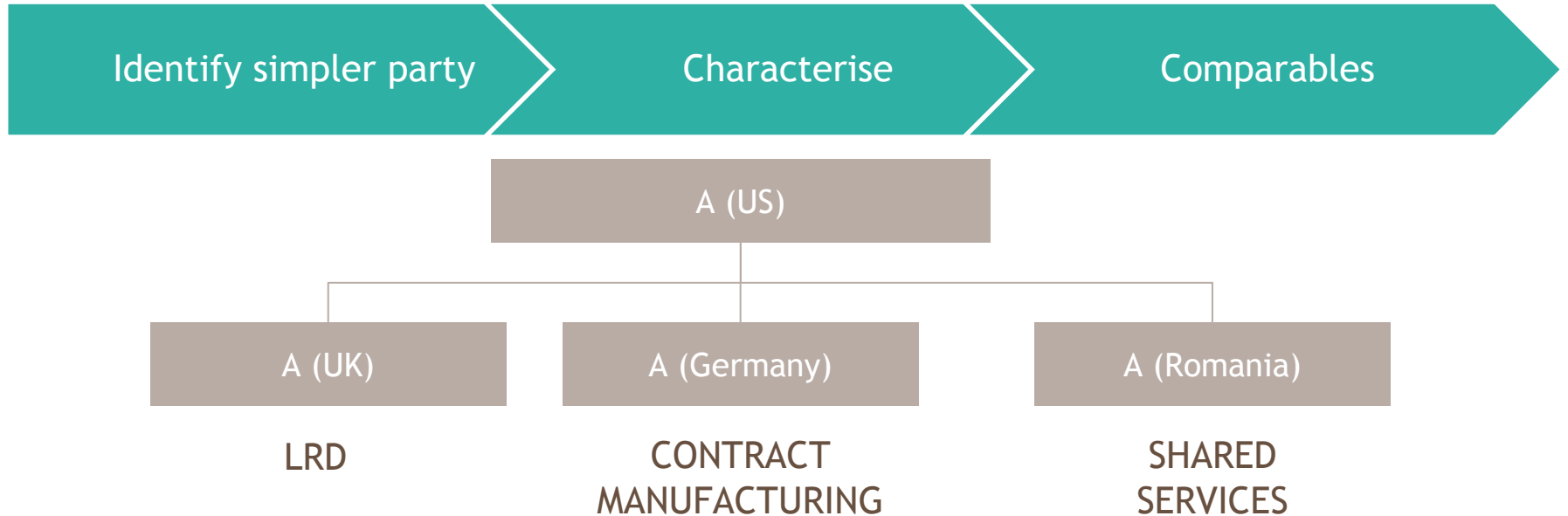
Aftermarket

INTELLECTUAL PROPERTY

SYSTEM PROFIT

# ECONOMIC SUBSTANCE - THE 'CHARACTERISE AND PRICE' APPROACH

HISTORIC EMPHASIS ON ENTITY CHARACTERISATION



# UNDERSTANDING SUBSTANCE

WHEN CHARACTERISATION IS NO LONGER ENOUGH

## BEPS

focuses on substance as key to an effective international tax system

## OECD

documents clearer and firmer on how substance should be considered, and applied

# UNDERSTANDING SUBSTANCE

## WHAT DOES THE OECD EXPECT?

A greater level of understanding, granular analysis and sophistication reflected in transfer pricing policies and documentation



Substance and specific characteristics over entity characterisation

# ECONOMIC SUBSTANCE

DEMPE

Introduced through considerations in the new Chapter VI of the Transfer Pricing Guidelines

For IP, who manages:

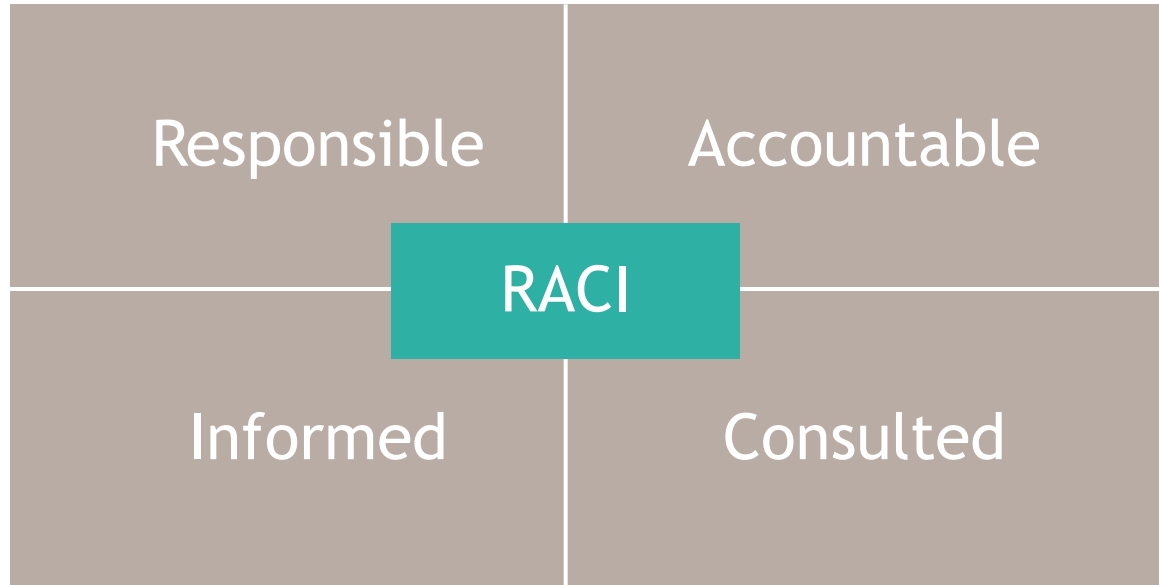


What is the value in each step?

# UNDERSTANDING SUBSTANCE

## RACI

For key value drivers, who is





# UNDERSTANDING SUBSTANCE

## MORAL HAZARD

### Discussed in OECD's revision of Chapter I of the Transfer Pricing Guidelines

“Lack of incentive to guard against risk where one is protected from its consequences”

Unrelated parties try to avoid this - aligning risks (and associated reward) with control of those risks

What impact does this have where common control and aligned objectives?

Do intercompany agreements and transfer pricing policy reflect this?

# UNDERSTANDING SUBSTANCE

## A SPOTTER'S GUIDE

Understand the business' value chain	<ul style="list-style-type: none"><li>• Title flow</li><li>• Organisational structure.</li></ul>
Identify key value drivers	<ul style="list-style-type: none"><li>• Intangible assets, eg technical or trade mark IP</li><li>• Tangible assets, eg stock, plant or logistics infrastructure</li><li>• What are the key risks?</li></ul>
Determine key: <ul style="list-style-type: none"><li>• Functions</li><li>• Assets</li><li>• Risks</li><li>• Management.</li></ul>	<ul style="list-style-type: none"><li>• Who signs off on decisions or projects; who performs stage gate reviews?</li><li>• Who develops and maintains key assets?</li><li>• Where do key risk sit, eg warranty risk? Who gets sued, and who mitigates this likelihood?</li><li>• Who provides financing?</li><li>• Can attributes be outsourced?</li></ul>
Locate these attributes by <ul style="list-style-type: none"><li>• Territory</li><li>• Entity.</li></ul>	
Evidence these findings	<ul style="list-style-type: none"><li>• Show management decision-making - show 'no' as well as 'yes'</li></ul>
Consider how these attributes fit into the wider business organisation	<ul style="list-style-type: none"><li>• Is decision-making set up to be practical and achievable?</li><li>• Would (or could) third parties work in this way?</li></ul>
Are they consistent with <ul style="list-style-type: none"><li>• Legal framework</li><li>• Tax and transfer pricing policy.</li></ul>	

Functional analysis

Documentation

Policy review

# UNDERSTANDING SUBSTANCE

## PRACTICAL HURDLES

### Identifying substance

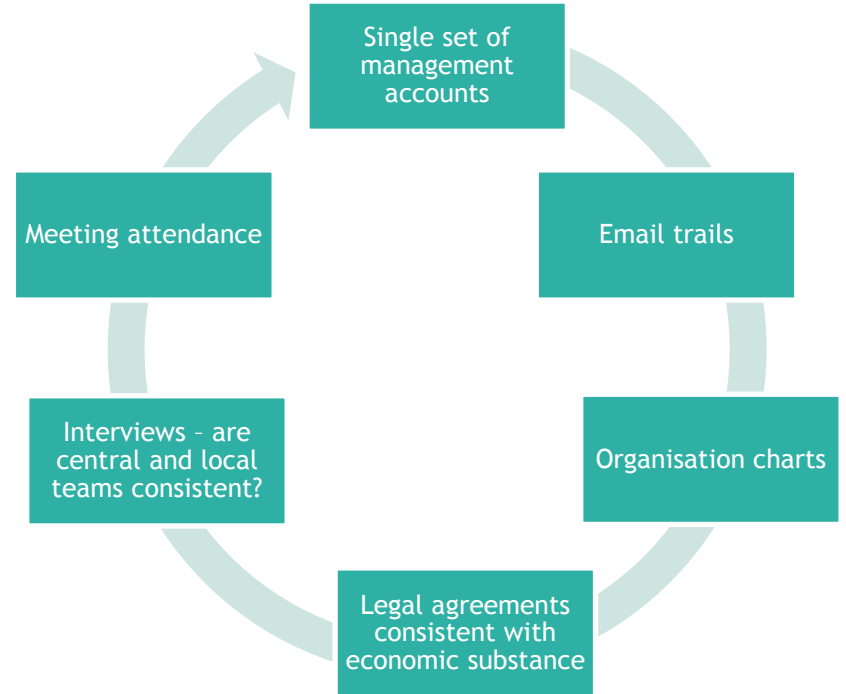
- Need for effective functional analysis
- Interpretation - everyone thinks they are key
- Central v local
- Frequency - the business does not stand still
- Quantifying the risk
- Impact on global effective tax rate.

# UNDERSTANDING SUBSTANCE

## PRACTICAL HURDLES

### Evidencing substance

- Showing decision making - saying 'no' as well as 'yes'
- Board minutes and emails
- Challenges of mobile management
- Financing arrangements and location of cash.



# UNDERSTANDING SUBSTANCE

## CONCLUSIONS

Economic substance is a measure and an expectation, but does not come with definitive triggers and thresholds

### Key considerations

- Economic substance is not tied to legal form
- It will depend on the key value drivers of the business
- This will be specific by industry and business
- Those key value drivers may not be the most senior - a 'rubber stamp' is not substance
- People move - both day-to-day and year-to-year - substance may not be set in stone
- Financing can be important, but not necessarily on its own.

# BENEFITS OF A CLEAR UNDERSTANDING

## Achieving comfort

### Tax risk

- Non-recognition/  
Re-characterisation
- Additional/double taxation
- Other tax risk - DPT/VAT?

### Effective planning

- Robust tax and transfer  
pricing planning -  
no surprises
- Clarity on global effective  
tax rate

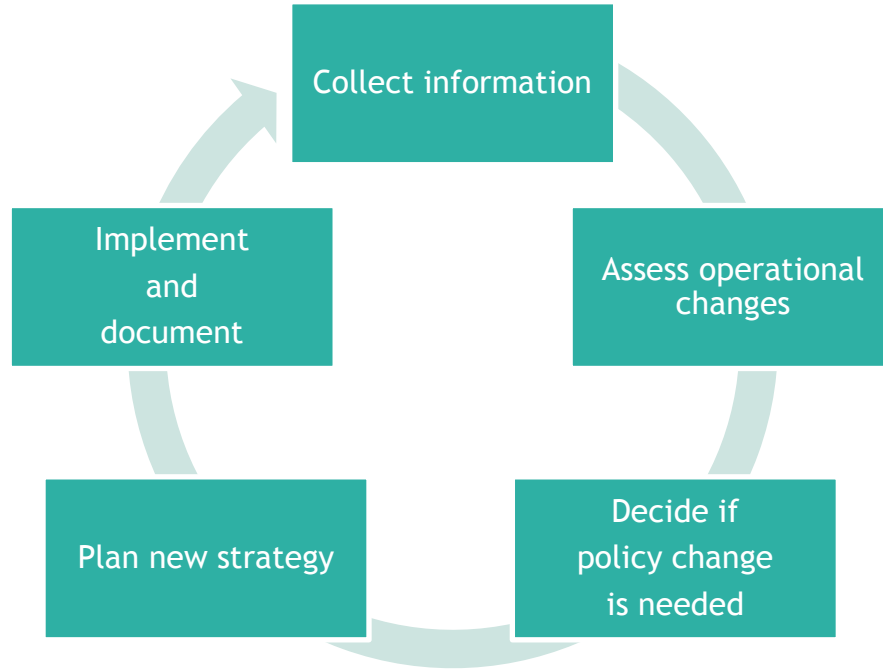
### Stakeholder comfort

- Clarity when reporting  
to stakeholders
- Reduced risk from negative  
outside perceptions
- Low-risk rating from  
tax authorities

# IMPLEMENTATION AND MONITORING

Richard van der Poel, Spain

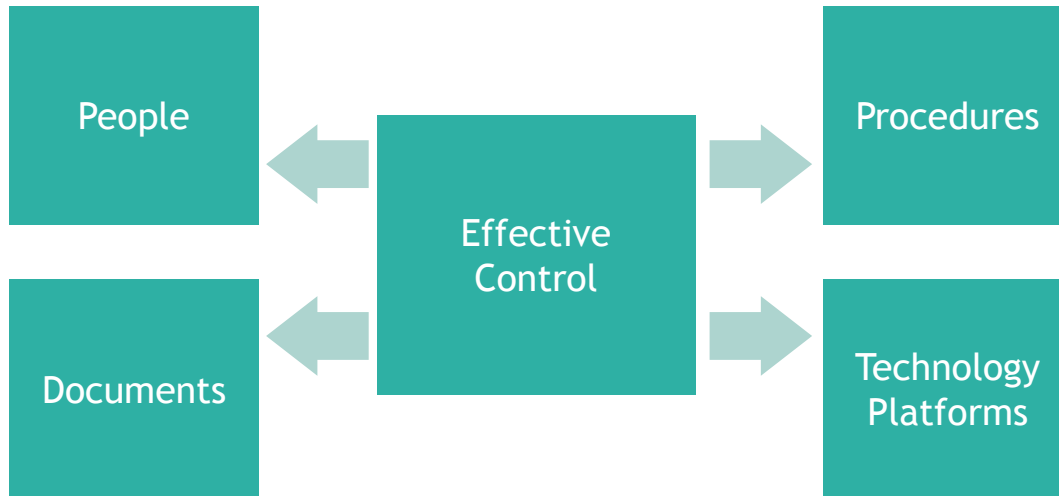
# EFFECTIVE IMPLEMENTATION AND MONITORING





# EFFECTIVE IMPLEMENTATION AND MONITORING

Effective implementation and monitoring of transfer pricing policies can only be achieved by an integrated approach.



# PEOPLE

## WHO SHOULD BE INVOLVED?

- Implementation and monitoring is a central responsibility, but requires the assistance of local resources
- People should be involved in the TP control framework if their actions or omissions may affect the critical assumptions of the TP policies
- People should also be involved if they can provide factual or financial information that may be relevant to:
  - Assess level of compliance with the TP policies and strategies
  - Prepare the local transfer pricing documentation
  - Identify any frictions with the policies and strategies (practical/behavioural)
  - Identify any changes in the business model that may warrant a change in policies.

# PEOPLE

## HOW TO STIMULATE BEHAVIOUR?

- Any person included in the framework must **understand** the importance of the transfer pricing policies:
  - Provide ongoing training and central access to training material
  - Perform knowledge assessment and quality reviews
  - Offer helpdesk function
- TP related roles must be clearly defined:
  - Responsibility and accountability
  - Hierarchy → central ownership.

# WHAT DOCUMENTATION SHOULD BE IMPLEMENTED?

- Transfer pricing policy document
  - Pricing mechanism for specific transaction types
  - Explanation of the logic and critical assumptions behind the policies
- Contractual agreements
  - Consistent with transfer pricing policy
- Contemporaneous documentation
  - Group Masterfile → central responsibility
  - Local files → central and local responsibility
- Transfer pricing procedures manual
  - Overview of roles and responsibilities
  - Actions to be taken (general reporting, annual documentation, ad hoc transactions, etc)
  - Actions not to be taken (unconsulted changes in business models, atypical transactions)
  - Internal and external deadlines.

# WHAT PROCEDURES SHOULD BE IN PLACE?

- Communication of transfer pricing policies in the organisation
- Collection of information from operational units/local entities:
  - To assess compliance with TP policies and the arm's length standard
  - To identify any changes that could create threats or opportunities from a TP point of view
- To be able to prepare the mandatory transfer pricing documentation in local jurisdictions (and the group masterfile)
- Training and assessment of the performance of the persons involved in the TP monitoring framework.

# TECHNOLOGY PLATFORMS

## HOW TO PROMOTE IMPLEMENTATION AND MONITORING?

### Use of knowledge sharing portals:

- One access point for all tax and transfer pricing related matters
- Version control: always the most recent version a document
- Tasking and delegation functionality: allow monitoring of actions by the persons involved
- Helpdesk functionality (FAQ, forum etc).

### Integration of transfer pricing policies in primary accounting / ERP systems:

- Facilitate application of correct price or margin
- Facilitate automated collection of financial information on related party transactions
- Link transactions to responsible person or business units.

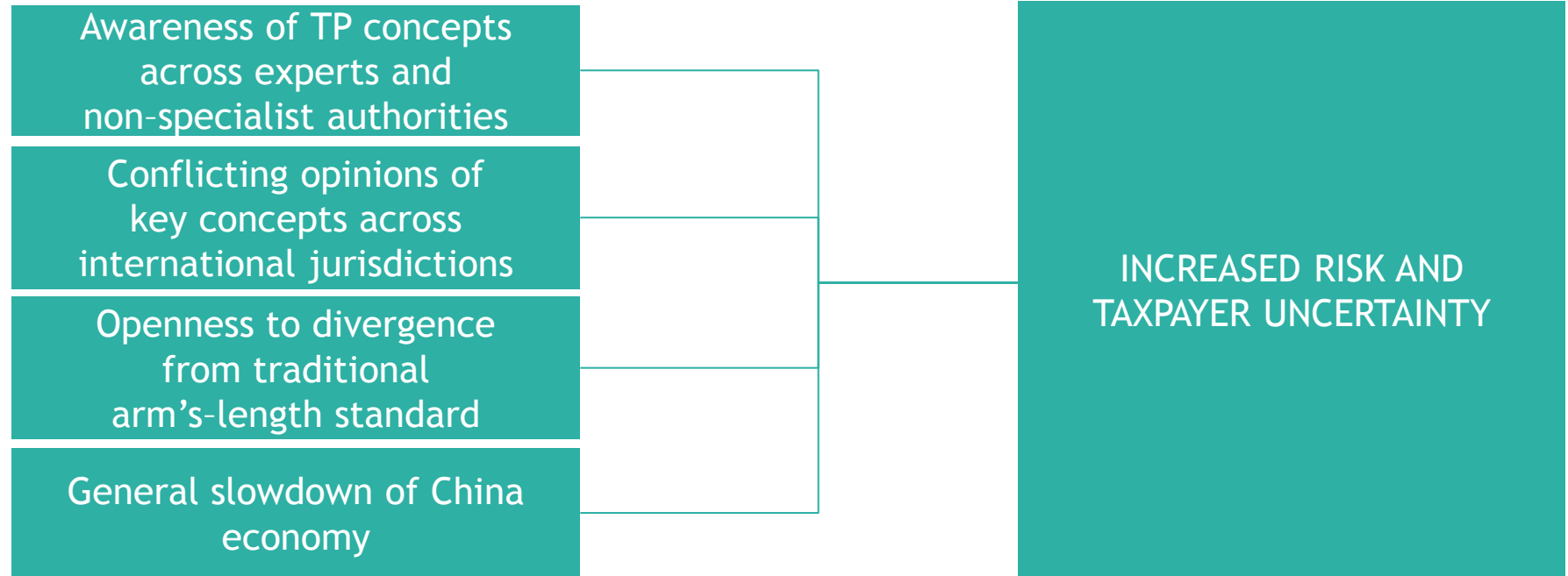


# MANAGING EXPECTATIONS GLOBALLY

Jay Tang, China

# CURRENT FORCES SHAPING TRANSFER PRICING LANDSCAPE

## China





# OVERVIEW ON CHINA ANTI-AVOIDANCE

**Service**  
APA and bilateral consultation

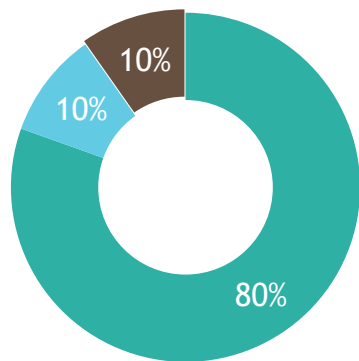
10%

**Investigation**  
TP audit, covering the transaction types of tangible assets, service transactions, intangibles and transfer of equity

10%

**Administration**  
Routine anti-avoidance administration, including review of TP documentation on a national scale, self-assessment, and follow-up administration after TP audit

80%



- Administration
- Investigation
- Service

## Increased Tax Revenue

(Billion RMB)	2010	2011	2012	2013
Administration	7.2	20.8	28.3	37.7
Investigation	2.3	2.4	4.6	4.6
Service	0.8	0.7	1.7	4.6
<b>Total</b>	<b>10.3</b>	<b>23.9</b>	<b>34.6</b>	<b>46.9</b>

# CHINA'S LOCAL COUNTRY PRACTICE

- Comparability concerns and the use of profit split methods
- Quantification and allocation of location specific advantages
  - Cost advantage
  - Market premium
  - Local marketing intangibles.
- Identification and valuation of intangibles
- Practical issues and solutions.

# SAT FOCUSED ON BEPS ISSUES

## SAT focused on BEPS

- Full consideration of market factors in TP
- Taxing rights must be consistent with economic activity
- Chinese entity's share of group profits.

## Areas of divergence

- Key people function (strategy vs execution)
- Creation of intangibles
- Manufacturing as a source of IP?
- Management services vs Key People Functions.

# 15 UNACCEPTABLE TAXPAYER BEHAVIOURS

1. Base erosion and profit shifting
2. Double or multiple tax exemption
3. Harmful tax planning
4. Non-transparent tax mechanisms
5. Structure without economic substance
6. Unreasonable charging of expenses
7. Loss-making single-function entity
8. Tax treaty abuse
9. Excessive intangibles pricing
10. Mismatch in value contribution and profitability
11. Low remuneration of 'High-Tech Enterprises'
12. Lack of consideration for China-specific market factors
13. Shifting of overseas losses into China
14. Company uncooperative in providing documentation
15. Hybrid mismatch arrangements for the purpose of tax avoidance.

**MOST OF THE 15 BEHAVIOURS ARE  
INTERRELATED WITH TRANSFER PRICING**

# PRACTICAL TIPS TO MANAGE TP RISK IN CHINA

- Review profit level of related party transactions periodically to make necessary price/profit adjustment if applicable
- Review the arm's length nature of transfer pricing policies on a continuous basis especially when there is a change in business operation or regulatory environment
- Assess on overall supply chain profitability with reference to other players' profitability in the same industry
- Caution needed in responding to any queries related to company's profitability or related party transactions or disclosing anything that may arouse tax bureau's interest
- Ultimate measure (applicable for certain cases) would be an application for an Advance Pricing Agreement to obtain certainty on transfer pricing position.

# RECOMMENDATIONS FOR TAXPAYERS

## ‘China-conscious’

Assess potential impact of China-specific factors

Understand regional and national audit approaches

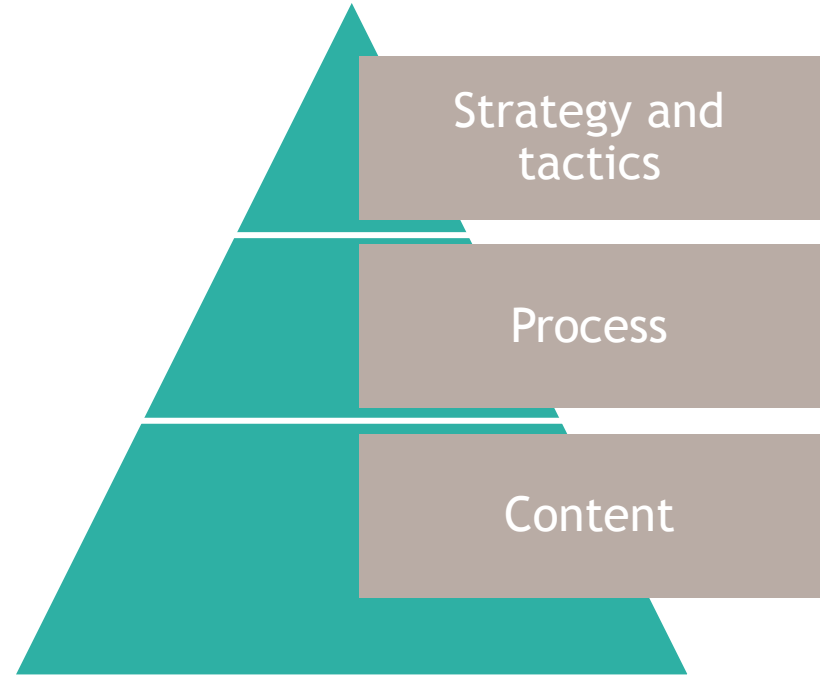
Approach adjustment horizontally; compare with peers/competitors

## ‘Audit-ready’

Evidence Chain (commercial substance)/Familiarity of the employees regarding the TP policies

Establish internal TP measures to raise awareness/prepare for potential audit

Contingency plan: process communication protocol, data restriction, etc





# CLOSING REMARKS

Anton Hume, United Kingdom

# CLOSING REMARKS

## WHAT HAVE WE LEARNT TODAY?

- We've entered a more complex and no less uncertain environment for transfer pricing with arguably more scope for controversy
- Transfer pricing (and planning) needs to be underpinned by appropriate economic substance and control functions, exercised by the right people
- TP analysis has moved on - an holistic view of the value chain is now the norm
- Proper implementation and good supportive documentation is key
- Managing and monitoring TP on an ongoing basis is more critical than it has ever been and this needs to be embedded within the business
- Different tax authorities will often have different views with regard to how the 'arm's length principle' should be applied - the emerging economies in particular.



# QUESTIONS



# THANK YOU

Anton Hume | [anton.hume@bdo.co.uk](mailto:anton.hume@bdo.co.uk) | +44 (0)20 7893 3920

Daniel McGeown | [dmcgeown@bdo.ca](mailto:dmcgeown@bdo.ca) | +1 416 369 3127

Veena Parrikar | [vparrikar@bdo.com](mailto:vparrikar@bdo.com) | +1 408 352 3534

Richard van der Poel | [richard.vanderpoel@bdo.es](mailto:richard.vanderpoel@bdo.es) | +34 91 436 4195

Jay Tang | [jay.t@bdo.com.cn](mailto:jay.t@bdo.com.cn) | +86 021 2328 1506