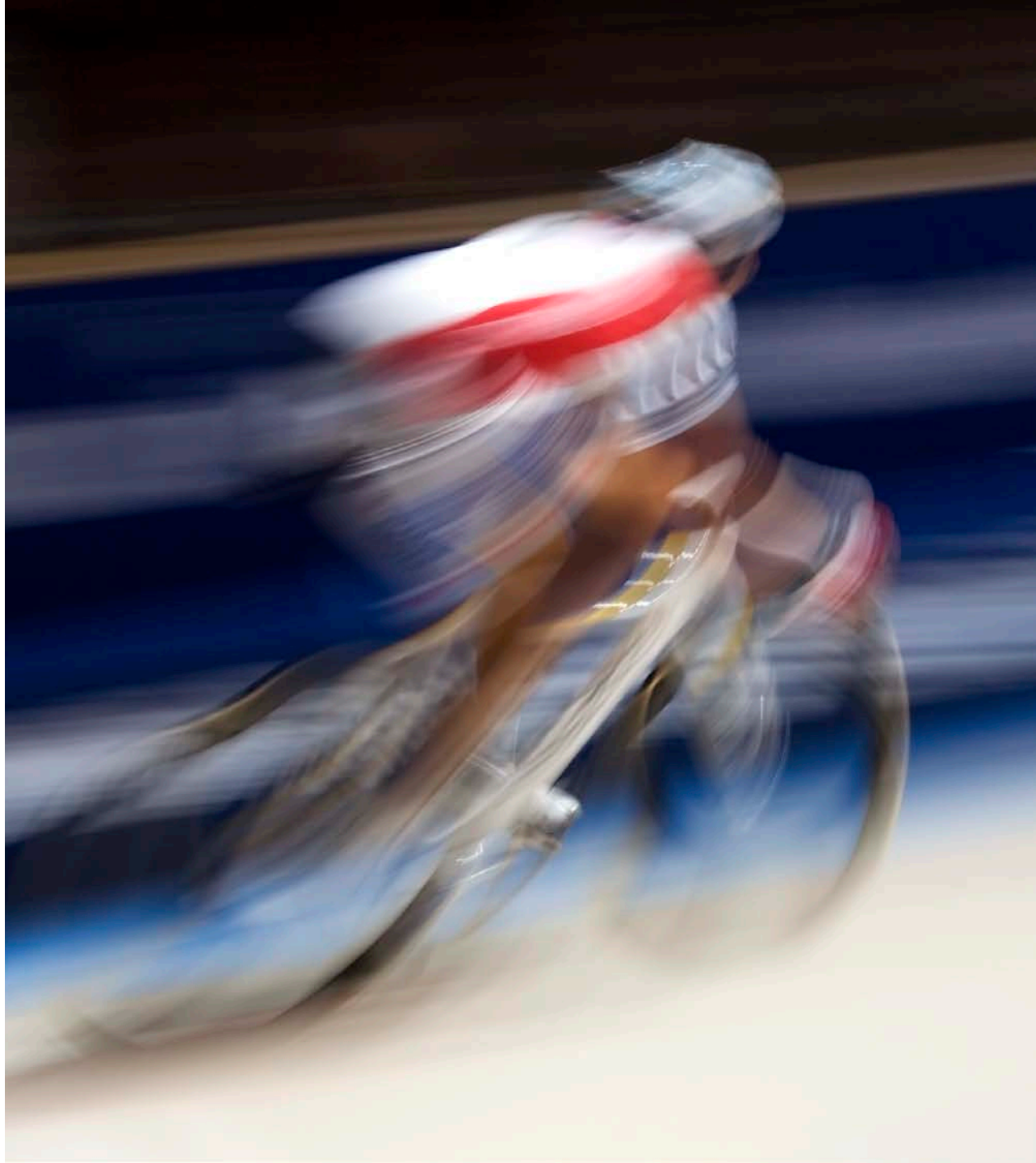




Evolving BMO Models in a BEPS Age

Darcy Alamuddin
Jim Gannon
Mike Gilson
Deloitte Tax LLP

March 1 - 4, 2015



Agenda

Discuss the evolution of business models, current tax environment, and what the future holds

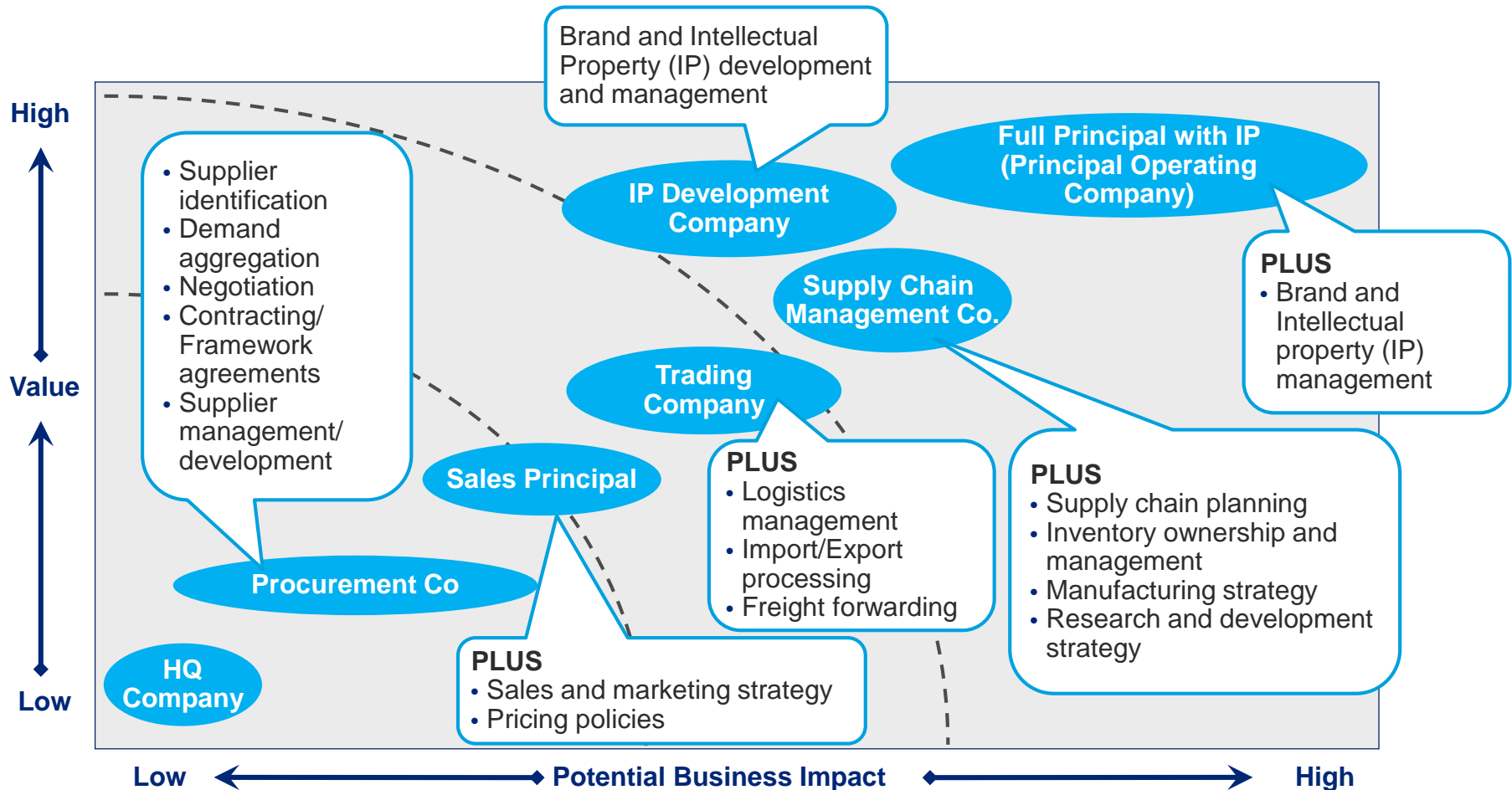
Understand key focal points in the OECD's BEPS Project and potential impact on BMO structures

Explore alternative models to address certain elements of BEPS

Embrace BEPS guiding principles on current tax positions and future tax planning

Our current environment

The evolution of the center-led business model



Business is driving towards center-led models that require alignment from a tax and legal perspective

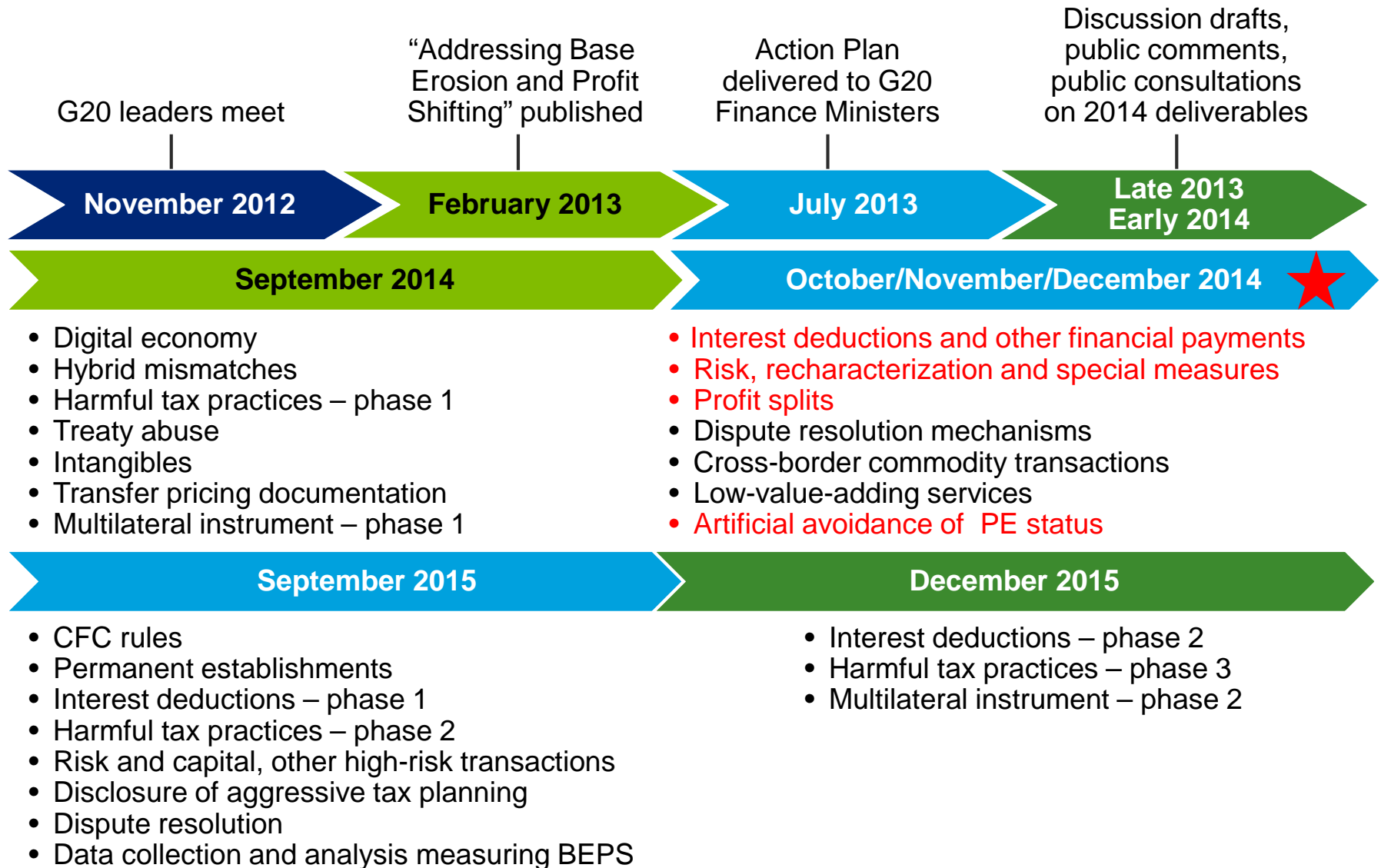
Defining the current “perceived” problem

Base erosion and profit shifting through business model and IP planning

“

There is a growing perception that governments lose substantial corporate tax revenue because of planning aimed at eroding the taxable base and/or shifting profits to locations where they are subject to a more favourable tax treatment. Civil society and non-governmental organisations (NGOs) have been vocal in this respect, **sometimes addressing very complex tax issues in a simplistic manner and pointing fingers at transfer pricing rules based on the arm’s length principle as the cause of these problems.**

Progress to date



Strategic tax questions

What is the significance of the debate?

**Why is there
such a focus on certain
U.S. companies?**

**Is the criticism based
on “fair analysis”?**

**Is this scrutiny limited
to large multinationals?**

**Is press commentary
leading to an increase in
Tax Authority scrutiny?**

**What can companies
say about their business model
to help support their position
and defend themselves
from a challenge?**

Facts help

Business Facts

The business model is driven by commercial factors

Regulatory/Compliance/Admin costs are reduced

Routine/Back-office processes streamlined

Tax Facts

Compare total tax burden
(VAT/Customs/Employee vs. income)

Certain governments are reducing tax rates
to attract business

The future

What does it hold, how should we plan?

- Political capital spent so far suggests that BEPS review will recommend change. What might they be?
 - Transfer pricing changes
 - Restrictions to PE exemptions (Article 5.4 OECD)
 - Restriction on deductibility for payments
 - Changes to the situs of income/imposition of withholding taxes
- Tax authorities may be more aggressive during audit
 - Use of information powers
 - Use of “criminal” law
 - Litigation
- Political pressure may rise
 - Peer/Public pressure aimed at “income line”
 - Reporting requirements increased



Critical that reorganizations are substantive and are considered to be business transformations...not tax projects

BEPS actions and potential impact on BMO structures

Key focal points in BEPS project

Treaty limitations

- Limitation of benefits article
- Main purpose test

Transfer pricing

- Risk
- Nonrecognition and recharacterization
- Use of special measures
- Profit splits

Permanent establishment

- Distribution activities
- Scope of agency provisions
- Tolling

Hybrid mismatches

- Hybrid instruments, hybrid entities, imported mismatch
- Impact of CFC inclusions
- Further analysis of regulatory capital, stock lending, repos

Digital economy

- Defining taxable nexus for digital businesses
- Transaction vs. net income tax

Harmful tax practices/ preferential tax regimes

- Substantial activity requirement imposed on tax preferences for intangible property
- Exchange of rulings providing for preferential status

BEPS overall challenge on BMO structures

- All of the proposed challenges support less income at principal operating company
- Risk issue is quite complex
 - Mere allocation of risk under contract is not enough
 - Substance, management and control are determinative
- Where in the company is real value being created – people vs. capital
- IT considerations

Risk

- Decreases the importance of contractual allocations of risk
- Increases emphasis on substance of a transaction and how the parties' functions generate value for the MNE – “Super Functional Analysis”
- Focuses on managing and controlling risk
- Questions whether risk can be shifted within an MNE
 - Emphasizes options realistically available to the parties in deciding whether the transaction entered into (as opposed to the realistic alternative) best meets the commercial objectives of the parties
- Risk management comprises both the capability to manage risk along with the decision making function in responding to risk in three areas
 - Ability to make or decline risk-bearing opportunities
 - Ability to respond to risks as they arise
 - Ability to employ risk mitigation strategies
- Financial capacity to bear risk is relevant but not determinative
- Limited ability to transfer core risks at arm's length situations
- Risk transfer is only likely to take place where the transferee is well placed or better placed to manage risk

Nonrecognition and recharacterization

Current guidance

- Nonrecognition or recharacterization permitted in very limited circumstances
 - Transaction not seen between independent parties
 - Structure impedes determination of price
- Emphasizes dangers of pricing something other than actual transaction

New standard proposed

- Transaction should be respected for transfer pricing purposes only if it has the “fundamental economic attributes of arrangements between unrelated parties and commercial rationality”
 - Both parties should be better off from a financial and commercial perspective
- Example of transaction that leaves the group worse off on a pre-tax basis and concludes that the transaction lacks fundamental attributes of an arrangement between unrelated parties

Rationale for new standard

- MNEs can fragment their operations into multiple entities
- Consequences of fragmented allocating of assets, risks, and functions to these entities can be overridden by control

Special measures

Discussion of five options when the arm's-length principle is considered not to cause the desired allocation of profit

- Hard-to-value intangibles sold for a lump sum when contemporaneous robust projections and analysis are not available
- High returns obtained by only providing capital justified by reference to a hypothetical “independent investor” test or “thick” capitalization by reference to capital global ratios
 - Might be unnecessary in light of work on Action 4, dealing with interest deductions, and Action 8, dealing with intangibles
- Minimal functional entities that lack the functional capacity to create value and rely on a framework of arrangements with other group companies leading to a mandatory profit split or controlled-foreign-corporation-style apportionment
 - Might be unnecessary once the transfer pricing guidelines are amended as a result of Actions 8, 9 and 10
- Ensuring appropriate taxation of excess (low-tax) returns, including a primary CFC rule and a secondary rule to allocate taxing rights to other jurisdictions
 - Might be unnecessary in light of amendments to the transfer pricing guidelines as a result of Actions 8, 9 and 10 and the tightening of CFC rules under Action 3

Profit splits: Overview

- The discussion draft does not contain specific proposed modifications to the OECD's transfer pricing guidelines, but rather, **presents ten situations (with nine example scenarios) whereby the profit split method could potentially be applicable**, and solicits comments from interested parties to elaborate on these scenarios regarding the relative reliability of such methods
- The discussion draft appears to be an attempt to identify a broader set of facts where profit split methods may be applied
- The fact that no language has been proposed may suggest
 - Governments are struggling to find an approach that would enable profit splits to be reliably applied in a broader, more general context
 - Some OECD member countries are concerned regarding the direction of the changes in Chapters I and VI

Profit splits: Concerns about new guidance

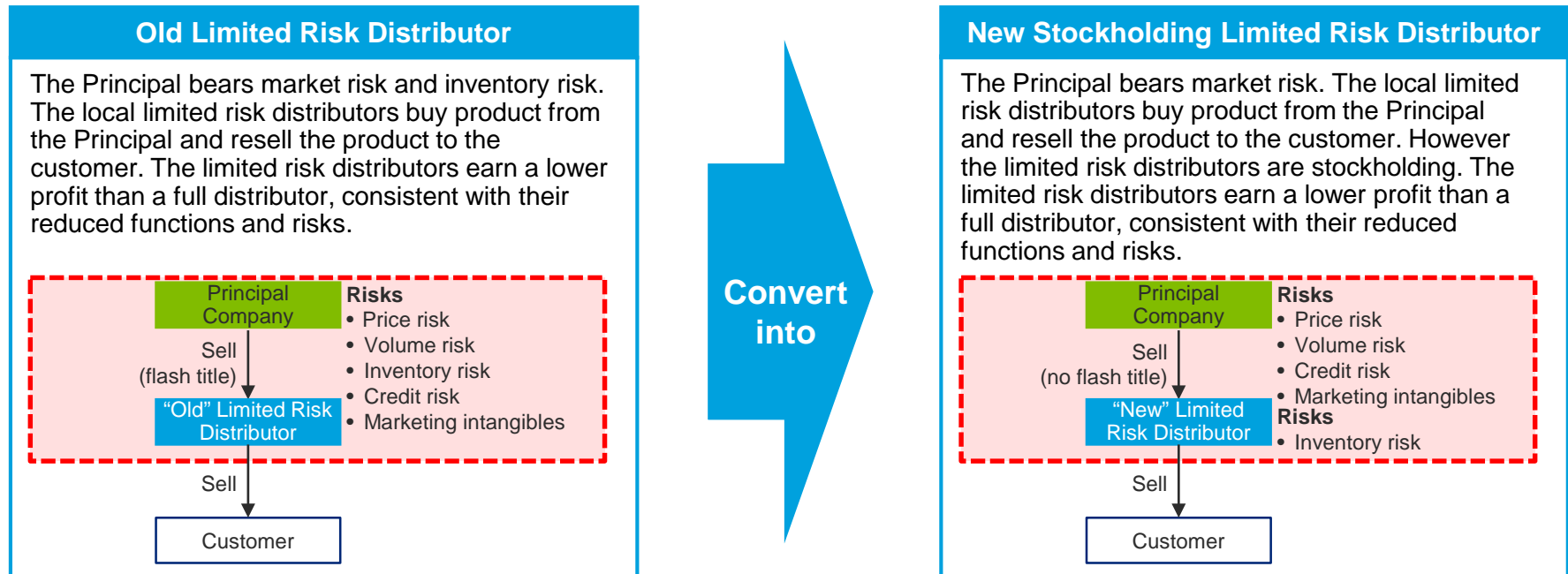
- Data availability: Still a concern for many MNEs. Country-by-country reporting would not be sufficient for a reliable profit split analysis
- Taxpayer structures and solutions: The discussion draft contains several scenarios for MNEs sharing risks, but does not address taxpayer structures in similar situations
 - Cost sharing
 - Principal company structures

Profit splits: Concerns about new guidance (cont'd)

- Importantly, the discussion draft does not suggest specific solutions to many of the issues that made profit splits challenging for MNEs to apply, including
 - The lack of comparable for transactional profit splits
 - Allocation keys to split profits that do not end up being simply a form of formulary apportionment
 - Creation of partnerships for tax and commercial purposes
 - Reduction in the protection of the rights afforded to separate entities with respect to creditors
 - Splitting profits between more than two entities and double-tax relief in case of tax authority adjustments
- Profit splits are a good method for APAs, or resolving double-tax cases, or controversies, but their use for planning and compliance would be limited

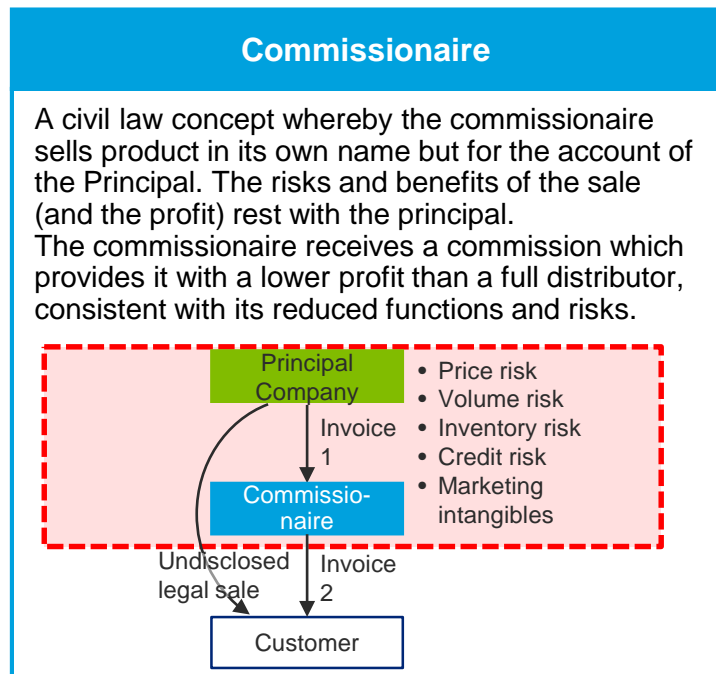
Alternative models to address: Distribution agency tolling

Convert limited risk distributors to stockholding LRDs

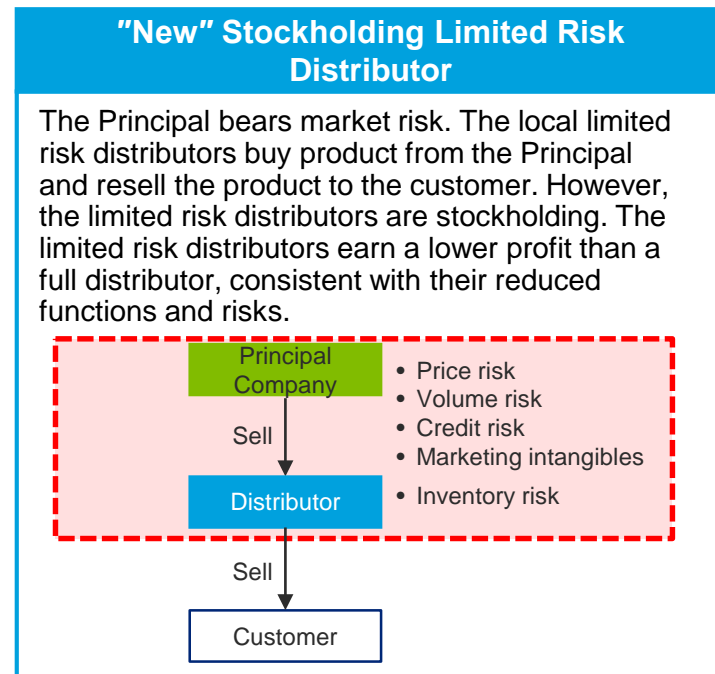


- Under the existing limited risk distribution set-up POC owns all finished products inventory and keeps these in the country of the Limited Risk Distributor ("LRD"). POC sells these products to LRD based on flash title sales.
- Considering the anticipated change in PE definition under BEPS, POC most likely cannot hold any inventory in the country of the LRD as these activities will no longer be considered 'auxiliary or preparatory' to the business, and may therefore, constitute a PE of the POC. Therefore, the LRD needs to own such inventory in country.
- This would mean that the existing flash title LRD set-up needs to be converted into a stockholding LRD set-up.

Convert commissionaires to stockholding LRDs

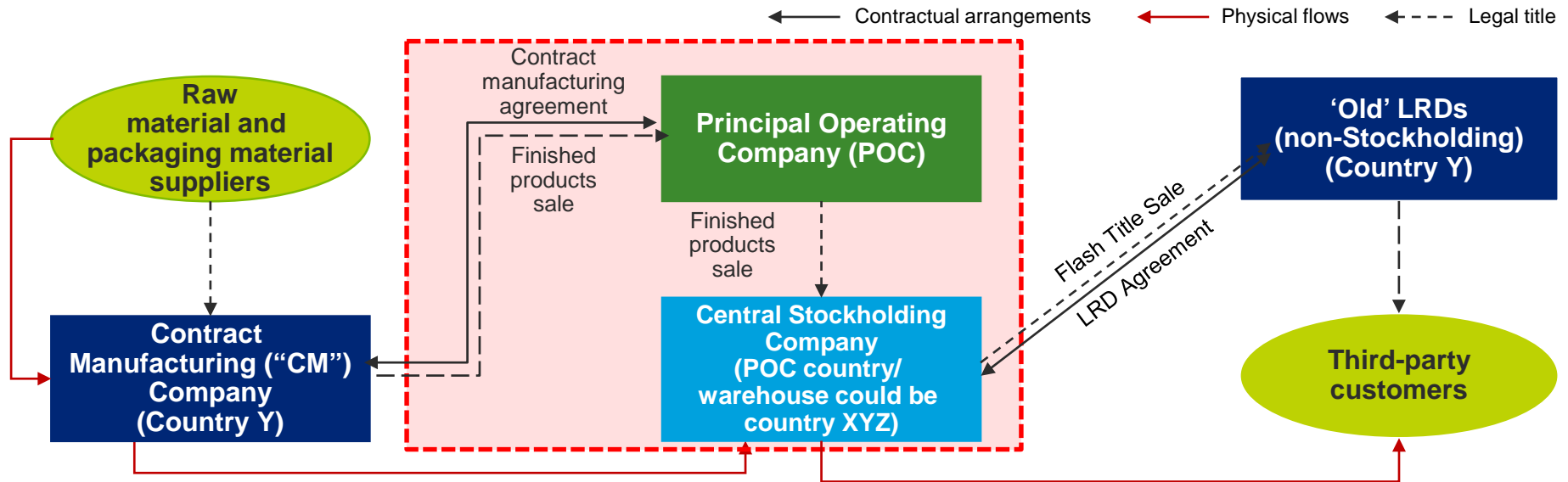


Convert
into



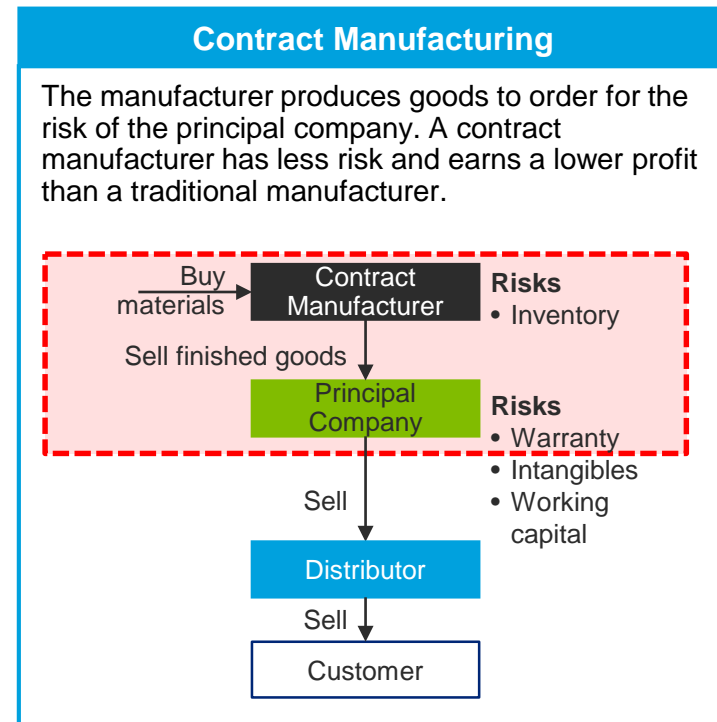
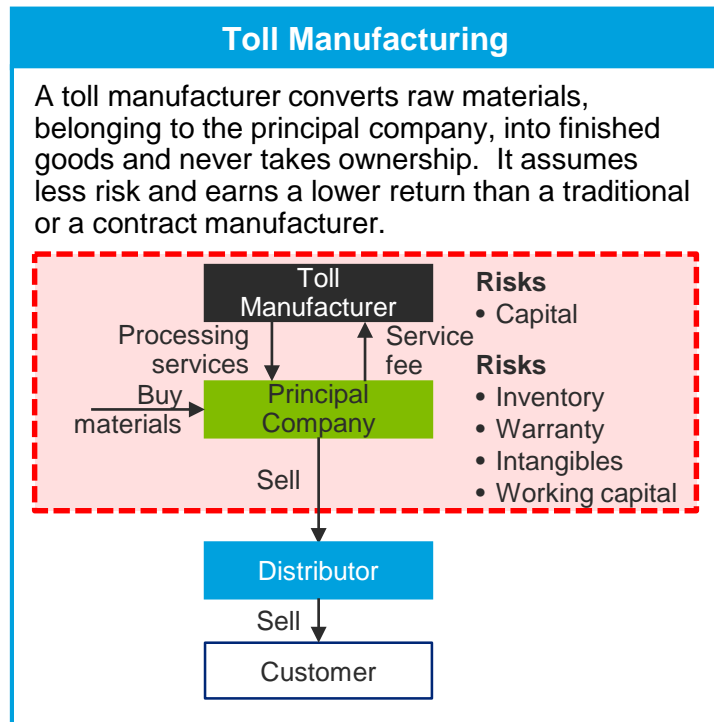
- Under the existing commissionaire set-up, commissionaire will sell finished products to third party customers in its own name but for the risk and account of POC binding the POC not legally but economically.
- Considering the anticipated change in PE definition under BEPS, a commissionaire set-up will most likely result in a PE for POC as the PE rules will also cover local entities who are not in business on their own account. In addition, the new PE rules will most likely cover situations where the economic effect of local activity is to commit the POC.
- This would mean that the commissionaire set-up needs to be converted into a stockholding LRD set-up.

Central stockholding company with TMs and non-stockholding LRDs (buffer)



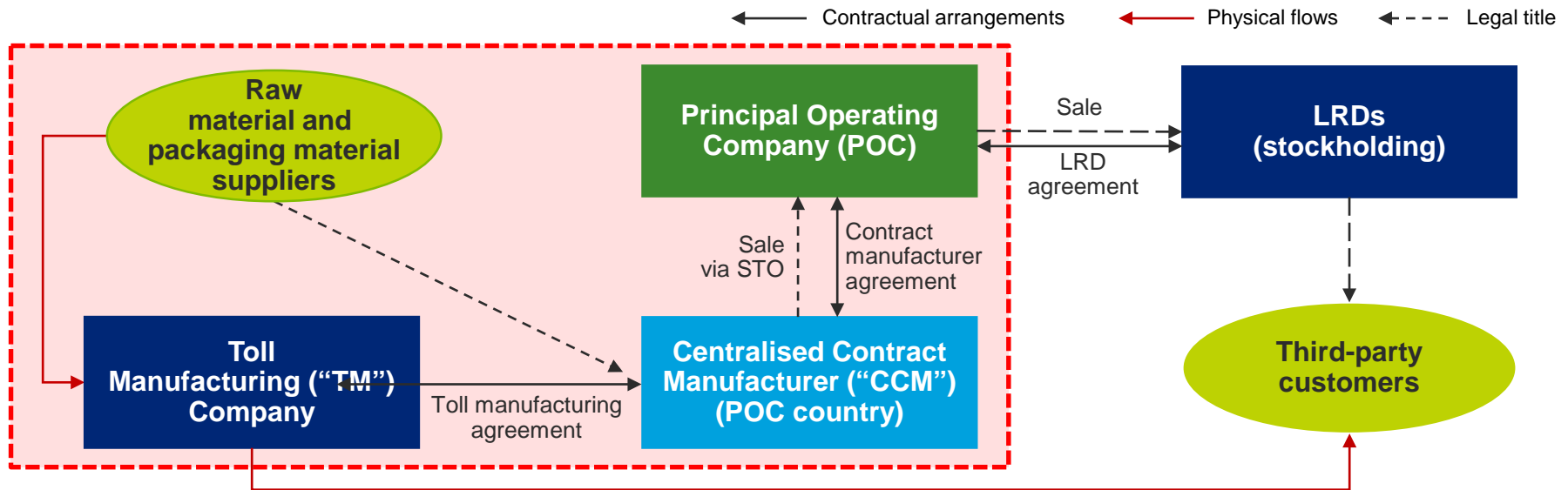
- Considering the anticipated change in PE definition under BEPS, POC most likely cannot hold any inventory in the country of the manufacturer & distributor as these activities will no longer be considered 'auxiliary or preparatory' to the business and may therefore constitute a PE of the POC.
- A Central Stockholding Company ("CSC") would own all finished goods inventory. Its warehouse could be in the country of the manufacturer or in country XYZ. Most likely CSC would have more warehouses through the region.
- POC would obtain the finished goods based on the CM Agreement and would directly sell to the Central Stockholding Company. The Central Stockholding Company would only sell the finished goods to the LRD's (via flash title) once needed for sales to customers. From a LRD point of view nothing should change compared to today (different contract party/supplier of goods).
- Inserting a Central Stock Holding Company owning all finished goods locally would most likely establish a PE for this Central Stock Holding company locally however the value attributed to such PE should be minimal.

Convert toll manufacturer to contract manufacturer



- Under the existing toll manufacturing (“TM”) set-up, the Principal Company (“POC”) owns all raw materials, in-process goods and finished products and keeps these in the country of the toll manufacturer.
- Considering the anticipated change in PE definition under BEPS, POC most likely cannot hold any inventory in the country of the TM as these activities will no longer be considered ‘auxiliary or preparatory’ to the business, and may therefore, constitute a PE of the POC. Therefore, the manufacturer needs to own such inventory in country.
- This would mean that the existing toll manufacturing set-up needs to be converted into a contract manufacturing (“CM”) set-up.

Centralized contract manufacturer with toll manufacturing locally (buffer)



- POC would conclude a Contract Manufacturing Agreement with a Centralized Contract Manufacturing Company in POC country. Hereby the Centralized Contract Manufacturing Company should actually manage and control the supply operations.
- The CCM Company would conclude toll manufacturing agreements with the local toll manufacturers. Local toll manufacturing operations could run as today based on the Toll Manufacturing Agreement with the CCM located in the POC country.
- Considering the anticipated change in PE definition under BEPS, CCM Company most likely cannot hold any inventory in the country of the toll manufacturer as these activities will no longer be considered 'auxiliary or preparatory' to the business, and may therefore, constitute a PE of the CCM Company. However, the value attributed to such PE should be minimal.

BEPS guiding principles

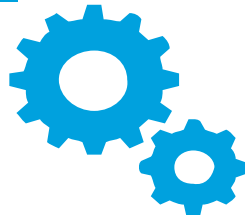
Guiding Principles

1.



Assume transparency

2.



Ensure substance

3.



Maintain flexibility

What are clients changing today

- Review of agreements for appropriate language and allocation of roles and responsibilities
- Super functional analysis to confirm substance and control
- More enhanced economic analysis as the world of one-sided TP analyses may be gone
- Strategies to avoid PE: Reviewing commissionaires and assessing steps necessary to move away from that structure
- Review their structure for likely areas affected and assessing: Likely exposure and the time and effort to amend

Responsible tax and BEPS

10 points to address with respect to tax positions and planning for the future

1. What is our current tax approach? Can we articulate our approach and are we ready to defend it, if needed? Will it be considered to be “fair” as well as “legal” in the current political and press environment?
2. Are there any elements of our current tax approach that we would be uncomfortable to explain on national television? If so, what is the value of these strategies (in terms of impact on global tax burden, earnings per share and share price)? Can we replace them (if so, how and with what)?
3. What would be the impact on our business of a challenge by the press or politicians on our tax planning approach? (Some businesses suffer little effect but others see significant reduction in their income as customers react to bad press.)
4. What taxes do we pay currently? It is useful to be able to state the total tax paid, and to be able to break this down to compare taxes that are a cost of the business (corporation tax, local business and property taxes, customs duty, fuel duty, employer taxes, environmental taxes, etc.) and taxes that we collect from others (VAT, payroll taxes, fuel duty, etc.).
5. Can we explain why we pay low or no taxes in any appropriate jurisdiction (cumulative past losses, government incentives, capital allowances, etc.)?
6. Prepare a short brief covering the points above that all board members can refer to if they are asked about our taxes.
7. How might the potential changes to international tax standards being considered by the OECD Base Erosion Profit Shifting group affect our business? Can we evaluate them in terms of potential impact to our global tax burden, compliance costs and cash taxes paid?
8. Can we replace any of our business models to secure our position? What would it cost to make these changes?
9. Do we need, and can we build, additional flexibility into our decision-making so that we can react to changes in international tax rules as they become clear? What would this cost?
10. In the changed public and political environment, is tax adequately represented in the decision-making forums of our business?

Please remember
to complete your
evaluation

Speaker bios

Darcy Alamuddin is a tax principal in the Chicago office of Deloitte Tax LLP. With 15 years of experience, Darcy provides multinational clients with tax consulting services on many aspects of transfer pricing and international taxation. She has worked on a wide variety of transfer pricing cases that include planning, strategy review, audit defense, and documentation engagements. In the context of these engagements, she works with clients in the areas of structuring, tax planning, and foreign tax credit planning. Her projects have covered inbound and outbound tangible product transactions, outbound intangible product transactions, licensing of intangible assets, as well as provision of contract R&D and trading services. Darcy has served U.S., UK, Japanese, German and French multinational corporations.

Darcy has spoken at seminars on both international tax and transfer pricing. Her seminars on international tax include topics such as Global Earnings Mobilization, the Taxation of Intellectual Property, Allocation and Apportionment of Interest Expense and Subpart F. She has spoken on Japanese, European, South American and U.S. transfer pricing issues in the US and Japan.

Darcy received her BBA and JD-MBA from the University of Wisconsin-Madison.

Phone: +1 312 486 2049

Email: dalamuddin@deloitte.com

Jim Gannon is a partner in the Washington National Tax Office and is a member of the International Tax Service Line of Deloitte Tax LLP. His areas of concentration are cross-border M&A, restructuring and financing, and tax-efficient structuring of intellectual property. As a member of the International Tax service line in Washington, D.C., Jim assists the firm's partners, principals, and managers in the service of Deloitte's multinational clients, and acts as the lead international tax person on selected client engagements. Jim has more than 20 years of experience in the international tax field. He has worked with clients in many industries including financial services, technology, consumer goods and manufacturing.

Jim has been published in the BNA Portfolio, Practicing Law Institute, Tax Management International Journal, and International Tax Review publications addressing the taxation of intellectual property. He is co-author of the international taxation chapter of the Commerce Clearing House treatise on electronic commerce, Cybertaxation.

Jim received a Bachelor of Science in Accountancy from the University of Illinois at Urbana-Champaign and a Masters in Public Accounting – Tax from the University of Texas at Austin. He is a CPA licensed in the State of Illinois and the District of Columbia.

Phone: +1 202 378 5224

Email: jgannon@deloitte.com

Speaker bios

Mike Gilson is a Partner with Deloitte Tax LLP's Global Strategy Group specializing in designing and implementing Business Model Optimization (BMO) strategies. BMO strategies focus on helping companies structure their value chain functions and intellectual property in a tax efficient manner.

Over the last 17 years, Michael has helped many clients in the manufacturing, consumer products and services industries realign their value chain (Marketing, Sales, Supply Chain, Procurement, Manufacturing, Quality) in both Europe and Asia by designing and implementing BMO strategies involving the creation of tax efficient structures utilizing principal or central entrepreneur companies located in Switzerland, Ireland, Singapore, and other jurisdictions. Many of these projects involved reviewing the specific location to hold the company's intellectual property (IP) and structuring the transfer of such IP.

Michael received a Bachelors of Science - Accounting degree from Indiana University and a J.D. from Chicago-Kent College of Law. He is also a CPA and a licensed Illinois attorney.

Phone: +1 312 486 3240

Email: mgilson@deloitte.com

This presentation contains general information only and Deloitte is not, by means of this presentation, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This presentation is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte, its affiliates and related entities, shall not be responsible for any loss sustained by any person who relies on this presentation.



Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms.

Deloitte provides audit, tax, consulting, and financial advisory services to public and private clients spanning multiple industries. With a globally connected network of member firms in more than 150 countries, Deloitte brings world-class capabilities and high-quality service to clients, delivering the insights they need to address their most complex business challenges. Deloitte has in the region of 200,000 professionals, all committed to becoming the standard of excellence.

This communication contains general information only, and none of Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the “Deloitte Network”) is, by means of this publication, rendering professional advice or services. Before making any decision or taking any action that may affect your finances or your business, you should consult a qualified professional adviser. No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person who relies on this communication.

© 2015. For information, contact Deloitte Touche Tohmatsu Limited.