THE DEFINITION OF ASSOCIATED ENTERPRISES UNDER THE OECD MODEL TREATY AND THE RELATIONSHIP BETWEEN TRANSFER PRICING AND ANTI-AVOIDANCE

BY

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THE ISSUES AT STAKE, IN PRACTICE

ASSOCIATION = KEY REQUIREMENT FOR APPLICATION OF TP REGIME(S) AND SPECIFIC OBLIGATIONS AND RIGHTS

✓ Arm’s Length Standard
✓ Selection and Application of Most Appropriate TP Method
✓ Requirement of TP Documentation
✓ Application of TP Specific Audit Rules and, possibly, Penalties
✓ Application of TP Specific Dispute Resolution Mechanisms
✓ Obligation of Corresponding Adjustment under Art. 9(2) OECD MC
THE ISSUES AT STAKE, IN PRACTICE

CHALLENGEABLE AGAINST AN ARM’S LENGTH BENCHMARK

IF RELATED
SAME TRANSACTION
IF UNRELATED

CAPABLE OF BECOMING THE BENCHMARK AND OF AFFECTING DEDUCTIBILITY OF COMPARABLE TRANSACTIONS/DEALINGS UNDERTAKEN BY THE ENTERPRISE
STRUCTURE OF THE PRESENTATION -THE TRIANGLE-

- THE ESSENTIAL FRAMEWORK -

- CONFLICTING DOMESTIC NOTIONS -

- THE PROBLEM & A TENTATIVE SOLUTION -

- ECONOMICS OF MULTINATIONAL BUSINESSES -

- CONTEXT & RATIONALE OF THE OECD MODEL CONVENTION -

- UNCERTAIN WORDING & REGIME UNDER ART. 9 OECD MC -
THE NOTION OF ASSOCIATED ENTERPRISES IN SELECTED COUNTRIES

AUSTRALIA

- Control relationship not required
- Transfer pricing rules also applicable in tax avoidance / tax evasion transactions.

BRAZIL

- No equity interest required. Also includes non-resident exclusive agent, distributor or dealer for the purchase of sale of the company’s goods, services, rights.
- Dealings with counterparties resident in countries with a favourable corporate income tax rate (< 20 %)
THE NOTION OF ASSOCIATED ENTERPRISES IN SELECTED COUNTRIES

FRANCE
- Two Forms of Control are relevant:
  - De Jure: Majority holding - Voting rights – Decision Making Power
  - De Facto: Contractual or even factual relationships

GERMANY
- Substantial participation (holding of at least 25%)
- Controlling influence
- Interest in income of other person

ITALY
- Very broad notion of De Facto Control
THE NOTION OF ASSOCIATED ENTERPRISES IN SELECTED COUNTRIES

- **JAPAN**
  - Direct or indirect ownerships of at least 50% of the shares with or without voting power
  - Special relationship enabling to substantially determine business policies of other enterprise.

- **NETHERLANDS & UK**
  - Wording similar to the one contained in Art. 9(1) of the OECD MC

- **UNITED STATES**
  - Parties owned or controlled directly or indirectly by same interests;
  - Ability to cause parties to make arrangements differing from those made by unrelated parties.
THE NOTION OF ASSOCIATED ENTERPRISES IN SELECTED COUNTRIES

SHAREHOLDING  DIRECTORSHIP

G

DE JURE CONTROL

DOMESTIC NOTIONS OF ASSOCIATED ENTERPRISES

DE FACTO CONTROL

SEVERAL TYPES OF CONTRACTUAL OR FACTUAL RELATIONSHIP
“… 1. Where

a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, …”
What does “participation” mean?

Does it require that the “managers” of both/all the companies involved in the scrutinized transaction/s are the same?

Can the enterprises be regarded as associated if their “managers” are linked by:

- family relationships (e.g. parent-children, brother-sister, otherwise relatives);
- common membership of organizations, circles, groups of interests;
- past common experiences or friendship?

Do the internal control/audit (Sarbanes-Oxley) procedures play a role in the present assessment?
PARTICIPATION IN CAPITAL
- NON VOTING SHARES -

INDIVIDUAL NON VOTING SHAREHOLDER "A"

51% NON VOTING EQUITY INTEREST

BUSINESS DEALING

CO. "B"
**PARTICIPATION IN CONTROL**

- **CONTRACTUAL CONTROL** -

<table>
<thead>
<tr>
<th>CONTROLLING PARTY</th>
<th>CONTROLLED PARTY</th>
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<tr>
<td>Franchisor</td>
<td>Franchisee</td>
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<tr>
<td>Intellectual Property Licensor</td>
<td>Intellectual Property Licensee</td>
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<tr>
<td>Monopolist Supplier</td>
<td>Purchasers/Clients</td>
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<tr>
<td>Sole Client/Purchaser</td>
<td>Supplier(s)</td>
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<tr>
<td>Exclusive Agent</td>
<td>Principal</td>
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<tr>
<td>Principal</td>
<td>Non-exclusive Agent</td>
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Co. A. is financially overexposed vis à vis Co. B, which granted to Co. A an amount of credit essential for Co. A’s business. Are Co. A and Co. B associated enterprises for the purposes of Art. 9(1)?

Are Co. A and Co. B associated enterprises for the purposes of Art. 9(1)?
- Participation in the capital or management of the same (third) Company -
- Participation to the same joint venture project -

JOINT VENTURE PROJECT
(NO LEGAL ENTITY)
“...Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest (royalties), having regard to the debt-claim (use, right or information) for which it is (they are) paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article ....”

OECD MODEL CONVENTION - ART. 11(6)
OECD MODEL CONVENTION – ART. 12(4)
“...It is clear from the text that for this clause to apply the interest (royalties) held excessive must be due to a special relationship between the payer and the beneficial owner or between both of them and some other person. There may be cited as examples cases where interest (royalty) is paid to an individual or legal person who directly or indirectly controls the payer, or who is directly or indirectly controlled by him or is subordinate to a group having common interest with him. These examples, moreover, are similar or analogous to the cases contemplated by Article 9. ...”
“...the concept of special relationship also covers relationship by blood or marriage and, in general, any community of interests as distinct from the legal relationship giving rise to the payment of the interest (royalty)…”

OECD MODEL COMMENTARY TO ART. 11 - § 34
OECD MODEL COMMENTARY TO ART. 12 - § 24
“... As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the laws of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State...”
Vienna Convention On The Law Of Treaties

SECTION 3. INTERPRETATION OF TREATIES

Article 31 – “General rule of interpretation”

Article 32 – “Supplementary means of interpretation”
1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:
   (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;
   (b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

ARTICLE 31 – “General rule of interpretation”
3. There shall be taken into account, together with the context:
   (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
   (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
   (c) any relevant rules of international law applicable in the relations between the parties.

4. A special meaning shall be given to a term if it is established that the parties so intended.

ARTICLE 31 – “General rule of interpretation”
“Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:
(a) leaves the meaning ambiguous or obscure; or
(b) leads to a result which is manifestly absurd or unreasonable”.

ARTICLE 32 – “Supplementary means of interpretation”
“... The context is determined in particular by the intention of the Contracting States when signing the Convention as well as the meaning given to the term in question in the legislation of the other Contracting State...”

OECD MODEL COMMENTARY ON ART. 3 - § 12
THE RELEVANT CONTEXT OF THE CONVENTION

CASES OF TREATY RELIEF OF THE ECONOMIC DOUBLE TAXATION

- TRANSFER PRICING
- DIVIDEND TAX CREDIT

SAME ECONOMIC SUBJECT

COMMUNITY INTEREST
THE RELEVANT CONTEXT OF THE CONVENTION

COMPANY A

COMPANY B

COMPLETELY UNRELATED COMPANIES

TAXABLE INCOME

NON DEDUCTIBLE EXPENSE

NO TREATY RELIEF OF ECONOMIC DOUBLE TAXATION
THE RELEVANT CONTEXT
OF THE CONVENTION

THE CONTEXT

<table>
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<tr>
<th>RELIEF OF ECONOMIC DOUBLE TAXATION</th>
<th>PECULIARITY OF THE TP PHENOMENON</th>
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<td>SAME ECONOMIC SUBJECT</td>
<td>ABILITY TO INFLUENCE DECISION MAKING</td>
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Control (for the purpose of this Standard) is the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities.

A subsidiary is an enterprise that is controlled by another enterprise (known as the parent).
An associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control over those policies.
**Significant Influence**

If an investor holds, directly or indirectly through subsidiaries, 20% or more of the voting power of the investee, it is presumed that the investor does have significant influence, unless it can be clearly demonstrated that this is not the case.

Conversely, if the investor holds, directly or indirectly through subsidiaries, less than 20% of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated.

A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.
**Significant Influence**

The existence of significant influence by an investor is usually evidenced in one or more of the following ways:

(a) representation on the board of directors or equivalent governing body of the investee;

(b) participation in policy making processes;

(c) material transactions between the investor and the investee;

(d) interchange of managerial personnel; or

(e) provision of essential technical information.
Persons shall be deemed to be related only if:

(a) they are officers or directors of one another's business;
(b) they are legally recognized partners in business;
(c) they are employer and employee;
(d) any person directly or indirectly owns, controls or holds 5% or more of the outstanding voting stock or shares of both of them;
(e) one of them directly or indirectly controls the other;
EU CUSTOMS CODE
Article 143 Implementing Code

Persons shall be deemed to be related only if:

(f) both of them are directly or indirectly controlled by a third person;

(g) together they directly or indirectly control a third person or

(h) they are members of the same family:
   - husband and wife,
   - parent and child,
   - brother and sister (whether by whole or half blood),
   - grandparent and grandchild,
   - uncle or aunt and nephew or niece, etc. (…)

OTHER INTERNATIONAL STANDARDS
Persons who are associated in business with one another in that one is:

- the sole agent,
- sole distributor or
- sole concessionaire, however described, of the other shall be deemed to be related only if they fall within the above outlined criteria.