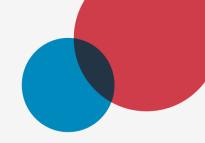


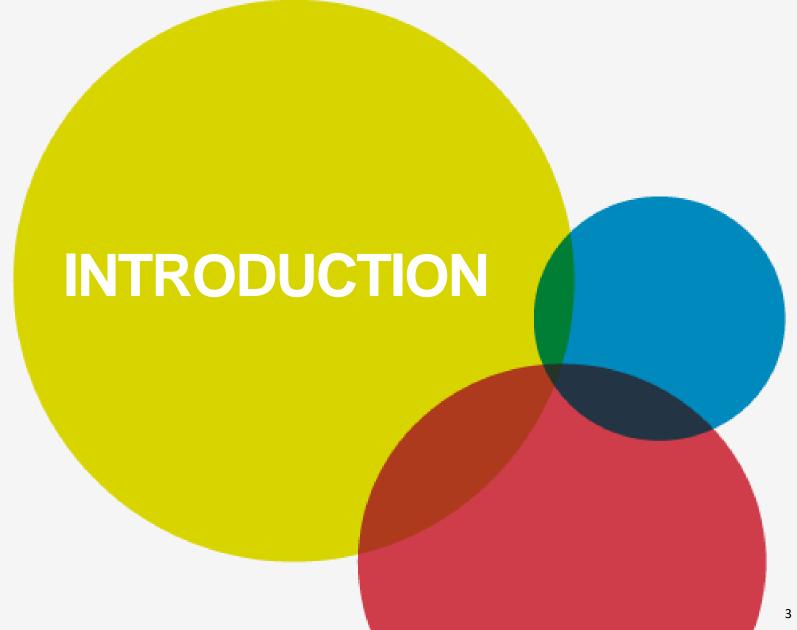
## **AGENDA**



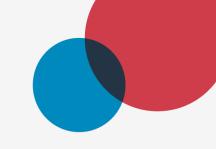
- Introduction
- Ownership of IPs and allocation of return from exploitation of IP
  - Outsourcing of functions
  - "Control-concept"
- Preferential IP regimes and harmful tax practices
  - Substantial activity requirement
- Impacts on already implemented IP structures? What does it mean for future IP structures?
- Case Studies and Practical Examples







## WHY THIS TOPIC?



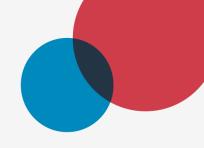
## Components of S&P 500 Market Value



Source: Ocean Tomo, LLC







## What is intangible property?

- Not a physical or financial asset
- Capable of being owned or controlled for use in commercial activities
- The use or transfer would be compensated had it occurred in a transaction between independent parties under comparable circumstances
- The OECD distinguishes between marketing and trade intangibles
  - <u>Marketing</u>: An intangible that relates to marketing activities, aids in the commercial exploitation of a product or service, and/or has an important promotional value for the product concerned
  - Trade: Commercial assets other than a marketing intangible





## **OVERVIEW OF DEMPE FUNCTIONS**



#### **DEMPE**

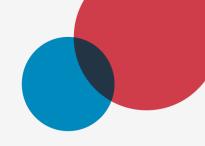
- **D**evelopment
  - Everything associated with coming up with ideas for intangibles, and putting plans and strategies in place for their creation
- Enhancement
  - Continuing to work on aspects of intangibles to make sure they can perform well at all times and continue to be improved
- Maintenance
  - Actions that ensure intangibles continue to perform well and generate revenue
- Protection
  - Ensuring that the value of the intangible remains strong
- **Exploitation** 
  - Refers to the way in which intangibles are used to generate profits











## Identified issues

- Structures predominantly based on contractual terms
- Which entity is entitled to derive return form exploitation of IP ("IRR")?

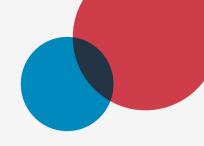
## Conclusions of OECD – in a nutshell

- Legal ownership of IP alone does not determine entitlement to IRR
- Assumption of risk: requires control over risk & financial capacity to assume risk
- Allocation of IRR
  - Accomplished by arm's length compensation of MNE group members performing functions/assuming risks/using assets in DEMPE of IP 

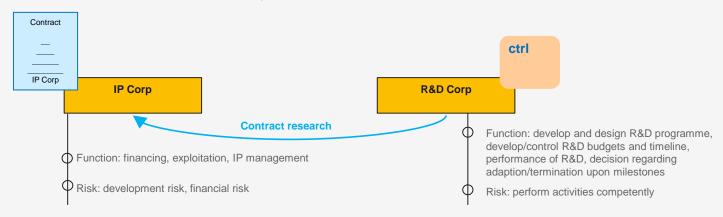
    contribution to value of IP
  - Relevant: "functional" ownership of IP no fragmentation of (economic) ownership of IP
- Mere IP-funding ≠ DEMPE-relevant function
  - If funder controls related financial risks: only risk-adjusted return on funding
  - If funder does not even control related financial risks: no more than risk-free return
- ⇒ Allocation of IRR based on DEMPE-specific F/R-analysis







## DEMPE-specific F/R-analysis - overview

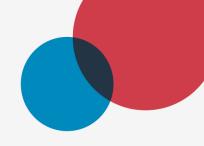


#### Analysis of facts & circumstances

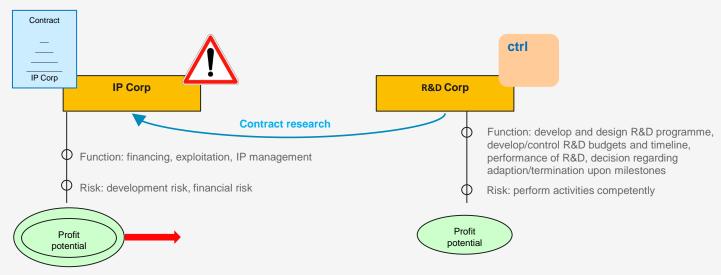
- Step 1: Identify IP & economically significant risks associated with DEMPE
- Step 2: Identify legal rights and contractual arrangements
  - Legal owner? Contractual assumption of risks?
- Step 3: Functional analysis (conduct of the parties)
  - Which party performs functions (in particular important function), uses assets (incl funding), manages risks related to DEMPE of IP?
  - Which party performs control over...
    - economically significant risks?
    - performance of outsourced functions







## DEMPE-specific F/R-analysis - overview



- Analysis of deviations
  - Step 4: Contractual arrangements ≡ (conduct of parties + effective control over risks + financial capacity to assume risks)?
  - Step 5: Delineation of actual transaction
- Potential adjustments
  - Step 6: Determine ALPs for actual transactions consistent with each party's contributions of functions performed/assets used/risks assumed







## F/R-ANALYSIS IN DETAIL: FUNCTIONS



- Detailed analysis of performance / control of performance of DEMPEfunctions
- Note: outsourcing of functions acknowledged, but control required
  - "Control over risk" concept to be applied by analogy
  - Legal owner ≠ entitled to any ongoing benefit attributable to outsourced functions if it neither performs nor controls functions related to DEMPE
- Special significance of "important functions"

For self-developed IP (or acquired IP that serve as platform for further development activities)

- Design and control of research and marketing programmes
- Direction of and establishing priorities for creative undertakings (including determining course of "blue-sky" research)
- Control over strategic decisions regarding IP development programmes
- Management and control of budgets

#### For any IP

- · Important decisions regarding defence and protection of IP
- Ongoing quality control over outsourced functions (that may have material effect on value of IP)
- outsourcing requires application of transactional profit split methods!





- Assumption of risk determines which party is entitled to returns from assuming risk and responsible for consequences if risk materialises
- Economically significant risks related to DEMPE







- 6-step process for analysing risk (OECD-TPG 1.60) to be applied to determine...
  - which party assumes risks related to DEMPE
  - whether other parties perform control and/or risk mitigation functions
  - whether party assuming risk has financial capacity to assume risk



## F/R-ANALYSIS IN DETAIL: RISKS (3/4)



"Control over risk" concept (OECD-TPG 1.65)

## Risk Management

Capability to make decisions to take on/lay off/decline risk-bearing opportunities

Capability to make decisions on whether and how to respond to risks associated with opportunity

Capability to manage dayto-day risk mitigation

together with functional performance

- = "Control over risk"
- Focusses on active decision-making
- Relevant for assumption of risk

- May be outsourced
- But: under direction of risk-assuming party



## F/R-ANALYSIS IN DETAIL: RISKS (4/4)



- But: in case of outsourcing day-to-day risk mitigation ⇒ "control over risk" by risk-assuming party requires capability to
  - Determine objectives of outsourced activities,
  - Decide to hire provider of outsourced risk mitigation functions,
  - Assess whether objectives are being adequately met, and,
  - Decide to adapt/terminate contract with provided
  - performance of such assessment and decision-making
- Conclusions on "control over risk"
  - personnel substance & competence/experience in area of particular risk
  - "Control over risk" ≠
    - Setting of policy environment relating to accepted level of risk
    - Establishing control framework for managing and reporting risk
    - Mere formalising outcome of decision-making
    - But: active decision-making
  - Note:
    - Compensation of party contributing to control over risk (without assuming the risk) shall include a profit sharing element (OECD-TPG 1.105)



## F/R-ANALYSIS IN DETAIL: SUMMARY



- Legal owner only entitled to all anticipated ex-ante IRR if
  - Performs/controls outsourced DEMPE-functions (including important functions)
  - Provides all assets (incl funding) necessary to DEMPE of IP and
  - Assumes all risks related to DEMPE
  - ⇒ For "clear-cut" case: legal owner of IP has to be "process" or "functional" owner of IP
- Outsourcing of DEMPE-functions acknowledged <u>but</u> control of legal IP owner required
  - Application of "control over risk"-concept by analogy
  - Note: outsourcing of important functions critical & arm's length remuneration should include a profit sharing element
  - Problem: funding without performing functions related to DEMPE



## F/R-ANALYSIS IN DETAIL: SUMMARY



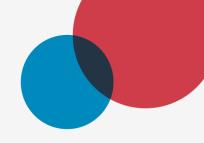
- Assumption of risk requires (i) exercising control over risk and (ii) financial capacity to assume risk
  - "Control over risk"-concept
  - Note: contributions to control of risk (without assuming risk) require arm's length remuneration that includes profit sharing element
  - Financial capacity to assume risk on equal footing with control
- Practical guidance
  - In case of outsourcing: IP owner should be capable of actually performing control over functions & control over risk
  - "Process"/"functional" ownership of IP requires personnel with respective capabilities/experiences & actual performance of risk management
    - E.g. implementation of R&D steering committee



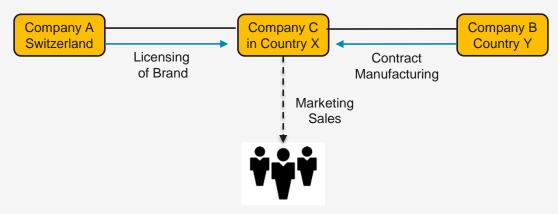




## CASE STUDY 1: UPDATED OECD TRANSFER PRICING GUIDELINES - LICENSING OF IP



- Company A, Company B and Company C are related parties in the consumer goods business
- \* Company A is the owner of the **brand** of the group. Company A licenses the brand to Company C, which **purchases** the goods from a related contract manufacturer (Company B) and **distributes** them in its local market. Company A is responsible for **global marketing strategy and brand-building**.
- Company C also performs significant marketing activities in order to increase the sales of products in its local market, e.g. through advertising, active strategy towards retail/wholesale through own shops etc.
- Company C paid a royalty to Company A and deducted marketing expenses.
- The MNE has in each jurisdiction a sales companies with that profile.





## CASE STUDY 1: UPDATED OECD TRANSFER PRICING GUIDELINES - LICENSING OF IP



- Tax authorities in country X may take the following positions how should these arguments be considered in the context of DEMPE?
  - Transaction was not correctly delineated de facto a marketing service agreement was in place between Company A and Company C according to which Company C should have been remunerated for the marketing activities by Company A through a cost plus
  - Company C is the co-owner of the brand due to its marketing activities, therefore no
    justification for a royalty charge
- DEMPE analysis and pricing
  - Delineation as basis for allocation of return
  - Question of definition of "Exploitation" and importance of exploitation in value creation?







## **Digital Economy**

#### Client profile

- Successful App developer
- IP owned by parent company, utilisation of patent-box-regime
- Contract developer in high-tax jurisdiction

#### Client needs

- Allocation of IP-related return to parent company (patent-box-regime)
- BEPS-proof business model

#### Challenges

- Delineating the value-added process relating to DEMPE-functions in highly creative undertakings (incl. identification of important functions)
- Effective control-over risk by party contractually assuming the risk (sufficient human resources?)
- Control/assumption of risks in comparable uncontrolled transaction?

#### **Results**

Relocation of human resources to IP-owner (important functions, effective control-over risk)



## **CASE STUDY 3: RACI ANALYSIS**



#### Purpose of Undertaking a RACI Analysis in Terms of DEMPE

In terms of defining which of the DEMPE functions should be allocated to the respective entities in question, the RACI analysis can be used to allocate the functions of Development, Exploitation, Maintenance, Protection and Enhancement depending on the fact which entity is responsible, accountable, to be kept consulted or informed within the respective business process.

The RACI concept assumes that within a business process the involved entities are contributing their value to the respective process according to the importance of their involvement for the relevant process steps and to which extent the participating entities can influence the further course of the process. Therefore, the RACI analysis always follows a prior in-depth process analysis, in which the relevant DEMPE process steps are broken down into several subprocesses, so that it is possible to assign the RACI-responsibilities for the specific process.

The RACI concept therefore differentiates between strong involvement (being responsible or accountable for the process) and a rather weak involvement (consulted or informed) in the process.



# CASE STUDY 3: STEPS FOR PERFORMING A BUSINESS PROCESS ANALYSIS (BPA) WITH RACI



1

#### Starting the BPA on the highest level by identifying the mega processes:

- "Mega Processes" = Main processes (series of activities) required to generate value within the group (depending on relevant industry) and the center stage of the Group's business set-up
- Examples for "Mega Processes": Research and Development, Purchasing/Production, Sales, After Sales, Administration. Number of main processes for most companies ranges between two and ten processes.

#### Case Study:

- Client profile: Engaged in the development of computer-controlled production and testing for all kinds of batteries (batteries for mobile phones, automotive batteries to huge submarine batteries. Within a JV, a very sophisticated production plant is built in the U.S. with a significant involvement of IP.
- Client needs: Identification of the profit entitlement for the involved parties out of the production plant (and correspondingly related IP)
- **Challenges:** Appropriate and transparent methodology within the scope of the required value chain analysis / Business process analysis and identification of a logical and transparent procedure.
- \* Approach: Perform a business process analysis and identify the relevant mega processes for this case, which are:

Mega Processes
Processes
Product Conception
Production Support

Error Analys

Fill in relative values

2

#### **Splitting up the "Mega Processes" into sub-processes:**

- Breaking down the main processes into underlying sub-processes ("Major Processes") in order to enable an in-depth analysis of the connected critical success factors in terms of the overall value chain contribution (including the identification of relevant input and output factors, contribution to core competences of the group, business risks associated and critical success factors related to a business process)
- Within the scope of this analysis step, it should be possible to define the most important value drivers (as critical success factors).

Value	Value Drivers				
Concept-Know-H	ow	20 (%)			
Project Managem	ent	15 (%)			
Testing Tools	15 (%)				
Managing Proces	s Data Material	15 (%)			
Software		15 (%)			
Customising		20 (%)			
	Total should	100 (%)			



# STEPS FOR PERFORMING A BUSINESS PROCESS ANALYSIS (BPA) WITH RACI



3

#### Determination of relevance of sub-processes for the overall value chain

- Within the next step, the identified sub/main-processes have to be weighted according to their contribution to the value drivers identified in step 1 and 2
- The weights are determined according to their relative value creation share (%).

#### Example Case:

Following our example, we identified the following sub-processes for the mega processes (i) product conception, (ii) product support and (iii) error analysis and identified their relevance for the identified value drivers as follows:

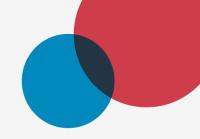
Fill in relative values

		Concept- Know How	Project Management	Testing Tools	Managing process data material	Software	Customising	Relative Processes Weights
	Value Driver Weighting	20 (%)	15 (%)	15 (%)	15 (%)	15 (%)	20 (%)	
Mega Processes	Sub Processes							
	Conceptional design	4,0	2,0	1,0	0,0	1,0	1,0	9,0%
	Prototype design	4,0	2,0	1,0	0,0	1,0	1,0	9,0%
Dradust sensenties	Product functionality	2,0	0,0	1,0	0,0	1,0	0,0	4,0%
Product conception	Software customising for production	3,0	0,0	1,0	1,0	1,0	1,0	7,0%
	Implementation support	2,0	0,0	1,0	0,0	1,0	2,0	6,0%
	Support in terms of mechanics and electronics	2,0	0,0	2,0	1,0	1,0	1,0	7,0%
	Making machines ready for production operation	1,0	0,0	2,0	1,0	1,0	0,0	5,0%
	Production of electronic control components	0,0	1,0	0,0	2,0	0,0	0,0	3,0%
	Acceptance reporting	0,0	1,0	0,0	2,0	0,0	0,0	3,0%
	Production of parts for steering elements	0,0	1,0	0,0	2,0	0,0	0,0	3,0%
Production support	Production of additional components	0,0	1,0	0,0	2,0	0,0	0,0	3,0%
	Sourcing of electronic control panels	0,0	1,0	0,0	1,0	0,0	0,0	2,0%
	Infrastructure of manufacturing lines	0,0	1,0	0,0	0,0	1,0	0,0	2,0%
	Project wise customising of operating software	0,0	0,0	1,0	0,0	2,0	0,0	3,0%
	Installation process	1,0	0,0	0,0	0,0	1,0	0,0	2,0%
	Putting production machines into operation /	0,0	1,0	2,0	1,0	1,0	0,0	5,0%
	machine monitoring							
	Acceptance testing	0,0	1,0	0,0	0,0	1,0	0,0	2,0%
Error analysis	Training of operating personnel	0,0	1,0	0,0	0,0	1,0	0,0	2,0%
Effor analysis	Support in terms of production error analysis	1,0	1,0	0,0	1,0	1,0	1,0	5,0%
	Data storage monitoring	0,0	0,0	1,0	0,0	0,0	1,0	2,0%
	Product testing	0,0	0,0	2,0	1,0	0,0	0,0	3,0%
	Governance / product safety	0,0	1,0	0,0	0,0	0,0	12,0	13,0%
Total		20	15	15	15	15	20	100%

Total should be 100%



# STEPS FOR PERFORMING A BUSINESS PROCESS ANALYSIS (BPA) WITH RACI



4

#### Determination of contribution to the mega process by using the RACI approach

The contribution share of the involved entities is derived from the RACI ("Responsible, Accountable, Consulted, Informed") approach, where the allocation of processes follows a structured analysis of the different "degrees of involvement" and roles of a group company's department within a specific process.

The "degree of involvement" is assumed by the following scale:

Responsible (Factor Weight is 4):	Persons or group companies with <b>implementation responsibility</b> (that is to say who are responsible for carrying out the operational functions. This role is perceived and exercised as part of day-to-day business).
Accountable (Factor Weight is 3):	Persons or group companies <b>with cost or overall responsibility</b> , who bear responsibility for budgets and the performance of functions and manage the function-specific risks.
Consulted (Factor weight is 2):	Persons or group companies who may have neither implementation responsibility nor cost or overall responsibility, but who <b>have important information and knowledge</b> for the performance of their functions.
Informed: (Factor weight is 1):	Persons or group companies with a <b>right to information</b> about the course or result of an entrepreneurial activity.

5

#### Determination of contribution share to the mega-process by using the RACI approach:

In a **final step**, a profit or loss portion attributable to the involved parties is derived from the result of the RACI analysis (step 4) together with the determination of the relative value contribution per sub-process (step 1-3). The following slide demonstrates the project steps for our example case:



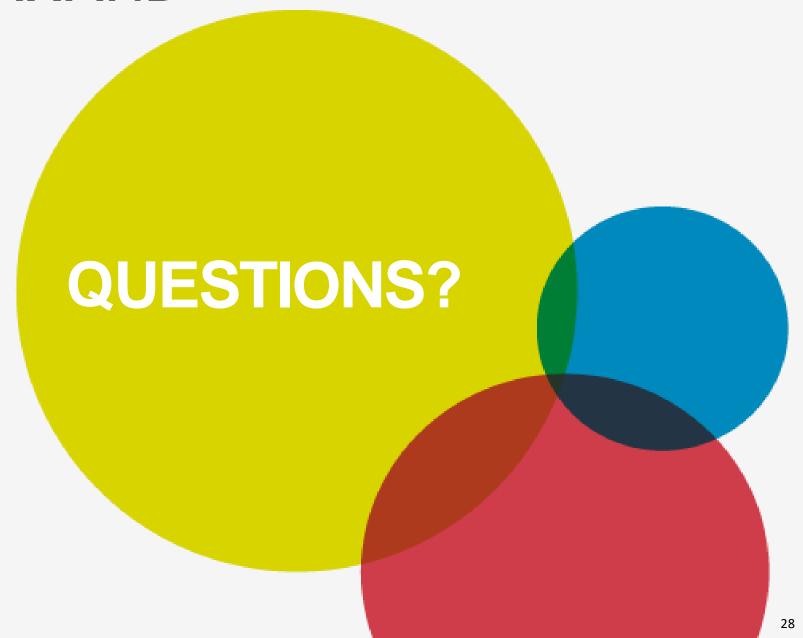
## Example Case:

	Process-description	Participating Entity P A			Pa	Participating Entity B						
Mega Processes	Sub-Processes	R	Α	С	ı	Total weight		R	Α	С	ı	Total weight
	Conceptional design	4	0	0	0	94%		0	0	0	1	6%
	Prototype design	4	0	0	0	94%		0	0	0	1	6%
Product Conception	Product functionality	4	0	0	0	94%		0	0	0	1	6%
Conception	Software customising for production	4	0	0	0	80%		0	0	2	0	20%
	Implementation support	4	0	0	0	80%		0	0	2	0	20%
	Support in terms of mechanics and electronics	4	0	0	0	80%		0	0	2	0	20%
	Making machines ready for production operation	4	0	0	0	80%		0	0	2	0	20%
	Production of electronic control components	0	0	2	0	20%		4	0	0	0	80%
Production Support	Acceptance reporting	0	0	2	0	20%		4	0	0	0	80%
	Production of parts for steering elements	0	0	2	0	20%		4	0	0	0	80%
	Production of additional components	0	0	2	0	20%		4	0	0	0	80%
Сарроп	Sourcing of electronic control panels	0	0	2	0	20%		4	0	0	0	80%
	Infrastructure of manufacturing lines	0	3	0	0	36%		4	0	0	0	64%
	Project wise customising of operating software	4	0	0	0	94%		0	0	0	1	6%
	Installation process	0	3	0	0	36%		4	0	0	0	64%
	Putting production machines into operation / machine monitoring	0	3	0	0	36%		4	0	0	0	64%
Error Analysis	Acceptance testing	0	3	0	0	36%		4	0	0	0	64%
	Training of operating personnel	0	3	0	0	36%		4	0	0	0	64%
	Support in terms of production error analysis	0	3	0	0	36%		4	0	0	0	64%
	Data storage monitoring	0	3	0	0	36%		4	0	0	0	64%
	Product testing	0	3	0	0	36%		4	0	0	0	64%
	Governance / product safety	0	3	0	0	36%		4	0	0	0	64%

Sub- Processes	Con.	bution	Relative Process			
Jub-110063363	Entity A	Entity B	300.00	Entity A	Entity B	
Conceptional design	94%	6%	9,0%	8%	1%	
Prototype design	94%	6%	9,0%	8%	1%	
Product functionality	94%	6%	4,0%	4%	0%	
Software customising for production	80%	20%	7,0%	6%	1%	
Implementation support	80%	20%	6,0%	5%	1%	
Support in terms of mechanics and electronics	80%	20%	7,0%	6%	1%	
Making machines ready for production operation	80%	20%	5,0%	4%	1%	
Production of electronic control components	20%	80%	3,0%	1%	2%	
Acceptance reporting	20%	80%	3,0%	1%	2%	
Production of parts for steering elements	20%	80%	3,0%	1%	2%	
Production of additional components	20%	80%	3,0%	1%	2%	
Sourcing of electronic control panels	20%	80%	2,0%	0%	2%	
Infrastructure of manufacturing lines	36%	64%	2,0%	1%	1%	
Project wise customising of operating software	94%	6%	3,0%	3%	0%	
Installation process	36%	64%	2,0%	1%	1%	
Putting production machines into operation / machine monitoring	36%	64%	5,0%	2%	3%	
Acceptance testing	36%	64%	2,0%	1%	1%	
Training of operating personnel	36%	64%	2,0%	1%	1%	
Support in terms of production error analysis	36%	64%	5,0%	2%	3%	
Data storage monitoring	36%	64%	2,0%	1%	1%	
Product testing	36%	64%	3,0%	1%	2%	
Governance / product safety	36%	64%	13,0%	5%	8%	

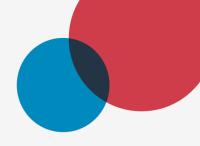














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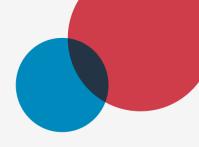
Margaret Critzer is a Senior Advisor with Alvarez & Marsal Taxand in the Bay Area, focusing on transfer pricing. She has more than 20 years of experience assisting both public and privately-held clients, leading engagements in the documenting and planning of transfer pricing policies, obtaining both bilateral and unilateral Advance Pricing Agreements and managing audit defense projects. Ms. Critzer's experience also includes supporting cost-share arrangements, buy-in payments, tangible transfers and litigation support.

Ms. Critzer's background includes leading teams in the evaluation of intercompany transactions to determine whether they meet applicable U.S. and foreign transfer pricing regulations, including OECD guidelines and the integration of transfer pricing policies following a merger or other business restructuring event.

She has significant experience providing clients practical advice in their transfer pricing arrangements and helping to resolve international tax controversy matters. Ms. Critzer has worked extensively with the Internal Revenue Service (IRS), as well as the revenue authorities of other countries, including Canada, India, Japan, and the U.K. in representing clients.

Before joining A&M, Ms. Critzer spent 20 years with KPMG in Silicon Valley, leading KPMG's West Coast transfer pricing practice. Prior to joining KPMG, Ms. Critzer was an international financial analysis manager with Raychem Corporation, where she held positions in cost accounting, general accounting, and financial planning. Ms. Critzer earned a Master of Business Administration from the San Jose State University and a bachelor of science degree in from Menlo College. She has written articles on transfer pricing issues in various publications and is a regular speaker at tax-related events.







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Clemens Nowotny is a tax advisor and has been a partner at Taxand Austria, LeitnerLeitner since 2008.

The practice of Clemens Nowotny mainly covers advising Austrian and foreign corporate groups as well as family owned businesses in matters relating to Austrian and international tax law. His specialties include in particular group reorganisations, group tax planning, issues associated with establishing PEs and PE profit allocation, as well as withholding tax and the taxation of international artists and athletes.

Furthermore, he counts as one of Austria's leading experts on transfer pricing and is listed as an acknowledged specialist in "World Transfer Pricing" and the "Expert Guide to the World's Leading Transfer Pricing Advisers". Clemens Nowotny regularly provides advice on the structuring and implementation of transfer pricing models, the defence of transfer pricing systems in tax auditing procedures, the collection of binding rulings, the resolution of international transfer pricing disputes, and the preparation of transfer pricing documentation and benchmarking analyses.

He is in demand as a speaker, both in Austria and abroad, on issues related to his areas of expertise, and his opinions on topics connected with transfer pricing are regularly published ("Verrechnungspreisrichtlinien – Praxiskommentar" [Transfer Pricing Guidelines – Practical Commentary]).







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Hendrik Blankenstein is a partner of Tax Partner AG and leads its transfer pricing team. From 1989 to 1995, Hendrik was an international tax consultant at Big 4 firms in both the US and The Netherlands, from 1996 - 2004 he worked as an in-house international tax and transfer pricing counsel at Nestlé's HQ in Switzerland and from 2005 to 2015 as a Swiss based partner in globally operating transfer pricing boutique consultancy firms.

Hendrik has been providing transfer pricing advice to Swiss and foreign multinational clients in a variety of industries, covering design of transfer pricing systems, preparation of Masterfile/local file documentation, negotiation and conclusion of unilateral / bilateral APAs, successful management of complex transfer pricing audits and setting up transfer pricing risk management frameworks.







#### **Christina Storm**

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Christina Storm is a certified tax advisor with Flick Gocke Schaumburg in Düsseldorf. Ms. Storm studied Taxation and Accounting (Master of Science) at the Mannheim Business School (University of Mannheim) and already gained consulting experience in the area of transfer pricing and international taxation since 2014.

Christina has extensive experience both in advising international clients investing into Germany and in advising German-based multinationals active outside of Germany. She was already involved in various transfer pricing projects covering cross border transactions of multinational companies in a wide range of industries.

Christina specialises in advising multinational companies in transfer pricing questions, being experienced in managing global documentation projects and relocation of functions. Furthermore, she supports clients in tax audits, mutual agreement procedures (MAPs) as well as in the taxation of permanent establishments. Her experience also includes several restructuring projects in relation to the development, planning and implementation of transfer pricing systems also in conjunction with IP structures.

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