FORUM

Verrechnungspreise aktuell

Post-BEPS – erste Erfahrungen in der Praxis

Philip de Homont

Sehr geehrte Leserin,
sehr geehrter Leser,

das Thema Verrechnungspreise bleibt nach wie vor aktuell.
Die Finanzverwaltungen national als auch international befassen sich intensiv mit Verrechnungspreisen und der Steuerplanung international agierender Unternehmen. Die OECD stellt mit dem BEPS-Maßnahmenpaket die Steuerabteilungen vor neue regulatorische Herausforderungen hinsichtlich Verrechnungspreisbildung und -dokumentation.

Erste Erfahrungswerte und Auswirkungen der neuen Regelungen sind Gegenstand der beiden beigefügten Publikationen.

Ich wünsche Ihnen viel Freude beim Lesen und interessante Impulse für Ihre Praxis.

Freundliche Grüße

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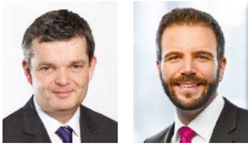
betreut eine Vielzahl von Außenprüfungen und Dokumentationen. Sein Schwerpunkt liegt in der Darstellung von komplexen Wertschöpfungsketten. Er ist Co-Autor von Standardwerken zu Verrechnungspreisen und IP-Bewertung.

Germany

Post-BEPS challenges and transfer pricing solution requirements in central management functions



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In a first of a series on transfer pricing technical challenges and solutions to changing economic and regulatory environments for global multinationals, this article focuses on the remuneration of top management functions in the intercompany context.

Historically, the intra-group transfer pricing treatment of top management functions of multinational companies has been the neglected step-child in terms of economic analysis. This matters less in set-ups where the group or divisional HQ operates as the central entrepreneur in the value chain, which accrues most of the (residual) profit anyway, be it through product pricing, or profit-absorbing royalties. In the other value chain set-ups, the situation is entirely different. Sometimes no remuneration is made for the management at all on the grounds that central management functions are of 'non-operative nature' and 'shareholder related'. Rarely, as this is often considered too cumbersome, central management services are market-priced based on the activity and time spent.

Most frequent is the use of cost allocation based charges. Activities of top management cost centres are first arbitrarily split up into 'shareholder-related activities' and consulting-type 'operating services' – mostly through subjective assessments and rarely backed up by substantial documentation. Second, the determined costs for operating services are allocated to the different service recipients, usually through the application of an appropriate cost allocation key (e.g. revenue, gross margin, headcount, capital invested) and a benchmarked cost plus service return. This traditional approach is tantamount to saying that top management services can be remunerated as 'routine' – i.e. a type of activity that could alternatively be outsourced. In a massively changing economic and regulatory environment, it is highly questionable whether such traditional approaches can sustainably be defended in tax audits where the challenge will inevitably arise.

The existing transformative economic environment (with the key megatrends of globalisation and digital transformation) has massively changed the traditional role of C-suite type activities from governance and control to being the economic driving force in companies. Top management leads the operational transformation of the group, its contribution to success and failure having a massive impact on the short-, medium- and long-term developments of operating entrepreneurial companies in the group value chain.

For the group to strive in the digital revolution and benefit rather than suffer from the massive upcoming of a new digital landscape, the CEO has in many groups become the driving force behind the development and implementation of new business models, digital solutions and consistent M&A activities that should enhance the group revenues and profitability. The COO is the master behind many (data-based) centralising Industry 4.0 initiatives that will help optimise the group operating model (footprint and supply chain operations) and increase underlying profitability. The CIO's role is transformed from the head of an important back-office IT-infrastructure support to front-line, high-value creating responsibilities for the group's digital customer and supplier service platforms. As a consequence, the CFO finance functions as business enabler shift from traditional control and compliance functions towards strategic transformational challenges. As it will fundamentally reshape the value propositions and way of working of multinationals, digital transformation is a high-opportunity, high-risk, and fairly costly challenge beyond the control of individual group companies that can only succeed through strong leadership, economic decision-making, and ownership at the level of the C-Suite.

The latest OECD initiatives provide new paradigms, in particular regarding decision making and intangible value creation. The OECD has stressed the importance of operating guidance, decision making and risk control as critical factors to be considered in the allocation of profits. This guidance will inevitably incentivise tax authorities to challenge intercompany structures that effectively compensate central group management functions like a routine service provider. Taxpayers should expect that value chain and profit split analysis which also focus on the value contribution of central management functions will be required and prepare their documentation accordingly.

Taxpayers should thereby be aware that profit-dependent remuneration for central management value contributions is already well-established in specific group principal structures (i.e. so-called centre-led models). Also, success fee-based remuneration also exists in true third party situations where external professional service providers can justify and document their value contribution to such an extent that customers remunerate them in proportion to the benefits they bring, even though the advisors leave the ultimate decision making and risk-taking responsibility completely to the customers.

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Germany

TNMM in a post-BEPS world – new transfer pricing solution requirements

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The OECD BEPS initiative has introduced numerous likely challenges to transfer pricing structures defended through application of the transactional net margin method (TNMM). This article focuses on the economic analysis enhancements needed to make TNMM-type transfer pricing solutions sustainable in the future.

In the last 20 years, the TNMM has *de facto* become the universal gold standard for the remuneration of local manufacturing and sales functions and a broad range of services. This paradigm has facilitated the tax-effective structuring of global value chains and international tax compliance and controversy dispute resolution. Accepting the basic principle of arbitrarily classifying functions into routine/non-routine categories, it has allowed to steer international tax disputes away from complex and controversial disputes on multinationals' local contribution to the global value creation process, and towards the simpler question of agreeing on the size of a certain functional return (on costs or sales) for the so-called 'tested party' presumably performing a routine function.

It seems fair to say that recently the quality of screening procedures and comparables obtained through database benchmarking has become less important when preparing documentation. This is because: (i) many selected comparables could reasonably be challenged; (ii) tax authorities were primarily results-driven and would challenge benchmarking results anyway if they did not like the results in terms of margins for local tested parties; and (iii) in such a case the double taxation risk would have been managed though competent authority procedures or EU arbitration anyway. Why then, in such a tax landscape, undertake more than the bare minimum to document arm's length ranges through TNMM benchmarking? Correspondingly, advisory fees from Big 4 and other tax consulting firms for benchmarking services have experienced a continuous 'race to the bottom'. Unsurprisingly, the quality of the resulting benchmarking studies, on average, has also deteriorated.

Take one typical objective advisors have been paid for in some cases – namely, to provide very high ranges for functional returns in a one-size-fits-all approach that allows multinationals to defend a wide range of outcomes through one benchmarking exercise (e.g., pan-European benchmark searches). Arm's length net cost plus margins of 1 to 10% for service providers and net sales margins of 2 to 10% for buy-sell distributors are not unheard of. If the latter applies to a multinational that, on average, earns a consolidated net margin of 10%, this would mean it would be considered arm's length for group distributors to earn anywhere between 20% and 100% of the total consolidated margin. It should be obvious that such outcomes are economically meaningless.

Multinationals should reasonably expect that such results will no longer be defensible in the future. The new transfer pricing (TP) guidelines provided by the OECD give tax authorities much more leeway to argue that local companies have contributed to intangibles. They will often find support for such claims in the fact that ever-deeper globalisation of the business of multinationals has trickled down to a global spreading of management functions. Potential development, enhancement, maintenance, protection, and exploitation of intangibles (DEMPE) functions can be suspected everywhere. From this, high-margin multinationals should expect that, in the future, the conflict strategy of many tax authorities will move from: i) accepting routine classifications and the TNMM framework; and ii) challenging individual comparables and negotiating for higher margins within the TNMM framework towards: i) challenging routine classifications and arguing for local intangible contributions; and ii) rejecting TNMM and asking for profit-split solutions.

Multinationals understandably are averse to this vision, as it will increase uncertainty and raise dispute resolution costs. If successful, it would also force multinationals to adopt a system (profit split) that runs against their existing operating models and systems and would generate high implementation costs. To avoid this, a dominant strategy is clearly to integrate the BEPS stimulus within the established TNMM framework. TNMM studies can and should be enhanced with market power, IP impact and risk adjustment analysis, based on a standard industrial and financial economics framework. This will provide TNMM analysis with the necessary flexibility to adjust results to per-country particularities while sticking to one global framework, methodology, and standardised documentation approach.

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