Business Restructuring

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Taxation of multinational enterprises: principle for sharing the tax base

- **The international consensus on the arm's length principle:**
  - **Profits of parts of a multinational enterprise should be determined as if they were operating independently**
- **Application:**
  - **The more valuable the functions, assets and risks of an affiliate, the higher the profits attributed to it**

Business restructurings

- Implementation of global organisations; cross-border redeployment by multinational enterprises of their functions, assets and risks and of the associated profit / loss potential.
- Intangible property and entrepreneur risks, which carry the biggest part of the profit / loss potential, are also the most geographically mobile.

What do we see in practice?

- Since the mid 90s: typically, conversion of “full fledged distributors” into “commissionnaires”; of “full fledged manufacturers” into “toll-manufacturers”; etc.

- Migration of intangible assets and of risks, together with asociated profit potential, often to low tax jurisdictions.

Business restructurings

- Can significantly affect the corporate income tax base in some countries
- Can be needed by business to adapt to globalisation
- OECD objective: arrive at a consensus on the correct treatment from an international tax point of view.
  - Recognise legitimate concerns of governments,
  - Not create tax barriers to MNE groups that need to restructure for genuine commercial reasons.

Business restructurings

- The transfer pricing question:

"Are there conditions made or imposed in the restructuring which differ from conditions that would be made between independent enterprises ?"

  - ✓ Article 9 of the OECD and UN Model Tax Conventions; arm's length principle

Business restructuring

- **Other issues:**

✓ **Permanent establishments (at a later stage)**

✓ **Domestic anti-abuse rules (not covered)**

✓ **VAT, customs… (not covered)**

Transfer pricing issues in business restructuring

- A discussion draft on the transfer pricing aspects (Article 9 of the MTC) was released on 19 September 2008 for public comment
- Deadline for comments

  = 19 February 2009
- Public consultation likely to be held in 2009

The September 2008 OECD discussion draft

- Risk allocation, risk transfer: to what extent is it arm's length?
  - Theoretically, in the open market, the assumption of increased risk must also be compensated by an increase in the expected return (TPG 1.23).
  - In arm's length dealings, it generally makes sense for parties to be allocated a greater share of those risks over which they have relatively more control (TPG 1.27).

The September 2008 OECD discussion draft

- Remuneration for the restructuring itself:
  - Not always the case that a restructuring would be remunerated at arm's length
  - Transfer of something of value (rights or other assets)
  - Indemnification for the termination or substantial renegotiation of existing arrangements

The September 2008 OECD discussion draft

- Remuneration for the post-restructuring transactions:
  - The arm's length principle and TP Guidelines apply in the same way to transactions that result from a restructuring and those which were structured as such from the beginning
  - (But there may be differences in the comparability analysis)

The September 2008 OECD discussion draft

- Recognition issues for transfer pricing purposes:
  - A tax administration's examination of a controlled transaction ordinarily should be based on the transaction actually undertaken by the associated enterprises as it has been structured by them (TPG 1.36).

The September 2008 OECD discussion draft

- **Recognition issues <u>for transfer pricing purposes</u>: two exceptions (TPG 1.37):**
  - **If the economic substance differs from the form;**
  - **If the arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the tax administration from determining an appropriate transfer price.**

Conclusion

- This project is important and complex. The Committee on Fiscal Affairs calls for balance between taxpayer and government perspectives. Objective of the OECD = improved certainty and clarity.

- This is a long term project. Business involvement is key; it has been and will continue to be sought at all stages of the project under different forms.

Thank you for your attention.

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