Agenda
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• Transfer Pricing Audit Environment and Driving Trends
• Introduction to BEPS
• Key Impacts of Chapter 5
• Key Impacts of Chapter 6
• What should companies do next?
• Q&A
Nothing new.....

“Recently more and more enterprises organised abroad by American firms have arranged their corporate structures aided by artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights, the shifting of management fees, and similar practices [...] in order to reduce sharply or eliminate completely their tax liabilities both at home and abroad.”

- JFK
Transfer Pricing Audit Environment and Driving Trends

The Main Challenges in a Transfer Pricing Audit
Transfer Pricing audit environment and driving trends

Need by nations to raise revenue to fund obligations

TP audits are multiplying in numbers and becoming more complicated and challenging to resolve

In general, every company that is subject to a tax audit and that have intercompany transactions is asked to submit, along with other specific information, any TP documentation in place

Transparency:
1. Requiring taxpayer cooperation
2. Tax Authorities might verify specific data at client’s site

In the future:
1. Increasing exchange of information among tax authorities
2. Increased emphasis on substance and “value creation”
Main issues challenged by the Tax Authorities:

- TP documentation update
  - More frequent demand
  - Contemporaneous documentation requirements in the US

- Global Study documentation
  Requires localization

- Loans, Guarantees and Cash Pooling
  Interest rates needs to be supported by a TP documentation

- Management fees allocation
  Cost base needs to be accurately supported by a TP documentation
Main issues challenged by the Tax Authorities:

- **Service transactions**
- **Reclassification of transactions**
- **Challenge the TP Methodologies**
- **Tax Authorities have their own databases**

**Whether stock base compensation has been included in the Cost Base?**

- 1. Claim of sales of IP
- 2. Marketing vs. Distribution and related tax exposures (such as PE)

**External comparables vs. internal comparables**

**Might challenge the interquartile range**
Introduction to BEPS
Yet a changed world with reputational impact

Belgium introduces a ‘fairness tax’

“Australian MP challenges Apple on Claims Of $5.5B in Costs, Resulting $40M in Tax”

“The big internet companies excel at routing their profits into tax havens.” French government report on digital economy taxation

Belgium introduces a ‘fairness tax’

Google’s £6billion Bermuda tax shelter

Web giant Google avoided £1billion in tax by using the island of Bermuda as a tax haven, official documents reveal, as David Cameron calls for a global crackdown on multinationals’ tax arrangements.
State aid: Commission investigates Transfer Pricing arrangements on corporate taxation

"In the current context of tight public budgets, it is particularly important that large multinationals pay their fair share of taxes. Under the EU's state aid rules, national authorities cannot take measures allowing certain companies to pay less tax than they should if the tax rules of the Member State were applied in a fair and non-discriminatory way."

- Commission Vice President in charge of competition policy

- Apple: Ruling issued by the Irish tax authorities on profit allocation;
- Starbucks: Ruling issued by the Dutch tax authorities on the calculation of the taxable basis for manufacturing activities;
- Fiat: Ruling issued by the Luxembourgish tax authorities on the calculation of the taxable basis for the financing activities.
The BEPS action plan

- In 2013, the OECD and G20 countries adopted a 15-point Action Plan to address BEPS.
- The Action Plan aims to ensure that profits are taxed where economic activities generating the profits are performed and where value is created.
The BEPS action plan - Timing

| ACTION 1: Address the challenges of the digital economy |
| ACTION 2: Neutralise the effect of hybrid mismatch arrangements |
| ACTION 3: Strengthen CFC rules |
| ACTION 4: Limit base erosion via interest deductions and other financial payments |
| ACTION 5: Counter harmful tax practices more effectively, taking into account transparency and substance |

| ACTION 6: Prevent treaty abuse |
| ACTION 7: Prevent the artificial avoidance of PE status |
| ACTION 8: Assuring that TP outcomes are in line with value creation Intangibles |
| ACTION 9: Assuring that TP outcomes are in line with value creation Risks & capital |
| ACTION 10: Assuring that TP outcomes are in line with value creation Other high-risk transactions |

| ACTION 11: Establish methodologies to collect and analyse data on BEPS and the actions to address it |
| ACTION 12: Require taxpayers to disclose their aggressive tax planning arrangements |
| ACTION 13: Re-examine transfer pricing documentation |
| ACTION 14: Make dispute resolution mechanisms more effective |
| ACTION 15: Develop a multilateral instrument |

**OECD Deadlines:**

- **Deliverable - Sept 2014**
- **September 2015**
- **September / December 2015**
Key Impacts of Chapter 5:

Transfer Pricing Documentation and Country-by-Country Reporting

Action 13
A three-tiered approach in the Transfer Pricing documentation requirements

- **Master File**: high-level overview of MNE’s business
- **Country-by-Country Report**: information on global allocation of income and other economic factors.
- **Local File**: specific information related to the transactions of the local taxpayer

A fourth tier: additional specific countries requested documentation

To be shared with each relevant jurisdiction in which the MNE has an affiliate subject to tax
In order for the three-tiered approach to be implemented, the US, Israel and other countries will have to amend the existing legislation

A lot of political and governmental pressure

This is not going to be easy...
Local File

- Provides detailed information relating to specific intercompany transactions of the local company.
- Supplements the Master File and helps to meet the objective of assuring that the taxpayer has complied with the arm’s length principle.
- The Local File will include:
  - Relevant financial information
  - Comparability analysis
  - The selection and application of the most appropriate TP method
**Country-by-Country Report**

- The Report requires wide information relating to the global allocation of the income, the taxes paid, and certain indicators of the location of economic activity among tax jurisdictions in which the group operates with an activity code for each member.

- The report will be helpful for high-level TP risk assessment purposes.
### Country-by-Country Template

<table>
<thead>
<tr>
<th>Tax jurisdiction</th>
<th>Revenues</th>
<th>Profit (loss) before income tax</th>
<th>Income tax paid (on cash basis)</th>
<th>Income taxes accrued – current year</th>
<th>Stated capital</th>
<th>Accumulated earnings</th>
<th>Number of full time employees</th>
<th>Tangible Assets (other than cash and cash equivalents)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unrelated party</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Related party</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### Country-by-Country reporting template disclosures

<table>
<thead>
<tr>
<th>Tax jurisdiction</th>
<th>Constituent entities resident in the tax jurisdiction</th>
<th>Tax jurisdiction of organisation or incorporation, if different from tax jurisdiction of residence</th>
<th>Main business activity(ies)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>Research and Development</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Holding or Managing intellectual property</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Purchasing or Procurement</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Manufacturing or Production</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Sales, Marketing or Distribution</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Administrative, Management or Support Services</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Provision of Services to unrelated parties</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Internal Group Finance</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Regulated Financial Services</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Insurance</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Holding shares or other equity instruments</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Dormant</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Other</td>
</tr>
</tbody>
</table>
**Master File**

- The Master File contains key information about groups operations, global TP policies, intangibles, and an overview from a legal financial and tax perspective.

- The Master File will include:
  - The group’s organisational structure
  - Description of the group’s businesses
  - The group’s intangibles
  - The group’s intercompany financial activities
  - The group’s financial and tax positions
## Master File

<table>
<thead>
<tr>
<th>Org. structure</th>
<th>Description of MNE’s business</th>
<th>MNE’s intangibles</th>
<th>MNE’s financial activities</th>
<th>MNE’s financial &amp; tax positions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chart showing legal &amp; ownership structure &amp; geo. location of operating entities</td>
<td><strong>Important drivers of business profit</strong></td>
<td>Overall strategy: Development, oversight, &amp; exploitation, including location of R&amp;D facilities &amp; management</td>
<td>Description of how the MNE is financed, including arrangements with third-party lenders</td>
<td>Annual consolidated financial statement for FY</td>
</tr>
<tr>
<td>Description of supply chain for material products &amp; services</td>
<td></td>
<td>List of IP and entities that own IP</td>
<td></td>
<td></td>
</tr>
<tr>
<td>List &amp; description of service arrangements among MNE members other than R&amp;D, including policies</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>List &amp; description of service arrangements among MNE members other than R&amp;D, including policies</td>
<td></td>
<td>Agreements related to IP, including CSAs</td>
<td>ID central financial function, country of org. &amp; management of entity providing function</td>
<td></td>
</tr>
<tr>
<td>Main geographic markets for products and services</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Functional analysis describing contributions to value creations by individual entity</td>
<td><strong>IP and R&amp;D transfer pricing policies</strong></td>
<td>Material transfers of IP among MNE members during FY, including details</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Business restructurings, acquisitions, divestitures in FY</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Key Impacts of Chapter 6:

Transfer Pricing Aspects of Intangibles

Action 8
Introduction

THE END
OF THE WORLD
AS WE KNOW IT
Transfer Pricing aspects of intangibles

- Main Goal: Aligning functions, risks and costs with claims to intangible related returns.
- After appropriately rewarding other members for their important functions, risks and assets, the income of legal owner related to the intangible may be positive, negative or zero.
- Presence of a uniquely qualified or experienced workforce will affect arm’s length pricing and comparability analysis.
Which entity contributes to the relevant functions associated with the development of the intangible?
Arm’s length remunerations - What is going to change….

- Compensation based on costs, plus modest mark-up, will not reflect the correct value for the contributions of the research team.
- New Transfer Pricing methods, such as Profit Split and valuation techniques.
- Funding risk entity → Return on its funding activities only.
- Financial risk (such as funding intangible development) may no longer be respected.
- Pure IP holding companies may not be respected.
- Focus on Significant People Functions (SPF).
What Should Companies Do Next?
What should companies do next?

Identify gaps
in your current TP policies and documentation vs. new overall BEPS requirements

Assess gaps
that are particularly sensitive and develop an action plan

Identify IT systems
current potential limitations

Stay informed
on developments and early adopters of new rules

Monitor and reassess
your strategy in light of overall BEPS action items

Be ahead
of Tax Authorities’ increased pressure, expectations and requirements

Use the opportunity to tell your story
Questions?
Thank you!

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