

BEPS & Transfer Pricing Implications  
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## Transfer Pricing – Brief Concept

# Transfer Pricing Basics

- **Transfer Price** – Price at which related parties transact
- **Arm's length price** – price at which related parties should transact on an arm's length basis
- **Transfer Pricing** – the process whereby the related party price is arrived at
- Transfer Pricing can be right ie in conformity with arm's length pricing or it could be a form of mis-pricing
- **Why have Transfer Pricing Regulations** – Objective of Transfer Pricing is to ensure that multinational companies are not shifting profits from high to low tax jurisdiction
- **Documentation** - Transfer Pricing Regulations require proof that related party price is a fair price or arm's length price

# Transfer Pricing Methods - Snapshot

Method	Description	Remarks
CUP Method	Directly compare the price per unit of good or service	Most Accurate – directly tests price
Resale Price Method	Compare the gross margin of reseller	Closer to price – not influenced by overheads
Cost Plus Method	Compare the Gross Profit earned by manufacturer	Closer to price – not influenced by overheads
Transactional Net Margin Method (TNMM)	Compares net profit relative to appropriate base	Net profit dilutes the accuracy but most practical and commonly used
Profit Split Method	System net profit is split between transacting parties in ratio of contributions towards intangible development	Subjective - used only if multiple parties develop intangible and not possible to determine return for each separately

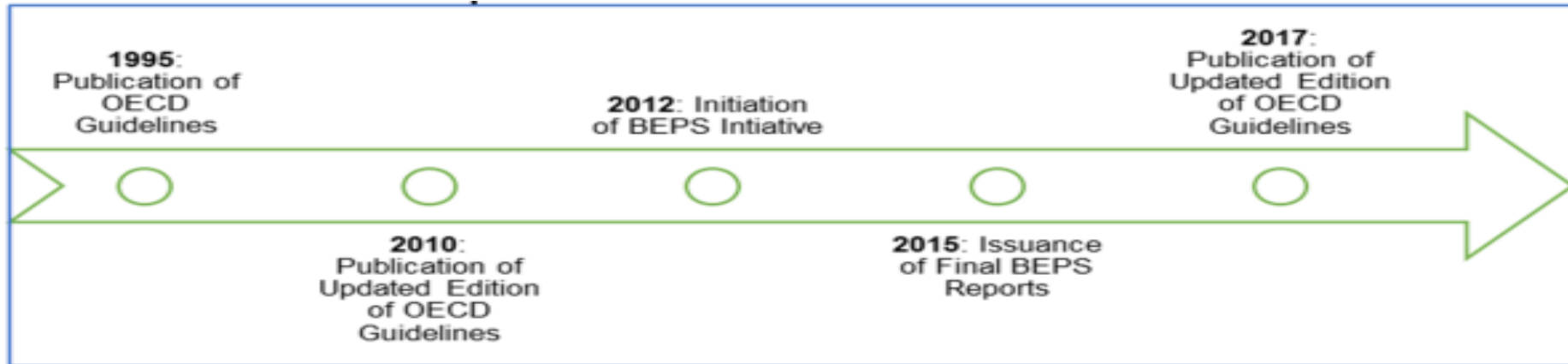


## **OECD Role & BEPS Project**

# OECD - FRAMEWORK

- Organization for Economic Cooperation & Development ('OECD') is an international organization with mission is to **promote policies to improve economic and social well-being** – 36 Member Countries as on date
- The OECD helps policy makers **shape the tax systems of the 21st century.**
- OECD is at the forefront of efforts to **improve international tax co-operation between governments to counter international tax avoidance and evasion**
- Recent OECD Guidance
  - **February 11, 2020** – Transfer Pricing Guidance on **Financial Transactions**
  - **March 24, 2020** – Second Peer Review Report on **Treaty Shopping** – Inclusive Framework on BEPS: Action 6
  - **April 3, 2020** – Analysis of **Tax Treaties and the Impact of the COVID -19 Crisis**

# OECD and Transfer Pricing



- OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (**‘OECD TP Guidelines’**) establish a **consistent international framework** for addressing transfer pricing issues - this environment has created a new patchwork of transfer pricing approaches and regulations.
- The **2017 edition** of the Manual reflects a number of **agreed revisions based on the outcome of the OECD/G20’s 2015 Base Erosion and Profit Shifting (BEPS)** project.



# OECD AND UAE

- **Since 2006**, UAE and OECD jointly offered a **series of annual seminars to facilitate development of tax treaty networks in the Middle East and North African (MENA) region** and to assist with the adoption of international taxation provisions aimed at meeting the needs of their increasingly integrated economies and expanding cross-border transactions
- **July 2014** - UAE officially joined as a **member of OECD**
- **May 16, 2018** - The United Arab Emirates (UAE) joined the Base Erosion and Profit Shifting Inclusive Framework (BEPS IF) and has **since taken significant steps to implement the BEPS minimum standards** and cement its position as an attractive regional and global hub for foreign direct investment
- **30<sup>th</sup> April, 2019** – ESR introduced (BEPS Action Plan 5)
- **30<sup>th</sup> April, 2019** – CbCR Regulations Introduced (BEPS Action Plan 13)

# WHY BEPS? – THE BACKGROUND



## Starbucks not a bean in taxes, thanks to transfer pricing

Starbucks UK sales in 2011 were worth £ 398 million, but paid nil taxes by charging UK operations high prices for use of logo



## Amazon

With sales of £ 3.35 billion reports tax paid of € 1.8 million (0.005%) in UK



## Apple uses subsidiaries to dodge billions in taxes

US Senate Panel alleged that Apple is using so called cost-sharing agreement to transfer valuable intellectual property assets offshore and shift resulting profits to tax haven jurisdictions



## Dolce and Gabbana stylists face £ 320 million tax fraud case

Accused of evading more than £ 400 million in tax when they sold their D&G and D&G brand to a holding company Gado, which they set up in Luxembourg in 2004



## Google

UK unit paid £ 6 million to treasury in 2011 on UK turnover of £ 395 million (1.5%)

# WHY BEPS? – THE OBJECTIVE

- Tax planning, which exploits gaps in tax rules, making profits shift to locations with little or no activity and having low taxes
- Three popular mechanisms for profit shifting are
  - Hybrid Mismatch
  - Special Purpose Entity/Vehicle
  - Transfer Pricing
- Not always illegal, but taking advantage of current archaic tax rules that is disassociated with today's environment

*“BEPS arises because under existing rules MNEs are often able to artificially separate allocation of their taxable profits from the jurisdiction in which these profits arise...”*

- OECD

# BEPS EVOLUTION

- G20 countries realized the need to prevent BEPS and approached OECD to address the issue related to BEPS
- OECD published a report on BEPS in February 2013
- In July 2013, OECD released an Action Plan on BEPS which was presented to the meeting of G20 Finance Ministers in Moscow
- The OECD and G20 released their recommendations on BEPS action plans (15 action plans) on 5 October 2015.



# BEPS ACTION POINTS - SNAPSHOT

Action Point	Description
1	Addressing the challenges of the digital economy
2	Neutralising the effects of hybrid mismatch arrangements
3	Strengthen CFC rules
4	Interest Deductions and other financial payments
5	Countering harmful tax practices more effectively
6	Treaty abuse
7	Prevent the artificial avoidance of PE Status
<b>8</b>	<b>Intangibles</b>
<b>9</b>	<b>Risks and Capital</b>
<b>10</b>	<b>Other high-risk transactions</b>
11	Establish methodologies to collect and analyse BEPS data and actions addressing it
12	Mandatory disclosure of aggressive tax planning arrangements- Action 12
<b>13</b>	<b>Guidance on TP documentation and CBCR</b>
14	Making tax disputes more effective
15	Developing a multilateral instrument

# BEPS Action Plans 8 - 10 (Transfer Pricing)



- ❑ Assure that transfer pricing outcomes are in line with value creation
- ❑ **Action Point 8 – ‘Intangibles’:** Develop rules to prevent BEPS by moving intangibles among group members
- ❑ **Action Point 9 – ‘Risk’ and ‘Capital’:** Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to group members
- ❑ **Action Point 10 - Other high risk transactions:** Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties

# BEPS Action 13 (Transfer Pricing)



- Guidance on TP documentation
  - Master file
  - Local File
  - Country by Country Report
- CBCR
  - Applies to MNEs with annual consolidated group revenues > €750m
  - File in parent jurisdiction ... made available under EOI provisions



## ESR and CbCR in UAE



# UAE ESR Rules – Objective

- **12<sup>th</sup> March, 2019** - EU revised its EU list of non-cooperative jurisdictions for tax purpose identifying UAE as **one jurisdiction that facilitated offshore structures and arrangements aimed at attracting profits without real economic substance**
- UAE included on the **EU list of non-cooperative jurisdictions for tax purposes**
- **30<sup>th</sup> April, 2019** - UAE introduced Economic Substance Regulations to honour the UAE's commitment as a member of the OECD Inclusive Framework on BEPS (and in response to a review of the UAE tax framework by the EU)
- ESR Regulations comply with OECD BEPS Action Plan 5

# ESR Snapshot

## Economic Substance Test

Any natural or juridical person performing '**relevant activity**' like banking, insurance, investment fund management, shipping, lease-finance, distribution and service centers, headquarters and intellectual property (IP) activities etc

**Directed and Managed** for specific activity in UAE

**Perform Core Income Generating Activity (CIGA)** in UAE

**Adequate** level of qualified full time **employees** in UAE

**Adequate** amount of **operating expenditure** in UAE

Adequate **physical assets** in UAE

BOD meet in adequate frequency

Banking: Raising funds, managing risk, providing loan, credit etc.

Quorum of directors physically present

Insurance: Predicting and Calculating Risk etc.

Meetings are recorded and signed by director and should be kept in UAE

Headquarter: management decisions, incurring operating expenditure, coordinating group activities

Minutes should record strategic decision taken

Directors should have necessary knowledge and expertise to discharge the functions of board

IP: Patent, R&D, Trademark, branding, marketing and distribution etc.

Branch office:- manager should be present while taking key decision

High Risk IP: strategic decision and managing principle risk related to development of intangible etc.

### Adequate:-

adequate or appropriate for each entity **depends on the nature and level of the relevant activities.**

ESR is not intended to impose requirements that businesses engage more employees or incur more expenditures than what is needed.

**Instead, a licensee should maintain sufficient records to demonstrate the adequacy and appropriateness of the resources utilized and expenditures incurred.-**

# Comparison – CbCR Filing requirements in UAE

Particulars	UAE	OECD	India
Who is to file?	UAE tax resident entity, which is an Ultimate Parent Entity of the MNE Group	Ultimate Parent Entity of the MNE group	Parent Entity or Alternate Reporting Entity resident in India
Threshold Limit	MNE groups with annual consolidated revenue $\geq$ AED 3.15 billion ( <b>approx. USD 855 million</b> ) for the financial year preceding the reporting year concerned	MNE groups with annual consolidated revenue $\geq$ EUR 750 million ( <b>approx. USD 840 million</b> )	MNE groups with annual consolidated revenue $>$ 5500 crores ( <b>approx. USD 825 million</b> )
When to file?	Within 12 months from the end of the reporting year of the MNE Group	Within 12 months after the last day of reporting period	Within 12 months following the end of reporting accounting year
Penalties	<ul style="list-style-type: none"> <li>- AED 100,000 (approx. USD 27,000) for failure to retain documents and information for at least 5 years</li> <li>- AED 100,000 for failure to provide information to MoF</li> <li>- AED 1,000,000 (approx. USD 270,000) + AED 10,000 (approx. USD 2700) per day up to maximum of AED 250,000 (approx. USD 68,000)</li> <li>- AED 50,000 to 500,000 (approx. USD 13,500 to 135,000) for failure to ensure completeness and accuracy of information in CbC Report</li> </ul>	No model penalties legislation is provided	<ul style="list-style-type: none"> <li>- INR 5,000 (approx. USD 77) per day up to 1 month</li> <li>- INR 15,000 (approx. USD 230) per day beyond 1 month</li> <li>- INR 50,000 (approx. USD 780) per day for continuing default after service of notice</li> </ul>

# CbCR Information – Comparative View

Contents	UAE	OECD	India
Revenues from unrelated parties	✓	✓	✓
Revenues from related parties	✓	✓	✓
Profit (loss) before tax	✓	✓	✓
Income Tax Paid	✓	✓	✓
Income Tax accrued	✓	✓	✓
Stated Capital	✓	✓	✓
Accumulated Earnings	✓	✓	✓
Number of Employees	✓	✓	✓
Tangible Assets (other than cash or cash equivalents)	✓	✓	✓
List of all constituent Entities	✓	✓	✓

# ESR and CbCR

Particulars	Economic Substance Regulation	Country by Country Reporting
<b>Regulation No.</b>	Cabinet of Ministers Resolution 31 of 2019	Cabinet of Ministers Resolution 32 of 2019
<b>BEPS Action Plan</b>	Action 5	Action 13
<b>To whom Notify/Report</b>	Relevant Authority (i.e. Licensing Authorities for Relevant Activities)	Competent Authority (i.e. Ministry of Finance)
<b>Applicable to:</b>	<p>Licensee carrying out any of the following Relevant Activities:</p> <ol style="list-style-type: none"> <li>1. Banking Business</li> <li>2. Insurance Business</li> <li>3. Investment Fund Management Business</li> <li>4. Lease-Finance Business</li> <li>5. Headquarters Business</li> <li>6. Shipping Business</li> <li>7. Holding Company Business</li> <li>8. Intellectual Property Business</li> <li>9. Distribution and Service Centre Business</li> </ol>	<p>MNE Group</p> <ul style="list-style-type: none"> <li>- includes 2 or more enterprises the tax residence for which is indifferent jurisdictions/country, or includes an enterprise that is resident in one country and is subject to tax with respect to business carried through a permanent establishment in another country</li> <li>- having total consolidated group revenue equal to or more than AFD 3.15 Billion (equal to 750 Million Euro) during Fiscal year as reflected in Consolidated Financial Statements for such preceding Fiscal Year.</li> </ul>

# ESR and CbCR

Particulars	Economic Substance Regulation	Country by Country Reporting
<b>Due Date</b>	To be filed no later than 12 months after the last day of the end of each Financial Year of the Licensee.	<p><b>For Notification:</b> to be filed no later than the last day of the Reporting Fiscal Year of such MNE Group.</p> <p><b>For Report:</b> To be filed no later than 12 months after the last day of Reporting Fiscal Year of such MNE Group.</p>
<b>Filing Obligation by:</b>	Licensee Carrying out Relevant Activities and is required to satisfy the Economic Substance Test.	Constituent Entity of the MNE Group, Ultimate Parent Entity or Surrogate Parent Entity
<b>What is to Notify/Report?</b>	<p>The following information in respect to the Licensee:</p> <ul style="list-style-type: none"> <li>a) Type of Relevant Activity</li> <li>b) Amount and type of relevant income from Relevant Activity</li> <li>c) Amount and type of Operating expenditure &amp; Assets in respect of Relevant Activity</li> <li>d) Location of Business</li> <li>e) Total number of full-time employees, their qualifications</li> <li>f) Information showing State Core Income-Generating Activity</li> <li>g) Declaration whether Economic Substance test is met or not</li> </ul>	<p><b>Notification:</b></p> <ul style="list-style-type: none"> <li>a) Name of the Group</li> <li>b) The jurisdiction where the group is tax resident</li> <li>c) Whether the UPE is reporting entity</li> <li>d) List of Constituent Entities under the MNE Group</li> <li>e) Name of UAE Entity filing CbCR notification</li> </ul> <p><b>Report:</b></p> <ul style="list-style-type: none"> <li>a) Amount of revenue, profit(loss) before Income-tax, Income-tax paid, Income-tax accrued, stated capital, accumulated earnings</li> <li>b) Number of Employees</li> <li>c) Tangible Assets are other than Cash &amp; Cash Equivalent with regard to each Jurisdiction in which MNE Group operates</li> <li>d) Identification of each constituent entity of MNE Group and its Jurisdiction</li> </ul>



## **Action Point 8 - Intangibles**

# Determining economic return through DEMPE functions

- Which entity or entities shall share in economic returns from exploiting intangible?
- Mere legal/ contractual rights do not confer right to the return from exploitation of intangible
- Identify DEMPE Functions (*value-creating functions of developing, enhancing, maintaining, protecting and exploiting the intangibles*)
- Allocation of Return shall be guided by DEMPE functions

*Economic ownership trumps legal ownership*



# What are DEMPE Functions?

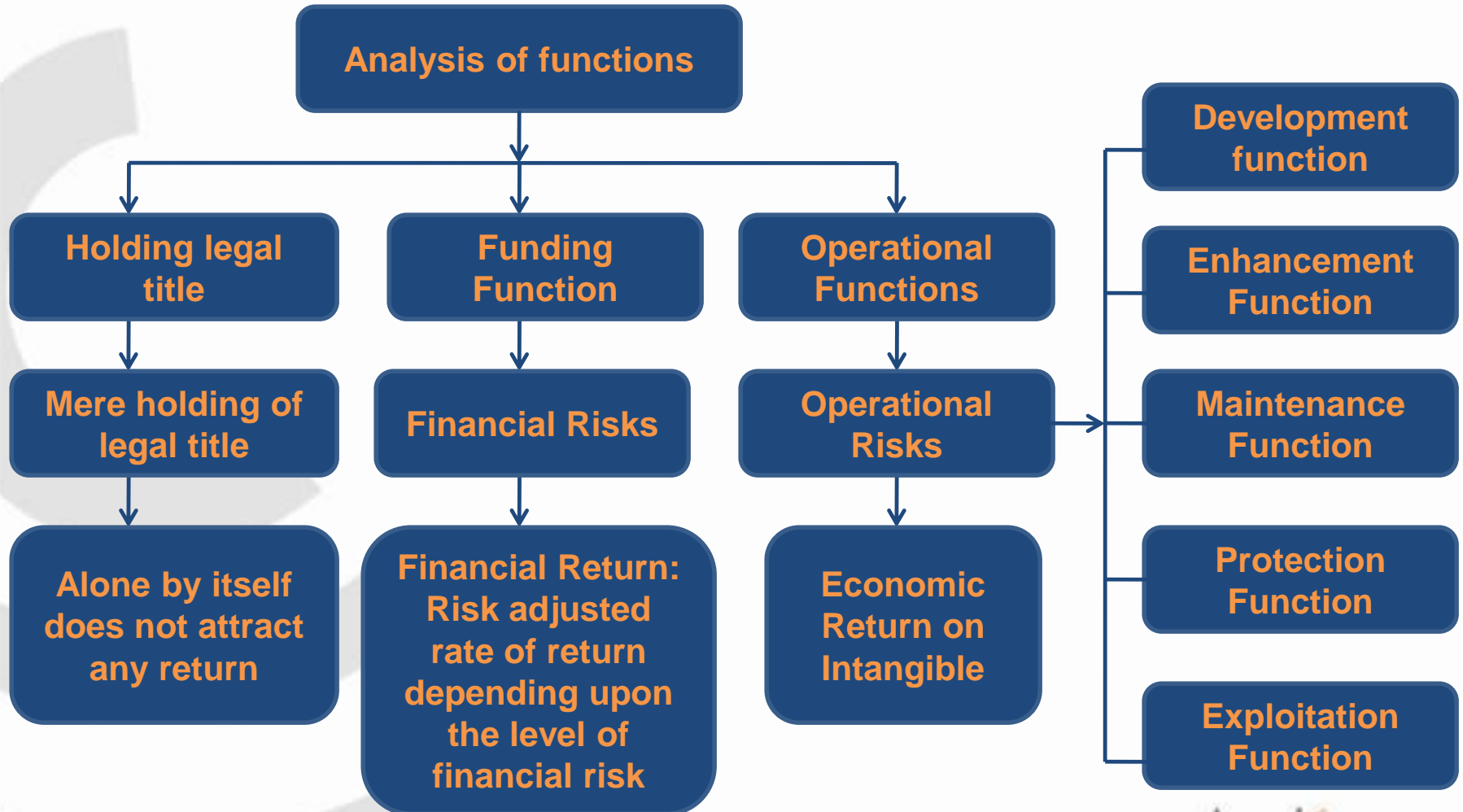
Functions pertaining to **Development, Enhancement, Maintenance, Protection** and **Exploitation** of risk

An enterprise should *functionally exercise control over the risk;*

- the *capability to make the decision to take on, lay off, or decline the risk-bearing opportunity; and*
- the *decision-making capability to decide whether and how to respond to risk associated with the opportunity.*

*Day to day risk management functions can be outsourced, so long as the enterprise controlling the risk has the capacity to take the decision to outsource and oversee the performance of risk management*

# What are DEMPE Functions?



# Return for Funding Activity

An entity that funds the development of an intangible but does not perform or control any DEMPE functions relating to the intangible can generally expect a risk-adjusted return on its funding

- i.e., an expected return similar to the return that could be achieved by funding a comparable project of similar risk
- Where the entity does not exercise control over the financial risks associated with the funding, then it is entitled to no more than a risk-free return.



## **Action Point 9 – Risk and Capital**

# Accurate Delineation of the Transaction and Risk

## Guidance on risk analysis

The Chapter now incorporates a section on “Risks” (analyzing risk) (as contained in Action Plans 8-10 of the BEPS project relating to aligning transfer pricing outcomes with value creation). A six-step process has been set out to accurately delineate a transaction which is as follows:

Step 1

- Identification of economic significant risks in relation to a particular transaction (basis of the likelihood and size of the potential profits or losses arising out of transaction)

Step 2

- Analysing contractual arrangement to determine the assumption of economically significant risks in relation to the transaction

Step 3

- Undertaking functional analysis to determine actual conduct of the AEs in relation to the assumption and management of risks in relation to a transaction

# Accurate Delineation of the Transaction and Risk (Contd.)

## Step 4

- Confirm consistency between contractual arrangement and conduct on ground

## Step 5

- Guidance on allocating risks amongst parties to the transaction, in case, the party identified in the steps above do not control such risks or do not have the financial capacity to assume that risk

## Step 6

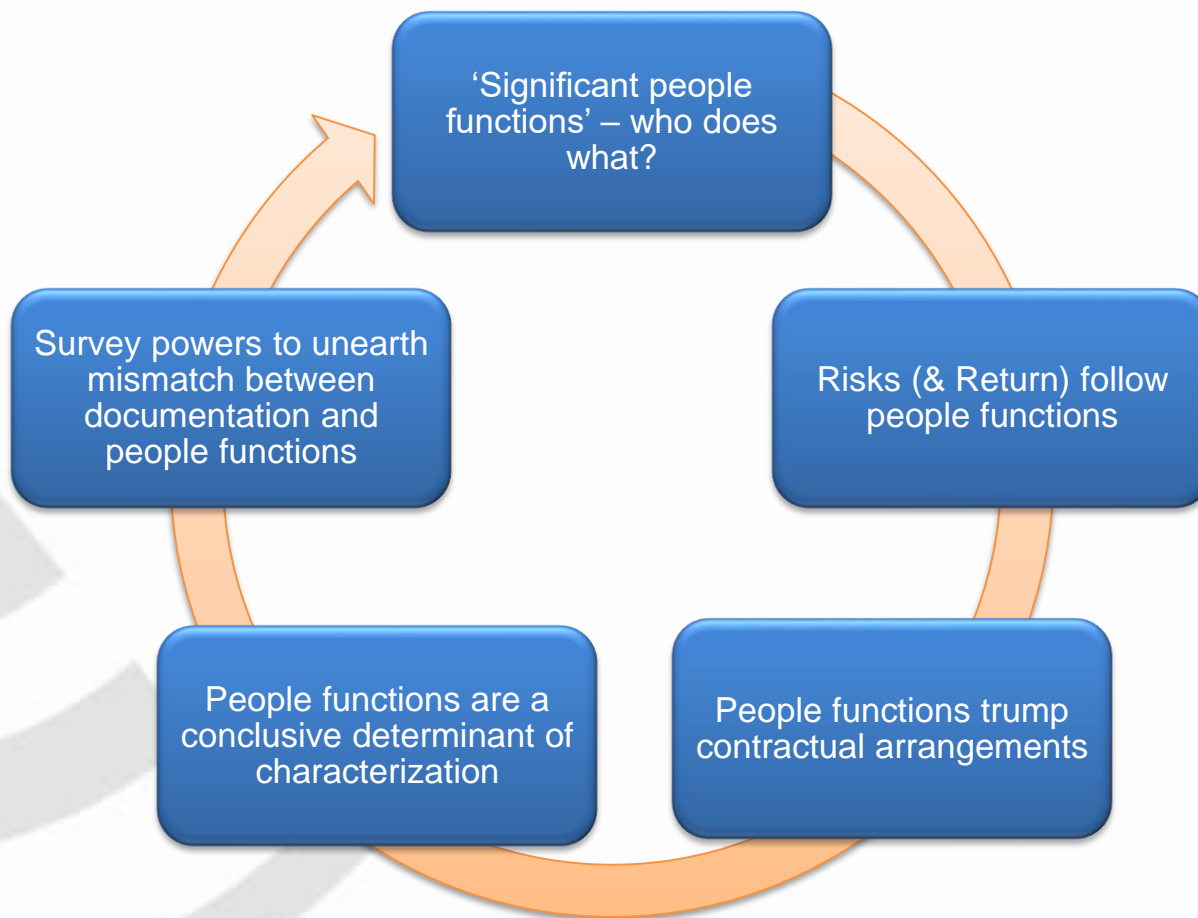
- Determination of arm's length price based on financial and other consequences of risk assumption as documented and understood between points 1 to 5 above.

# Significant People Functions (Illustration)

Risk	'Significant People Functions'
Market / Price Risk	Who takes marketing and pricing decisions, at what price to sell, how much to volume to sell etc
Credit risk	Who undertakes credit evaluation, who decides to extend credit or not, how much credit to extend etc
Contract Risk	Who approves the contract, who has the final decision making power etc
Technology Risk	Who takes all important decisions relating to technology – which technology to use, which to discard, which to buy, when to update etc
R&D Risk	Who controls the R&D, who gives direction to R&D, who decides the R&D budget etc

*Allocation of risk based on contract is meaningless unless supported by significant people functions*

# 'Substance' in the Transfer Pricing Context





# Accurate Delineation of the Transaction and Risk (Contd.)

## SUMMING UP

- ❖ Party which controls the risk should be compensated for such functions
- ❖ Where an AE only provides funding, but does not control the risk, such AE should be remunerated only for the financing cost and the no risk premium should be paid to such an AE
- ❖ Where a party contributes to the control of risk but does not assume the risk, then the potential upside or downside on taking risk, should be shared basis its contribution on control.



## **Action Point 10 – Other High Risk Transactions**

# Low Value Adding Intra-group Services

Features of Low Value Adding Intra-group Services :-

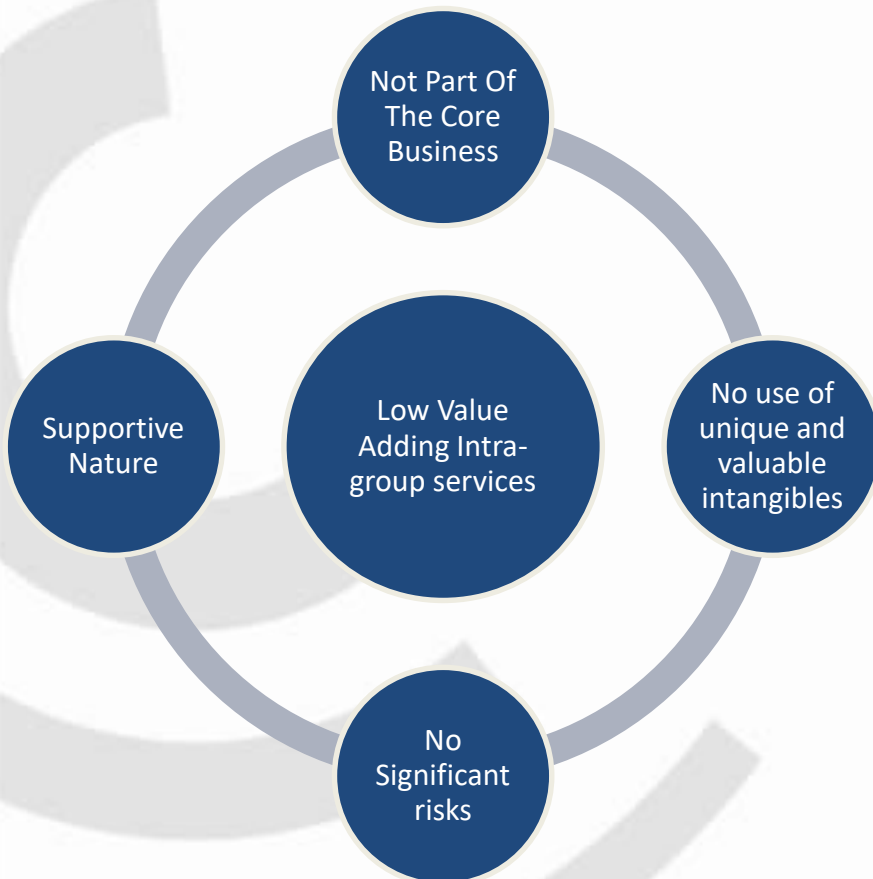


Illustration of Low Value Adding Intra-group Services :-

- ✓ General services of administrative nature.
- ✓ Accounting and auditing activities
- ✓ Human resources activities, such as staffing and recruitment.
- ✓ Information technology services (not part of the principal activity of the group).
- ✓ Internal and external communications and public relations support (excluding specific advertising and marketing)
- ✓ General legal services

# Determination of Arm's Length Pricing

Step 1

- Application of the benefits test – Benefit Test must be satisfied.

Step 2

- Determination of cost pools - The costs to be pooled are the direct and indirect costs of rendering the services.

Step 3

- Allocation of Cost - Allocation among members of the group the costs in the cost pool that benefit multiple members of the group.

Step 4

- Profit mark-up – OECD has recommended a mark up equal to 5%

# Passive Association

- An incidental benefit attributable solely to an entity's association and linkages with other entities that are part of an MNE
- A subsidiary generally receives some level of implicit benefit from its relationship with the parent entity
- A borrower's credit quality generally has a significant impact on the interest rate applied to a loan or the price of a credit guarantee

# Impact of Group Synergies (Example)

## Stand-Alone

**Subsidiary Company (S)**  
Credit Rating BAA

Loan

Interest Rate  
as per **BAA**  
credit rating

Lender

## MNE synergies

**Parent Company (P)**  
Credit Rating AAA

**Subsidiary Company (S)**  
Credit Rating BAA

Loan

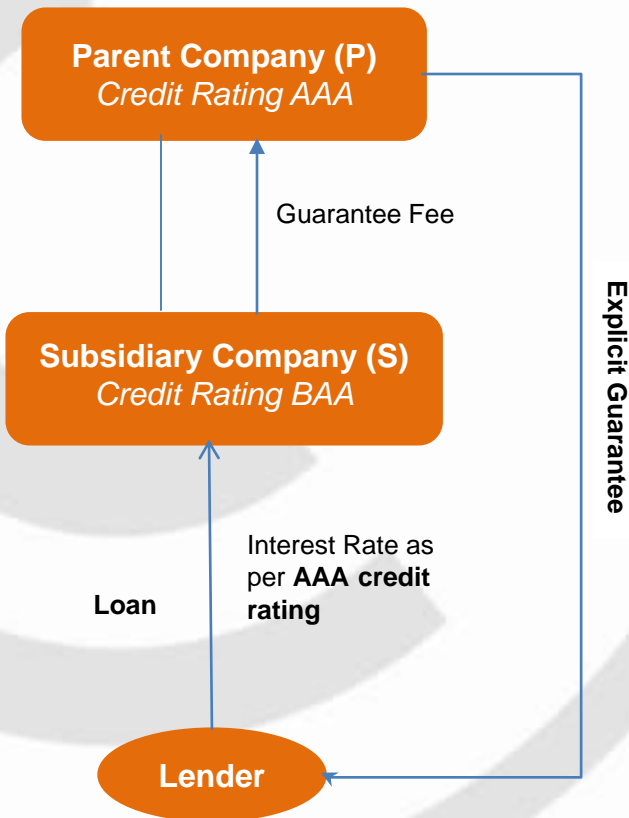
Interest Rate as  
per **A credit  
rating** (credit  
rating enhanced  
due to MNE  
synergies)

Lender

- On stand-alone basis, strength of the subsidiary would support a credit rating of only BAA
- However, since S is the member of group P, therefore large independent lenders are willing to lend to it at interest rate that would be charged to independent borrowers with an A rating
- Such interest is lower than would be charged if S was an independent entity, but a higher interest rate than would be available to the parent company of the MNE group.
- OECD noted that no payment or adjustment is required for group synergy benefit because the benefit arises from S's group membership and not from any deliberate concerted action of members of MNE

# Impact of Group Synergies (Example)

## MNE synergies



- A similar principle is applied but in a situation where the parent entity provides a **guarantee**. In such scenario, the independent lenders are willing to lend at interest rate that would be charged to borrower with an AAA rating
- Such interest rate is lower than would be charged if no guarantee is provided by the parent entity
- OECD guidelines state that S would be required to pay a “**Guarantee Fee**” to P based on the enhancement of S’s credit standing from **A to AAA**, not on the enhancement of S’s credit rating from BAA to AAA (due to implicit support)

# Conclusion

With the OECD guidance on group synergies and passive association, it is important for all MNEs with intragroup debt arrangements or financial guarantees to:

**Review global transfer pricing policies**

**Consider the impact of passive association**

**Determine appropriate entity rating while considering incidental benefits**

**Evaluate tax risk inherent in intragroup financial transactions**

**Analyze arm's length nature of such transactions**

**Prepare relevant documentation**





## **Action Point 13 - Master File, Local File and CbCR**

# Objectives of TP documentation



To ensure that taxpayers undertake requisite Transfer Pricing Planning (ex-ante)

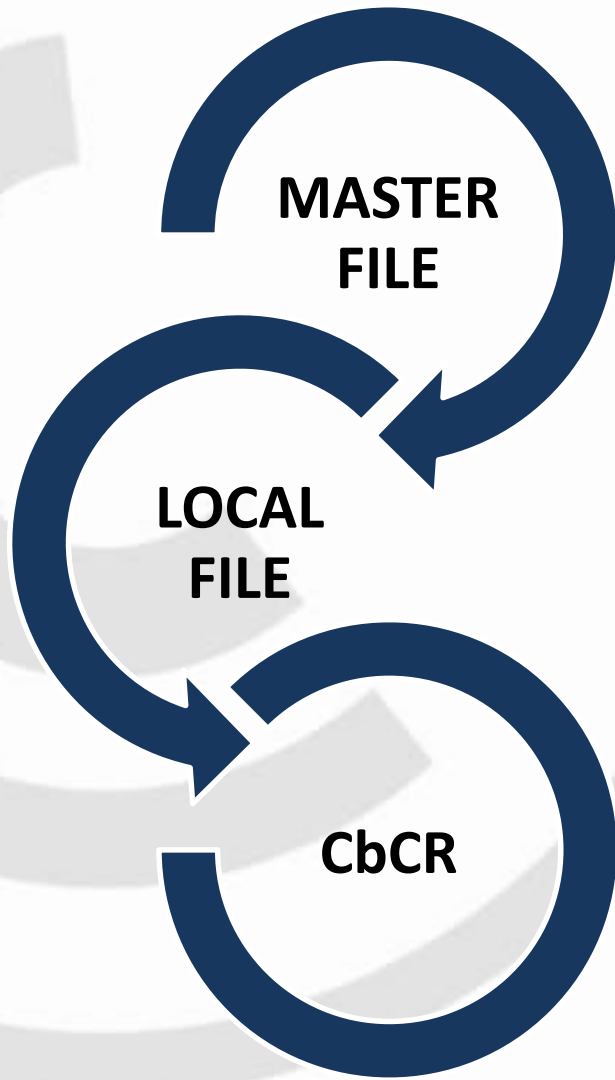


To provide tax administrations with the information necessary to conduct an informed TP risk assessment



To facilitate Tax Audits

# OECD BEPS Action Plan 13



## Three Tier Documentation

# Master File

- **Organisational structure with geographical location of entities**
- **Description of MNE's business(es)**
  - Important drivers of profit
  - Supply chain for 5 largest products/services + any > 5% turnover
  - List + brief description of important intragroup service arrangements (other than R&D) + principal locations + TP policy
  - Description of main geographic markets
  - Brief written functional analysis of principal contributions to value by individual entity (key functions, important risks, important assets)
  - Description of important business restructuring transactions, acquisition, divestitures in the year
- **MNE's intangibles (as defined)**
  - General description of strategy for development, ownership, exploitation of intangibles + location of principal R&D facilities/management
  - A list of intangibles (or groups of them) that are important for TP purposes and which entity legally owns them
  - General description of TP policies re R&D and intangibles
  - Description of an important intragroup intangible transfers in year (entities, countries, compensation)

# Master File

## ➤ **MNE's financial activities**

- General description of how the group is financed + important arrangements with unrelated lenders
- Identification of any central group financing functions + country where organised and effectively managed
- General description of TP policies re intragroup financing arrangements

## ➤ **MNE's financial and tax position**

- Annual consolidated financial statement
- List and brief description of existing APAs + other tax rulings re allocation of income between countries.

# Local File

## Local Entity

- Management Structure
- Local org chart
- Local reporting lines

## Controlled transactions

- Description & Context
- Payments / receipts
- Transfer Pricing Analysis

## Financial Information

- Financial Accounts
- Reconciliations
- Comparable Data

# Country by Country Report (CbCR)

## ➤ For each tax jurisdiction

- Unrelated party revenues
- Related party revenues
- Profit (loss) before income tax
- Income tax paid (cash basis)
- Income tax accrued (current year)
- Stated capital
- Accumulated earnings
- Number of employees
- Tangible assets other than cash (cash equivalents)

When to file?

If consolidated revenue > Euro 750 million

## ➤ List of all the constituent entities in each jurisdiction +

- Tax jurisdiction of organisation or incorporation if different from tax jurisdiction of residence
- Identifying the main business activity(ies) of each from a menu

## ➤ Any further brief information or explanation considered necessary or helpful

# CbCR - Exchange of Information

<b>Purpose</b>	There were difficulties for tax authorities to carry out transfer pricing assessments on transactions between linked companies due to lack of quality data. Therefore, there was a need to facilitate the implementation of CbC Reporting and exchange of such information
<b>BEPS Action 13</b>	<p>Three model Competent Authority Agreements included in BEPS Action 13 report i.e.</p> <ol style="list-style-type: none"><li>1. Multilateral Convention on Administrative Assistance in Tax Matters;</li><li>2. Bilateral tax conventions; and</li><li>3. Tax Information Exchange Agreements (TIEAs).</li></ol> <p>The CbC report is subject to exchange of information if the country is a signatory to Competent Authority Agreements (CAA).</p>
<b>Implications</b>	Supports tax administrations by incorporating CbC Reports into their tax risk assessment and assurance processes to understand better the risks posed to their jurisdictions



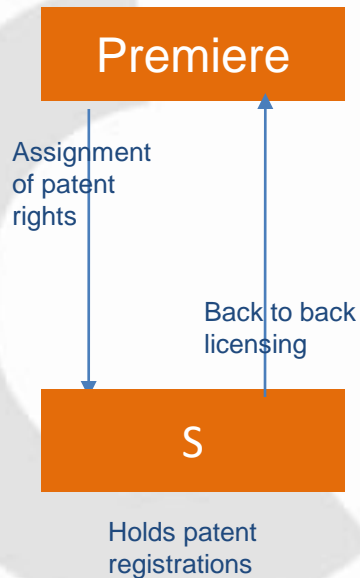
# TP Documentation Requirements in Middle East - Snapshot

Country	Master File	Local File	CbCR
UAE	Not Required	Not Required	Required
Qatar	Not Required	Not Required	Required
Egypt	Required	Required	Required
Saudi Arabia	Required	Required	Required
Israel	Not required (Draft Bill)	Not required (Draft Bill)	Not required (Draft Bill)
Turkey	Required	Required	Required



## Case Studies – DEMPE Functions

# Case Study 1 – Patent Administration Arrangement



- Funds R&D for patents
- Performs R&D function (has R&D team)
- Key decision-making around patent defense
- Key decision-making around licensing
- Uses patents in manufacturing and selling products

- Patent Rights assigned to S (for nominal fee) to centralize global patent admin
- S grants Premiere a back to back exclusive, royalty-free patent license with full rights to sublicense over full life of patent
- Employs 3 lawyers – advises Premiere on patent defense (no R&D personnel)
- Makes no commercial use of patents

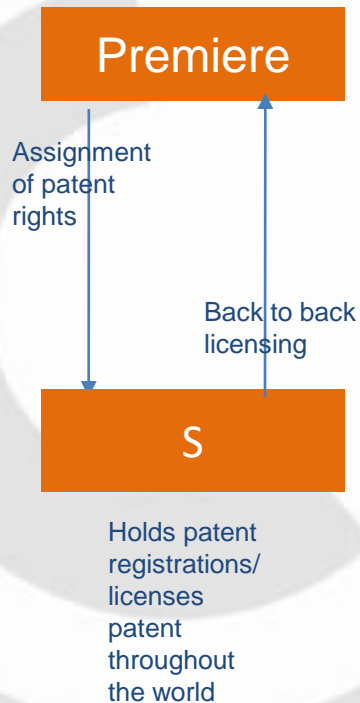
## TP Analysis (Premiere)

- Premiere performs all DEMPE and assumes all risks
- Balance of returns should be earned by Premiere

## TP Analysis (S)

- Arm's length return determined for patent administration services

# Case Study 2 – Patent Administration Arrangement (Variant)



- Funds R&D for patents
- Performs R&D function (has R&D team)
- Key decision-making around patent defense
- Key decision-making around licensing
- Uses patents in manufacturing and selling products

- Patent Rights assigned to S (for nominal fee) to centralize global patent admin
- S grants Premiere a back to back exclusive, royalty-free patent license with full rights to sublicense over full life of patent
- Employs 3 lawyers – advises Premiere on patent defense (no R&D personnel)
- Grants licenses to related and unrelated parties throughout the world in exchange for royalties – under control and direction of Premiere

## TP Analysis (Premiere)

- Premiere performs all DEMPE and assumes all risks
- Balance of returns should be earned by Premiere

## TP Analysis (S)

- Arm's length return determined for patent administration services

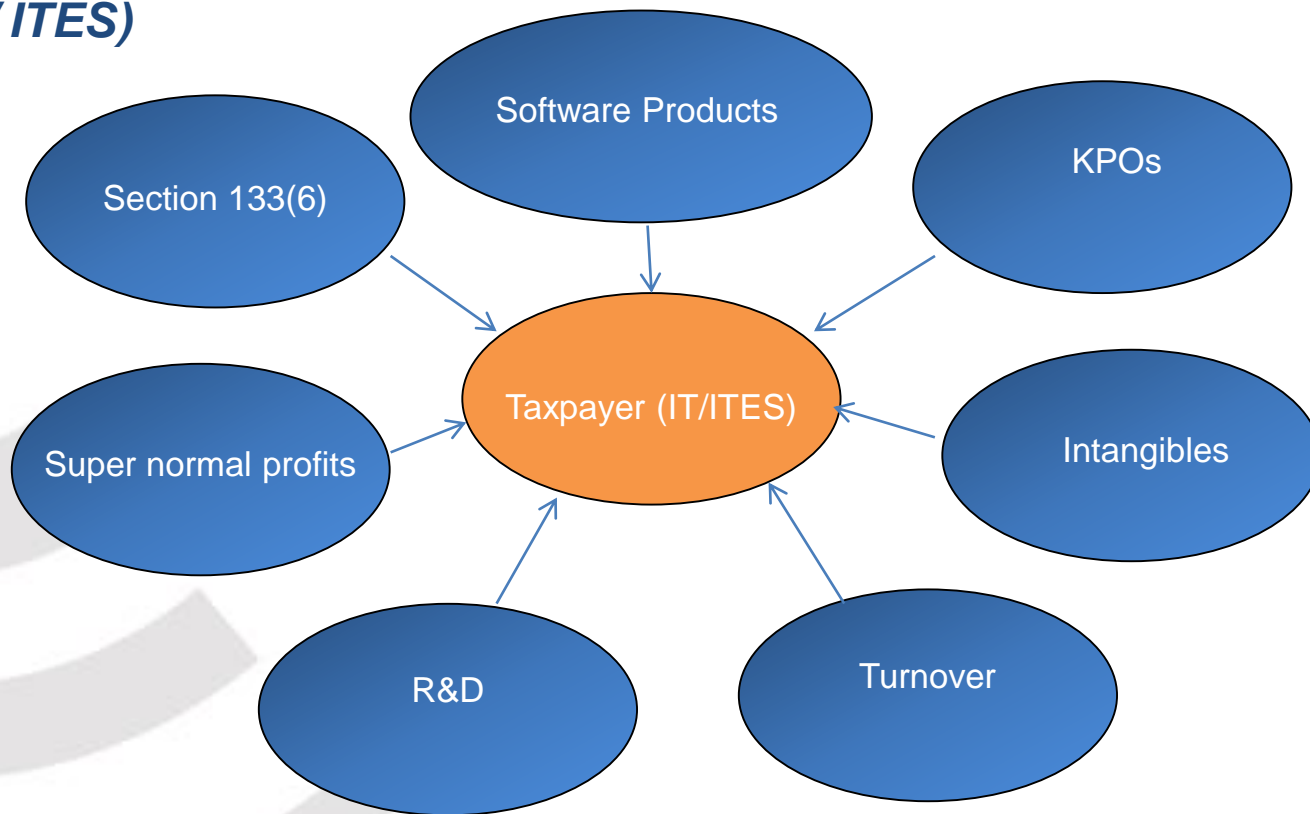


# **Case Study\* - Adjustments in Information Technology sector**

**[\*Based on Actual Cases]**

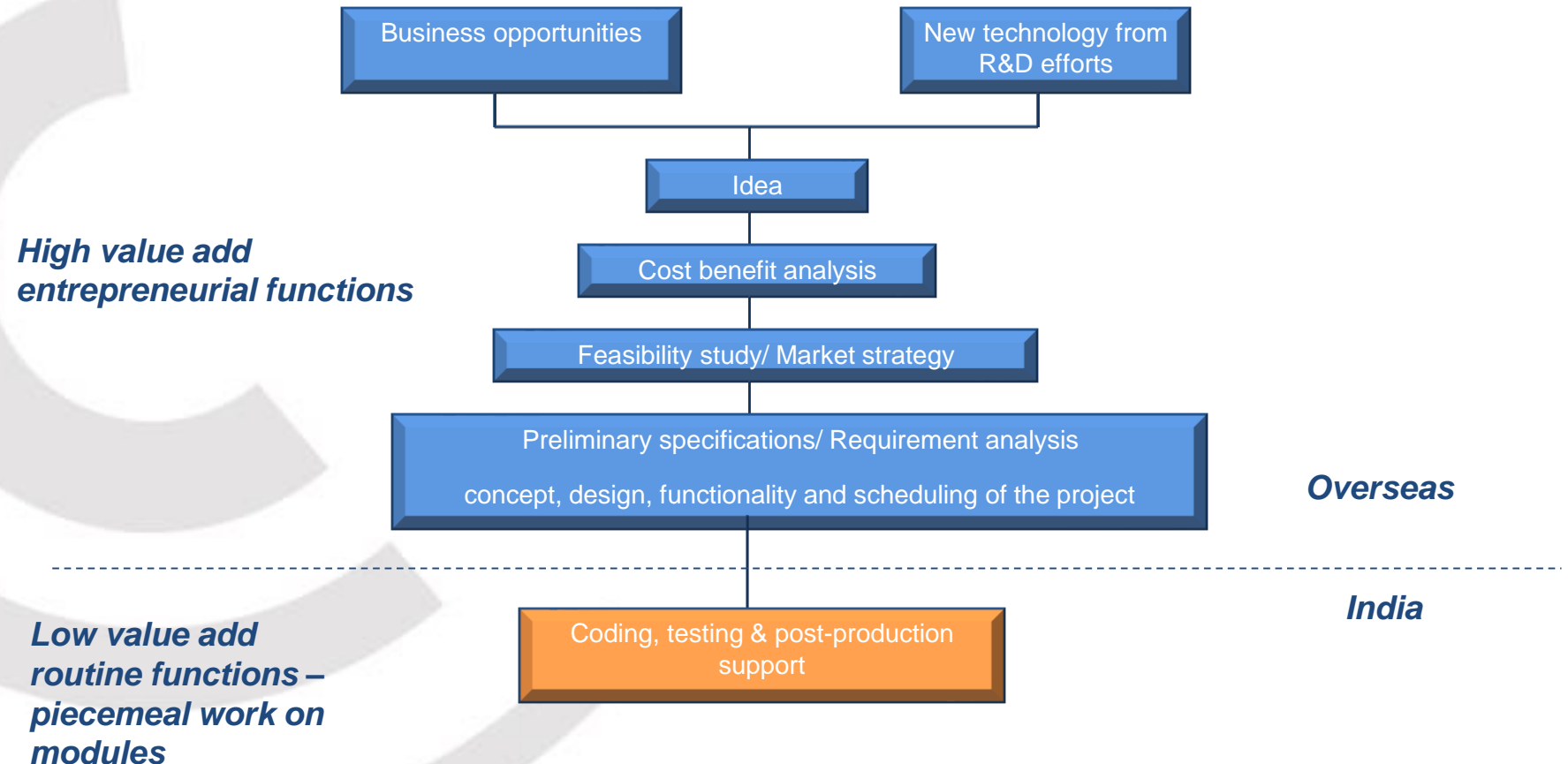
# Indian Revenue's Approach – A Snapshot

## Treatment of Cost Plus Captive Units (IT/ITES)



**Arm's length Price determined at 25-30%**

# Understanding Functions – Value Chain Analysis for Software Services



# Understanding Risk - Captive vs Independent

## Taxpayer/ Tested party

### Captive

- Limited risk profile
  - Not market facing (Ltd price & market risk)
- Assured return in most cases
- Access to global technology and marketing support

## Comparable

### Independent

- Full-fledged risk taker
- Return contingent on market conditions
- May own intangibles

- Risk adjustment is essential – but how to make risk adjustment?
- Revenue ignoring risk differential and imposing ad-hoc adjustments



# Solution – Filter Out Wrong Comparables

Software Products

Captives are mere service providers not owning software products

Intangibles

No significant intangibles in fixed asset base

R&D

No intensive R&D (typically less than 3-4% of sales)

A & M

No intensive marketing activity (typically A&M spend less than 3-4%)

Turnover

Can't compare a 'pigmy' with 'giant' – Agnity India (Delhi Tribunal)



# **BEPS – Planning Implications (Attention: CFOs/ Tax Heads!)**

# BEPS Impact on Multinational Enterprises

Scenario	Potential Questions
Payment of royalty by subsidiary	<ul style="list-style-type: none"><li>❖ Whether entity charging royalty is actually carrying out any economic activity [Development, Enhancement, Maintenance, Protection, Exploitation (DEMPE) functions]?</li><li>❖ Whether entity received any economic benefit from availing the brand/technology</li></ul>
Contract R&D/captive services rendered by UAE subsidiary	<ul style="list-style-type: none"><li>❖ More enquiries on following aspects:<ul style="list-style-type: none"><li>- Department wise bifurcation of employees</li><li>- Qualification of employees</li><li>- Services defined under inter-company agreement</li><li>- Role played by Indian entity in entire value chain</li></ul></li><li>❖ Whether remuneration for the entity matches with the FAR contribution it makes? Profit split more suitable?</li></ul>

# BEPS Impact on Multinational Enterprises

Scenario	Potential Questions
Foreign entity operating as a distributor in global market	<ul style="list-style-type: none"><li>❖ Remuneration for the distributor vis-à-vis FAR profile, the value contribution, etc</li></ul>
Granting of loan	<ul style="list-style-type: none"><li>❖ Economic rational for granting interest free loans?</li><li>❖ Whether favourable borrowing options were available to overseas entity?</li></ul>
Intangibles registered outside UAE	<ul style="list-style-type: none"><li>❖ Bifurcation of intangibles related activities (DEMPE)</li><li>❖ Where does the intangibles actually get created?</li><li>❖ Group's intangibles strategy</li></ul>

# Intangible Planning – What must be done?

## Mapping of DEMPE Functions Across the Group

*State of Alignment of Return with DEMPE Functions*

	Title	Funding	DEMPE Functions
Country A	Yes	Yes	Yes
Country B	No	No	No
Country C	No	No	No

*Divergence of Return and DEMPE Functions – Requires alignment*

	Title	Funding	DEMPE Functions
Country A	Yes	No	No
Country B	No	No	Yes
Country C	No	Yes	No

# Intangibles - Planning Implications (Cont)

- OECD's Revised Guidance in terms of DEMPE Functions is the new planning platform - Taxpayers must re-evaluate intangible returns in light of the new guidance (address gaps between value creation and return allocation)
- Inter-alia, OECD BEPS Guidance addresses Transfer Pricing controversy around marketing intangibles, royalty pay outs and R&D centers
- Dovetail planning for Intangibles (DEMPE Functions) with POEM (Key management & commercial Decisions)

# Three Tier Documentation - Implications

- Tax Authorities have information on global supply chain
- Tax Authorities have access to clear picture on distribution of functions across the globe
- Information can be used for **risk based audit** – select cases wherein taxable profits are low despite high value of other economic activity indicators – turnover, number of employees etc
- Possibility of **increase in the number of disputes**
- Need for Corporate Finance/ Tax Teams to **harmonize CbCR/ Master-files and Local Files** – apply **coordinated** approach

## Ashutosh Mohan Rastogi Speaker Profile



Founding Partner at Amicus (Law Firm) and Tax Counsel/ Advisor with more than 15 years of experience in Transfer Pricing and International Taxation

### Tax/ Transfer Pricing Advisor

Ashutosh has successfully represented several multinational companies before tax authorities in Transfer Pricing/ International Tax audits and provides Transfer Pricing planning / documentation services

- Transfer Pricing Documentation, preparation of Local, Master-files and CbCR
- Transfer Pricing Planning & Profit Benchmarking
- Transfer Pricing Audit Defense
- Transfer Pricing Litigation (before Transfer Pricing Officers and higher Courts)

Assisted by:

**Aanchal Kesari**  
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### Tax Counsel (Tribunal/ High Court)

Regularly argues Tax/ Transfer Pricing matters before Tax Tribunal / High Court. Some of the cases argued by Ashutosh before Delhi Tribunal.

- De Diamond (Auto) – whether manufacturing and trading constitutes one business (Delhi Tribunal)
- Pyramid It Consulting (Software & Staffing) – Accept-reject of comparables (Delhi Tribunal and High Court)
- Astra Business Services (Software) – Exclusion of branded comparables
- Corbus IT Consulting (Procurement) – Interest imputation on receivables
- Renu Creations – Best Judgement Assessment

Rated as the Transfer Pricing Lawyer of the Year by Finance Awards (2017)  
Recommended by Legal 500 (2014-2020) for Transfer Pricing advisory and dispute resolution services

Education: SRCC, Eco(Hons), LLB, LLM, New York University School of Law (Tax & Corporate Law)



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**Let's stay strong and fight back:**

- **Stay home, stay safe**
- **Maintain Social Distancing**
- **Eat Healthy**
- **Exercise**
- **Think Positive**
- **Follow Government Guidelines**

*Remember nothing lasts forever, better days are coming, but they will come faster with faith.*