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Strategic Transfer Pricing Version 2.0 Increasing the Return from Transfer Pricing

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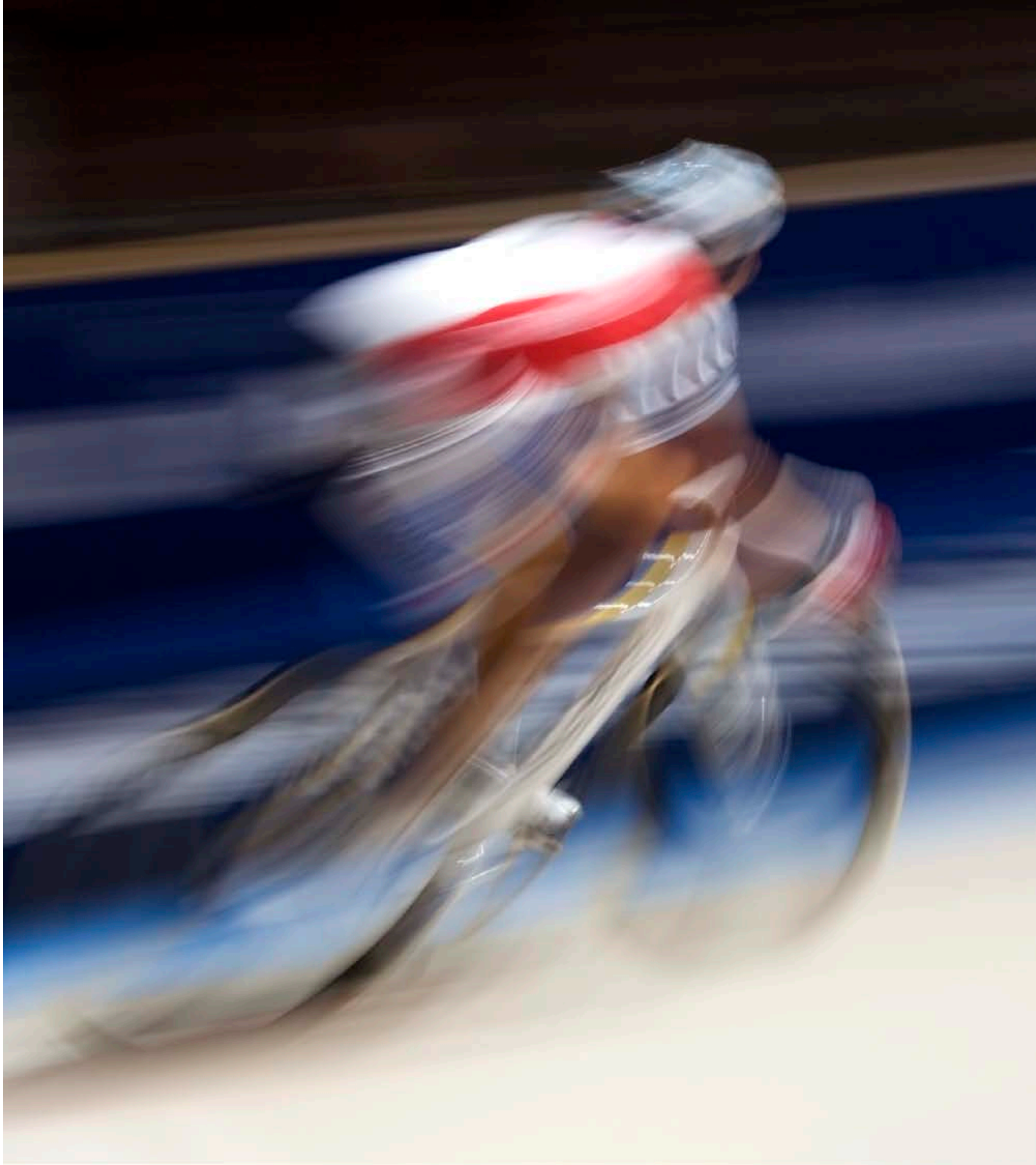
March 1 - 4, 2015



Agenda

Introduction

1. Foundational Transfer Pricing – get transfer pricing right
2. Progressive Transfer Pricing
3. Increasing tax benefits and cash utilization
4. Business Model Optimization
5. Strategic Transfer Pricing – the integrated structure

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Strategic TP

Version 2.0

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Introduction – “TP never ends”

Transfer pricing has become a critical international tax issue for multinational companies

- Higher transfer pricing enforcement – both stricter enforcement and more countries looking at transfer pricing
- Multinational companies are operating in a globally integrated model, creating more transfer pricing issues

Changes in transfer pricing and tax regulations (including current Base Erosion Profit Shifting (“BEPS”) discussions), coupled with changes in ways that multinational companies operate demand

- A more strategic approach to TP compliance
- A global strategy, which integrates international tax and treasury, drives meaningful benefits to a taxpayer

The following slides illustrate numerous approaches and considerations for increasing potential transfer pricing opportunities to reduce global taxes

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What is strategic transfer pricing?

An alternative way to think about a company's transfer pricing

- Strategic transfer pricing allows a company to manage its TP compliance in a manner that is integrated into its tax and business objectives
- Strategic transfer pricing builds on the foundation of a data driven analysis

Foundational Transfer Pricing

At the **base**, get transfer pricing right

- Understanding margins and transactions flows
- Aligning expenses and revenues
- TP implementation assistance
- Documentation/APA
- Managing in real time with data analytics
- Post-planning review/ further opportunities

Progressive Transfer Pricing

More advanced transfer pricing

- Review structure post planning for proper implementation or utilizatoin of additional benefits
- Look for and properly price unplanned IP sharing
- BEPS risk review of data availability and results and alignment of value drivers

Increasing Tax benefits and cash utilization

Build upon foundation and advanced TP by

- Efficiently mobilizing cash
- Reduction of local country and U.S. taxes
- Utilizing existing tax attributes (e.g., FTCs)
- Migration of intellectual property
- Refine risks and IP ownership within existing business model

Business Model Optimization

The **pinnacle**

- Aligns transfer pricing with business changes
- Integrates companies' operational and tax planning activities

Strategic Transfer Pricing

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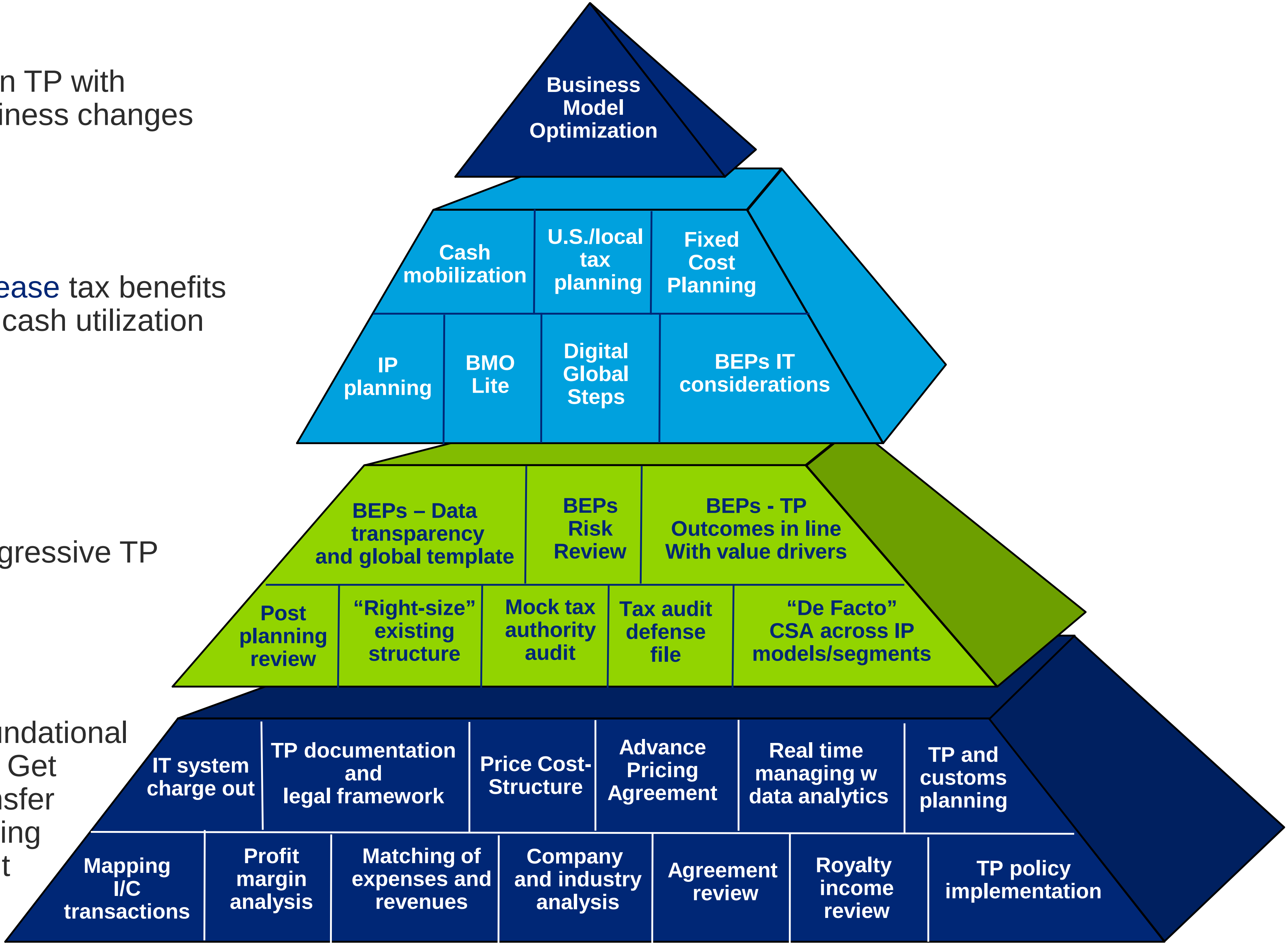
Align TP with business changes

Increase tax benefits and cash utilization

Progressive TP

Foundational TP: Get transfer pricing right



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Foundational Transfer Pricing – get transfer pricing right

Benefits

- Manages TP risk and compliance in a cost effective manner
- Provides foundation and building blocks for tax planning and Business Model Optimization

Mapping I/C transactions	Profit margin analysis	Expense and revenue matching	Company and industry alignment	Real-time managing with data analytics
Rationale: Managing TP requires clear understanding of entities and transactions	Rationale: Analyzing profits and losses provides valuable information about potential TP risks/opportunities	Rationale: Significant mismatches between expenses and revenues may indicate risks and opportunities	Rationale: Under-standing distinct factors of client's business and industry will assist in getting their TP right	Rationale: Post implementation monitoring and governance of TP model in real time
Activities • ID transacting parties • ID transaction type and amount • Perform functional characterization • ID cost pools that provide group benefits (e.g., services, IP, etc.)	Activities • Obtain legal entity financial statements • Calculate profitability, current and historical	Activities • Analyze G&A expenses • Analyze R&D expenses • Analyze marketing expenses • Analyze sales and customer relation-ship expenses • Analyze cost pools creating "soft IP"	Activities • Review of Company's SEC 10-k and other relevant company documents • Review of industry reports • Conduct phone interviews/on-site visits with client to understand client's business and industry	Activities • Real time transaction-based data analytics

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Foundational Transfer Pricing – get transfer pricing right (cont'd)

Benefits

- Manages TP risk and compliance in a cost effective manner
- Provides foundation and building blocks for tax planning and Business Model Optimization

TP policy implementation	TP documentation and legal framework	Agreement review	Advanced Pricing Agreement	TP and customs planning
Rationale: Assist clients in the implementation of supportable transfer pricing	Rationale: Manage TP risk and compliance in an efficient manner and support ownership of IP	Rationale: Review of intercompany agreements may indicate risks and opportunities where terms can be refined	Rationale: Manage TP risk through negotiating agree-ment(s) between a taxpayer and tax authorities	Rationale: Create linkage with Customs to efficiently set or adjust intercompany pricing
Activities • Perform benchmarking analyses to determine supportable TP approaches • Provide guidance for implementing TP based on results of benchmarking analyses (e.g., year-end adjustments)	Activities • Prioritize TP risks and compliance needs • Fix TP where necessary to manage risk and documentation burden • ID opportunities to leverage analysis and documentation	Activities • Confirm intercompany agreements are consistent with transfer pricing policy as well as actual functions of each related party	Activities • Development of TP methodology • Develop APA strategy • Anonymous pre-filing meetings • Refine approach • Reply to tax authorities' position papers • Negotiate/Draft APA	Activities • Confirm that transfer pricing policies are consistent from customs perspectives

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Foundational Transfer Pricing – get transfer pricing right (cont'd)

Benefits

- Manages TP risk and compliance in a cost effective manner
- Provides foundation and building blocks for tax planning and Business Model Optimization

IT system chargeout	Royalty income review	Price Cost-structure
Rationale: Assist client in allocating costs incurred for global implementation of IT systems	Rationale: Review of royalty payments and impact on operating margin	Rationale: Review and account for cost-structure as a comparability factor when assessing risk
Activities • Analyze all costs incurred for global IT systems (e.g., SAP) • Consider different allocation keys • Consider depreciation of related hardware costs • Support the charges with documentation	Activities • Confirm royalty base is calculated according to agreement (e.g., % on third party sales, % on specific product line sales) • Check impact of royalty payment to overall profitability	Activities • Analyze cost-structure of tested party and potential comparables to align risks • Consider and apply reasonable adjustments for using cost-structure as a comparability factor

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Data gathering, including country-by-country reporting

- Taxpayers should perform a readiness assessment of their financial reporting systems for compliance with CbC reporting
  - Can existing systems generate the data that may be required?
  - If not, can existing systems be easily modified to generate such data? Automate?
  - Are there multiple ERP systems in use across the organization? If so, are the systems sufficiently interconnected to centrally obtain the relevant information?
- Consider adding a technological Operational TP or TP Data Analytics solution
  - Most solutions sit “on top” of ERP systems and can help to bridge the gaps
  - Facilitate and automate gathering, centralization and monitoring of relevant data
  - Data can be exported in required format for CbC compliance purposes

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Data gathering, including country-by-country reporting (cont'd)

- Start early to identify inconsistencies and anomalies to proactively change transfer prices to mitigate future controversy risks
  - Important to analyze the data early and allow for changes to take effect, before handing the CbC information over to the tax authorities
  - Proactive management needed to avoid ad-hoc analyses, last minute fire fighting and year-end surprises

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Profit margin analysis

Target Operation Margin (%)	
Sales	4.00%
Manufacturing	6.00%
Combined (Sales and Manufacturi	8.00%
Services	7.00%

(from 2008 consolidating financials in USD)

Operation Margin Analysis

(1) Legal Entity Name	(2) Country	(3) Type of Entity	(4) Sales/ Service Income	(5) Operating Margin	(6) Operating Margin as a % of Sales	(7) Target Operating Margin	(8) $ Amount of Op Margin Based Upon Target	(9) Actual Margin Over/(Under) Target
Company 1	United States	Combined (Sales and Manufacturing)	505,433,786	17,432,642	3.45%	8.00%	40,434,703	(23,002,061)
Company 2	United States	Services	6,009,000	483,000	8.04%	7.00%	420,630	62,370
Company 3	United States	Services	16,483,000	16,502,000	100.12%	7.00%	1,153,810	15,348,190
Company 4	United States	Combined (Sales and Manufacturing)	310,683,420	41,678,294	13.42%	8.00%	24,854,674	16,823,620
Company 5	United States	Sales	70,911,000	748,000	1.05%	4.00%	2,836,440	(2,088,440)
Company 6	United States	Combined (Sales and Manufacturing)	1,971,000	(346,899)	-17.60%	8.00%	157,680	(504,579)
Company 7	United States	Combined (Sales and Manufacturing)	26,892,450	(935,788)	-3.48%	8.00%	2,151,396	(3,087,184)
					0.00%	0.00%	-	-
U.S. Total			938,383,656	75,561,249	8.05%		72,009,332	3,551,917
Foreign 1	Canada	Combined (Sales and Manufacturing)	91,809,361	10,738,632	11.70%	8.00%	7,344,749	3,393,883
Foreign 2	Malaysia	Services	35,488,000	21,216,000	59.78%	7.00%	2,484,160	18,731,840
Foreign 3	China	Services	7,912,385	3,169,000	40.05%	7.00%	553,867	2,615,133
Foreign 4	Germany	Combined (Sales and Manufacturing)	139,621,433	9,990,387	7.16%	8.00%	11,169,715	(1,179,328)
Foreign 5	United Kingdom	Combined (Sales and Manufacturing)	97,398,000	100,610,200	103.30%	8.00%	7,791,840	92,818,360
					0.00%	0.00%	-	-
Non U.S. Total			372,229,179	145,724,219	39.15%		29,344,330	116,379,889
Grand Total			1,310,612,835	221,285,468	16.88%		101,353,663	119,931,805

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Matching expenses and revenues

Review P&L data to identify planning opportunities

P&L ratios to consider

- R&D expenses to sales ratio vs. royalty rate
- U.S. IP income and global income
- SG&A comparison
  - Compare sub Cos' GA to sales with range of GA to sales earned by independent comparable companies

Sample comparison of intercompany P&Ls

In USD '000s	Parent Co.	Sub Co. 1	Sub Co. 2
Sales	5,500	1,925	1,100
COGs	3,025	1,059	715
Gross profit	2,475	866	385
General admin Expenses	2,298	477	255
Operating profit	177	389	130
Operating Margin (%)	3.2%	20.2%	11.8%
GA to sales (%)	41.8%	24.8%	23.2%

Parent Co. assuming higher GA to Sales than Sub Cos

Sub Cos earning higher operating margin than Parent Co

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Progressive Transfer Pricing – data transparency and global template – Organization for Economic Co-operation and Development (“OECD”) Action Item #s 5, 13

What will governments do with the global template

- Perform effective risk assessment
- Assess compliance with the arm’s length standard
- Have information necessary to start, conduct, and complete an audit

Calculations

- Business function
- Headcount
- Management team’s location
- TP policies
- Taxable income
  - Before and after extraordinary items and interest
- Taxes paid
- Assets (tangible and intangible)
- Ratios

Analysis

- Identify inconsistencies
- Justifiable?
- Business support
- Areas of potential concern

Address concern areas

- Discuss solutions
  - Change TP policies
  - Change contracts
  - Business changes
  - APAs
  - Strategic TP

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Progressive Transfer Pricing – IP outcomes in line with value drivers – OECD Action Item #s 8, 9 and 10

This seeks to develop rules to prevent profit shifting by moving intangibles among group members, including

- Setting out a clear definition of intangibles
- Ensuring that profits from intangibles are not divorced from value creation
- Setting out special measures for the hard-to-value intangibles

Any changes may have an effect on cash flow, reporting and ETR
Groups with related party IP transactions should consider

- If an appropriate transfer pricing policy is in place
- If the arm's length nature of the transaction is documented
- Whether the holder of the intangibles has sufficient experienced people to control the risk of those intangibles and determine the strategy for them. Without such people, a routine return on the investment may be a more appropriate TP methodology – do changes need to be made?

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Progressive Transfer Pricing – proactive management of potential audit risk

- Mock tax authority audit
  - Issue mock IDRs and follow same timing for responding to tax authorities
  - Hold discussions similar to agent-taxpayer negotiations
- Tax audit defense file
  - Review the entire structure relating to that tax jurisdiction
  - Discuss risks, support, potential changes, etc.
- BEPS risk review
  - Planning is still viable, need to assess the structure, measure the impact of potential BEPS legislation and develop a communication plan with leadership

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Increasing tax benefits and cash utilization

Potential benefits

- Uses Transfer Pricing to reduce tax expense
- Increases cash available for repatriation or investment

Cash mobilization	Local country tax planning	U.S. tax planning
Rationale: Fixing TP may reduce the cash build up in one entity and/or increase cash in another entity	Rationale: Fixing TP may reduce local tax expenses	Rationale: Fixing TP may reduce U.S. tax expenses and/or use foreign tax credits
Opportunities • Integrate with cash pooling and other treasury and financing strategies • Alternative to or in conjunction with structural and/or situational cash repatriation strategies	Opportunities • Entities with current or carry forward losses • Use of excess credits	Opportunities • NOLs or other tax losses • Use of excess credits • Avoid Subpart F • Create foreign source income (e.g., royalty, franchise fees)

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Increasing tax benefits and cash utilization (cont'd)

Potential benefits

- Uses Transfer Pricing to reduce tax expense
- Increases cash available for repatriation or investment

Fixed cost planning	IP planning	"BMO Lite"
Rationale: Using fixed costs to push funding obligations to achieve planning objectives	Rationale: IP planning strategies may • Generate FSI • Use losses • Lower global tax burden	Rationale: Implement tax planning structure to reduce tax costs of specific business reorganization
Opportunities • Cost sharing R&D • Migration of IP to a partnership • Review and adjust royalty charges based on licensee's upfront cost to exploit IP	Opportunities • Migration of IP to low tax countries • Use of losses to reduce cost of IP migration • Clean up of de facto cost sharing	Opportunities • Centralized procurement/ sourcing • Conversion to limited activity/risk functionary • Shared services centers • Expanding principal structures to Tier 2 countries

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Increasing tax benefits and cash utilization int’l tax and treasury – the integrated approach

- **Success requires an integrated, sustainable, global strategy that not only considers transfer pricing, but also tax and treasury objectives**
- **Tax efficient planning must view the Treasury organization as a strategic partner with Tax**
- Repatriation and dividend strategy
- Establishing cash mobilization and pooling strategies in tax efficient manner
- Impact of principal structure and legal entity strategies on cash flows and FX risks
- Risk management center that has visibility and control over financial risks (counterparty, interest rate, foreign exchange, liquidity, credit, and commodity price)
- Aligned with shared services functions to enhance operations
- Involved in assessing and valuing strategic transactions (M&A, divestitures, funding growth)
- Strong understanding of overall technology strategy and determine treasury’s infrastructure is aligned

Integration with Tax may increase the benefits while allowing Treasury to manage its resources and support effectively

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Increasing tax benefits and cash utilization int’l tax and treasury – the integrated approach
(cont’d)

- Changes to legal entity and business model structures do have an impact to treasury
- Changes in funding mechanisms and intercompany loan arrangements resulting in updates to “funding rules”
- Updates to existing bank accounts and structures creating administrative burden to execute changes
- Change in cash flows
- Updates to existing procedures to reflect changes to treasury’s operations
- Potential impact to existing credit arrangements with banking partners and geographic footprint/scope of credit availability, i.e. restrictive bank covenants on IP migration

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Business Model Optimization Lite
Opportunity assessment

Considerations	Potential opportunities
Company is centralizing its procurement or establishing a sourcing function	• Centralized procurement charge • China business trust
Company is centralizing sales and marketing or reducing manufacturing activities in a jurisdiction	• Conversion to limited risk distributor or contract manufacturing
Company is standardizing business processes	• Implement business system royalties or franchise fees
Company is centralizing G&A activities or centers of excellence Company has a principal company and wants to include Tier 2 countries	• Implement global or regional service charges • IP planning opportunities • Principal company would provide services to Tier 2 countries (BMO Lite)

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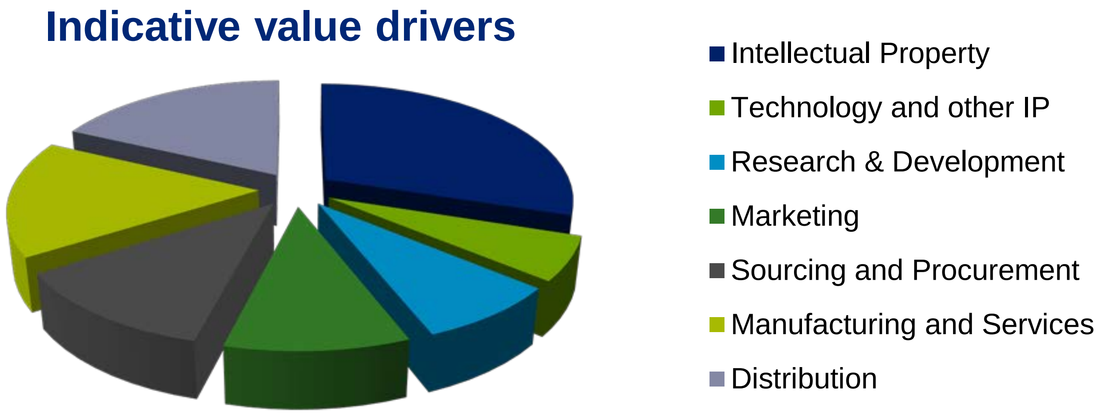
Business Model Optimization – align transfer pricing with business changes

- Businesses essentially consist of value drivers: **Assets, functions and risks** which generate a return to their owner
- Locating value drivers in a tax-efficient jurisdiction may provide significant **savings**
- Merely locating the assets and risks in a tax-efficient jurisdiction is not sufficient: The **functions**, including people, must be located in the tax-efficient jurisdiction to manage the assets and risks to create a sustainable tax benefit
- Business Model Optimization services focus on **helping multinational companies integrate their operational and tax planning activities**
- **Transfer Pricing is integral and applies across the board**



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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.

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Nancy Stacy is the partner-in-charge of Deloitte Tax LLP’s International Tax practice in the Chicago office. Nancy has more than 20 years of tax and accounting experience in the areas of treasury planning, mergers and acquisitions, effective tax rate planning, business model optimization, and repatriation for both public and private multinational corporations.

Nancy received a Bachelor of Science in Accountancy from the University of Illinois at Urbana-Champaign and a Masters in Taxation from DePaul University. She is a CPA licensed in the State of Illinois.

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