Global Tax/Transfer pricing Trends & Key controversy issues

Supporting with practical business case studies

Housekeeping

Keep your mics muted for the duration of the webinar

Keep your cameras turned off

Please post any questions to Q&A

The session will be recorded, as well as the Q&A session

The presentation slides will be available on L&D on the PKF Hub

This session is NASBA or CPE accredited

About the Speakers

Jimy Cruz
PKF - Transfer Pricing
Transfer pricing Centre of Excellence Leader – Mexico
Jimy.cruz@pkf.com.mx

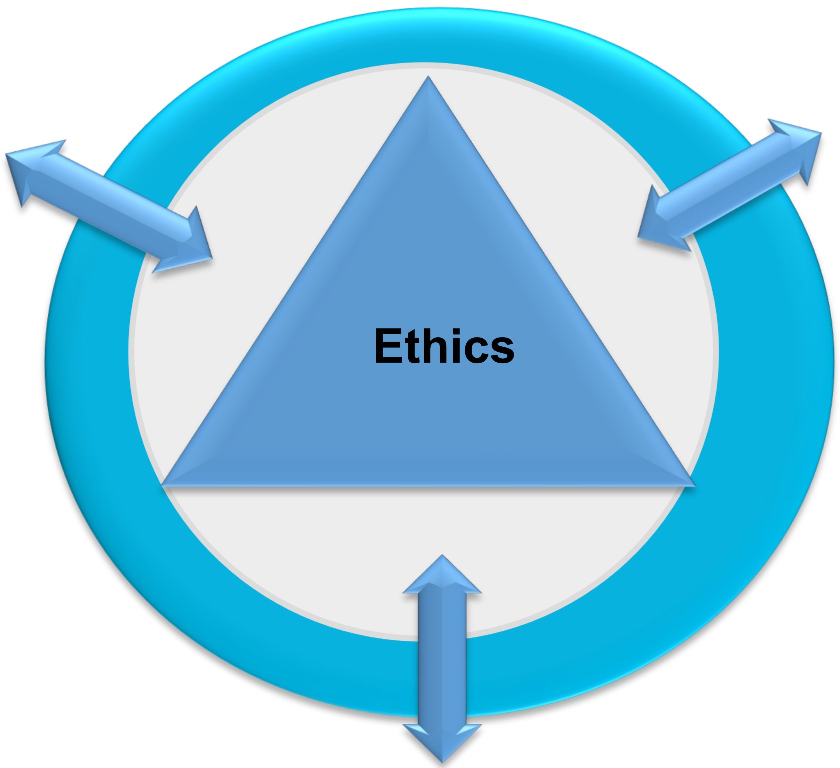
Anand Vemuganti
PKF - Transfer Pricing
Senior Economist, Transfer pricing Centre of Excellence – Mexico
anand.vemuganti@pkf.com.mx

Contents

Transfer Pricing Conceptual Framework

Regulatory Environment

Keeping track of evolving transfer pricing regulatory framework. Regulatory framework include OECD TP guidelines/ UN TP guidelines, Country specific Acts, regulations & guidelines, International treaties & commentary, Global Accounting standards etc..



Economic theories

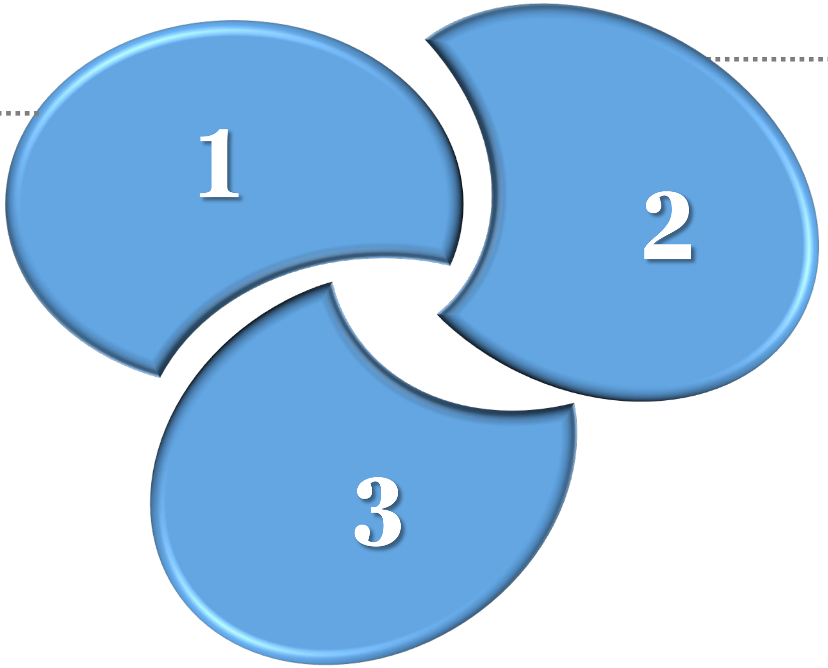
Amalgamation of economic theories and models based on financial projections, mathematical derivations and statistical models.

Practical Aspects

Understanding the practical aspects like ground level procedures, understanding the concept of burden of proof and identifying inconsistencies and provide practical solutions

Global Transfer Pricing Trends

Global Tax/Transfer pricing Trends



1 Transposing BEPS 2.0 Pillar Two into domestic legislation.

- The Pillar Two design introduces minimum effective taxation of 15% for multinational entities (MNEs) with annual revenues of at least **€750 million** implementing as domestic legislation for 138 member countries.
- EU adoption of **minimum tax directive** – transpose to legislation by end of 2023.
- **Safe harbor** that allows an MNE to avoid undertaking the full detailed GloBE rule calculations for those jurisdictions in which the safe harbor is met
- Pillar Two contemplates the filing of a standardized GloBE information return that is still under development by the Inclusive Framework
- New **nexus and profit allocation** rules aimed at assigning a greater share of the taxing rights over global business income to market jurisdictions.

2 New transparency and governance requirements

- The implementation of new regimes for reporting by **digital platforms and with respect to crypto assets**, along with the expansion of the Common Reporting Standard
- Mandatory disclosure regimes and beneficial owner registries in Latin American jurisdictions.
- **EU Public CbCR** directive – starting on or after 22nd June 2024. This will apply to both EU-based MNEs and non-EU based MNEs doing business in the EU
- Australia will subject large MNEs, including those headquartered outside Australia to public reporting of country-by-country tax and operating data starting July 2023.
- Update on Middle East, where disclosure requirements are already existed in Egypt, KSA, Qatar & Jordon – UAE provisions will be effective from 1st June 2023.

3 Sustainability tax measures

- EU has reached a provisional agreement to implement an **EU Carbon Border Adjustment Mechanism** (CBAM) from 1st October 2023.
- The EU adopted a temporary “solidarity contribution,” which is effectively a windfall tax on energy company profits, that will be levied by EU Member States.
- How the existing transfer pricing model allocates marginal income or loss associated with **ESG** projects across jurisdictions.

Regional Updates and Tax Governance Trends

Ongoing reforms in Americas

Global Trends and Developments in Transfer Pricing Controversy

Key TP Controversy Issues to Consider

Critical focus on TP documentation – The documentation provided is deemed to be insufficient, the likelihood of challenge sharply increases.

Harmonised approach – The impact of BEPS-related guidance regarding profit split methods, financial transactions, and other issues.

Automotive & Media - Rethink established paradigms and to evaluate arm's-length results in industries that are undergoing fundamental transformation (for example, a shift to electric cars, and a shift from theatrical release of films to streaming).

Local Savings - To determine properly what entity effectively owns the local savings. Expense intensity issues.

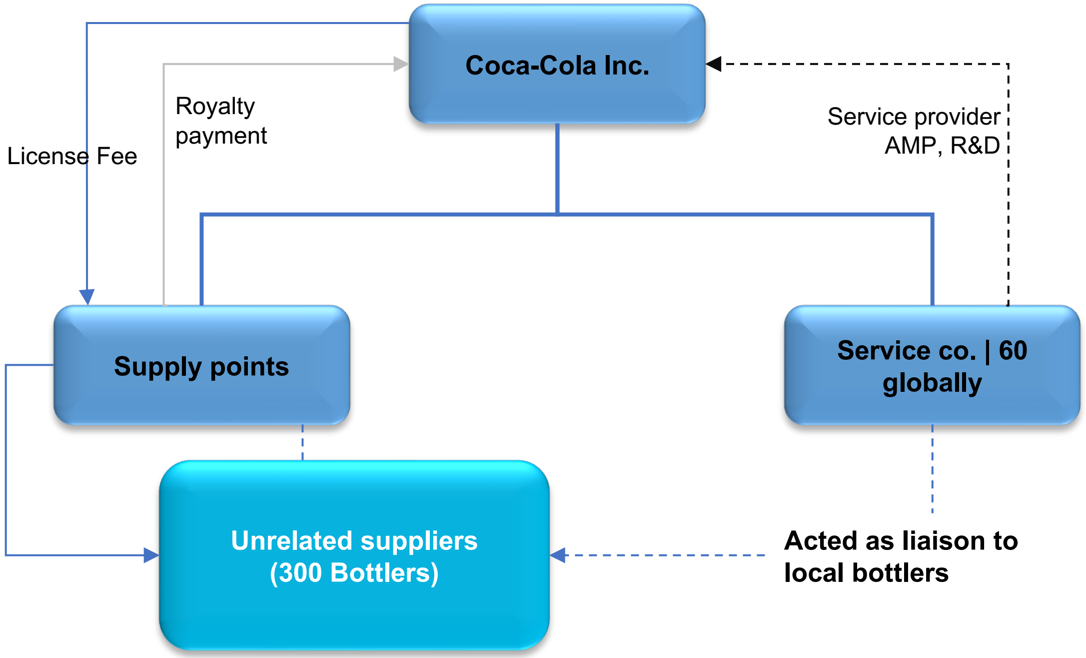
Audit and Litigation trends – The information requests in audits have become increasingly sophisticated and comprehensive, as auditors often request detailed information concerning the motivation behind specific transactions.

Price Discrimination – Selling of different blocks of products at different prices. CUP Method may not apply.

Coca Cola – U.S. Transfer Pricing Controversy Case

Case Study: Coca Cola – U.S. Controversy

The recently-decided Coca Cola case provides an important model for transfer pricing globally. On November 18, 2020, the U.S. Tax Court ruled that the IRS had not abused its discretion under §482 when it reallocated more than USD 9 billion in income for tax years 2007 to 2009 to petitioner Coca-Cola from its foreign manufacturing affiliates. Below illustration depicts the relationships among the USA parent entity (Coca-Cola), its foreign manufacturing affiliates (labelled "supply points"), its local foreign service companies ("ServCos"), its independent foreign bottlers, and its "extremely valuable" intangible assets (including trademarks, logos, patents, secret formulae, and "the best-known brand in the world".



- Marketing intangibles to be asserted by a taxpayer must be established by contract
- The non-exclusivity and termination at will of the licenses would not constitute a “sale” or conveyance under intellectual property law
- Taxpayers cannot affirmatively use the economic substance doctrine to assert marketing intangibles
- Pure advertising is an annual expense and likely would not constitute brand building or “non-routine” expenses

The Coca-Cola case highlights the importance of legal agreements. The starting point to assert that Coca-Cola’s affiliates possess economically beneficial marketing intangibles starts with the legal relationship by and between the respective parties. The court painstakingly reviewed the Distribution and/or License Agreements and found that Coca-Cola’s legal agreements did not support its argument that the Supply Points possessed non-routine marketing intangibles.

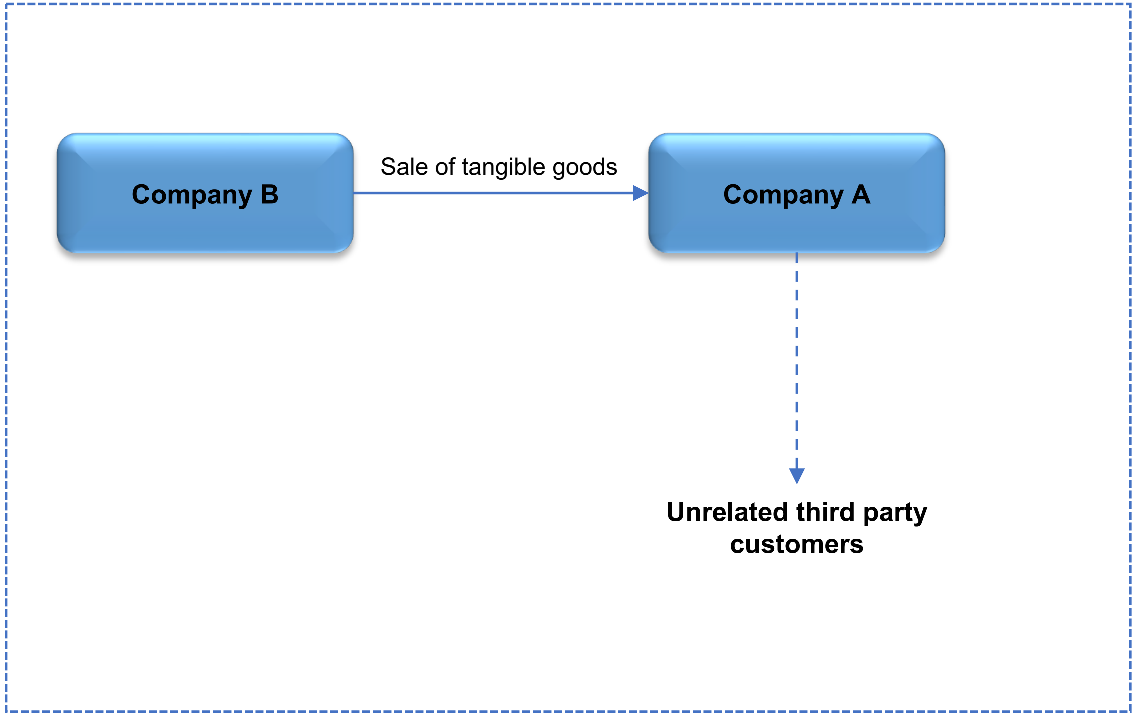
PKF Mexico COE – Approach to TP Best Practices

TP Modelling - Resale Price Methodology – Apple Case Study

The **RPM** is generally applied in circumstances where tangible property is purchased and resold and the reseller has not added substantial value to it, either by physically altering the goods or by the use of intangible property. In this regard, the RPM is typically used to analyze the transfer pricing of distribution operations. In making comparisons for purposes of the RPM, fewer adjustments are normally needed to account for product differences than under the CUP method, because minor product differences are less likely to have as material an effect on profit margins as they do on price

^TP = RSP x (1-^GPM)

Where there is an adjustment in gross margin.



- **^TP** = the adjusted Transfer Price of a product sold between Company A and B.
- **RSP** = the Resale Price at which a product is sold by Company A to unrelated customers in the region; and
- **^GPM** = the Gross Profit Margin that Company A should earn, defined as the ratio of gross profit to net sales. Gross profit is defined as Net Sales minus Cost of Goods Sold.
- **^GP** = adjusted gross profit includes addition of operating loss difference to current gross profit amount.

Resale Minus for Apple Distributors – Case Study Analysis

Intergroup Transfer

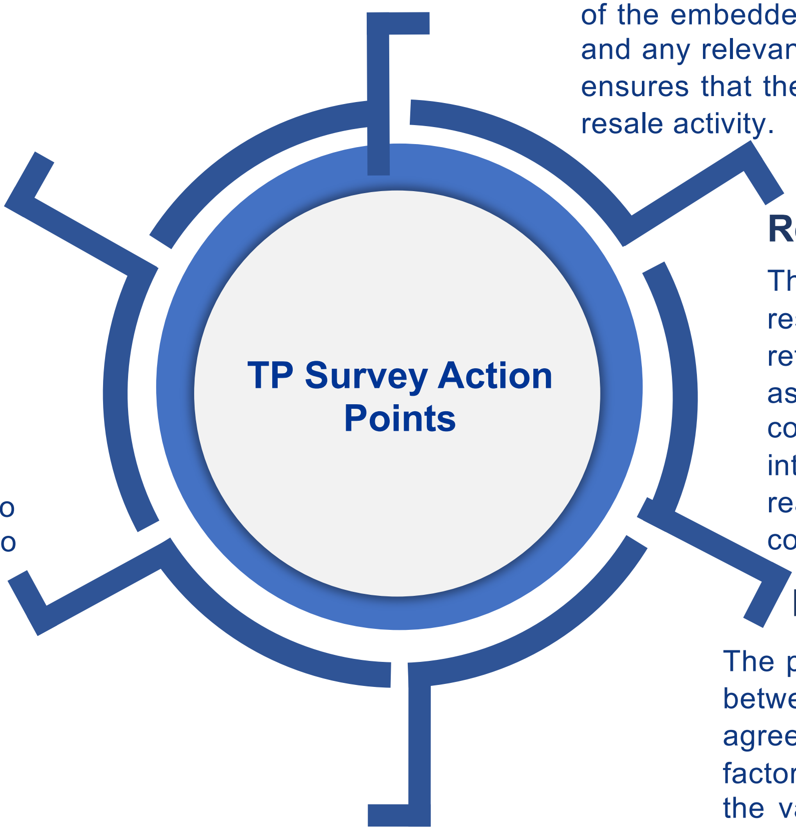
Apple Inc. which owns the intangibles and is typically responsible for the design and development of Apple products, transfers the finished products, including the embedded intangibles, to its subsidiaries for resale. This transfer is governed by internal pricing agreements or transfer pricing policies within the related party group.

Internal Pricing agreement

Apple Inc. and subsidiaries establish an internal pricing agreement or transfer pricing policy to govern the resale of Apple products. This agreement outlines the pricing methodology, profit allocation, and other relevant terms to ensure compliance with transfer pricing regulations and to maintain consistency with market conditions.

Compliance and Documentation

The parent entity and subsidiaries maintain comprehensive documentation to support the intercompany transactions, transfer pricing methodology, and the valuation of the embedded intangibles. This documentation ensures compliance with transfer pricing regulations and provides a robust defense in case of tax or regulatory scrutiny.



Valuation of Intangibles

Apple Inc. and subsidiaries determine a fair value for the intangibles embedded in the Apple products. This valuation considers various factors, such as the functionality and features of the embedded software, the brand value, customer demand, and any relevant licensing or royalty agreements. The valuation ensures that the pricing of the intangibles is appropriate for the resale activity.

Resale Pricing

The subsidiaries, acting as resellers, determine the resale price of the Apple products. The resale price reflects the value of the embedded intangibles, as well as other factors like production costs, market demand, competition, and the pricing guidelines specified in the internal pricing agreement. The resale price should be reasonable, aligning with market conditions and consistent with transfer pricing regulations.

Profit Allocation

The profit resulting from the resale minus activity is allocated between the parent entity and subsidiaries according to the agreed transfer pricing policy. The profit allocation considers factors such as the functions performed, risks assumed, and the value contributed by each entity within the related party group. This allocation should align with the arm's length principle and comply with applicable transfer pricing regulations.

American Airline – Case Study Analysis

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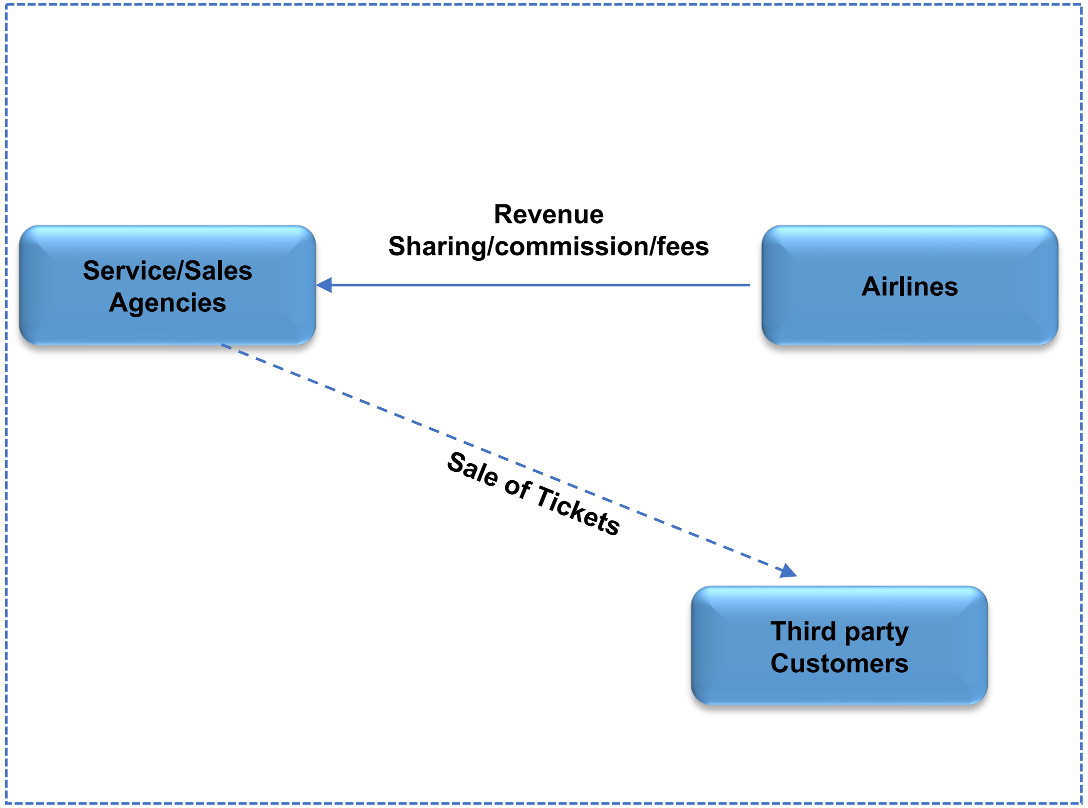
Determining ticket prices in an online world by related parties of American Airlines, carriers, service entities, and sales agencies worldwide, while considering the complexities of transfer pricing regulations, presents several challenges.



Cost Factors: Determining the price of flight tickets involves considering various cost factors. These include fuel costs, maintenance expenses, airport fees, crew salaries, aircraft leasing costs, and administrative overheads.

Transfer Pricing Methodologies: Related parties must employ appropriate transfer pricing methodologies to determine the price of flight tickets.

Revenue Sharing: In the case of related parties involved in the distribution and sales of flight tickets, revenue sharing arrangements are essential to ensure fair compensation and profitability. Service entities and sales agencies play a significant role in ticket sales and often receive a portion of the ticket price as commissions or fees.

Market Competition: Pricing flight tickets in the online world requires consideration of market competition. Related parties need to monitor competitor pricing strategies, market demand, and consumer behaviour to remain competitive.

Geographic Factors: Flight ticket pricing can vary across different geographic regions due to factors such as local taxes, fees, and regulatory requirements.

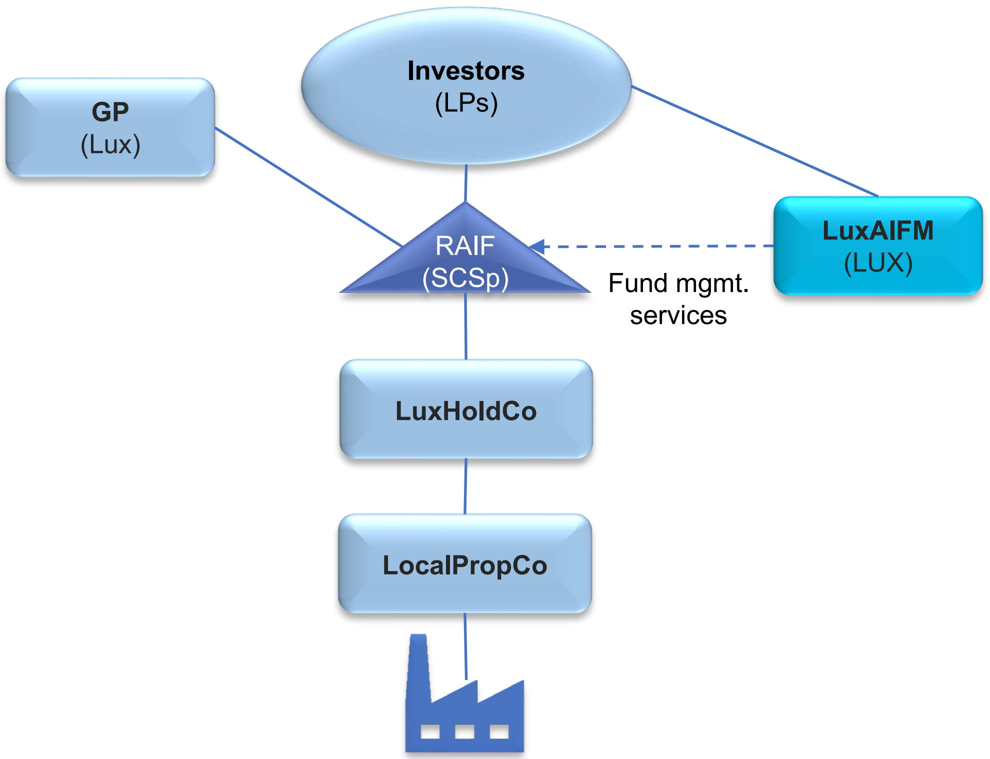
Seasonality and Demand: Flight ticket prices often fluctuate based on seasonal demand. Planning for peak travel periods, holidays, and events requires careful analysis of historical data, anticipated demand, and revenue goals

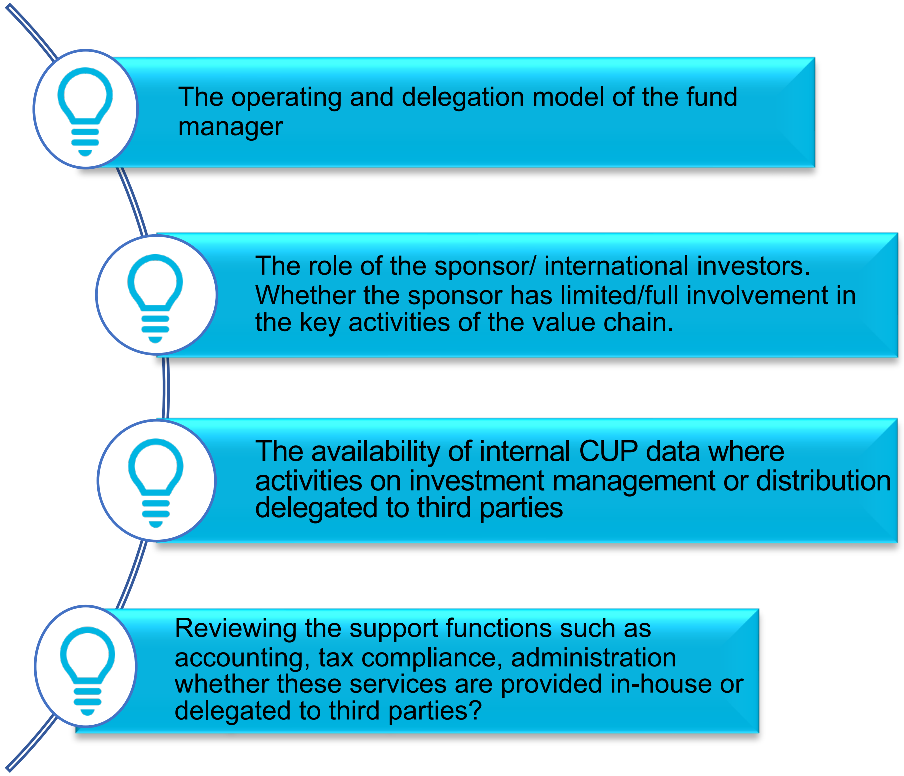
Customer Segmentation: Different customer segments may have varying price sensitivity and preferences. Related parties need to segment their customer base and tailor pricing strategies accordingly.

Promotions and Discounts: Offering promotions, discounts, and special offers is common in the online ticketing space to attract customers.

Fund Management Case – Luxemburg Infrastructure Fund

A Luxembourg infrastructure fund established as a Reserved Alternative Investment Fund (“RAIF”) in the legal form of a limited partnership is managed by a Luxembourg limited liability company which is the general partner (“Lux GP”) of the SCS. The international investors in the RAIF are limited partners (“LPs”) of the SCS. Lux GP appointed a Luxembourg alternative investment fund manager (“AIFM (Lux)”) which is owned by limited partners group.





Lux GP is in charge of the management and corporate governance of the RAIF and should be remunerated at arm’s length for both the functions performed and the amount of equity at risk. When it is not possible to apply the CUP method (e.g. in the absence of comparable data), the cost-plus method will likely be the most appropriate transfer pricing method for Determining an arm’s length remuneration for the functions performed. Given that Lux GP has an unlimited liability for the obligations of the RAIF, Lux GP should further earn an arm’s length remuneration for the equity at risk.

TP Policy for Healthcare Company - Approach to Value-Chain analysis

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Identification of value drivers

Key elements of the business that generate value and whose features, activities, strategies etc., provide a competitive advantage.

Identification of value chain

End to end value chain for the business.

Functional analysis

Detailed analysis of the functions performed, risks managed and the assets owned for each element of the value chain were performed. The detailed functional analysis identifies the concentration of activity, management of risk and ownership of assets around the group.

Value driver mapping

Mapping of identified key value drivers across the detailed value chain functional analysis to reconcile where value is created, focusing on:

- Nature and location of value generating activities
- Management of risks,
- Ownership of assets.

Value chain analysis/ Functional analysis

Proposed business model/ transactions

Selection of TP method

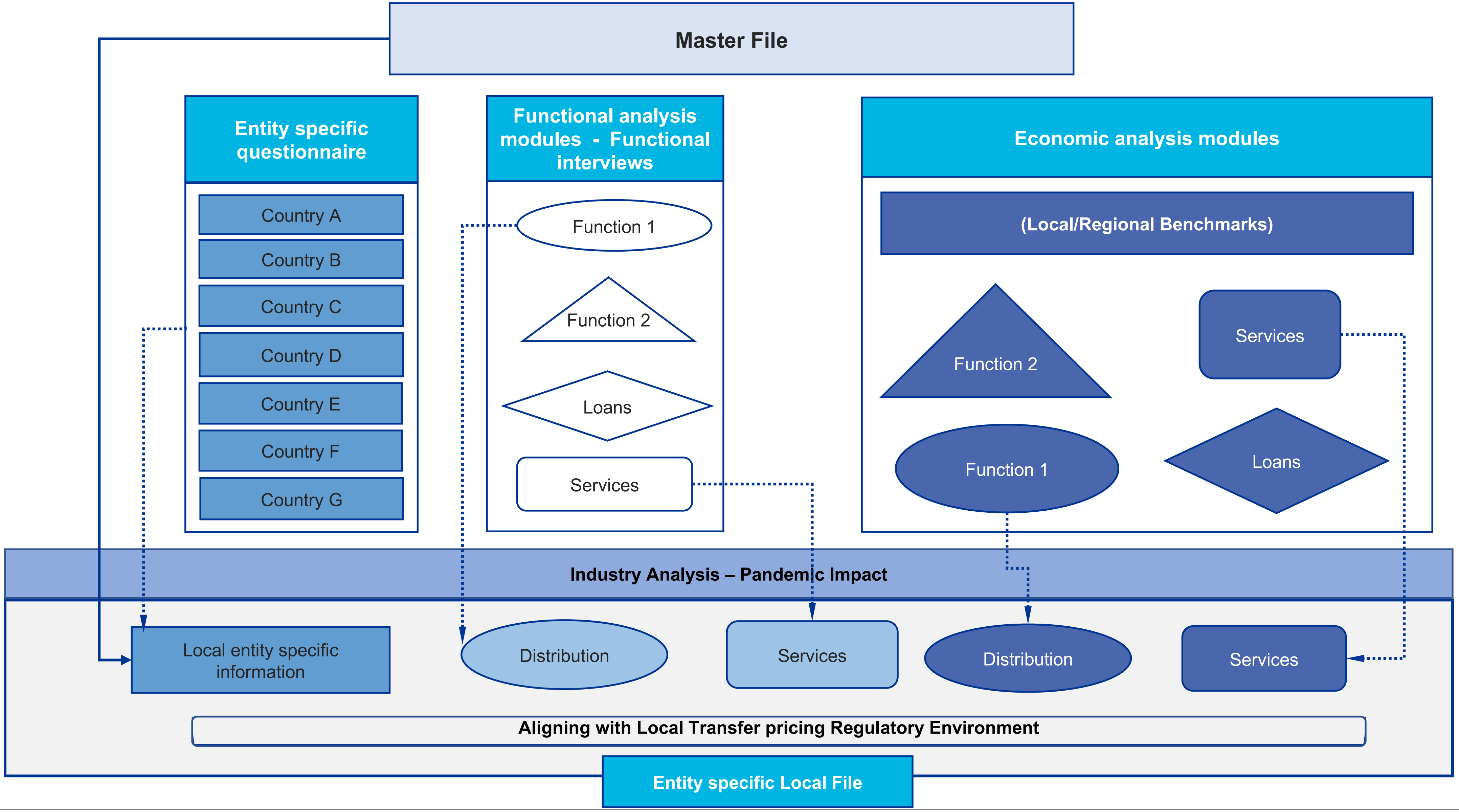
CUP

TNMM

Profit split

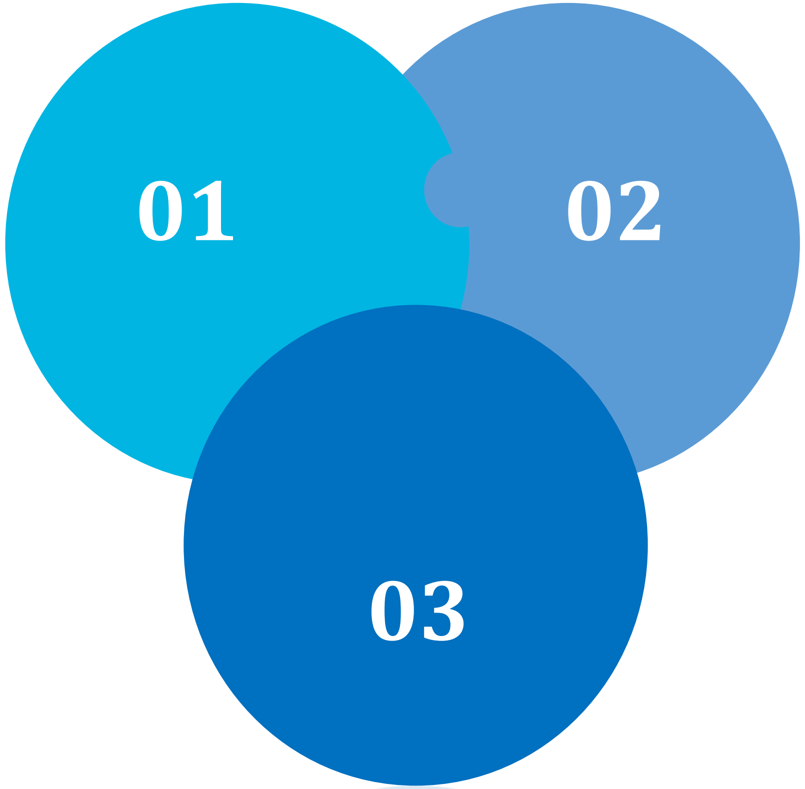
Transfer Pricing Policy Document

TP Compliance - Modular Approach to TP Documentation



Three Key Take Aways

Three Key Takeaways



Keep abreast of changes

- Constant evolution of Tax/TP landscape across the globe.
- Implementation update on Pillar 2 across local tax laws.
- Local tax transparency rules/regulations
- Assessment of the impact on your obligations.

Assessment of risk/modelling

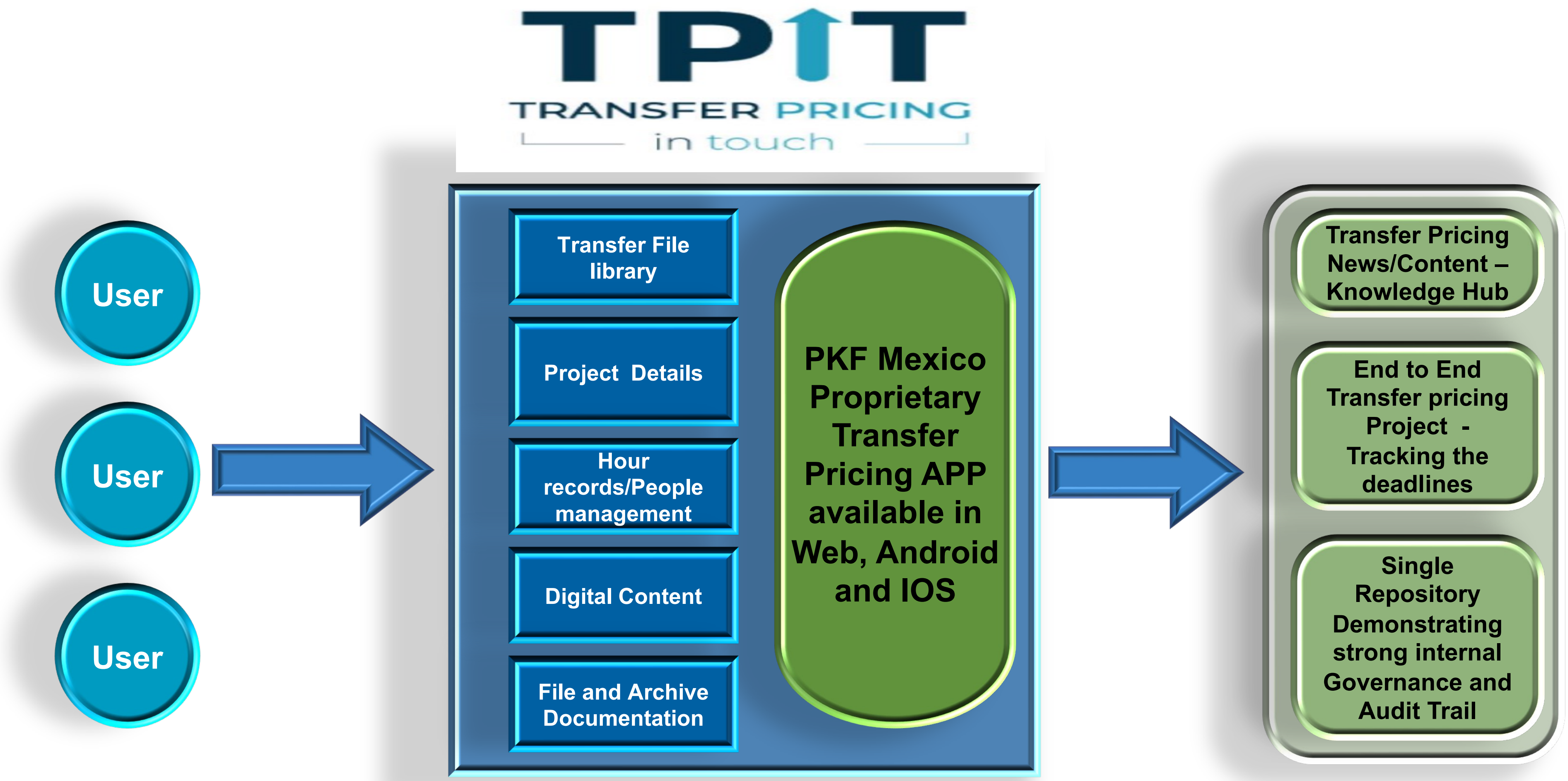
- Understand the client risk profile
- Creating operating models that aligns with new global value chains
- Involvement of key stakeholders across the business.
- Creating tax optimized models.

Documentation

- Proactive approach
- Reflection of reality- FAR
- Consistency
- Ensure supporting documents in place-policy/agreements

Transfer Pricing In Touch – App Launch

Transfer Pricing In Touch APP Launch



Questions

PKF International Ltd.
Studio 215-216, Great Western Studios, 65 Alfred Road, London, W2 5EU, United Kingdom
T: +44 20 3691 2500

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