Arm’s length remuneration post BEPS

25 May 2016

BEPS

Grant Thornton

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Alan Carey

International Division

OECD Base Erosion & Profit Shifting (BEPS) Project

- Action Plan published in July 2013
- 7 interim reports published in Sept 2014
- Series of discussion drafts and public consultations
- Engagement with stakeholders
- Final reports published on 5 October 2015
- Some further technical work remains

Areas of Output

- Aggressive Tax Planning
- Transfer Pricing
- Abuse of Tax Treaties

Classifications of the Reports

Classifications

- *Minimum Standard*
- *Common Approach*
- *Best Practice*

Minimum Standards

- Action 5: modified nexus approach & exchange of information on rulings
- Action 6: Tax Treaty Abuse (further work in 2016)
- Action 13: Country by Country Reporting
- Action 14: Dispute Resolution

Ireland & Minimum Standards

- Domestic legislation:

  -Country by Country Reporting (Action 13)

  - Knowledge Development Box & the Modified Nexus Approach (Action 5)

- Exchange of rulings (Action 5)
- Multilateral instrument for Actions 6 and 14

Multilateral Instrument (Action 15)

- Negotiations commenced in November 2015
- Open for signature by the end of 2016
- Update global tax treaties simultaneously

- Will look to implement:
  - Action 6 – Treaty Abuse
  - Action 7 – Permanent Establishment rules
  - Action 14 – Dispute Resolution

Common Approach

- Action 2 – Hybrid Mismatches
- Action 4 – Interest deductibility
- Further technical work

Best practice

- Action 3 – CFC rules
- Action 12 – Mandatory Disclosure

Transfer Pricing Guidelines

- Actions 8, 9 & 10
- New chapters for OECD TP Guidelines
- Domestic implementation
- Direct effect for treaty based MAP and APA

Transfer Pricing

Further work 2016/2017:

- Hard to value intangibles
- Low value-adding service
- Transactional profit split method
- Related party financial transactions

Interaction with Action 7 on PE

Other Actions

Action 1 – Digital Economy

- Non-consensus options

Action 11 – Data on BEPS

- Data analysis

Future Direction of BEPS Project

- Commitment of OECD members and G20 Associates to extend cooperation on BEPS until 2020
- Involvement of FTA including Large Business Programme
- Focus on Inclusive Framework

Anti-Tax Avoidance Directive (ATAD)

- Proposed EU Directive

- Six areas in total

- Exit tax, GAAR, switchover rules – origins in CCCTB proposals

- Hybrids, interest deductibility and CFC – OECD BEPS

Thank You

Revenue

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Value creation post BEPS

25 May 2016

Wendy Nicholls
Partner – Transfer Pricing
Grant Thornton UK LLP

Agenda

- background and overview

- BEPS action 8-10: Aligning transfer pricing outcomes with value creation
  - risk and capital
  - six step framework
  - other value creation activities – OECD new guidelines

- what next?

BEPS overview

- BEPS (Base Erosion & Profit Shifting) is a result of a strong political will for more transparency, cohesion and aligning profit recognition with substance
- the OECD was commissioned by the G20 in 2012
- they made public 15 "final reports" corresponding to the 15 actions under BEPS in October 2015
- these OECD recommendations range from new guidelines and requirements, new minimum standards as well as common approaches and best practices
- despite the term "final reports," BEPS is still an on going process

BEPS overview – The actions

Coherence

02 Hybrid Mismatch Arrangements

03 CFC Rules

04 Interest deductions

05 Harmful Tax Practices

Substance

06 Preventing Tax Treaty Abuse

07 Avoidance of PE Status

08 TP Aspects of Intangibles

09 TP / Risk and Capital

10 TP / Other High Risk Transactions

Transparency

11 Methodologies and Data Analysis

12 Disclosure Rules

13 Transfer pricing documentation and country by country reporting

14 Dispute Resolution

01 Digital Economy
15 Multilateral Instrument

Action 8-10: Aligning transfer pricing outcomes with value creation

- **Action 9: risk and capital**
  - accurate delineation of the actual transaction is fundamental: contracts are reviewed against conduct
  - transfer pricing cannot be based on contractual arrangements that do not reflect economic reality
  - legal ownership (intangibles) alone does not entitle profits
  - provision of funding alone: no more than a risk-free financial return
  - differences between anticipated and actual profits are allocated depending on assumption of risk/functions that warrant a profit share
  - contractual allocations of risk are respected only when they are supported by actual decision-making
  - six step framework to establish risk management or assumption.

Action 8-10: Aligning transfer pricing outcomes with value creation

- **Six step framework – analysis of risk in a comparability analysis:**
  - what are the significant economic risks?
  - how is the risk contractually assumed?
  - functional analysis
  - contractual assumption of risk aligned with conduct and other facts
  - does the party have control over the risk and financial capacity to assume the risk?
  - price transaction based on appropriate allocation of risk

Action 8-10: Aligning transfer pricing outcomes with value creation

- **Action 8: Transfer pricing aspects of intangibles:**
  - emphasis that entities will earn economic returns based on the value they create through the assets used, risks borne and functions performed.
  - applies to each aspect of an intangibles' life cycle – development, enhancement, maintenance, protection and exploitation
  - conduct "trumps" contract
  - comparability adjustments are only required when the intangibles used are unique and valuable. Reliable comparables (internal or external CUPs) may exist

Action 8-10: Aligning transfer pricing outcomes with value creation

- **Hard to value intangibles**
  - hard to value intangibles covers intangibles for which (at the time of transfer between associated enterprises), no reliable comparables exist, and uncertainty around expected income derived from the intangible
  - information asymmetry means its difficult for tax administration to evaluate the reliability of information on pricing
  - taxpayers must provide best estimate of valuation and implement a price adjustment mechanism post transfer, unless evidence of unforeseeable circumstances can be provided.

Action 8-10: Aligning transfer pricing outcomes with value creation

- **Cost contribution arrangements (CCAs)**
  - CCAs are a method of sharing the costs and risks of developing, producing or obtaining services, tangible or intangible assets.
  - business can only participate to a CCA if there is reasonable expectation of benefit from CCA activity
  - contributions to CCA should not be measured as a cost if it is unlikely that the cost will provide good representation of each participants' contribution.

- **Low value adding (LVA) intra-group services**
  - elective, simplified approach for specific LVA intra-group services
  - mark-up of 5% to be applied to LVA intra-group services, and does not need to be justified by a benchmarking study
  - examples of LVA include accounting and auditing activities, HR, accounts control, legal, tax and general admin

Action 8-10: Aligning transfer pricing outcomes with value creation

- **cross border commodity transactions**
  - CUP method can be used for commodity transactions between associated enterprises, with quoted or publicly available prices used as a reference to determine the arm's length price
  - recommendations that taxpayers document their price-setting policy for commodity transactions to aid tax authorities in conducting informed examinations
  - new provisions introduced in relation to determining the pricing date for commodity transactions, designed to prevent taxpayers from varying pricing dates in contracts to give a tax advantage

- **profit splits in the in the context of global value chains**
  - scope of work for 2016

What's next

BEPS actions 8-10:

- review functions and risks. Are these fully and fairly reflected in the transfer pricing policies with regards value creation?
- restructure operations/management/control structures to demonstrate risk is assumed in the desired territory

BEPS action 13:

- prepare:
    - CbCR (if size criteria are met)
    - Masterfile (MF) and
    - Local File (LF) documentation

Survey Results: BEPS Action 13 Timing Issues on Implementation of Master File/Local File/CbCR by Tax Authorities (5 May 2016)

Country	EU*	OECD	1. Does your country have legislation requiring Master File/Local File (MF/LF) documentation for calendar 2016 year ends? If so, will the full OECD master file contents (as per Annex 1 to the BEPS action 13 report) for the whole group be required?	2. If the parent is in a country that brings in MF/LF later than your country, is it an acceptable excuse that the subsidiary has not got all the MF information in its power or possession, and therefore cannot complete the MF?	3. Does your country have CbCR for calendar 2016 year ends? If the parent is in a country that requires CbCR later than your country, will your country require a)"full" CbCR for the whole group or b) only information from your local entity and any entities below it?
France	✓	✓	Yes, France has had MF/LF requirement since 2010, including ruling disclosure requirements for LF. However the disclosure is currently limited to "rulings and APAs that might affect profits of the French subsidiary".	No, as MF/LF has been applied in domestic laws.	At this stage, full CbCR for the whole group is expected. However the explanatory guidance for the new laws has not yet been released and we note that generally in a transitional period some flexibility and lower requirements may be acceptable in the first year.
Germany	✓	✓	No	Possibly not. The German tax authority would want to see the full picture, but the legal basis for providing information outside the jurisdiction of the German company is shaky, particularly where it is not directly relevant for testing the transfer prices for transactions with the German company[7]	No, however CbCR is currently the subject of discussion with the German tax authority.
Ireland	✓	✓	No requirement for 2016. Irish TP rules specifically reference the OECD guidelines, therefore Irish TP rules will be updated when the OECD issues new TP guidelines, and the Irish tax authority will expect to see the full MF/LF .	Possibly, although exchange of information provisions would likely be used to find the information another way.	Yes. Irish regulations provide that where the ultimate parent entity is not required to submit a CbCR, the Irish entity must file an equivalent CbCR with respect to the period. Guidance on what such equivalent report will include is yet to be released, but in all likelihood it will include information on the Irish entity and below.
United Kingdom	✓	✓	There are proposed changes in the Finance Bill 2016 which will apply for accounting periods beginning on or after 1 April 2016. The UK tax authority will expect to see the full MF, including unilateral APAs in other countries.	Possibly, although exchange of information provisions would likely be used to find the information another way.	Yes, although the UK will require information from the local entity and below only (but this is likely to create extra work and expense for the transitional period when the UK company will have to find CbC information for part of the group). Whether a light touch can be applied for this first year is yet to be confirmed by HMRC.

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25 May 2016

Peter Vale
Tax Partner
Grant Thornton Ireland

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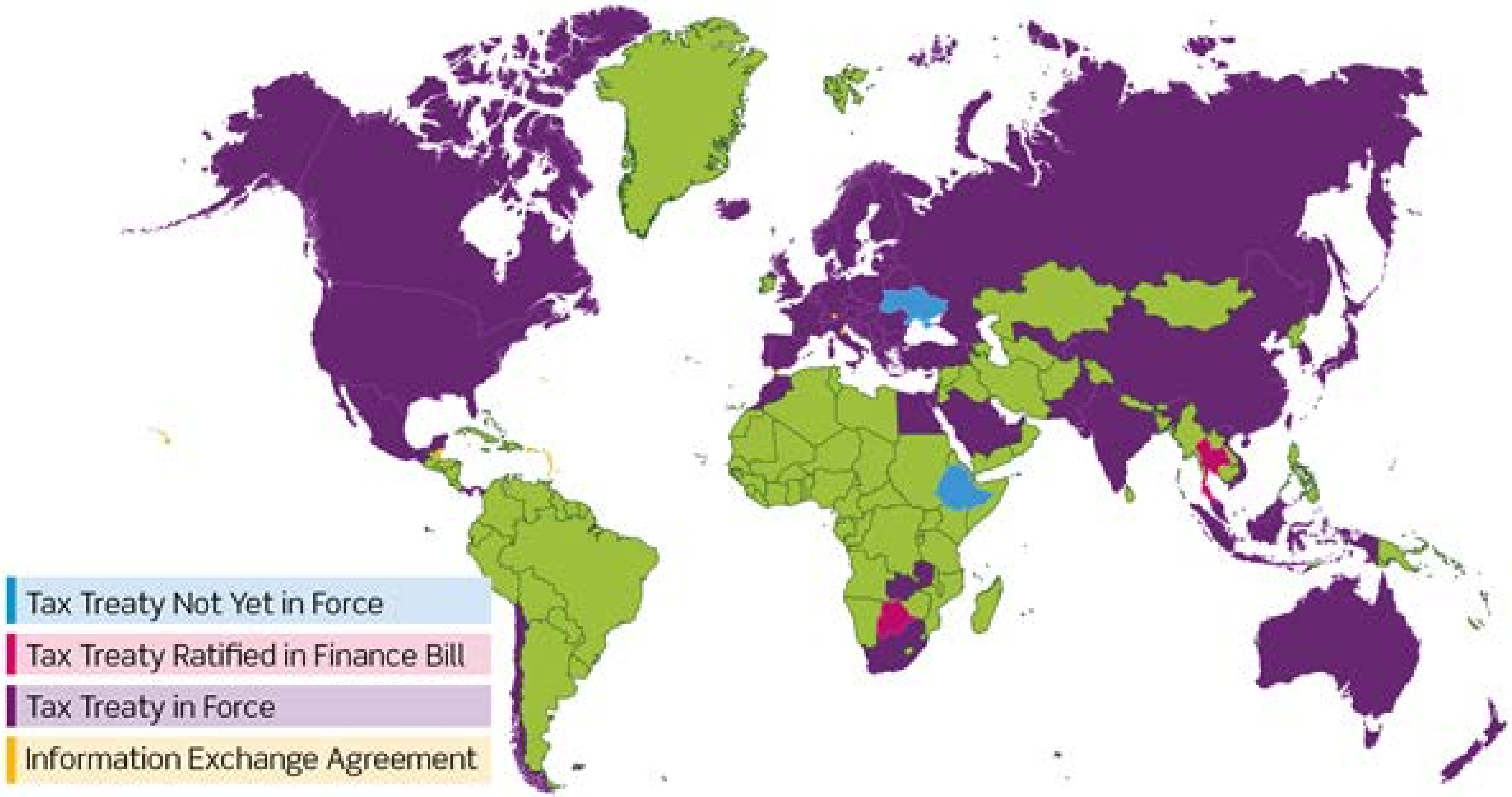
Ireland's ongoing approach to changing global tax environment

- evolving Irish tax system and suite of Irish IP incentives
  - standard 12.5% CT rate - 2003
  - R&D tax credit – 2004
  - intangible asset relief – 2009
  - manufacturing relief expired - 2010
  - knowledge development box – 2015
  - expanding DTA network
    - from 45 to c70 in ten years

Ireland’s tax treaty network



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Reaction to BEPS actions 8-10

- taxpayer reactions
  - shifting of IP away from haven jurisdictions
  - bringing IP onshore
  - enhancing substance in Irish operations - DEMPE
    - Development
    - Enhancement
    - Maintenance

    Protection

    Exploitation

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Ireland’s reaction to BEPS initiatives generally

- department of Finance reaction
  - eliminating IRNRs – 2020
  - intro of CbCR wef. 2016
  - evolving Irish IP regime
- future
  - adoption of New TP guidelines – timing uncertain – possibly 2017, wef 2018
    - how to implement?

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Action 13: transfer pricing documentation and CbCR

Master File

High level information about the MNC's business, transfer pricing policies and agreements with tax authorities in a single document available to all tax authorities where the MNC has operations.

Local File

Detailed information about the local business including related party payments and receipts for products, services, royalties, interest etc.

Country by Country Report

High level information about the jurisdictional allocation of profits, revenues, employees and assets.

Action 13: CbCR

Why

Provide tax authorities with information on an MNC's operations in the country but also about the MNC's entire global footprint. Allows a high level risk assessment

Next steps

Guidelines on implementation and filing

CbCR

When

Content final. Finalisation of implementation approach. Adoption by countries will vary

What it is not

CbC report is not intended as a substitute for a full transfer pricing analysis. And it is not intended to be used to make formulary apportionment based adjustments.

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Timing: When do the CBRC requirement start?

- first CbC Reports are to be filed for MNE fiscal years beginning on or after 1 January 2016

- MNEs have one year from the fiscal year-end to file the CbC report

- for MNEs with a fiscal year ending on a date other than 31 December, the first CbC report would be filed in 2018 (12 months after the close of the relevant MNE fiscal year) and would report on the MNE's group's first fiscal year beginning after 1 January 2016

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Current state CbCR readiness
High level data and technology readiness assessment

Data readiness assessment

- review current IT landscape and identify potential data sources
- identify what data is present in the organization’s data warehouse
- benchmark the environment’s complexity to determine the most
- appropriate solution for gathering, transforming and reporting on the CbC reporting data

Tools and technology assessment

- understand existing technology environment for extracting and gathering source data, analyzing and transforming data and consolidating and reporting for similar purposes
- compare new requirements to current technology
- analyze and recommend alternatives or incremental approaches for technology and reporting tools and processes

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In a nutshell
Master File/Local File

- intent is to provide transparency to tax authorities
- master file information can be submitted as a whole or by business line:
  - consistency with CbC Report if submitted as a whole
  - multiple master files to be maintained if done by business line
- consistency between master file, local file and CbC report is key

Other developments

- new Interest deductibility rules (BEPS 4)
- multilateral Instrument
  - limitation on benefits – treaty abuse (BEPS 6)
  - permanent Establishment rules (BEPS 7) – fragmentation, commissionaires, contract splitting
- EU anti-BEPS Directive
- EU CbCR Transparency Directive
- EU Illegal State Aid Cases – Apple Inc.
- new APA Programme
- director's compliance statements
- CCCTB

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Summary

- uncertainty as to how Ireland will implement actions 8-10
- inconsistency already in pace of implementation globally
- environment of increased exchange of information
- significant increase in documentation requirements (TP / CbCR)
  - pressure on resources of tax departments

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Questions & feedback