



# Transfer Pricing Developments: Future Business Models for Managing Global Companies

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*Session 14.00 – 16.00*

**JUBILEE CONFERENCE 1995 - 2015**  
**FOUNDATION FOR INTERNATIONAL TAXATION**

Chairman: **Gautam Doshi**, Reliance ADA India

Panel leader: **Caroline Silberztein**, Baker & McKenzie, France

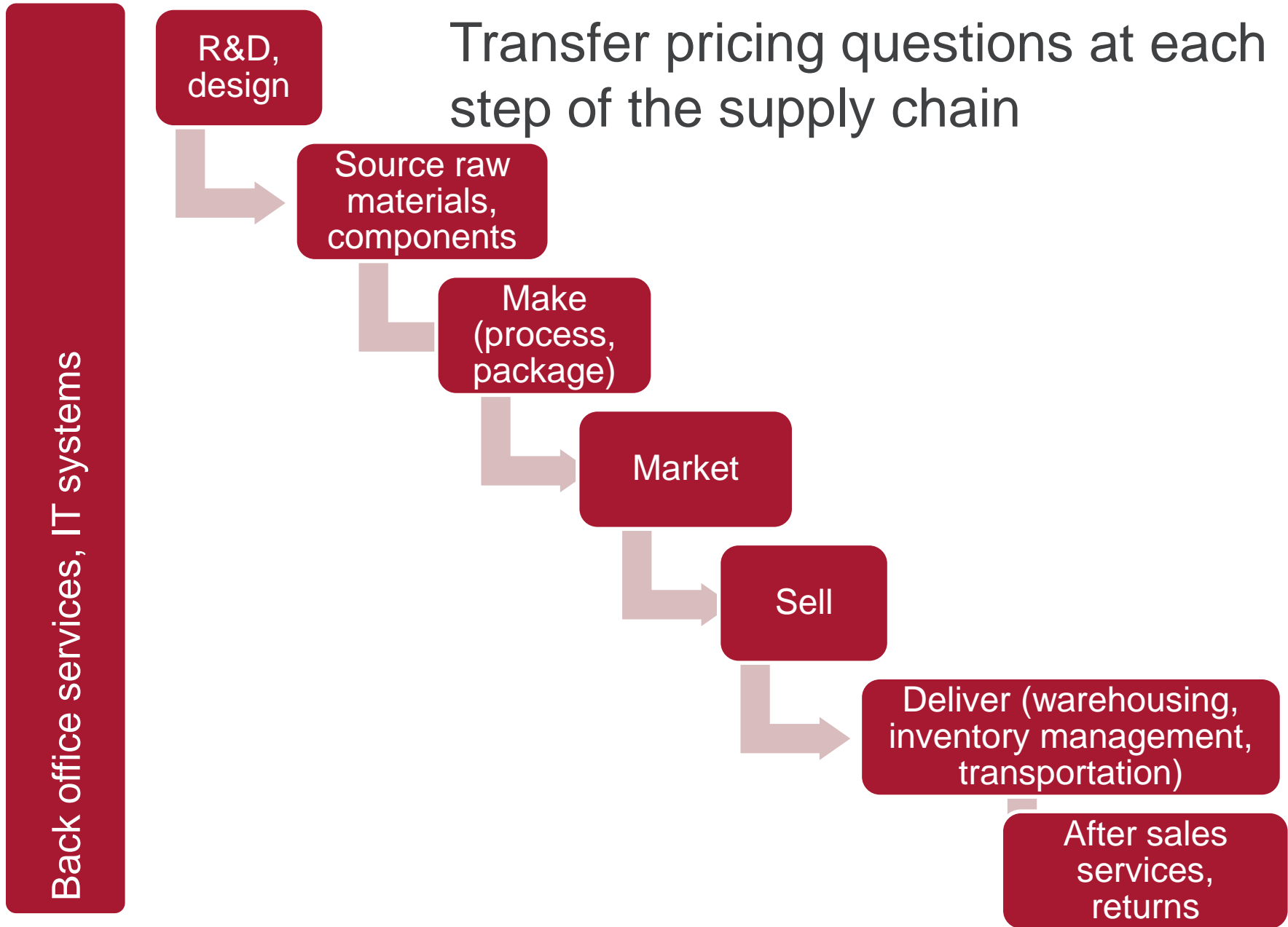
Panellists:

- **Anis Chakravarty**, Deloitte, India
- **Carol Dunahoo**, Baker & McKenzie, USA
- **Daniel Erasmus**, TRM, South Africa, Africa & USA
- **Sanjiv Malhotra**, Baker & McKenzie, Singapore
- **T.P. Ostwal**, T.P. Ostwal & Associates, India
- **Kamlesh Varshney**, Tax Commissioner responsible for APAs, India

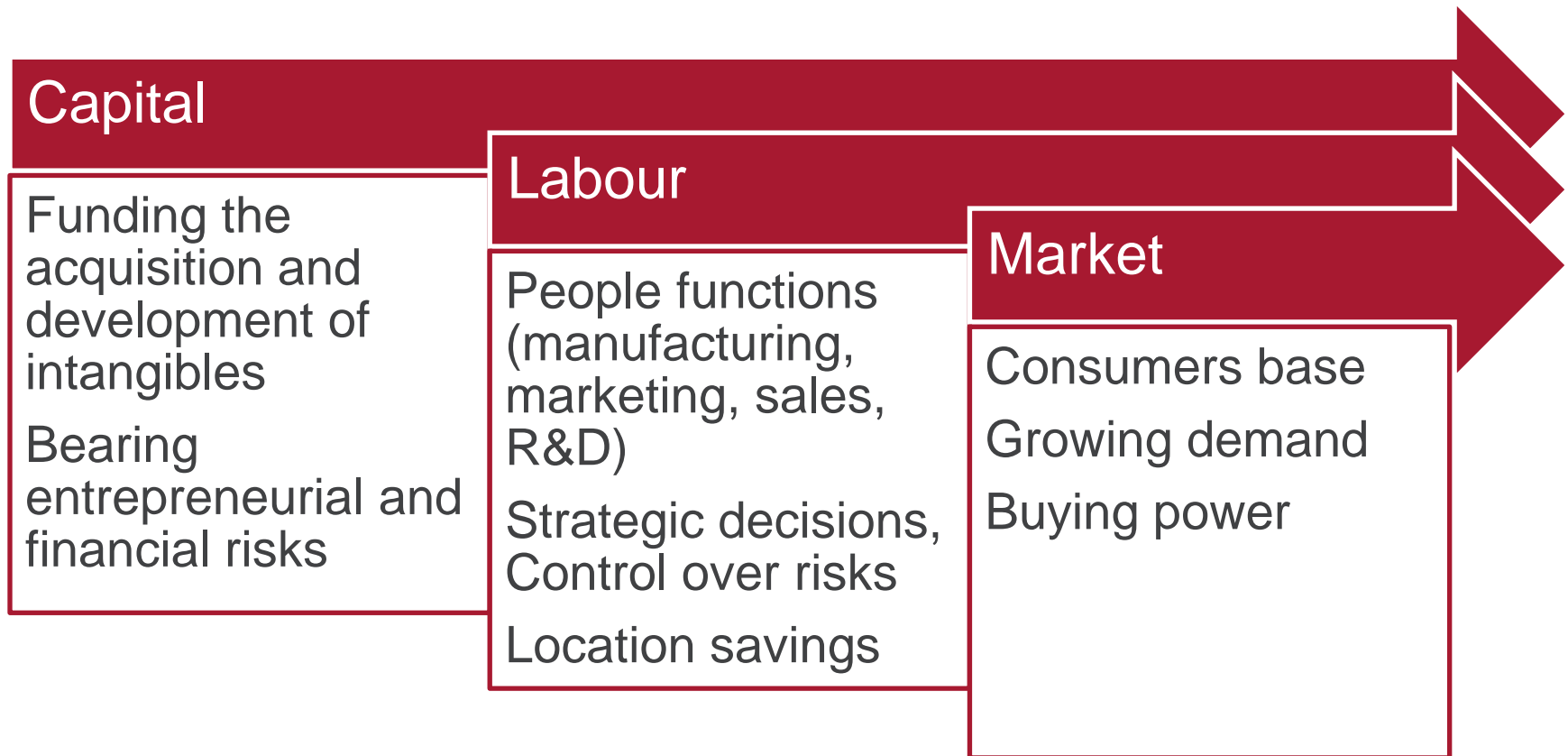


**1. “ASSURE THAT TRANSFER PRICING OUTCOMES ARE IN LINE WITH VALUE CREATION”**

# Transfer pricing questions at each step of the supply chain



# Creation of value ?



## **2. INTANGIBLES AND “DEMPE” FUNCTIONS**



# OECD-G20 Definition of intangibles for transfer pricing purposes

- Something which is not a physical asset or a financial asset, which is capable of being owned or controlled for use in commercial activities, and **whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances.**
- Not always an intangible asset for **accounting** purposes
- Availability and extent of **legal, contractual, or other forms of protection** may affect the **value**.
- **Separate transferability** is not a necessary condition for an item to be characterised as an intangible for transfer pricing purposes
- **Differing country definitions / experiences ?**

# Rewarding contributions of affiliates to the creation of intangible value : the “DEMPE” functions

- Determine, by means of a functional analysis,
  - which member(s) perform and exercise **control over development, enhancement, maintenance, protection, and exploitation** functions (“**DEMPE**”),
  - which member(s) provide **funding and other assets**, and
  - which member(s) assume the various **risks** associated with the intangible,
- whether or not legal owner of the intangible.



# In summary, where the legal owner...

**Performs and controls all of the DEMPE functions;** provides all assets, including funding, necessary to the DEMPE; and assumes all of the risks related to the DEMPE

- entitled to **all of the anticipated returns derived from the exploitation** of the intangible

Provides funding and **exercises control over the financial risk associated with the provision of funding**, without the assumption of, including the control over, any other specific risk

- generally only expect a **risk-adjusted return on its funding**

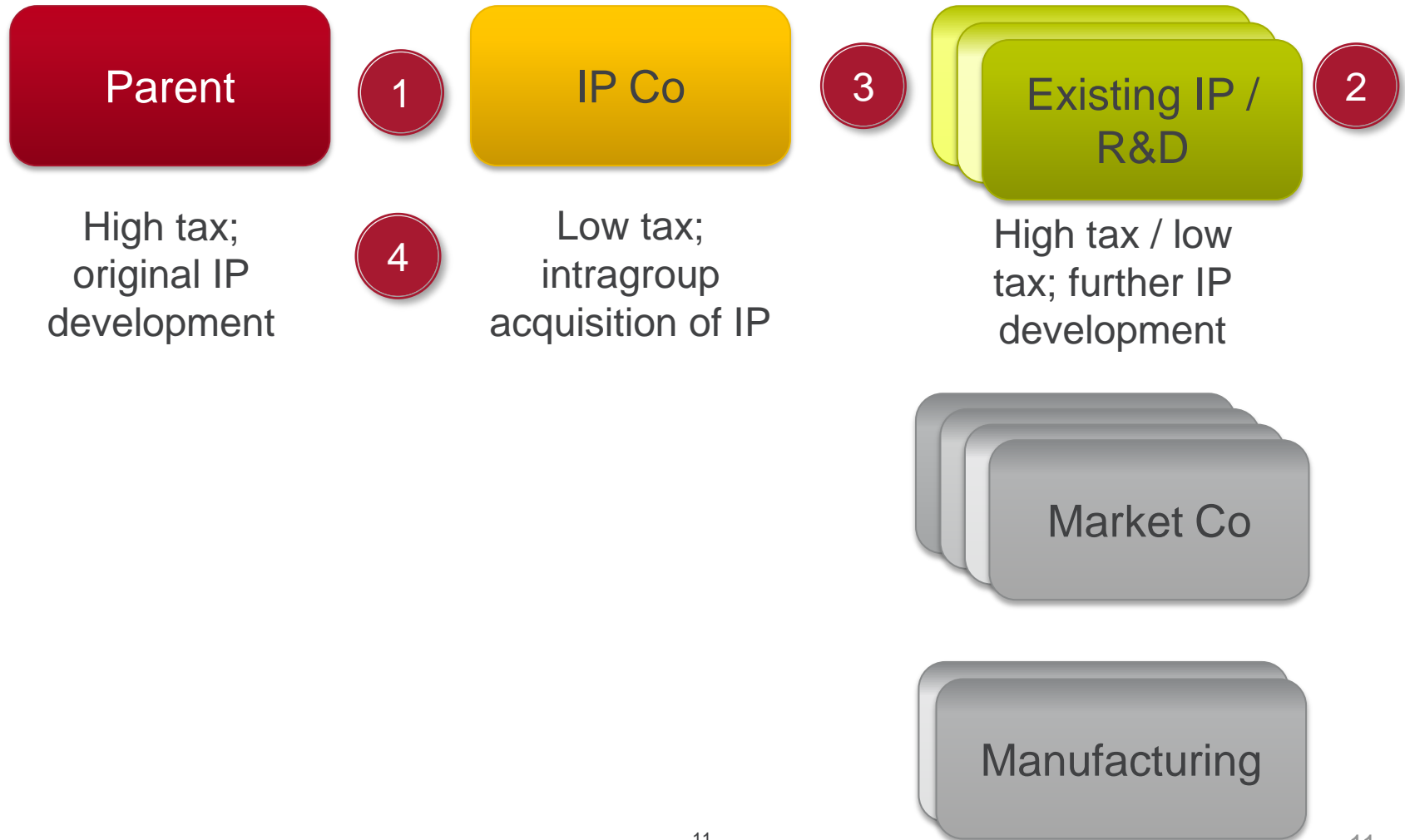
**Lacks the capability to control the risk** associated with investing in a riskier financial asset

- it will have no more than a **risk-free return**; even less if legal ownership is disregarded

# 3. IP HOLDING COMPANY

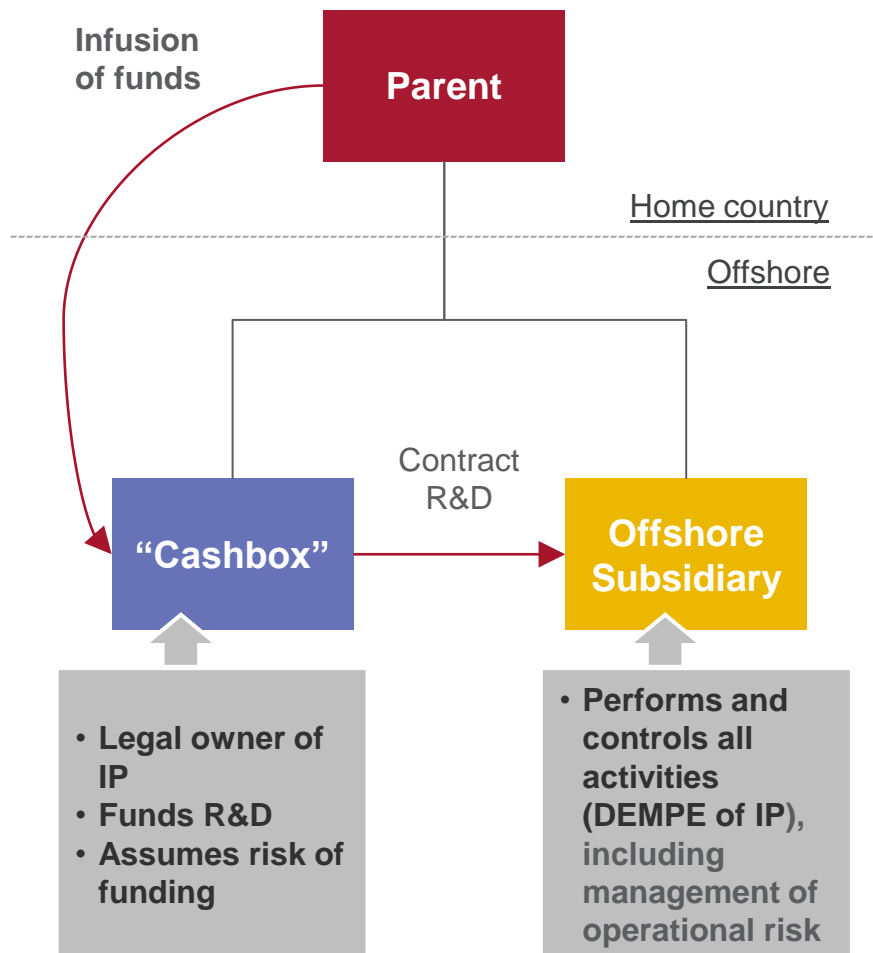


# High tech company



# Legal owner of product intangibles: Royalties

## Bermuda cash box



### Actions 8-10: Transfer pricing

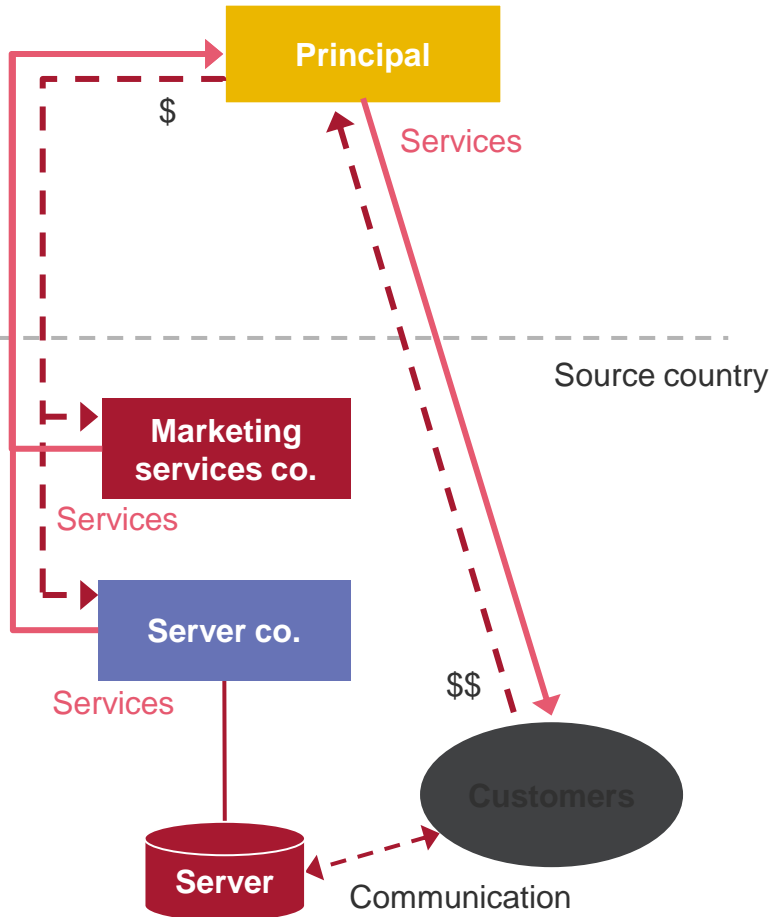
- Bermuda legal owner and funds development
- India performs
  - Design and control of R&D program
  - Management and control of budget
  - Control over strategic development
  - Defence and protection
  - Ongoing quality control
- Three scenarios possible:
  - No management of funding risk: entitlement to no more than risk-free return
  - Management of funding risk: entitlement to risk adjusted return
  - Management of funding risk and operational risk: not a cash box!

# 4. DIGITAL SUPPLIES



# Digital supplies

## Online auction platform, internet search and downloadable digital products



### Actions 8-10: Transfer pricing issues

- “*Profits should be taxed where economic activities deriving the profits are performed and where value is created.*” [G20 Leaders’ Communiqué Brisbane Summit, 15-16 November 2014]
- Particular area of interest
  - Interplay with Action 1
  - “Demand” or “supply” creates value?
- Fragmented functions:
  - Who, in fact, controlling the activity? Increased interdependencies create uncertainty
  - Will “profit split” likely be viewed by some as a reliable method? Value of fragmented functions in the value chain may not be observable in transactions with independent parties

## Multisided Business Models – Scenario 2 (from OECD 2014 draft on profit split)

RCo Group provides Internet services to customers worldwide:

- Advertising services ; fee based on number of users who click;
- Online services free of charge to users; provides RCo with a substantial amount of data

R = Parent company

- Original development and funding of technology IP

Local subs :

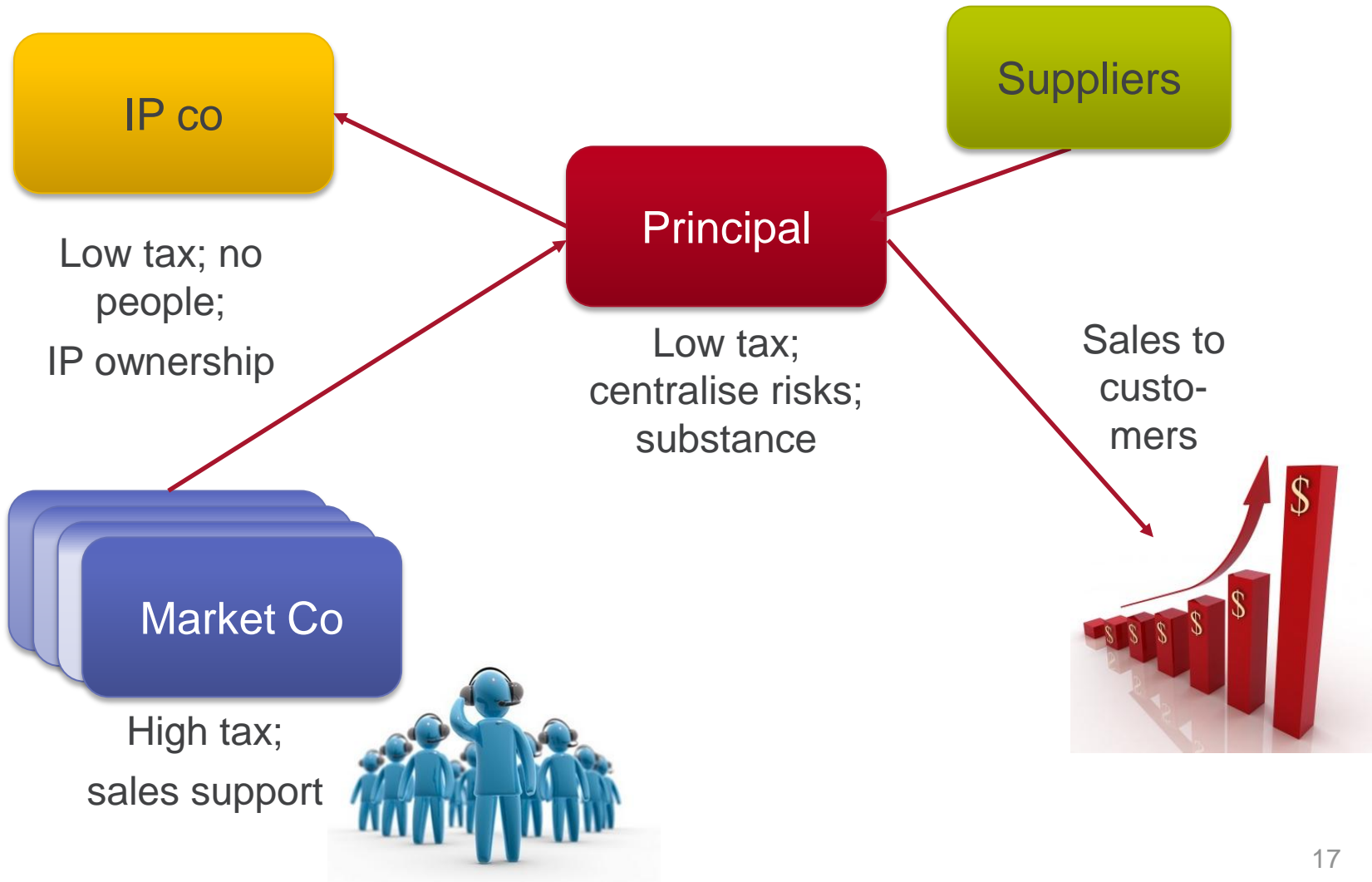
- Promote use of online services free of charge to users
- Generate demand and adapt advertising services

# 5. SALES ORGANISATIONS





# Principal and Sales



## Unique and valuable contributions – Scenario 3

- P = manufacturer of high tech equipment;
- Extensive R&D; funding and ownership of technology IP;
  - Global trademark; broad guidance to subs on marketing strategy



S = sales and marketing  
Close relationships with customers, on-site services;  
Extensive stock of spare parts;  
Highly proactive maintenance program; advice to customers  
and adaptation to local conditions =>  
Significant competitive advantage



## 6. MARKETING



# Example 5

- Company P in Country A owns trademark.
- It manufactures the products and sells them to Distributor in Country B.
- Distributor incurs Advertising, Marketing and Promotional expenses in Country B.

Does Company P acquire / develop

- a local marketing intangible ?
  - “economic ownership” of the trademark ?
  - co-ownership of the trademark ?
- Consider 3 cases :

### CASE 1 : ROS, no AMP refund

Sales revenue	1,000
COGS (Transfer Pricing)	(550)
Advertising, Marketing, Promotion (AMP)	(100)
Other OPEX	(300)
Return on Sales : 5%	+ 50

### CASE 2: ROS, AMP refund

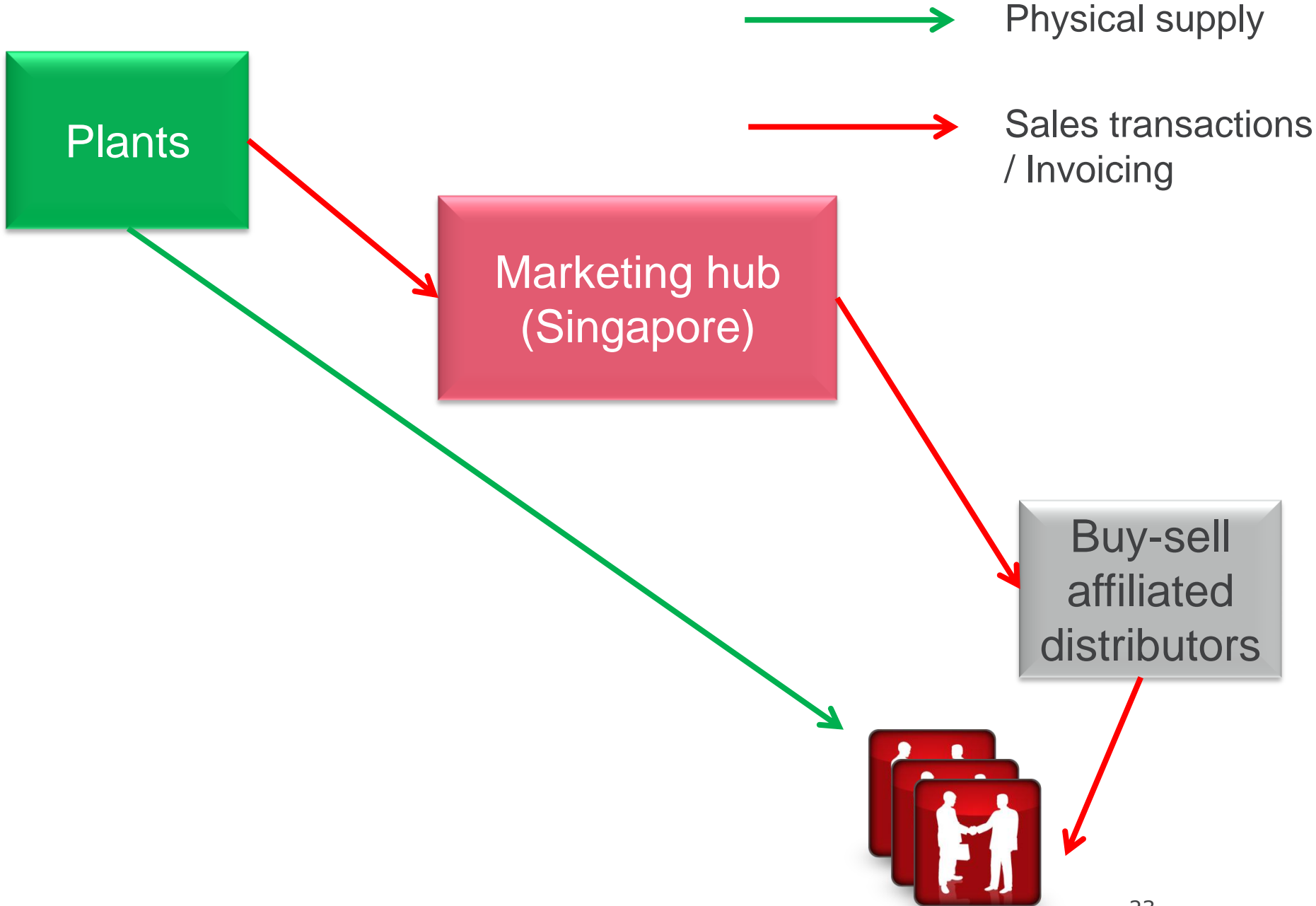
Sales revenue	1,000
COGS (Transfer Pricing)	(650)
Advertising, Marketing, Promotion (AMP)	(100)
Other OPEX	(300)
Reimbursement of AMP	+100
Return on Sales : 5%	+ 50

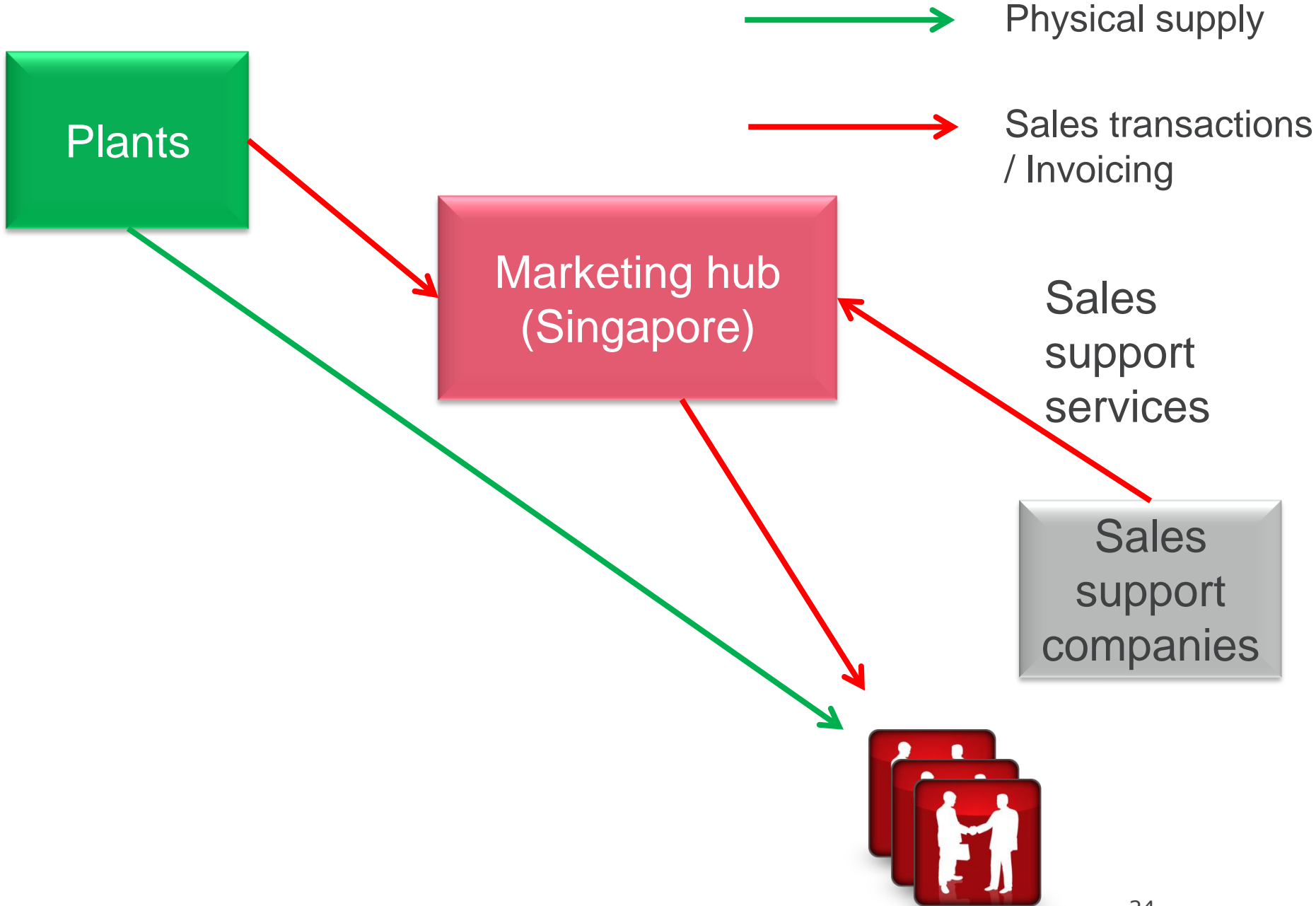
### CASE 3: ROS, partial AMP refund

Sales revenue	1,000
COGS (Transfer Pricing)	(580)
Advertising, Marketing, Promotion (AMP)	(100)
Other OPEX	(300)
Reimbursement of AMP	+30
Return on Sales : 5%	+ 50

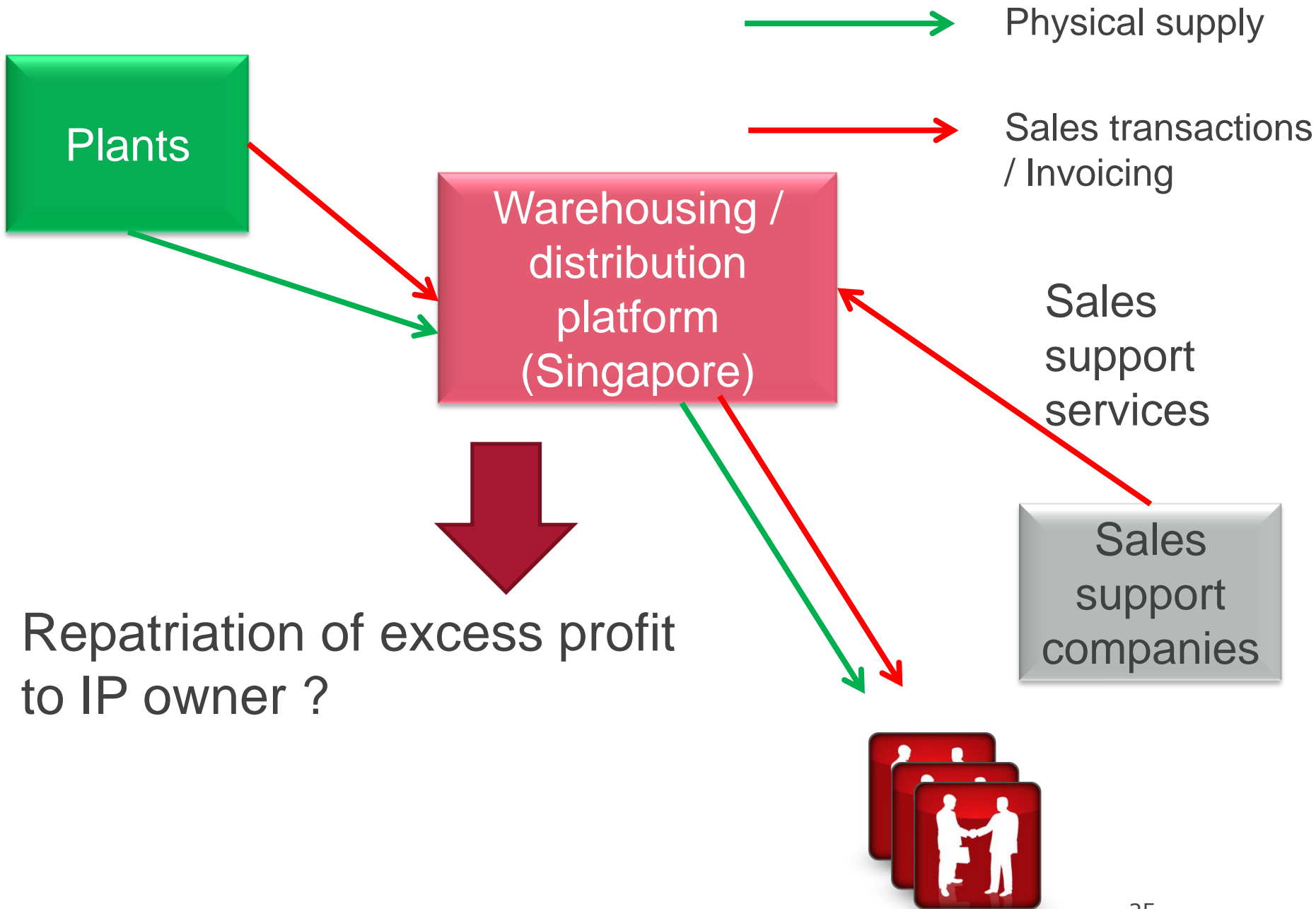
# 7. MARKETING AND PROCUREMENT HUBS

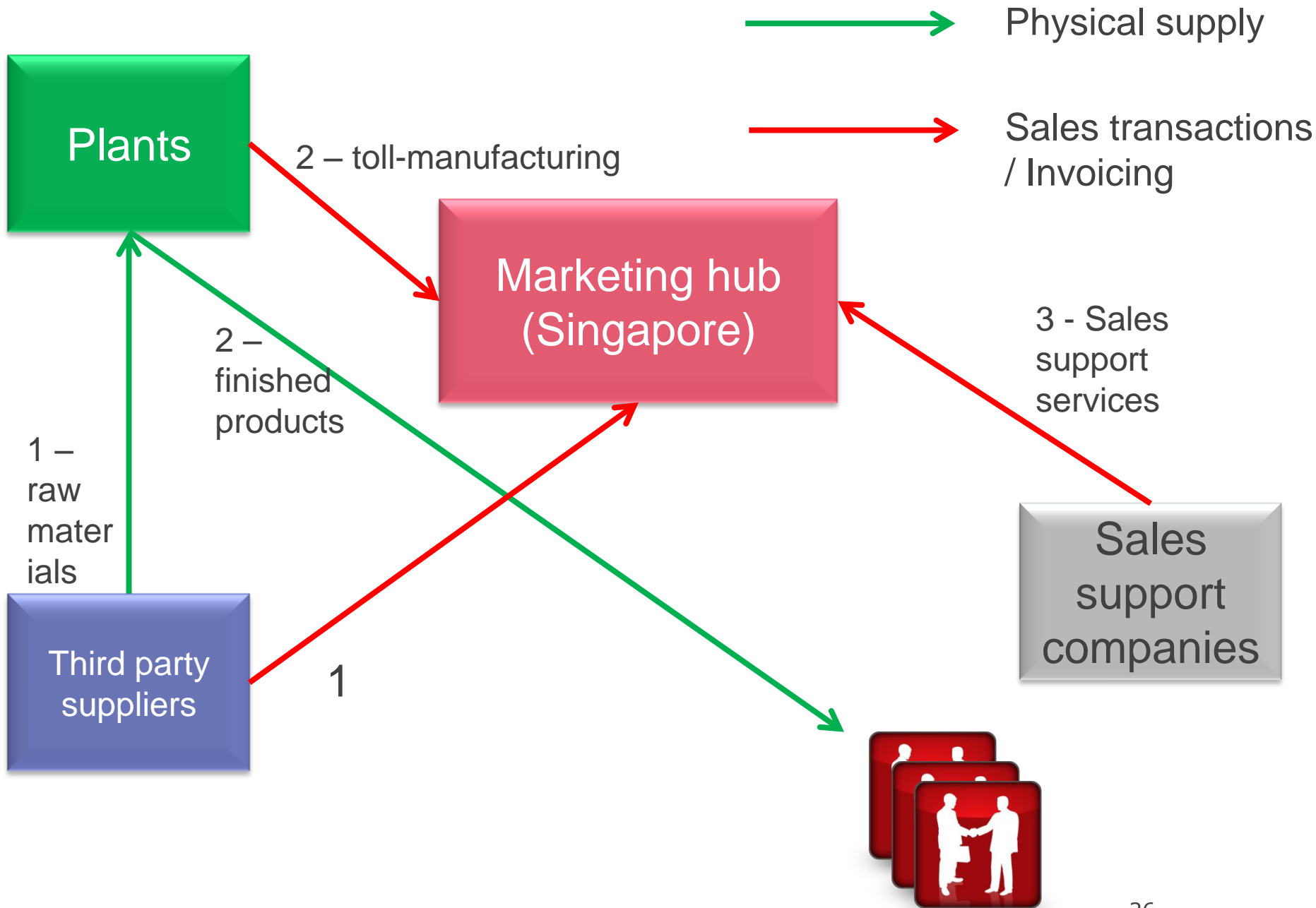








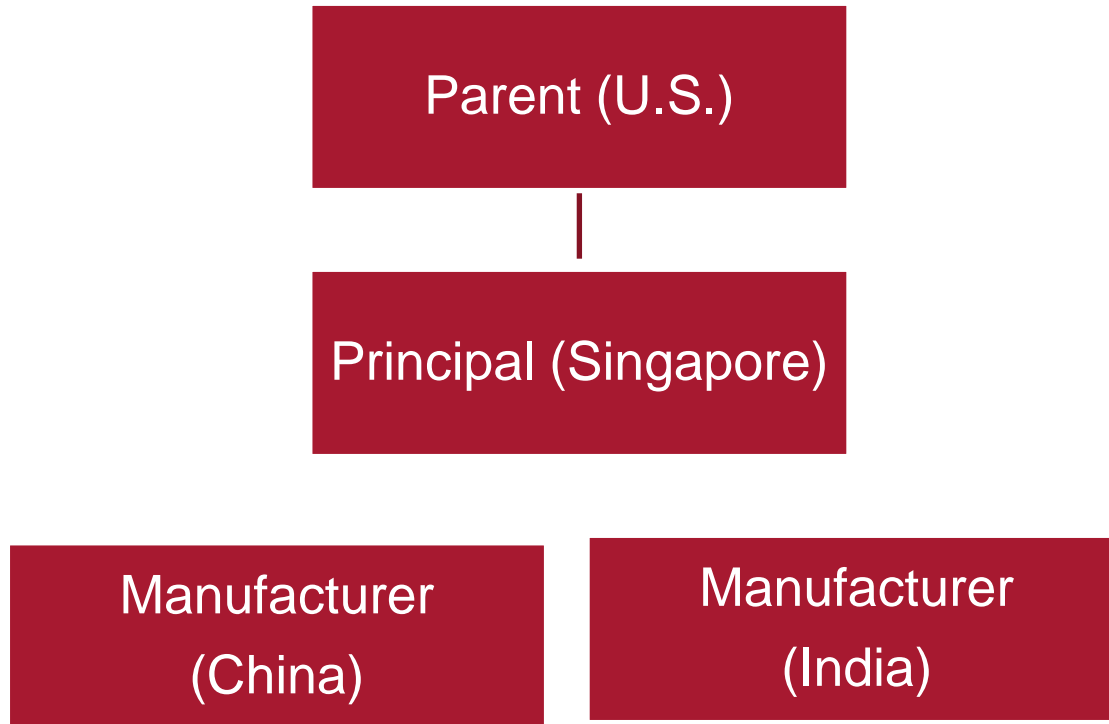




# 8. LOCATION SPECIFIC ADVANTAGES



# Location Savings

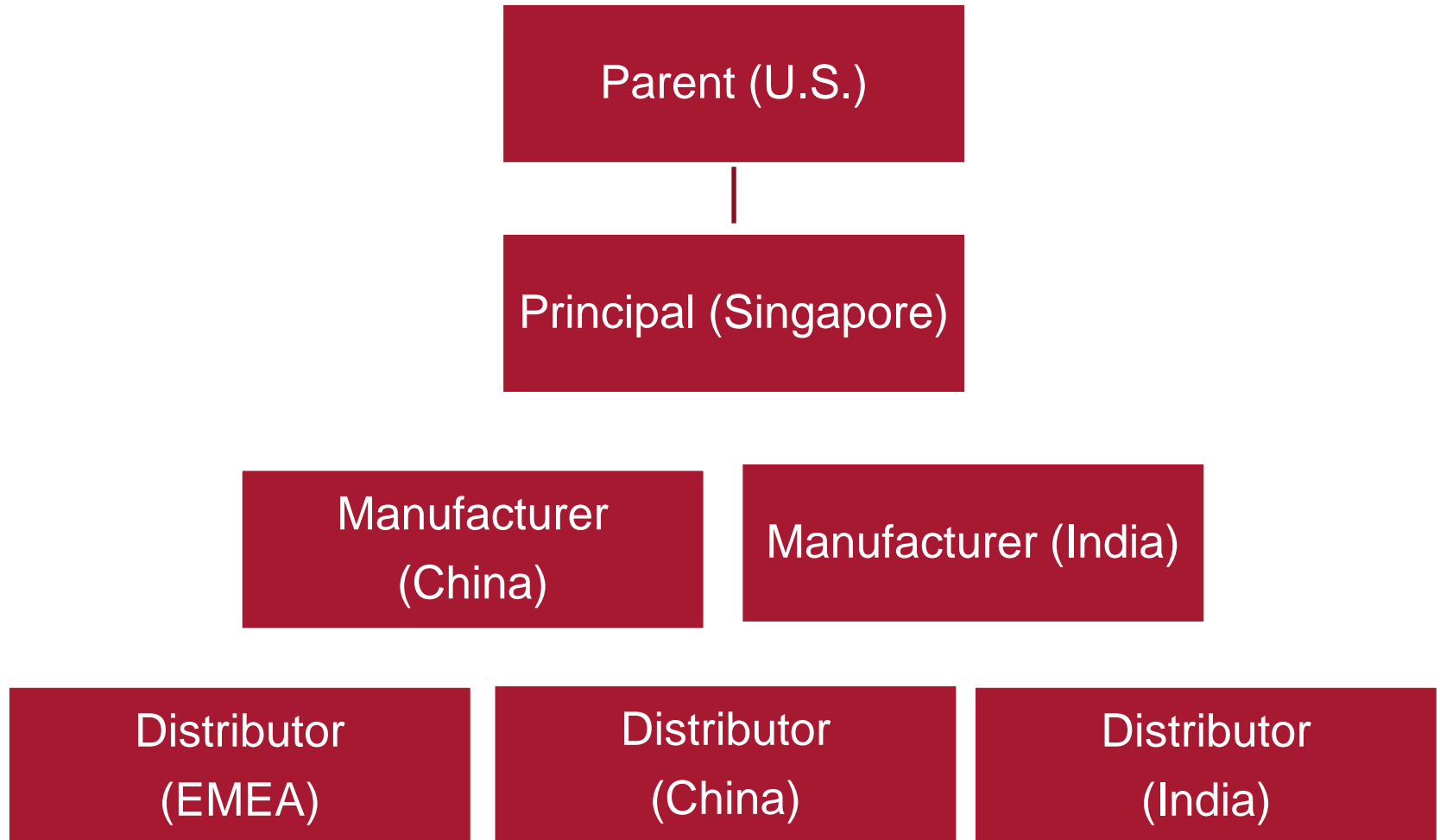


## How to quantify Location Savings:

- Compare to whom, what, and where ?
- What if no relocation of activity ?
- What if products evolve ?
- What about “dis-savings”?

## How to attribute Location Savings ?

# Market Premium



# 9. CONCLUSIONS, Q&A



Thank you

