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IP TRANSACTIONS AND INTRA-GROUP FINANCING AND SERVICES

PRESENTATION BY
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Your global tax partner

Agenda

1. Transfer Pricing and Intra-Group Services: the Benefit Test
2. Disallowing Intra-Group Management Services
3. Disallowing Director Fees
4. Transfer Pricing and Intra-Group Financial Transactions: Intra-group Loans
5. Transfer Pricing and Intangibles: Intra-group Royalties
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Intra-Group Services: the Benefit Test

Intra-Group Services: TWO-STEP PROCESS

(1) Has a service been provided?

- Benefit test

From the perspective of both the **service provider** and from the perspective of the **recipient of the service**

YES

(2) What is an arm's length charge?

- How should a charge be made?
- At a cost or at a profit? [TPG § 7.35-7.37]

[TPG § 7.5]

Step 1 the Benefit Test: Determining Whether a Service Has Been Rendered

So called: "Willing to pay/perform for itself test"

Conferring economic or commercial value to enhance the commercial or maintain the business position of recipient

Evidence of value being conferred:

Services that independent enterprises would have been **willing to pay for OR perform for themselves test.**

[TPG § 7.6]

Need to show what the **identified need** of the Group is?

And whether the activity conducted by other group member(s) has **satisfied the identified need.**

[TPG § 7.8]

Chargeable Services

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“Benefit test” is not met: Non-Chargeable services

- Shareholder activities [TPG § 7.9-7.10]
- Duplicated activities [TPG § 7.11]
- Incidental benefit—activity based [TPG § 7.12]
- Incidental benefit with no overt action: Passive association or implicit support [TPG § 7.13]
- Incidental benefit: Group synergies with no deliberate concerted group action [TPG § 1.177-1.180]
- On-call services provided that the need is remote [TPG § 7.16-7.17]
- Exemption: Pass-through costs—Services Chargeable with No Markup [TPG § 7.34]

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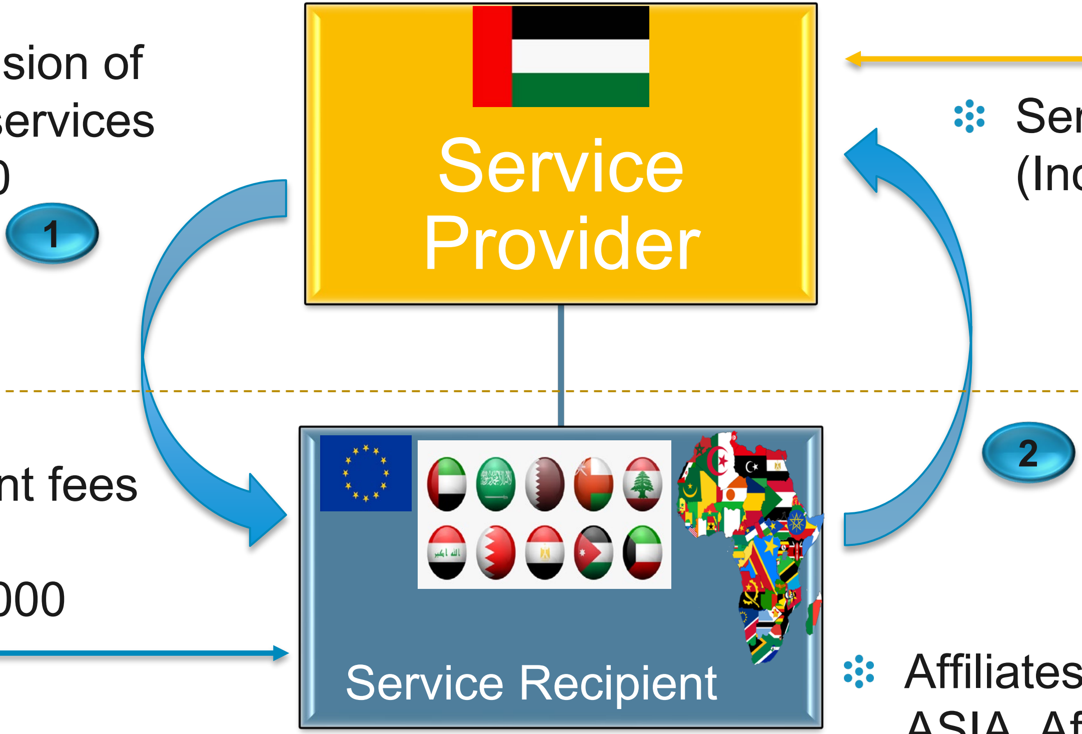
Disallowing Intra-Group Management Services

Practical Example: Disallowing Intra-Group Management Services—Facts

- Contract: Provision of management services AED 2,000,000



- Services Rendered (Income)
- Management fees (expense)
- AED 2,000,000
- Bank Payment AED 2,000,000
- Affiliates within EU, ASIA, Africa, GCC

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Case Law Example: Intra-Group Management Services*

- European headquarter company, namely Alfa Gomma S.p.A. (“**AG SpA**”), entered into “**contract for the provision of general management services**" with its affiliates, including an Italian wholly owned subsidiary, namely Alfa Gomma Sud s.r.l. (“**AGS Italy**”), to provide the following services: marketing, telephony, legal, accounting and tax consultancy services.

- Italian Tax authorities **disallowed the deductions** charged by the foreign parent with respect of **management costs** because AGS Italy:
  - **had not documented the services** received which justified an intra-group charge; and
  - had not shown what **benefit** it had received by incurring those costs.

- Provincial Tax Court allowed the appeal of the AGS Italy.

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*Supreme Court of Italy of July 2014, Alfa Gomma SUD s.r.l., No. 16480

Case Law Example: Intra-Group Management Services

- Regional Tax Court modified the decision of the Provincial Tax Court because it was for the taxpayer to demonstrate that the services received by it from a group company had produced an economic or commercial benefit to it:
  - some of the **invoices related to tax years not under review** and there was no indication on the invoices as to the individual subsidiaries to whom the services had been provided;
  - some of the documents issued by third party suppliers/subcontractors were in the name of AG SpA;
  - **documents had been produced which had no relation to AGS Italy** but to some other companies in the group;

Case Law Example: Intra-Group Management Services

- other invoices were issued to AG SpA for "assistance and reimbursement of expenses" **without specifying the subsidiaries** to which the services had been provided;
- documents prepared for the purposes of the **consolidated financial statements** showed that costs had been incurred for the **benefit of AG SpA** and **not AGS Italy**;
- the percentage charged by AG SpA to the subsidiaries was contractually established as a **fixed amount** and did not take into account the **actual benefit** received by them from such services;
- all the subsidiaries **did not require the same level of service**.

- The Supreme Court dismissed the taxpayer's appeal

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Disallowing Director Fees

Practical Example: Disallowing Director Fees—Facts

- Employment agreement

1

- Employment Income

2

- Bank Payment
- Director Fees
- AED 2,000,000

UAE Company

- Payroll Cost
- AED 2,000,000

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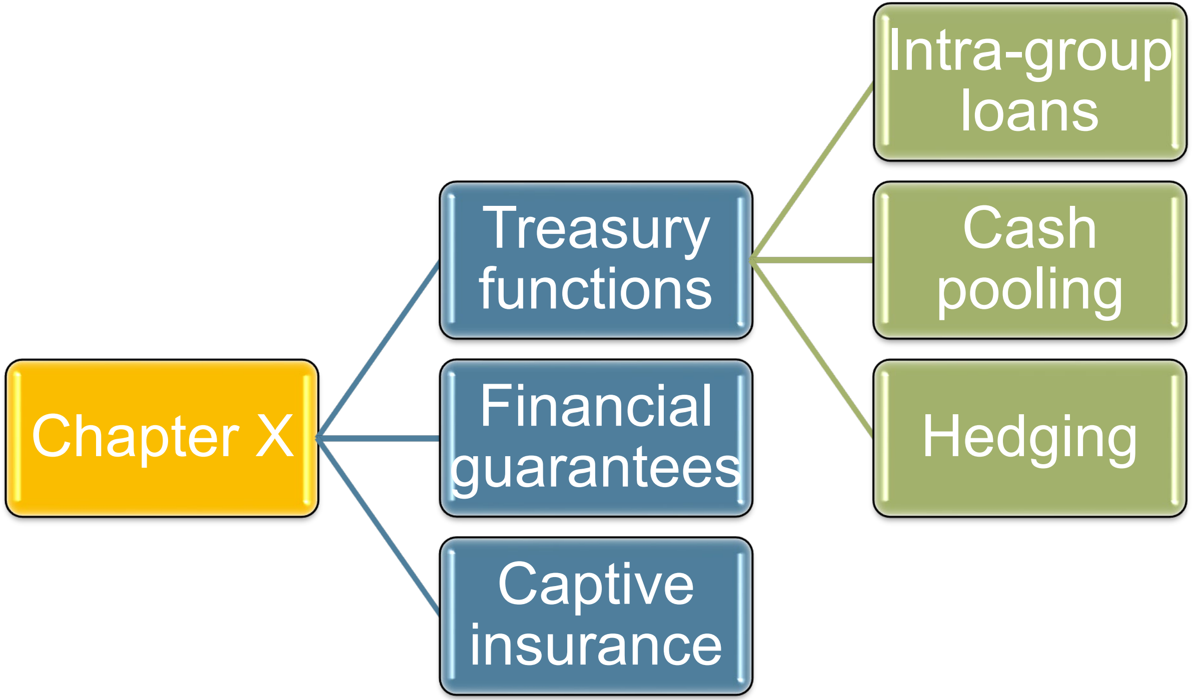
Pricing
Intra-Group Loans

OECD TPG Chapter X: Transfer Pricing Aspects of Financial Transactions



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Key Terms and Conditions of Intra-Group Loans: Impact on Interest Rates

Increase Interest Rate

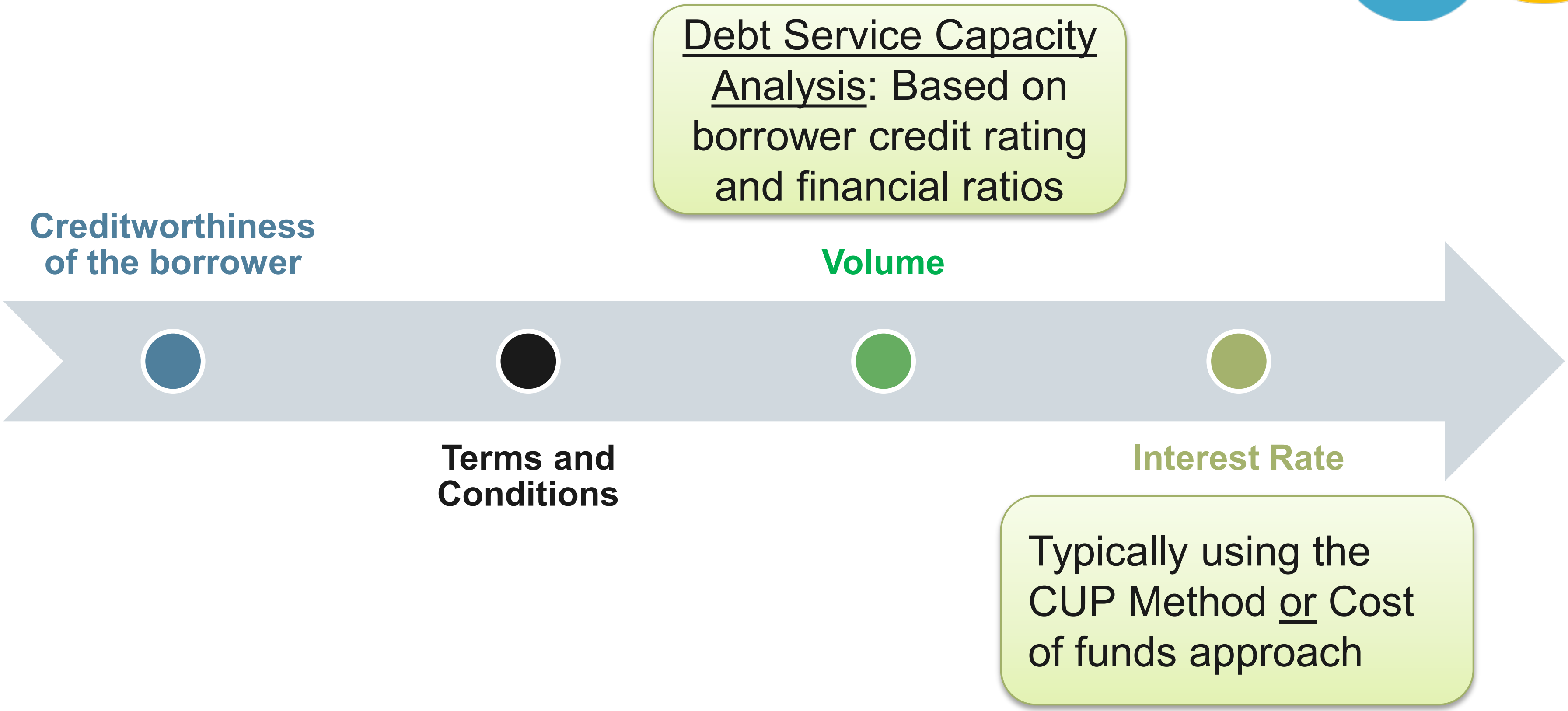
- **Term**: Long term
- **Conversion**: Non-Convertible
- **Currency**: High currency Risk
- **Guarantees**: Unguaranteed
- **Repayment**: Bullet
- **Seniority/Rank**: Mezzanine
- **Security**: Unsecured
- **Options**: Pre-payment
- **Interest payment**: On maturity

Decrease Interest Rate

- **Term**: Short Term
- **Conversion**: Convertible
- **Currency**: Low currency Risk
- **Guarantees**: Guaranteed
- **Repayment**: Capital & Interest
- **Seniority/Rank**: Senior
- **Security**: Secured
- **Option**: Call
- **Interest payment**: Monthly

[TPG § 10.12]

Arm's Length Loan Building Blocks



Pricing Intra-Group Royalties

Framework for analysing transactions involving intangibles: Six-step process

The allocation of returns from the exploitation of intangibles should especially be based on which parties perform the DEMPE functions, assume the risks and provide funds or other assets [OECD TPG 6.34]

1. **Identify** the **intangibles used** or transferred in the transaction with specificity, and the **economically significant risks** associated with the **Development, Enhancement, Maintenance, Protection and Exploitation** (**DEMPE**) of intangibles
2. **Identify** the full contractual arrangements, with special emphasis on determining **legal ownership** of intangibles
3. **Identify** the **parties** performing functions, using assets and managing **risks** related to the **DEMPE** of intangibles
4. **Confirm consistency** between the terms of the contractual arrangements and the conduct of the parties (allocation of risks)
5. **Delineate** the **actual** controlled transactions related to the DEMPE of intangibles
6. **Determine** arm's length prices for transactions consistent with each party's contribution of functions, assets and risks

[TPG § 6.35-6.72]

Going forward Legal Ownership becomes less important

How is income allocated between related parties from exploiting the intangible?

The legal owner of intangibles does not, in and of itself, necessarily imply that the legal owner is entitled to any income generated by the business after compensating other members of the MNE group for their contributions in the form of functions performed, assets used, and risks assumed [TPG 6.47].

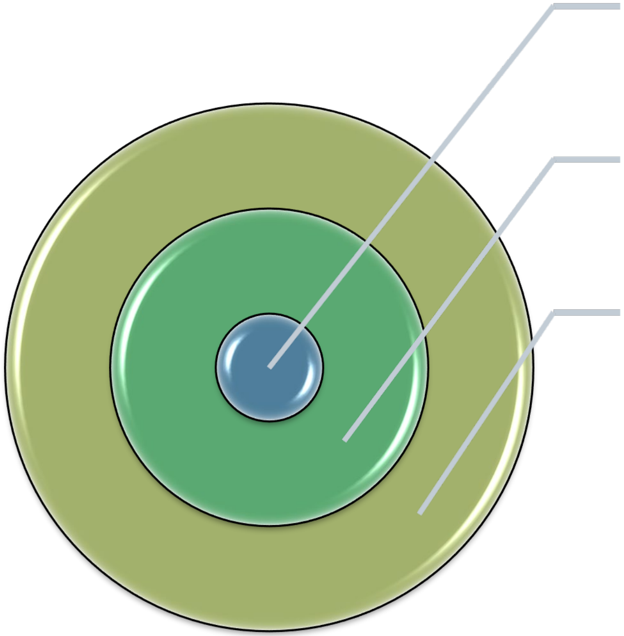
All members of the group receive appropriate compensation for any functions they perform, assets they use, and risks they assume in connection with the development, enhancement, maintenance, protection, and exploitation of intangibles [TPG 6.48].

– Which member(s) perform and exercise **control** over **DEMPE**;

– Which member(s) provide **funding** and other assets; and

– Which member(s) **assume the various risks** associated with the intangible.

DEMPE and Income Attribution



Risk-free return [TPG § 6.59] → Entity with limited functions (i.e., funder not controlling financial risk, e.g., Cash Box)

Risk-adjusted return [TPG § 6.61] → Entity with funding and financial risk (i.e., funder controlling financial risks)

Full intangible related return → Entity with full DEMPE* functions (see examples 14, 15 annex to Chapter VI)

*DAEMPE (UN TPM), Acquisition
DEMPEP (China) Promotion

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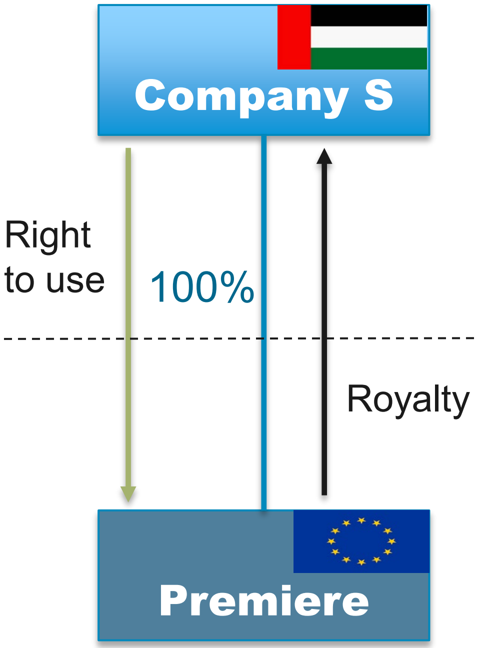
Practical Example: Holding intangible and simply performing a patent administration function is not entitled to intangible related returns



- Company S employs **three lawyers** to perform its **patent administration** work and has no other employees
- Company S **does not conduct or control** any of the R&D activities of the Premiere group

- Premiere **funds R&D** and performs ongoing R&D functions in support of its business operations.
- Premiere **performs all DEMPE functions** except for patent administration services.
- Premiere contributes and uses **all assets** associated with the development and exploitation of the intangible, and
- Premiere **assumes** all or substantially all of the **risks** associated with the intangibles.

OECD Conclusion

S is entitled to an arm's length price for the patent administration services and is **not entitled to any intangible related returns**

[OECD TPG Annex I Chapter VI]

Thank You!

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Christos Theophilou is a distinguished tax expert, providing advisory services to both private and corporate clients on intricate international tax and transfer pricing issues. His expertise encompasses cross-border investments, private equity structuring, structured finance, intellectual property structuring, and international trade.

Christos holds an MSc in Tax Law from Oxford University, a Bachelor's degree in Economics, and an LLB Law degree from Frederick University. He is a Chartered Accountant in England & Wales and has obtained the Advanced Diploma in International Taxation (ADIT) from the UK Chartered Institute of Taxation.

Christos is a prolific contributor to various esteemed international tax publications, including IBFD, Tax Notes International, Bloomberg Tax, International Tax Review, Edward Elgar, and IFA.

Christos also serves as a freelance lecturer for Tolley's (LexisNexis) and IBFD, where he lectures on ADIT Paper 1 Principles of International Tax, Transfer Pricing, and Pillar 2. He is a frequent speaker at international tax conferences, sharing his extensive knowledge and insights with the global tax community.

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ABOUT TAXAND

Taxand is the world's largest independent tax organisation with more than 550 tax partners and over 2,500 tax advisors in 50 countries. Taxand focuses on delivering high quality, integrated tax advice, free from conflict creating audit work. Taxand advisors work together to deliver global tax services for clients.

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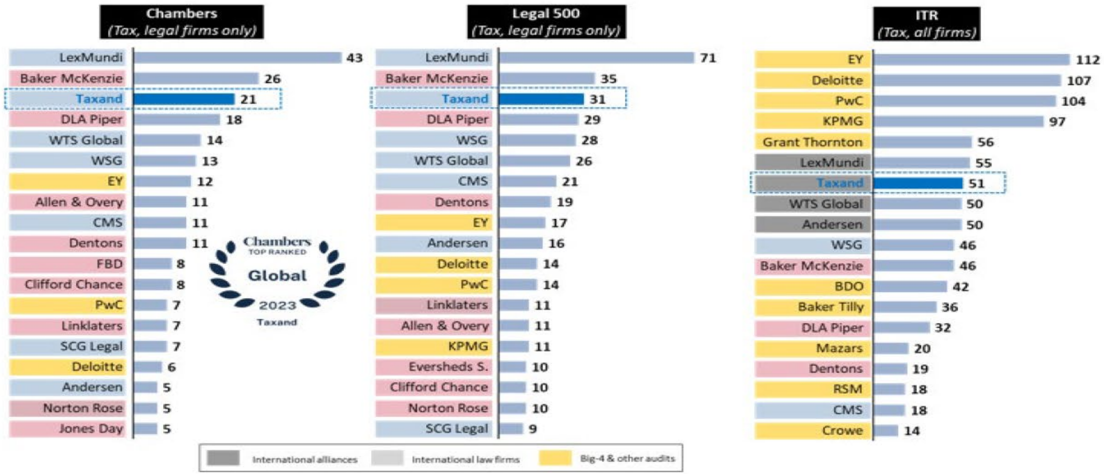
Taxand is a global organisation of tax advisory firms. Each firm in each country is a separate and independent legal entity responsible for delivering client services.

Awards

IN AGGREGATE TAXAND GLOBAL FIRMS ARE AMONG THE TOP RANKED



The figures provided above are sourced from our **Strategic Review 2022/23**, the latest 2024 Chambers rankings across Global, European, Asian and LatAm guides show further Taxand growth with member firms from **25 countries** ranked for Tax and **69 practitioners** recognised for their tax expertise.

Legal 500, 2024, rankings across 4 guides: APAC, EMEA, LATAM and Canada, with a total of 143 lawyers featured in Legal 500 firm profiles; member firms from 25 countries ranked for Tax by Legal 500 of which 18 are ranked Tier 1.

In 2023, ITR shortlisted Taxand member firms for over **80 awards** across the Americas, EMEA and APAC regions and at September's awards ceremony in London, **Taxand won 19 awards**.