

IBFD

Substantive Tax Planning – Supply Chain Restructuring

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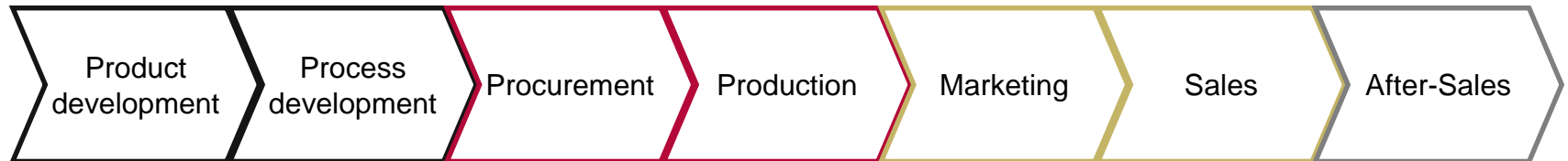
Agenda

- ▶ **Fundamentals of Supply Chain Restructuring**
- ▶ **Drivers of Tax Efficient Supply Chains**
- ▶ **Most Common Types of Business Models/Restructurings**
- ▶ **Transfer Pricing Aspects of Business Restructurings**
 - ▶ OECD TPG on Business Restructuring and the BEPS Project

Fundamentals of Supply Chain Restructurings

► Key concepts

- Business and business restructuring
- Supply chain vs. value chain
- Key value and profit drivers



Drivers of Tax Efficient Supply Chains

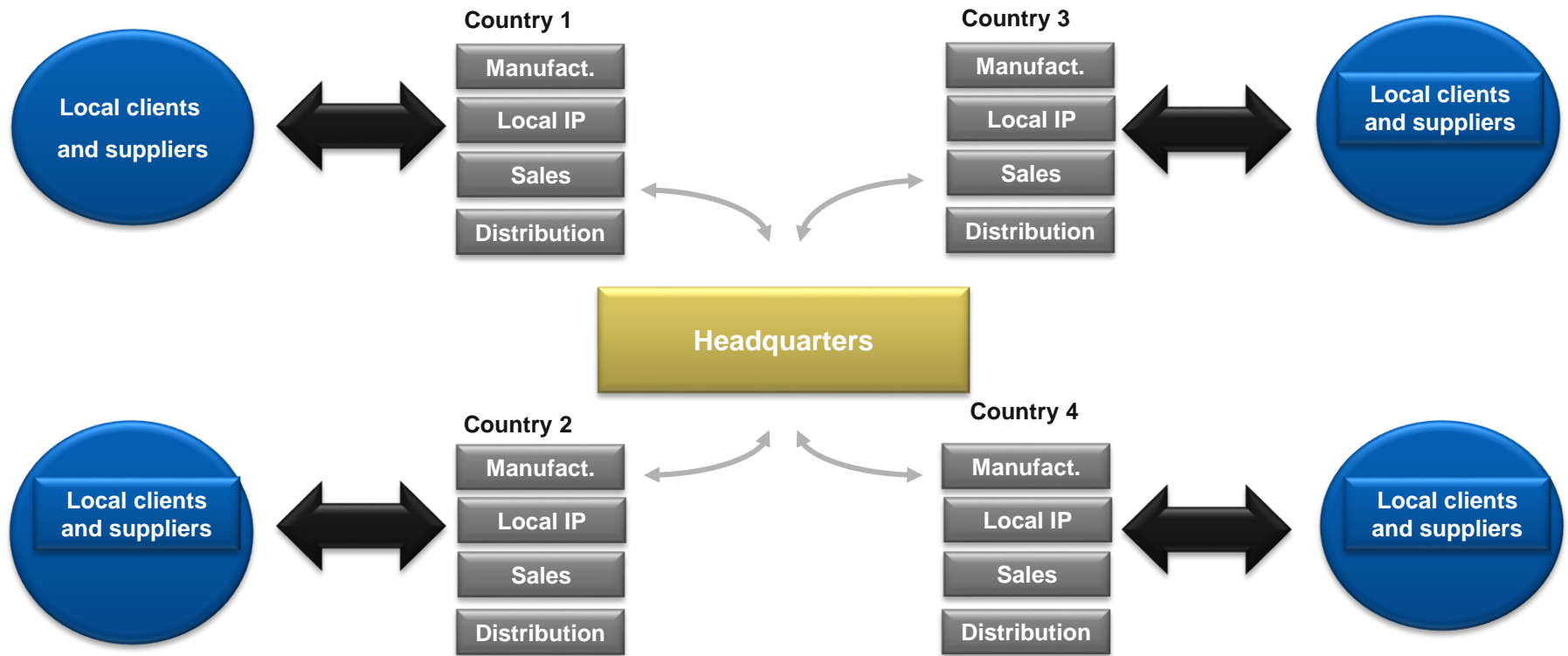
► Business Drivers

- ▶ Changes in organizational set-up
- ▶ Outsourcing
- ▶ Centralization
- ▶ M&A
- ▶ Rationalization
- ▶ IT changes (e.g. ERP)
- ▶ New markets
- ▶ New products

► Tax Drivers

- ▶ Lower tax rate in the business
- ▶ Tax model conforms operational model
- ▶ Overall ETR impact
- ▶ Cash flow improvement

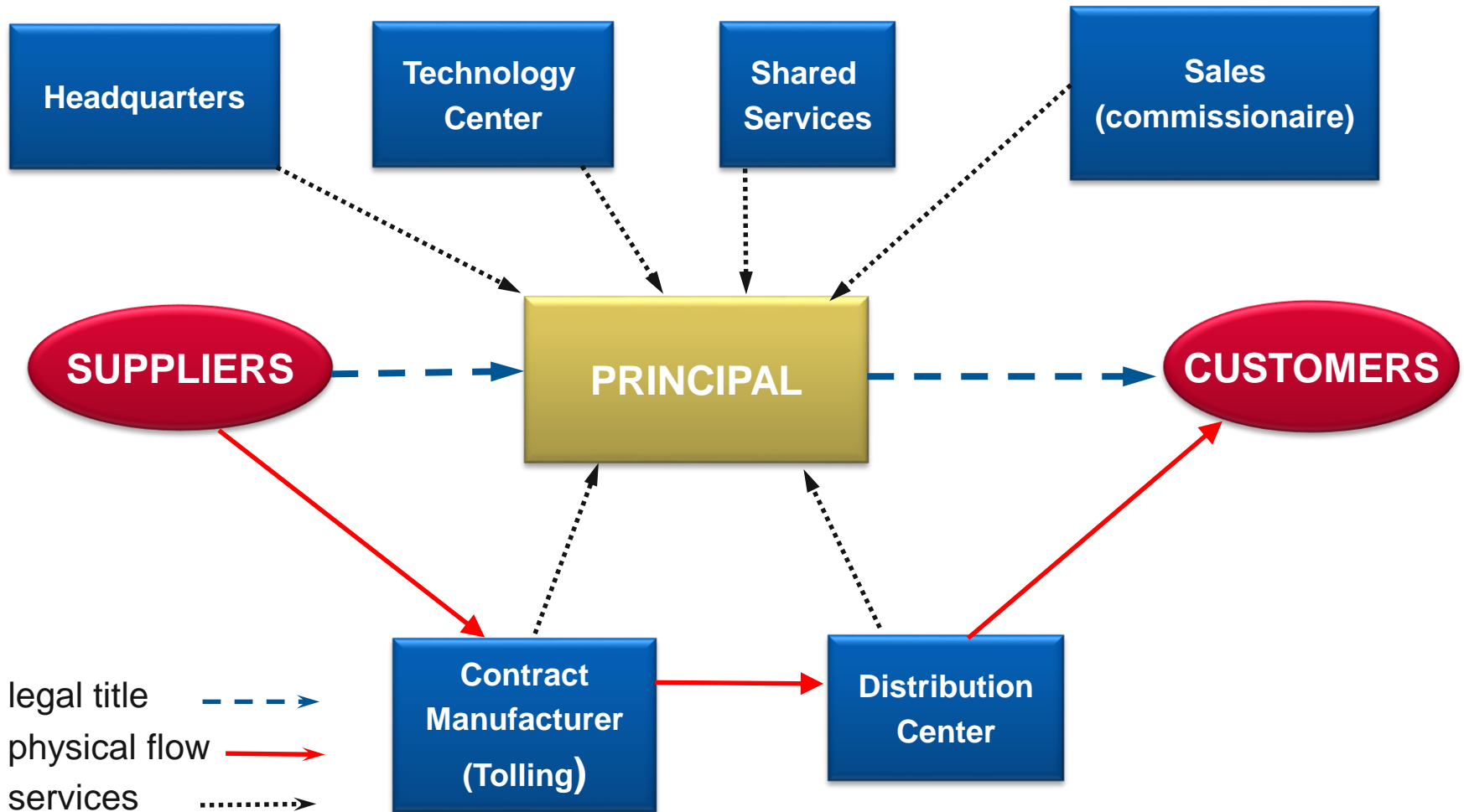
Traditional Business Model



Most Common Types of Business Restructurings

- ▶ **Conversion of full-fledged entities into limited-risk entities**
 - ▶ Manufacturing
 - ▶ Fully fledged, License, Contract, Toll
 - ▶ Distribution
 - ▶ Fully fledged, Limited risk, Agent, Commissionaire
- ▶ **Transfer of intangibles or rights in intangibles to a central entity (e.g. IP comp.) within the group**
- ▶ **Centralization of functions in a regional or central entity, with a corresponding reduction in scope or functions carried out locally – e.g. Procurement, sales support, supply chain logistics**

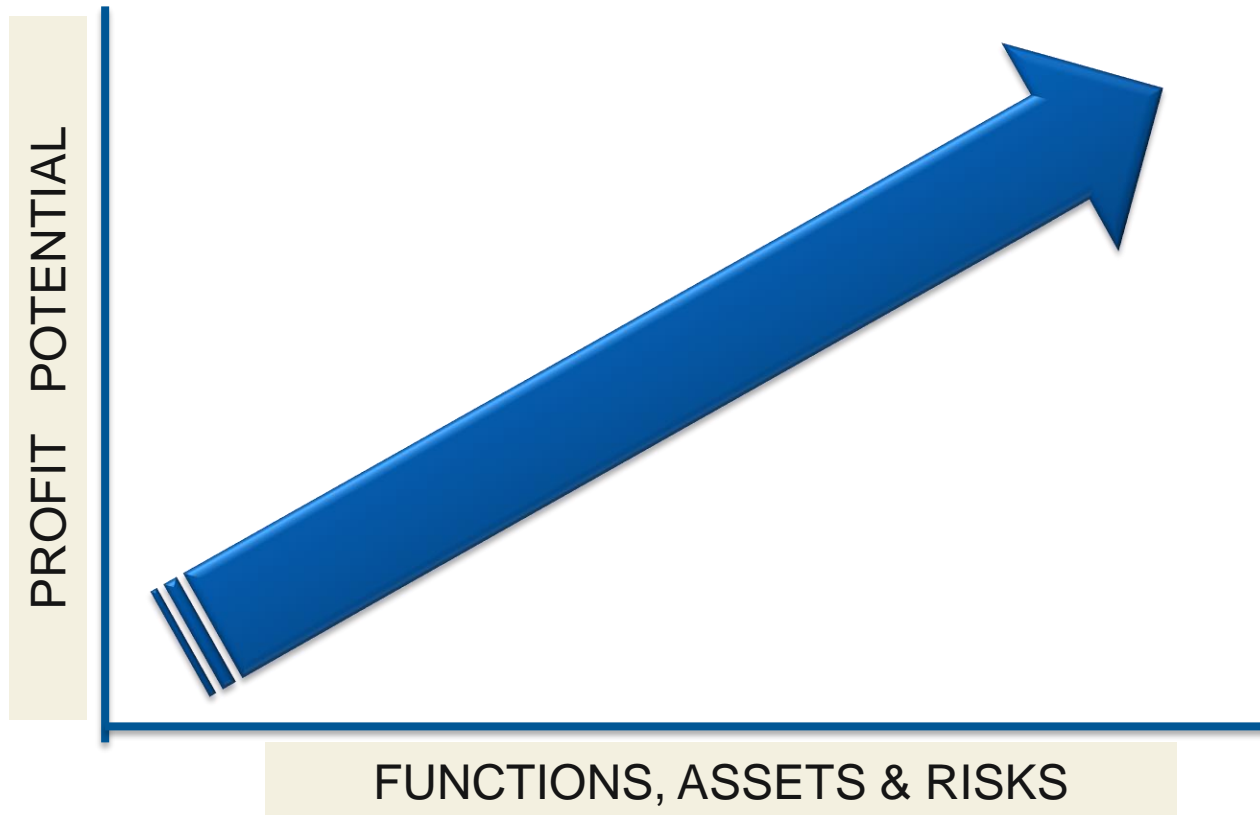
Tax Efficient Global Value Chain Structure



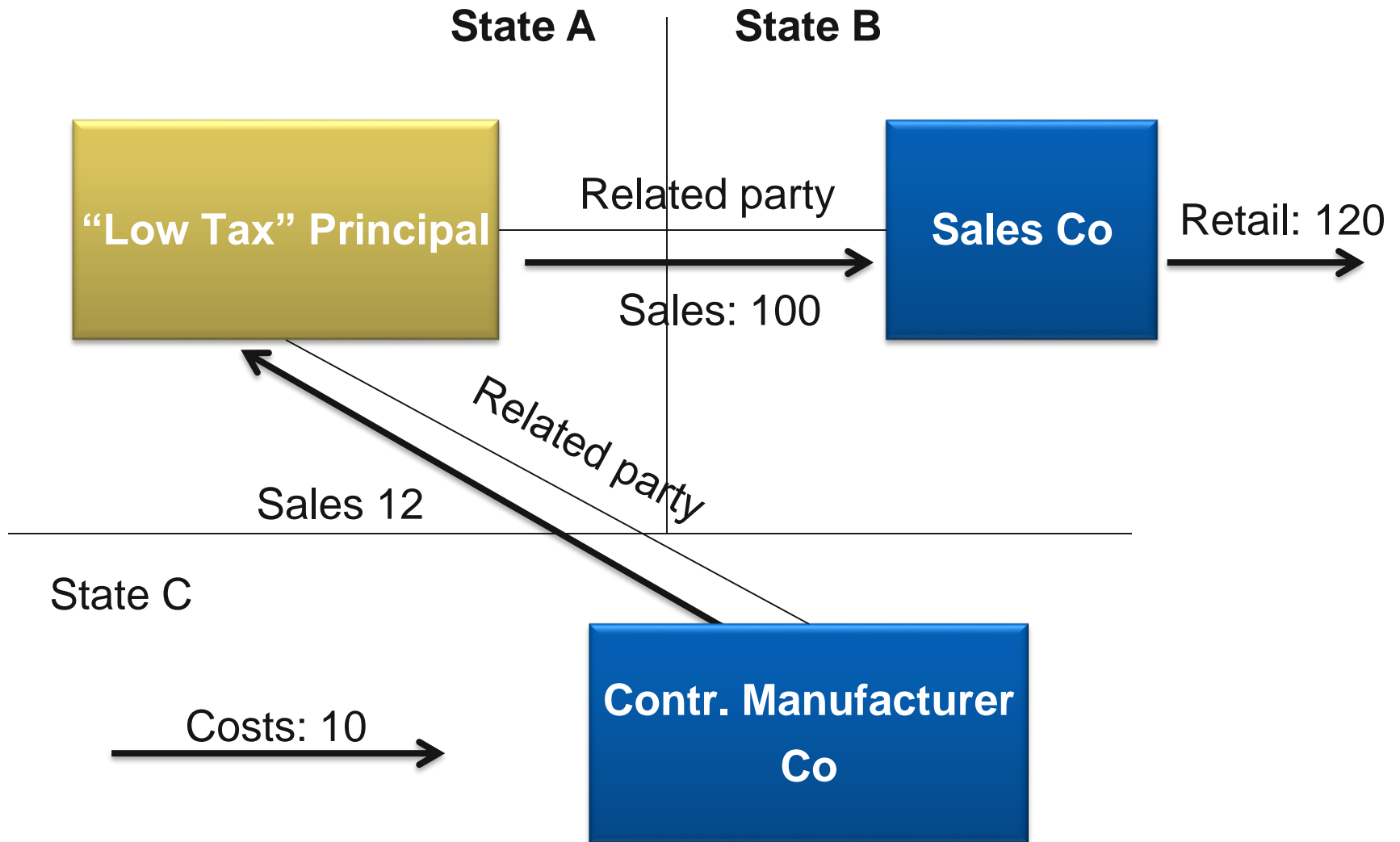
Elements of the Principal Structure

- ▶ Principal – primary risk taker of the business
- ▶ Manufact. – plants/specialized entities that convert raw materials into finished goods for the benefit and account (risk) of another. May be tollers or contract manufacturers
- ▶ Sales entities – specialized selling entities that are responsible for the face to the customer. May be buy sell entities, commissionaires or agents
- ▶ Support entities – specialized entities that provide services to the group. Can include sales support, IT support, treasury, R&D, shared service centers

The Importance of Transfer Pricing



Principal Structure – Example

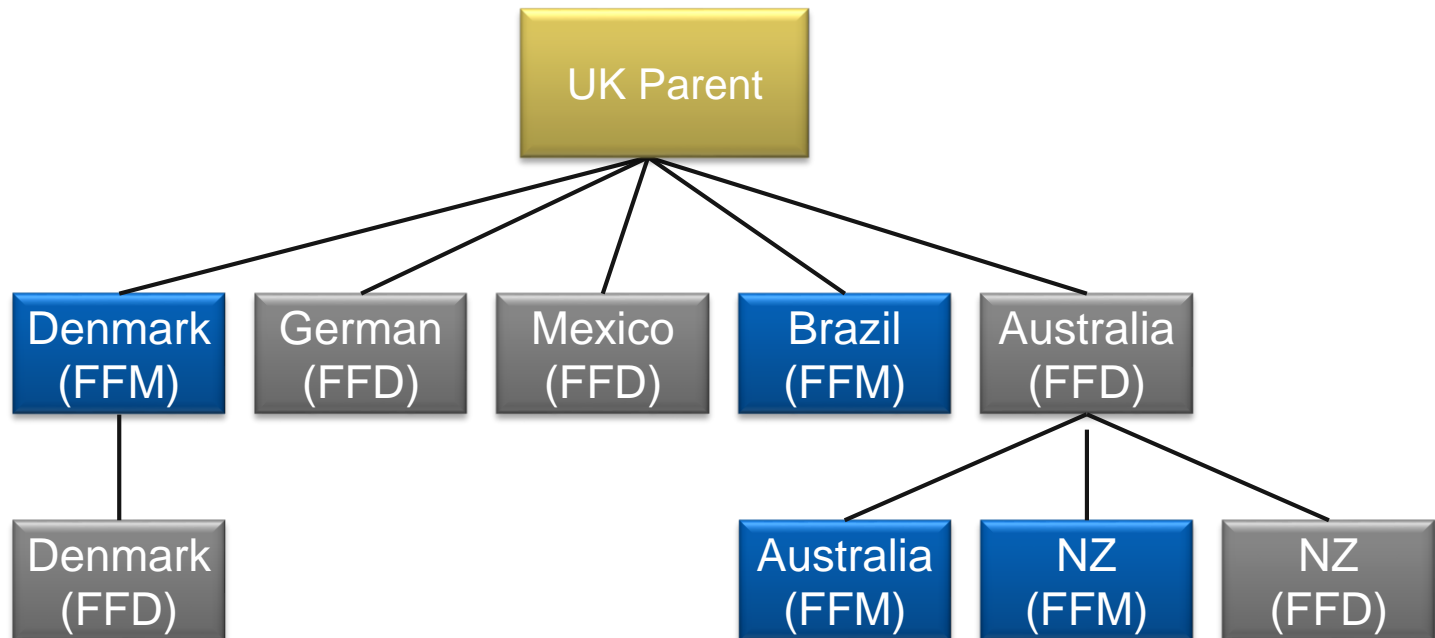


Relative Profits

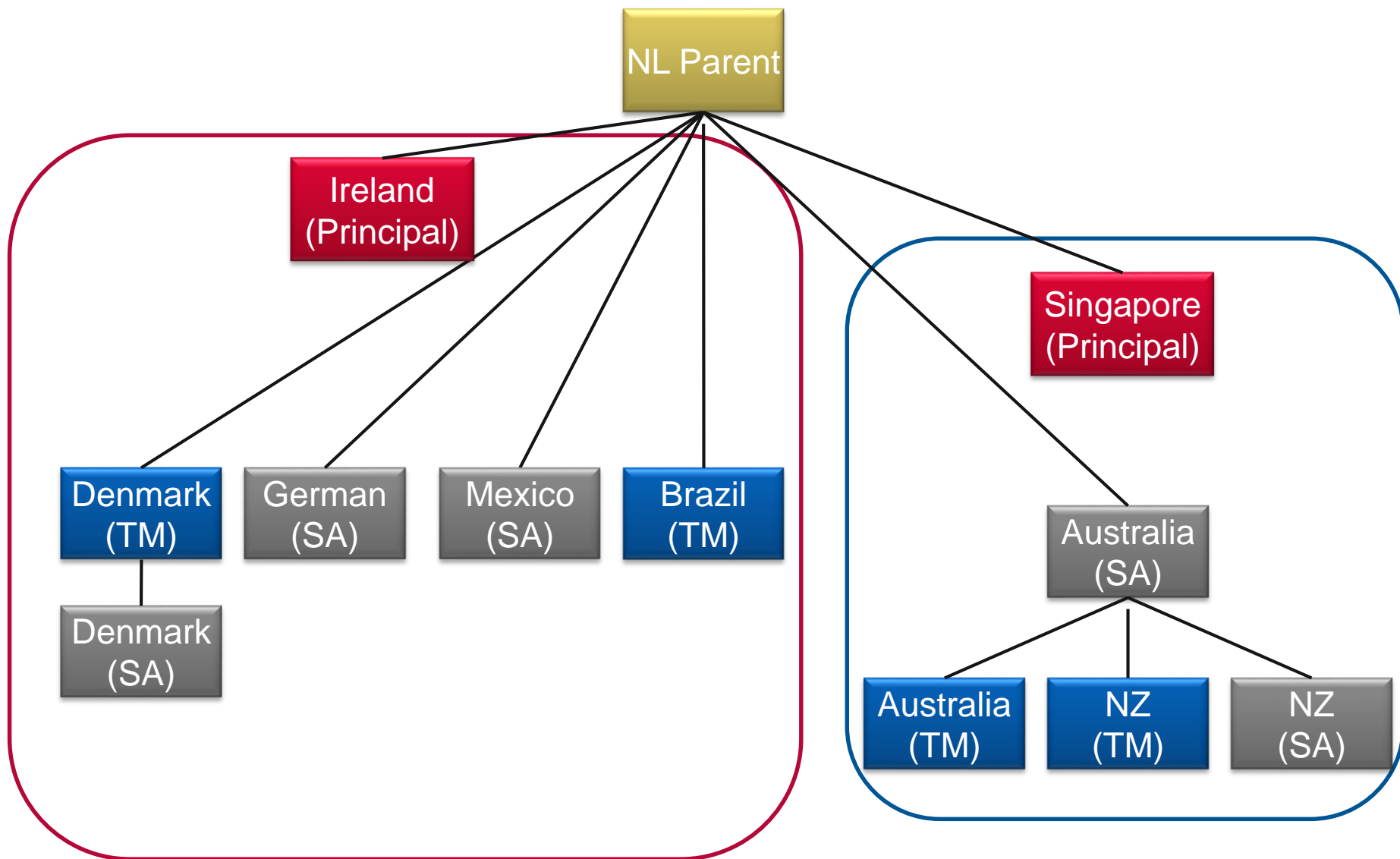
	Manufacturer	Principal	Sales Co	Total
Sales	12	100	120	232
Costs	10	12	100	122
Profit	2	88	20	110
PM	20% (C+)	RP	16.7%(RSM)	
Share of Global Profit	1.8%	80%	18.2%	100%

Case Study – Facts About Chemical Group

- ▶ Chemical Group is a multinational based in the United Kingdom. The business of the group is the development, manufacture and distribution of chemical products. The products are manufactured and sold worldwide through local subsidiaries, many of which were inherited through previous acquisitions.



Case Study – Is this a Problem?



Transfer Pricing Aspects of Business Restructurings

- ▶ **Chapter IX of the OECD TPG**
 - ▶ Dates back to 2010

- ▶ **Changes prompted by the OECD BEPS Project's final reports (2015)**
 - ▶ BEPS Report on Actions 8-10, "Aligning Transfer Pricing Outcomes with Value Creation"
 - ▶ BEPS Report on Action 13, "Transfer Pricing Documentation and Country-by-Country Reporting"

- ▶ **OECD issued conforming amendments to Chapter IX (2016)**

Pre-BEPS Guidelines

Chapter 9

- ▶ Special Considerations for Risks
- ▶ Arm's Length Remuneration for the Restructuring Itself
- ▶ Post Restructuring Remuneration of controlled transactions
- ▶ Recognition of the actual transaction undertaken

Post-BEPS Guidelines

Chapter 1

- ▶ Analysis of risks in commercial or financial relations
- ▶ Recognition of the accurately delineated transaction

Chapter 9

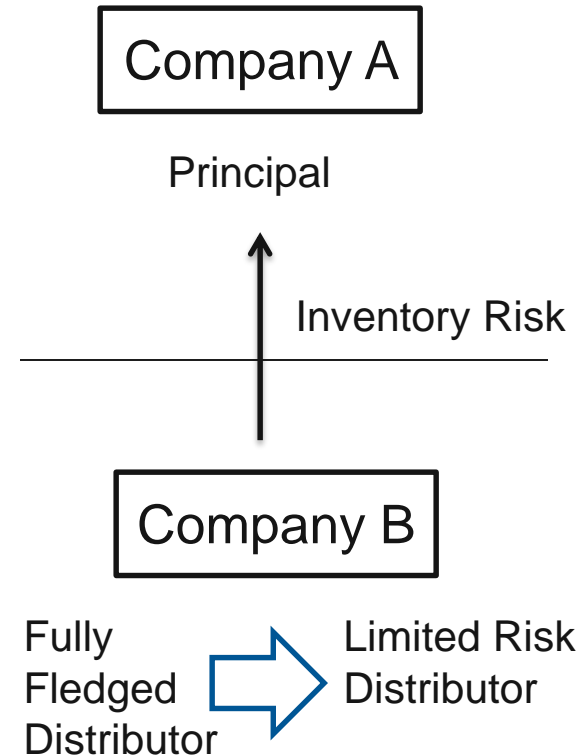
- ▶ Arm's Length Remuneration for the Restructuring Itself
- ▶ Post Restructuring Remuneration of controlled transactions

Part I. Arm's Length Remuneration for the Restructuring Itself

- ▶ **Understanding the restructuring itself**
 - ▶ Accurate delineation of the transactions comprising the business restructuring: functions, assets and risks before and after the restructuring
 - ▶ The analysis of risk in the context of business restructuring
 - ▶ New six-step approach in Chapter I. of the OECD TPG

Detailed Analysis of Risk - New Six-Step Approach

1. Identify **economically significant risks** with specificity
2. Determine how specific, economically significant risks are **contractually assumed** by the associated enterprise
3. **Functional analysis** to understand which enterprise
 - ▶ performs control and mitigation functions
 - ▶ encounter consequences of risk outcomes
 - ▶ has financial capacity to assume risk
4. Is the **contractual assumption** of risk is **consistent with the conduct of the associated enterprises** and other facts of the case?
5. Where the party assuming risk does not control the risk or does not have the financial capacity to assume the risk, **apply the guidance on allocating risk**
6. **The accurately delineated transaction should be priced**



Part I. Arm's Length Remuneration for the Restructuring Itself (cont'd)

- ▶ **Understanding the restructuring itself**
 - ▶ Understanding the business reasons for and the expected benefits from the restructuring
 - ▶ Options realistically available to the parties
 - ▶ TP documentation for business restructurings
 - ▶ Recognition of the Accurately Delineated Transaction

Recognition of the Accurately Delineated Transaction

- ▶ The transaction as accurately delineated may be disregarded, and if appropriate, replaced by an alternative transaction, where **the arrangements** made in relation to the transaction, viewed in their totality, **differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner in comparable circumstances**, thereby preventing determination of a price that would be acceptable to both of the parties taking into account their respective perspectives and the options realistically available to each of them at the time of entering into the transaction.



- ▶ Example: Company S1 conducts research activities to develop intangibles that it uses to create new products that it can produce and sell. It agrees to transfer to an associated company, Company S2, **unlimited rights to all future intangibles** which may arise **from its future work** over a period of **twenty years for a lump sum payment**.

Reallocation of Profit Potential

	Scenario 1	Scenario 2	Scenario 3
Full-fledged distributor Historical profitability data (last 5 years)	Year 1: - 2% Year 2: 4% Year 3: 2% Year 4: 0% Year 5: 6%	Year 1: 5% Year 2: 10% Year 3: 5% Year 4: 5% Year 5: 10%	Year 1: 5% Year 2: 7% Year 3: 0% Year 4: 8% Year 5: 6%
Full-fledged distributor Projected profitability (over remaining term of agreement)	(-2)% to 6% With significant uncertainties within this range	5% to 10% With significant uncertainties within that range	0% to 4% With significant uncertainties within that range (due to new competitive pressures)
Limited risk distributor Projected profitability (next three years)	2% per year	2% per year	2% per year

Transfer of Something of Value

- ▶ Transfer of something of value:
 - ▶ Tangible assets
 - ▶ Intangibles
 - ▶ Contractual rights (form of intangible)
 - ▶ A going concern

Chapter IX OECD TPG – Part II

- ▶ Application of TP Guidelines to restructured entities
 - ▶ Restructured entities are not different from entities that have been structured in the same way from the beginning (but there can be factual differences)
 - ▶ Pre and post restructuring comparisons may be helpful
 - ▶ Selection of one-sided or two-sided TP method

Summary

- ▶ **Why “substance” is important for business restructuring?**
- ▶ **What does “transparency” mean in respect to a business restructuring?**

Thank You!!!