

# Transfer Pricing in Post-BEPS Asia



International Fiscal Association

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# Propositions

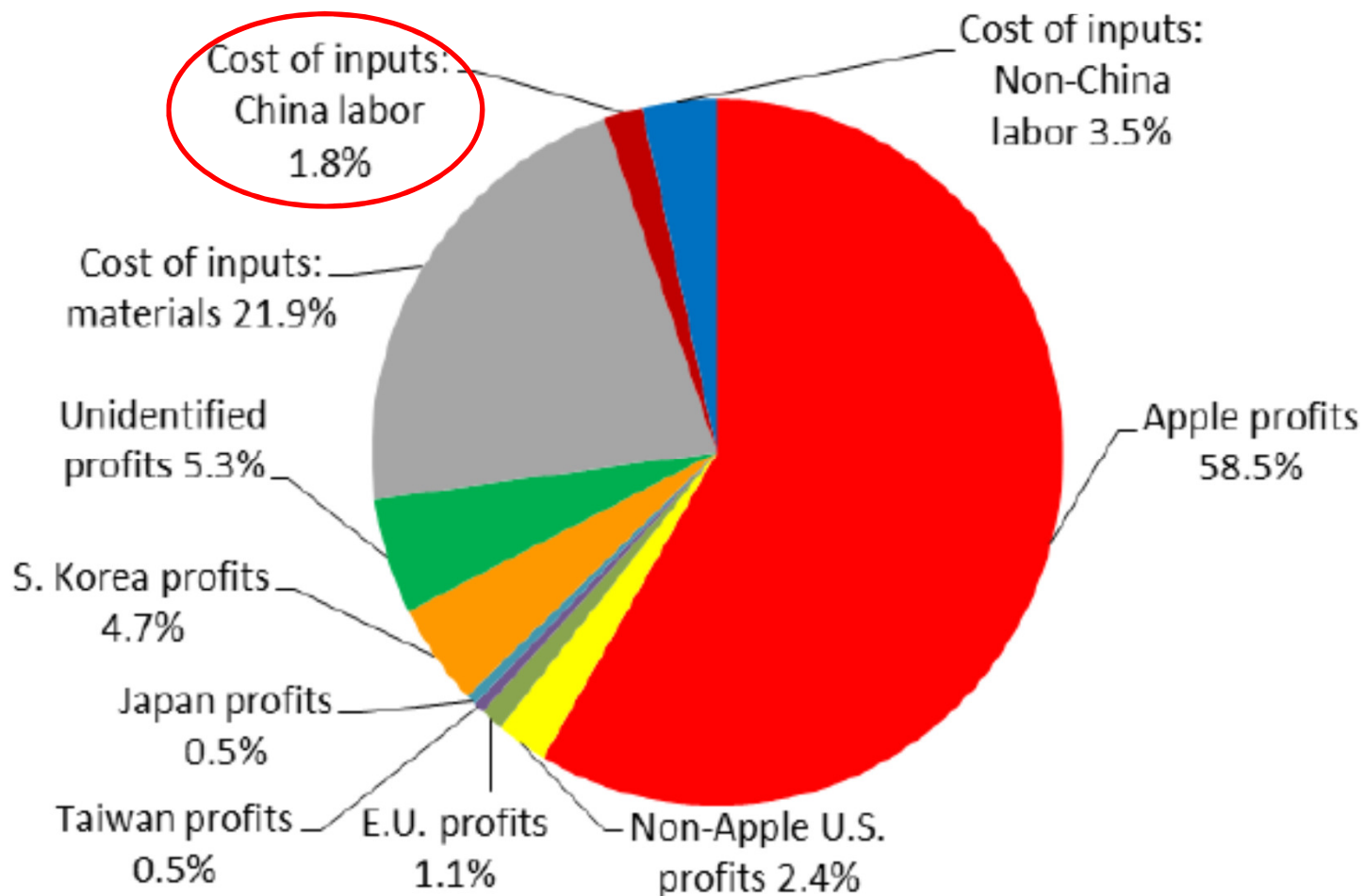
1. The PE fight is a side show, real battle is over allocation.
  - Deem PE or actual PE, is done right if the TP/AOA is right, outcome should not be greatly different.
  
2. Allocation principles – DEMPE, problems in implementation.
  - Question: Is this move advantageous to Malaysia? Labour to Capital to IP?
  
3. Arm's length principle under strain?
  - Tendency towards Profit split
  - Problems:
    - Value chain is getting divided to 3<sup>rd</sup> parties and beyond
    - How to weigh
    - Thin margin being split amongst multiple countries who all demand a profit – double taxation?

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Thank you.

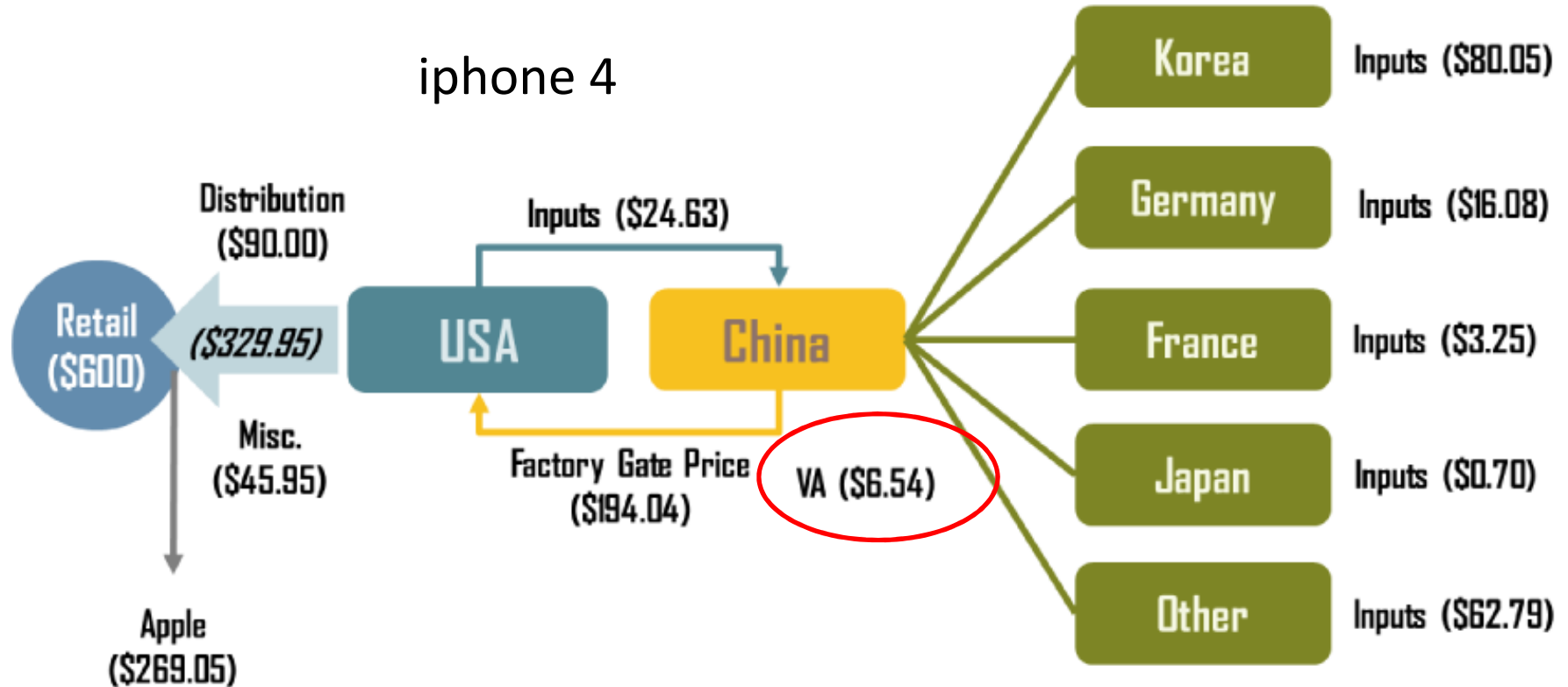
# BEPS Speaks to Value Creation, but Where?



School of Information Studies, Syracuse University  
Personal Computing Industry Center, UC Irvine and Syracuse University



## Where is Value Created? Economic Analysis



How to Apply Cir 2 *Value Contribution Method*? Profits allocated across value chain proportionate to value contribution to group profits with reference to revenue, assets, costs, sales and number of employees.

# History of Anchoring Mobile Factors to People's Functions

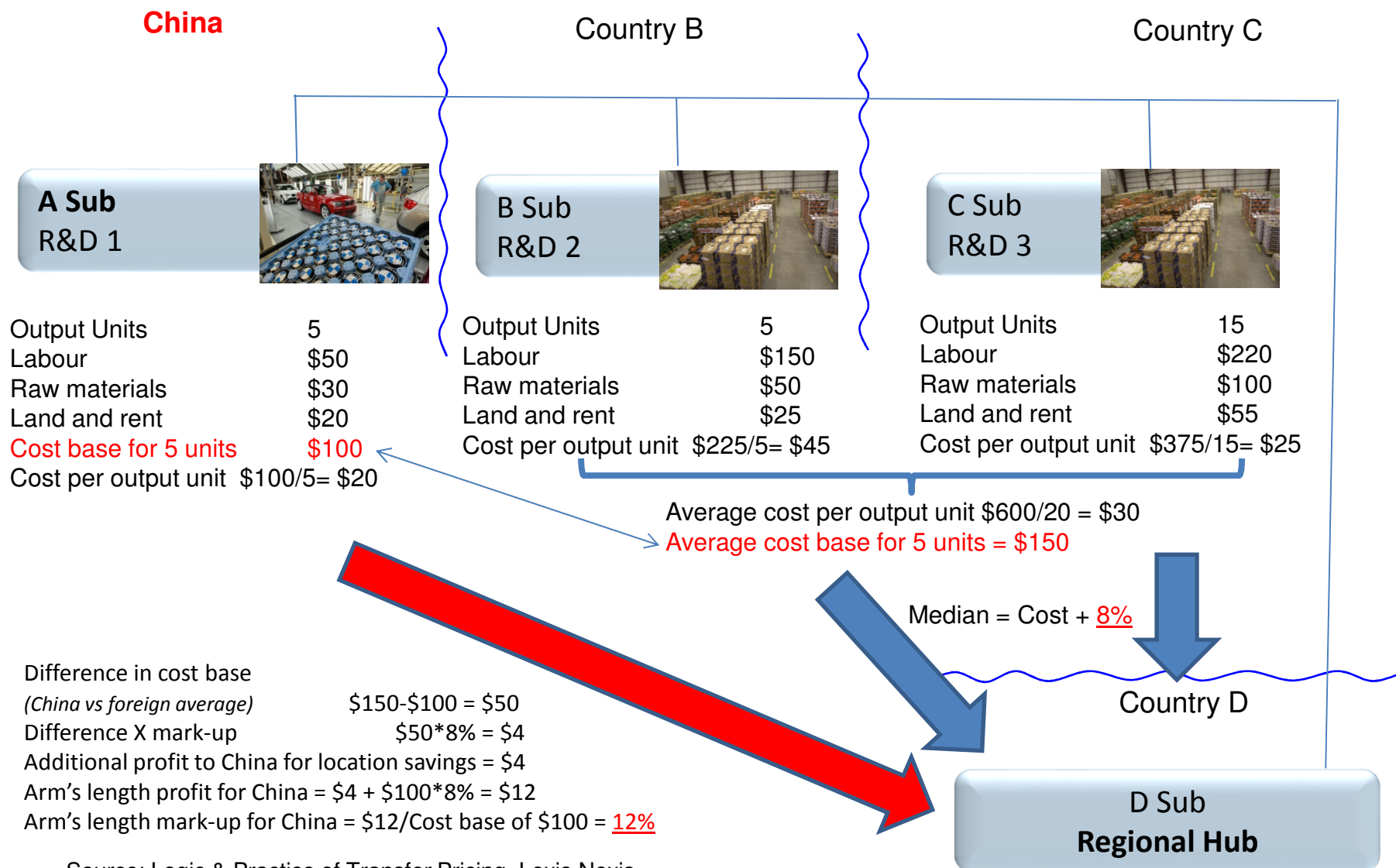
- **Authorized OECD Approach (AOA) & Chapter IX (OECD TP) 2010**
- Move returns away from legal or accounting booking entity to economic risk taking functions/entity
- **Significant People's Function (SPF) or Key Entrepreneurial Risk-Taking Functions**
  - (a) Pre-deal assumption and post-deal management/control of risk
  - (b) Ability to manage and capacity to bear risk
- **Economic ownership & returns is attributed to SPFs**
- **BEPS Recommendations 2015**
- **“DEMPE” functions:**  
Development, Enhancement, Maintenance, Protection and Exploitation of IP
- **Manage or control (including if outsourced)**
- **Ability to bear risk**
- Bare legal owner of IP retains only what is left after compensating others performing key functions
- Capital provider *per se* gets risk-free return

# China's Response Draft Cir 2 vs BEPS-OECD Compared

## (2016 onwards)

	Key Elements Beyond BEPS-OECD
Intangibles	<ol style="list-style-type: none"> <li>1. <b>Location savings</b> and <b>market premium</b> need to be considered in choice of TP method and in attributing gains from intangibles</li> <li>2. <b>DEMPE Promotion</b> with               <ol style="list-style-type: none"> <li>i. <i>emphasis</i> on adaptation to local conditions, product localization, local market research and promotion of brand awareness, maintenance of customer relations, enabling mass production, trial production, establishing marketing channels.</li> <li>ii. <i>de-emphasis</i> of control, decision making, management of development budget, IP legal defense.</li> </ol> </li> <li>3. TP Method Preferences               <ol style="list-style-type: none"> <li>i. <b>New Value Contribution Method</b>: Profits allocated across value chain proportionate to value contribution to group profits with reference to revenue, assets, costs, sales and number of employees.</li> <li>ii. Reversing the tested party where counterparty is Low Function, Low Tax entity.</li> </ol> </li> </ol>
Documentation	<p>OECD 3 Tier Documentation, including CbC introduced.</p> <p><u>Additional Requirements</u></p> <p>(i) <b>Value Chain Analysis</b> with detailed description of chain activities, how profits are allocated across chain and what each entity earns, standalone &amp; consolidated financial statements for each entity in chain.</p> <p>(ii) <b>Added Documentation</b> for related party services, Equity transfers in local file, exceeding thin cap with no minimum threshold, entities beyond certain thresholds and loss making limited risk and function entities.</p>

# Location Savings Illustrated



Source: Logic & Practice of Transfer Pricing, Lexis Nexis

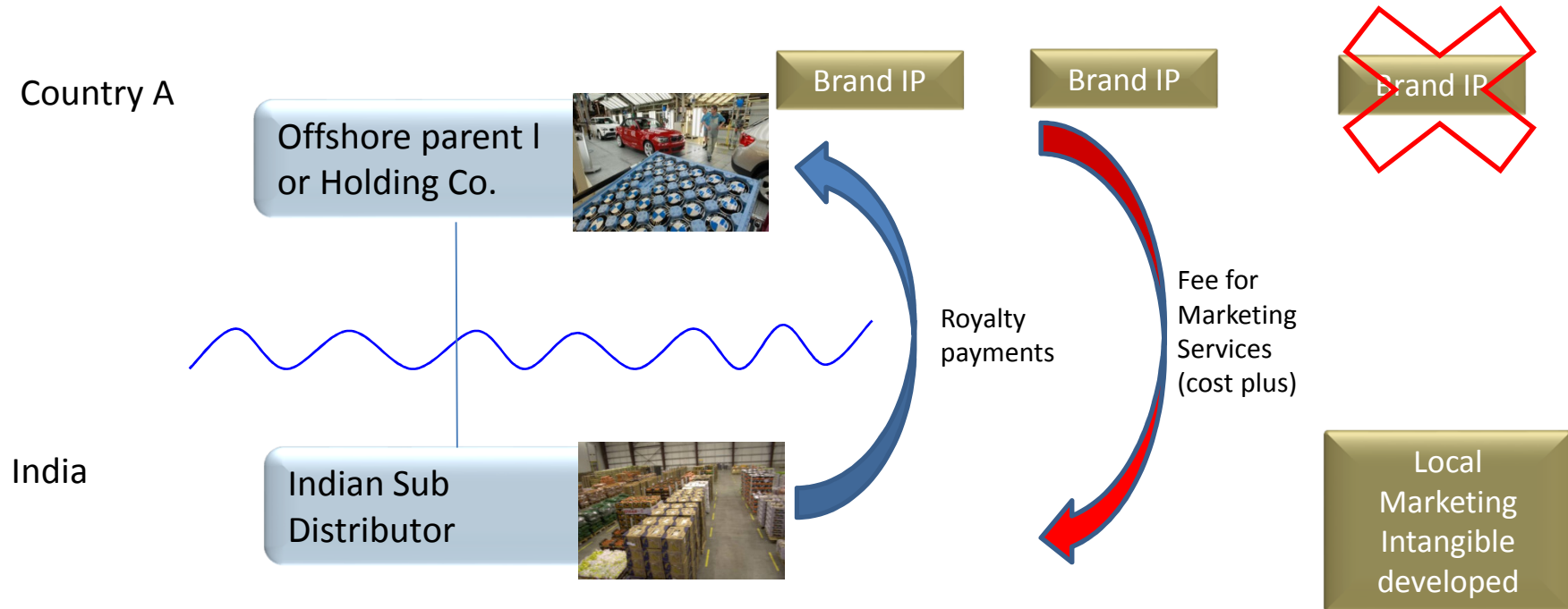


# The India Experience Compared

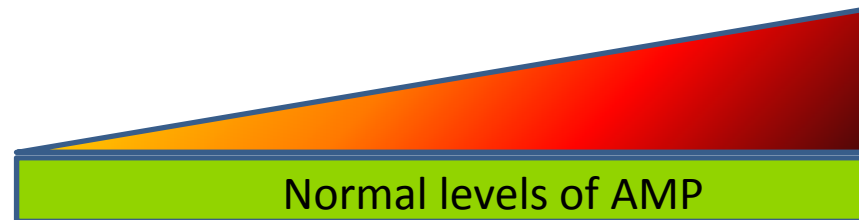
OECD Actions 8-10					
Development	Enhancement	Maintenance	Protection	Exploitation	
Acceptable to Outsource provided maintain Control, Management, Decision making + Ability to bear risks					
Residence	Residence	Residence	Residence	Source	
China (draft Circular 2)					
Development	Enhancement	Maintenance	Protection	Exploitation	Promotion
De-emphasizes control, no mention of decision making, management of development budget, IP legal defense, instead emphasizes adaptation to local, market research, maintain customer relations, enable mass production, trial production, establish marketing channels, CRM and brand promotion					
Residence/S	Residence/S	Residence/S	Residence/S	Source	Source
India					
Development	Enhancement	Maintenance	Protection	Exploitation	Advert/Promotion/Marketing
Local marketing intangibles					

How will India assessors and courts decide?

# The India Experience – AMP & Marketing Intangibles



Excessive Advertisement, Marketing & Promotion (AMP) expenditure beyond normal leads to either (a) an implied agreement to market the IP for the brand owner and/or the (b) creation of local marketing intangible.



Source: Logic and Practice of Transfer Pricing, Lexis-Nexis (2015)

# Learning from the Financial Services Experience

- Attribution of Profits to PE and AOA not widely adopted since 2010, even amongst OECD countries
- Divergence between Legal ownership, Economic ownership and Functions
  - Extensive use of **profit splits** to divvy up returns to an asset (capital) between people's functions. E.g. "Follow-the-Sun" global trading
- Attributing Returns from a Single Asset to Multiple Functions & Localities
  - Weighting **relative contribution** of multiple KERTs in different jurisdictions: Categorizing functions into Routine (low cost+), Higher Value (higher cost+) and KERT (share of profit)
  - Split functions in decision making, managing & controlling risks (HQ vs region vs local, different approval limits)
  - Capacity to bear risk
  - Reconciling with local statutory and regulatory reporting
  - OECD guidance generally limited to two parties in clear cut fact pattern, is inadequate.
- Tricky Issue of **Losses**

# Food for Thought



1. What position is most advantageous to Malaysia as a country keen to attract Foreign Direct Investment?
  - Balance emphasis between returns to People's functions vs capital and intangible property?
  - Assertion of Location Savings, Market Premium and local marketing intangibles?
  - Desire to be regional HQ or hub
    - Accede to low-value adding services safe-harbour?
    - Insistence on local comparables
2. How do you organize or manage your Transfer Pricing?
3. What trends are you seeing in TP audits in Malaysia?

Think  
further...



**The Logic and Practice of Transfer Pricing**

Author(s): Sam Sim

Quantity :

Publisher: LexisNexis  
Format: Softcover  
ISBN: 9789814406789  
Dec 2014

**Description**

**Author/Contributor**

**Key Features**

This book takes a ground-breaking approach in explaining transfer pricing in a logical, clear and easy-to-understand way with liberal use of diagrams and practical illustrations. The issue of transfer pricing has put companies with global presence like Starbucks, Google and Apple in the news.

Whether you are a CFO or financial controller with transfer pricing impacting your statutory accounts, a tax leader managing transfer pricing risk or a finance manager wrestling with transfer pricing true-ups, you will find this book to be an accessible and indispensable companion.

Includes:

- ◆ Making sense of BEPS ( Base Erosion and Profit Sifting) including the latest September 2014 Action 8 on intangibles and Action 13 on Country by Country Reporting
- ◆ User-friendly layout, diagrams and illustrations
- ◆ Logical sequence and exposition of key concepts using plain English



Been an Real Pleasure & Honour

Thank you!