MNES - HOW TO BENCHMARK AND DOCUMENT FY2020 TRANSFER PRICING REPORT IN THE LIGHT OF NEW TIGHT DEADLINES

Presenters

Becky Nguyen
Douglas Fone

DUFF & PHELPS
A KROLL BUSINESS

About Duff & Phelps, a Kroll business

ABOUT DUFF & PHELPS, A KROLL BUSINESS

For **nearly 100 years**, Duff & Phelps has helped clients make confident decisions in the areas of valuation, real estate, taxation and transfer pricing, disputes, M&A advisory and other corporate transactions.

Kroll is the world's premier provider of services and digital products related to **governance, risk and transparency**. We work with clients across diverse sectors in the areas of valuation, expert services, investigations, cyber security, corporate finance, restructuring, legal and business solutions, data analytics and regulatory compliance.

The firm's nearly **5,000 professionals** are located in **30 countries and territories** around the world.

~5,000
TOTAL PROFESSIONALS GLOBALLY

13,400
CLIENTS INCLUDING NEARLY
48% **OF THE**
S&P 500

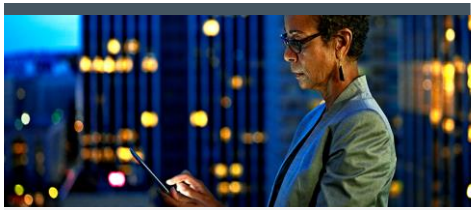
THE AMERICAS
2,000+
PROFESSIONALS

EUROPE AND MIDDLE EAST
1,100+
PROFESSIONALS

ASIA PACIFIC
850+
PROFESSIONALS

ENHANCING VALUE ACROSS A RANGE OF EXPERTISE

Our service areas



VALUATION ADVISORY

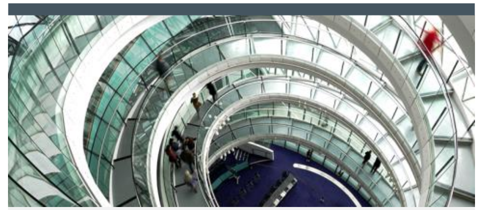
Valuation and consulting for financial reporting, tax, investment and risk management purposes

- Valuation Services
- Alternative Asset Advisory
- Real Estate Advisory
- Tax Services
- Transfer Pricing
- Fixed Asset Management and Insurance Solutions

CORPORATE FINANCE

Objective guidance to management teams and stakeholders throughout restructuring, financing and M&A transactions, including independent fairness and solvency opinions

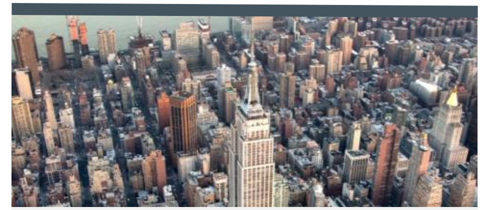
- M&A Advisory
- Fairness and Solvency Opinions
- Transaction Advisory Services
- ESOP and ERISA Advisory
- Private Equity - Financial Sponsors Group
- Distressed M&A and Special Situations
- Private Capital Markets and Debt Advisory



GOVERNANCE, RISK, INVESTIGATIONS AND DISPUTES

Risk management and mitigation, disputes and other advisory services

- Business Intelligence and Investigations
- Compliance and Regulatory Consulting
- Compliance Risk and Diligence
- Cyber Risk
- Disputes Consulting
- Global Restructuring Advisory
- Legal Management Consulting
- Security Risk Management



BUSINESS SERVICES

Complex legal and business solutions through our proprietary technology and team of experts

- Prime Clerk Restructuring
- Kroll Corporate Actions
- Lucid Issuer Services
- Lucid Agency and Trustee Services
- Kroll Class Action Administration
- Kroll Mass Tort Administration
- Kroll Notice Media Solutions
- Kroll Business Technology
- Kroll Agency Cloud

OUR EVOLUTION

In operation for nearly 100 years

1932
Duff & Phelps founded and evolves into diversified financial services firm

1994
Credit ratings business spun-off

2005
Acquired **Corporate Value Consulting** (CVC) from Standard & Poor's

2007
Listed on the **NYSE**

From 2007 to 2012, **acquired 14 businesses** to expand service offerings

2013
Taken private by a private equity consortium led by **The Carlyle Group** and the **Duff & Phelps management team**

2015
Acquired **American Appraisal** to expand global Valuation Advisory Services practice

Acquired **Kinetic Partners** and launched Compliance and Regulatory Consulting practice

2016
Acquired **CounselWorks** to expand Compliance and Regulatory Consulting practice

Acquired **Tregin Solutions** to expand technology solutions capability of Legal Management Consulting

2017
Acquired **Quantera Global Asia,** the leading Asia Pacific transfer pricing firm, to enhance our presence in the region

2018
Duff & Phelps is acquired by **Permira Funds**, the global private equity firm

Acquired **Kroll** and launched Governance, Risk, Investigations and Disputes practice

2019
Acquired **Prime Clerk**, **Forest Partners**, **Heffler Claims** and **Zolfo Cooper Asia**

2020
Duff & Phelps acquired by investor consortium led by **Stone Point Capital** and **Further Global**

Acquired **Blackrock Expert Services Group, Borrelli Walsh, Verus Analytics, Lucid Companies** and **RP Digital Security**

2021
Duff & Phelps rebranded to **Kroll**

OUR LOCATIONS

Across 30 countries and territories worldwide

THE AMERICAS

Addison
Atlanta
Austin
Bogota
Boston
Buenos Aires
Chicago
Dallas
Denver
Ellensburg
Houston
Los Angeles
Mexico City
Miami
Minneapolis
Morristown
Nashville
New York
Philadelphia
Reston
San Francisco
São Paulo
Seattle
Secaucus
Silicon Valley
St. Louis
Toronto
Washington, D.C.
Waterbury
Westchester

EUROPE AND MIDDLE EAST

Abu Dhabi
Agrate Brianza
Amsterdam
Barcelona
Bari
Berlin
Bilbao
Birmingham
Channel Islands
Dubai
Dublin
Frankfurt
Gibraltar
Lisbon
London
Longford
Luxembourg
Madrid
Manchester
Milan
Moscow
Munich
Padua
Paris
Pesaro
Riyadh
Rome
Turin
Zurich

ASIA PACIFIC

Bangalore
Beijing
Brisbane
Guangzhou
Hanoi
Hong Kong
Hyderabad
Kuala Lumpur
Melbourne
Mumbai
New Delhi
Shanghai
Shenzhen
Singapore
Sydney
Taipei
Tokyo

CARIBBEAN

British Virgin Islands
Cayman Islands

STRATEGIC PARTNERS

Athens
Jakarta
Moscow
Seoul

TRANSFER PRICING SERVICES

Our Transfer Pricing Services are dedicated to offering practical, effective solutions across the full spectrum of transfer pricing and valuation issues any multinational firm may encounter when setting up and maintaining global operations – spanning design and implementation of transfer pricing systems, preparation and maintenance of compliance documentation to support the integrity of the system, through to defense of the system when faced with challenges by global tax authorities.

OUR SERVICES

- Global and Country Specific Transfer Pricing Documentation
- OECD Policy Analysis and Implementation
- Transfer Pricing Risk Assessment, Strategic Planning and Due Diligence
- Intercompany Finance Policy Development and Support
- IP Structure Planning, Implementation and Defense
- Global Supply Chain Strategies
- Advance Pricing Agreements (APAs)
- Cost Sharing / Cost Contribution Arrangements
- Intangible Migration Strategies
- Expert Services in Litigation and Audit Support

OUR DIFFERENTIATORS

- Globally integrated transfer pricing practice with industry leading tax valuation and transfer pricing capabilities.
- Largest transfer pricing team globally outside the Big 4 accounting firms
- Proven ability to respond quickly to global regulatory changes with distinguished transfer pricing specialists in the Americas, Europe and Asia Pacific.
- Low leverage, partner-led engagements, with a focus on providing high quality practical and strategic transfer pricing advice.
- Complete independence from audit, tax and regulatory restrictions.
- Practical approach with a focus on local nuances and developing defensible global policies.

PRESENTERS

Douglas Fone
Singapore
+65 9022 0247
Douglas.Fone@duffandphelps.com

Becky Nguyen
Malaysia
+601 8329 2883
Becky.Nguyen@duffandphelps.com

Douglas is Managing Director in Duff & Phelps' Transfer Pricing practice in Singapore, with extensive transfer pricing experience advising multinational clients throughout South-East Asia and Australia. Prior to this, he was Managing Director and co-founder of Quantera Global; was a director in the transfer pricing group of PricewaterhouseCoopers (PwC) in Australia, and had worked in the Singapore and Hong Kong offices of PwC dealing with international tax, M&A and transfer pricing issues. He has provided transfer pricing advice to many multinational clients throughout the region, covering design of transfer pricing systems; preparation of Masterfile/local file documentation; negotiation and conclusion of unilateral/bilateral APAs; and successful management of complex transfer pricing audits. Douglas is a UK-qualified Chartered Accountant (ICAEW) and has a Bachelor of Laws (LL.B) from King's College London.

Becky is a Special Advisor in Duff & Phelps' Transfer Pricing practice in Malaysia, with over 12 years of transfer pricing experience across Southeast Asia. Prior to this, she was a director in Crowe's transfer pricing group in Malaysia, and was in the management team at Big Four firms in Malaysia, Singapore and Vietnam, dealing with the international tax and transfer pricing issues for multinational clients in the Asia Pacific region. She is Chief Legal Officer of the Vietnam–Malaysia Business Association and is a leading business mentor for international start-ups under a global accelerator programme organised by MaGIC. Becky holds a Master of Professional Accounting from Australia and a Bachelor of Economics from Vietnam. She is a chartered accountant of CPA Australia and Malaysian Institute of Accountants, and a member of Chartered Tax Institute of Malaysia (CTIM).

AGENDA

Part 1

Transfer Pricing Updates in Malaysia

Part 2

Transfer Pricing Documentation for Financial Year 2020 in light of COVID-19

Part 3

Typical operating transfer pricing models

Part 4

Questions & Answers

Part 1

Transfer Pricing Updates in Malaysia

Presenter

Becky Nguyen

Malaysia Transfer Pricing Laws and Regulations

- **Income Tax Act, 1967**
  - Section 138C – Advance Pricing Arrangement
  - Section 139 – Controlled companies
  - Section 140 – Power to disregard certain transactions
  - Section 140A – Power to substitute the price and disallowance of interest on certain transactions
- **Income Tax (Transfer Pricing) Rules 2012**
- **Updated Malaysia Transfer Pricing Guidelines 2012**
- **Organization of Economic Co-operative and Development (OECD) Transfer Pricing Guidelines**

Transfer Pricing Evolution in Malaysia

1967
- Sec 140(6) of ITA, Anti Avoidance provision

2003
- First Malaysian TP Guidelines issued

2005-2006
- TP team set up within IRB (6 members)
- First full fledged TP Audit carried out

2009
- **Effective 1 Jan 2009 -** Contemporaneous TP Doc was required
- Sec 140A of ITA

2012
- MTPG 2012
- Income Tax (TP) Rules 2012
- IRB involved in BEPS Discussion and part of Working Committee 6

2013
- TP Audit Framework
- IRB's TP team expanded – focused groups into industry segments

2014
- Tick the box in the tax return (Form C)

2015
- MNC Branch
- Separation of APA/MAP teams from TP MNC Branch

2016
- LTO Branch – focus on domestic companies
- Sec 113A, 112A, 119B of ITA
- Income Tax (CbCR) Rules 2016

2017
- **Wef 1 Jan 2017** – adoption of CbCR & BEPS Action 13
- Amended CbCR Rules 2017
- Labuan CbCR Reg 2017
- Updated MTPG
- Adoption of Earning Stripping Rules to replace Thin Cap
- Amended APA Rules 2017
- Updated MNE Form
- Joint audits with Customs

2018-2019
- Transfer Pricing Audit Framework 2019

Updated Malaysian TP Guidelines 2012

- The Malaysian TP Guidelines 2012 have been updated by the IRB w.e.f from **15 July 2017.**
- Consistent with the **Base Erosion and Profit Shifting (BEPS) Action Plan 8 – 10.**

Chapter I : Preliminary

Chapter II : The Arm's Length Principle *(updated)*

Chapter III : Transfer Pricing Methodologies

Chapter IV : Comparability Analysis

Chapter V : Business Restructuring

Chapter VI : Intragroup Services

Chapter VII : Cost Contribution Arrangement

Chapter VIII : Intangibles *(updated)*

Chapter IX : Intragroup Financing

Chapter X : Commodity Transactions *(New)*

Chapter XI : Documentation *(updated)*

Updated Malaysia TP Guidelines 2012

Chapter XI – Documentation

When need to prepare / update TP Doc?

- Update financial data & review the comparables **every year**.
- Update TP Doc **annually** if there is material change
- Update the benchmarking analysis / TP Doc **every 3 years** if no material change

Material Changes

- changes in shareholding
- changes in business model and structure
- changes in business activities
- changes in financial/ financing structure
- changes in TP policy
- merger & acquisition
- changes in economic conditions

CbCR

- Country-by-Country Report
- Master file
- Local file

Do I need to prepare full / limited TP Documentation?

Gross income
> RM25 mil

+

Related party transactions
> RM15 mil

Financial assistance
> RM50 mil

FULL
Contemporaneous TP Documentation is required

Gross income
< RM25 mil

+

Related party transactions
< RM15 mil

Financial assistance
< RM50 mil

LIMITED
Contemporaneous TP Documentation is required

Full TP Doc vs. Limited TP Doc

Full TP Doc

- Organizational structure and group ownership structure
- **Nature of the business/industry and market conditions**
- Controlled transactions
- Pricing policies
- Financial Analysis
- **Comparability, functional and risk analysis**
- **Selection of the transfer pricing method**
- **Application of the transfer pricing method**
- Supporting documents

Limited TP Doc

- Organizational structure and Group ownership structure
- Controlled transactions
- Pricing policies
- Financial Analysis

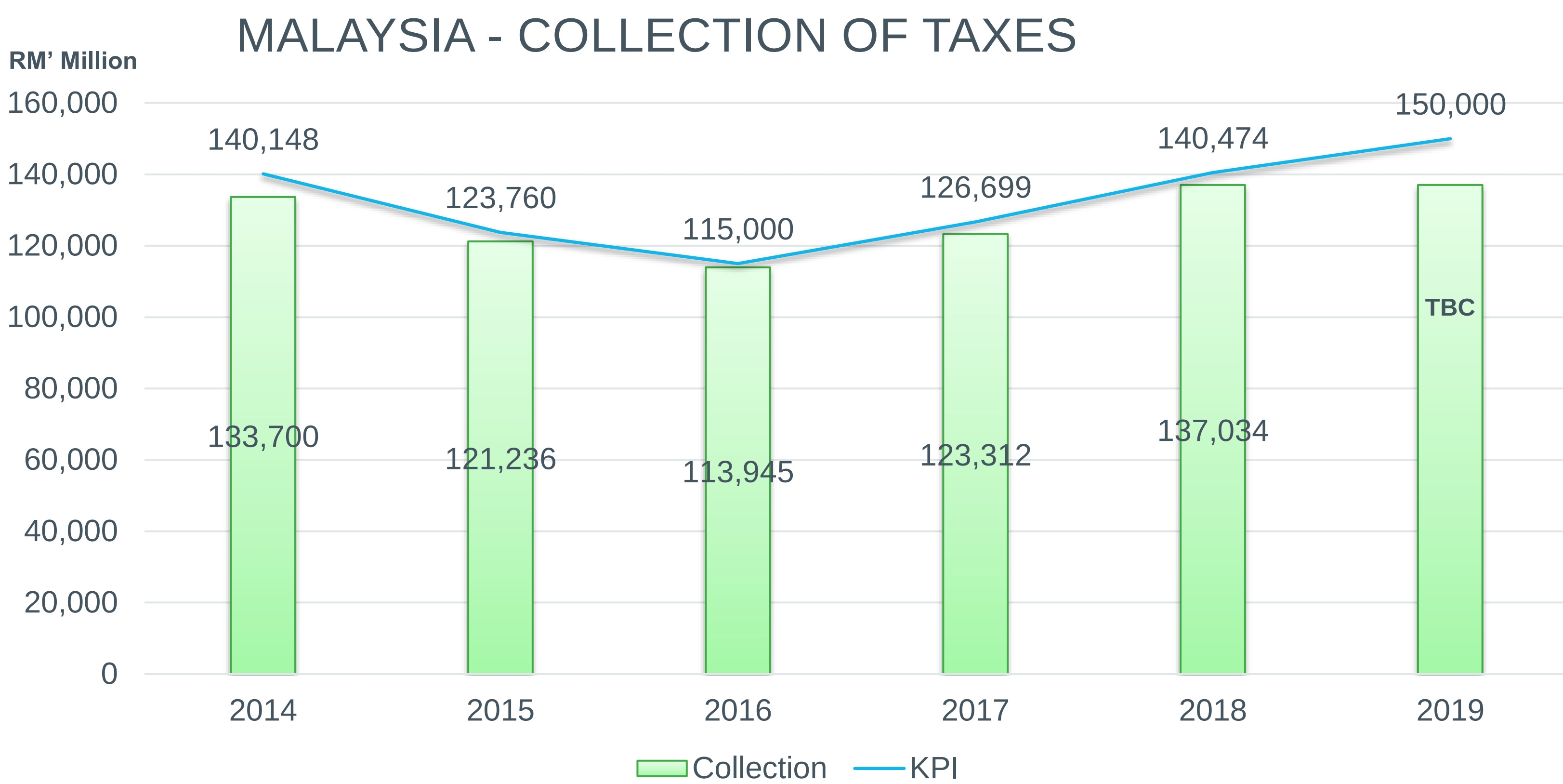
Malaysia Documentation – New requirements

New Penalty and surcharge w.e.f 1 January 2021	
Failure to furnish Transfer Pricing Documentation	RM 20,000 to RM 100,000 or imprisonment
Transfer pricing adjustment imposed by the IRB	5% surcharge on adjustment amount

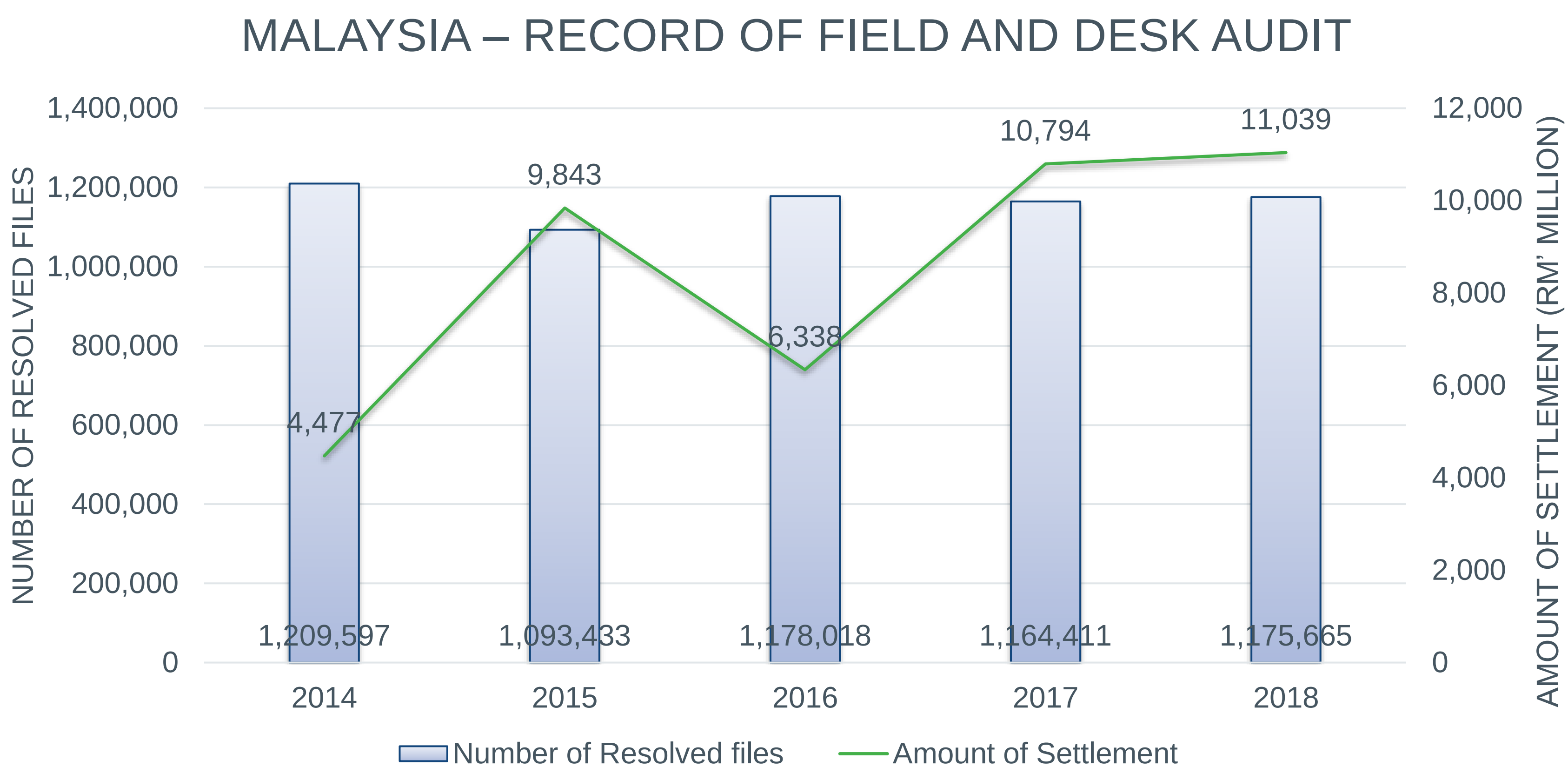
New Deadline - Submission of TP Documentation w.e.f 1 January 2021	
Previously	30 days upon request
New amendment	14 days upon request by the IRBM for audit cases that commence on or after 1 January 2021

Condition	Penalty rate (Normal case)
Taxpayer did not prepare a TP documentation	50%
Taxpayer prepared TP documentation, but not fully in compliance with requirements of the Guidelines	30%

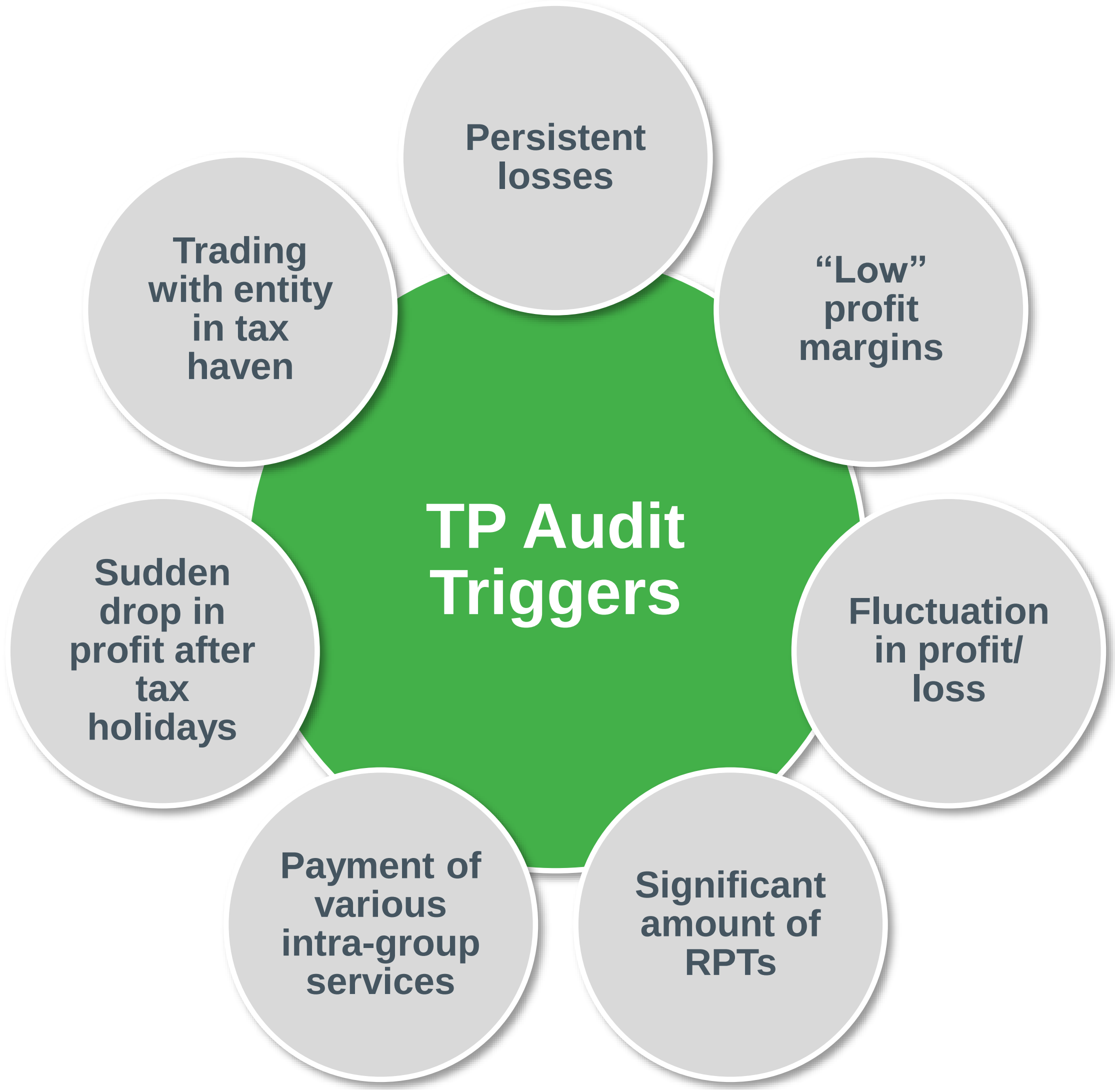
Increased KPI and collection of taxes



Increased number and intensity in tax & TP audits



TP Audit Triggers by the Inland Revenue Board



Part 2

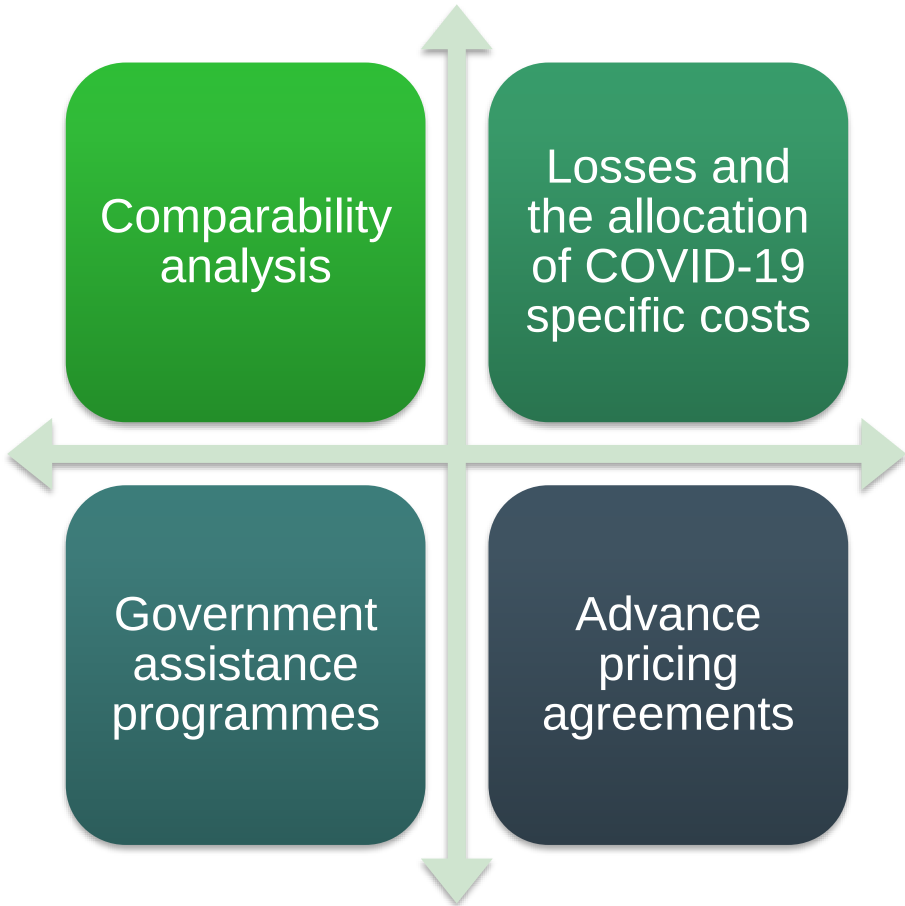
Transfer Pricing Documentation for Financial Year 2020 in light of COVID-19

Presenter

Becky Nguyen

OECD Guidance on the transfer pricing implications of the COVID-19 pandemic

Practical application of the arm's length principle
in **four** priority issues, identified in consultation with Business.



OECD Guidance

Comparability Analysis

Comparability Analysis

- Changes in sales volume/ utilization;
- Incremental or exceptional costs;
- Government assistance received, or government interventions that have affected the pricing of controlled transactions
- Publicly available financial statements
- Macroeconomic trends/ Statistical analyses;
- Comparisons of budgeted versus forecasted taxpayer data
- Analyses on the effects of profitability or third-party behavior observed during fiscal year 2020 or in previous recessionary periods

OECD Guidance
Comparability Analysis

Practical analyses may include:

1. An analysis of how sales volumes have changed during COVID-19, and specifically compared to sales generated in pre-COVID years.

2. An analysis of the exceptional costs borne by parties to the controlled transactions or by the group as a whole.

3. An analysis of the change in the capacity utilization experienced by the company during FY2020, with a view to making an adjustment to the results of the company in order to eliminate the financial impact of COVID-19 on the results of the company for the purposes of comparison of its performance to the comparable companies.

4. An analysis of internal budgets and/or forecasts relating to sales, costs and profitability of the company compared to the actual results of the year impacted by COVID-19.

OECD Guidance
Comparability Analysis

What Practical Approaches May Be Available to Address Information Deficiencies, Such as “outcome-testing” Approaches?

- Due to the time lag in availability of the financial data of comparables, there are three potential options for making financial adjustments to compensate for the impact of the COVID-19 pandemic:
  - Adjust the results of the tested party as far as possible to eliminate the impact of COVID-19 for the period in question, likely FY2020, and compare the adjusted results of the tested party to the range of the comparable companies’ results which will likely be from a multiple year period before the impact of COVID-19, such as FY2017-2019.
  - Determine the actual impact of COVID-19 on the sales, gross profit and operating expenses of the tested party, and adjust to the same extent the financial data of the comparable companies from the pre-COVID-19 period, such as FY2017-2019. This would likely lead to a lower range against which the tested party’s actual performance in FY2020 can be compared for the purposes of determining compliance with the arm’s-length principle.
  - Carry out the financial analysis of the tested party and comparables over a longer multiple-year period of review, say five years or more, to even out the relative impact of COVID-19 on FY2020. This more basic approach is not considered the best approach due to the exceptional (once in a century) circumstances of COVID-19

OECD Guidance

Comparability Analysis

What Practical Approaches May Be Available to Address Information Deficiencies, Such as “outcome-testing” Approaches?

- Another approach is to look at the impact on company profitability of past pandemics or economic shocks; however, the economic impact of COVID-19 is unique in many ways and still evolving in many places. Therefore, observable data from previous and arguably lesser/different epidemics/pandemics or economic shocks may not be particularly informative. In addition, the availability of benchmarking data on commercial databases is evolving rapidly in Asia, so coming up with a suitable set of comparables over an extended period would be practically difficult.

OECD Guidance

Losses and the Allocation of COVID-19 Specific Costs

When considering the allocation of COVID-19 specific costs or losses between associated entities, the OECD emphasized the following:

- The allocation of risks between related parties to an arrangement affects how profits or losses resulting from the transaction are allocated at arm's length through the pricing to the transaction

- It is necessary to consider the allocation of exceptional, nonrecurring operating costs arising as a result of COVID-19 between related parties, and such allocations should be based on an assessment of how independent enterprises allocate costs under comparable circumstances.

- Parties to intercompany agreements may consider whether they have the option to apply force majeure clauses, revoke or revise their intercompany agreements

OECD Guidance

Losses and the Allocation of COVID-19 Specific Costs

Can Loss-making Comparables Be Used?

- Typically, there is a reluctance among Asia Pacific tax authorities to allow the use of loss-making comparables.
- In certain cases, such as in Indonesia, the tax authority can go further to reject any comparable that has made a loss in any one year of the review period, or is lacking data in any one year in the review period.
- Other jurisdictions may allow loss makers but see them only as outliers and expect that at least the lower quartile would be positive.
- Certainly, for practical risk management purposes, taxpayers should try to avoid reliance on loss-making comparables.
- If this is not possible, then taxpayers can use on loss-making comparables and be prepared to argue for their inclusion in later discussions with the relevant tax authority, relying on the commercial reality that independent parties sometimes make losses without ceasing to be a going concern, as well as supportive comments by the OECD on this topic.

OECD Guidance

Losses and the Allocation of COVID-19 Specific Costs

Traditionally, IRB may **reject loss-making comparable companies** on grounds of non-comparability.

Comparable Analysis Results	**FY 2018**	**FY 2019**	**FY 2020** (Covid-19 pandemic)
Comparable Co. A	5%	6%	-5%
Comparable Co. B	4%	3%	-8%
Comparable Co. C	11%	10%	2%
Comparable Co. D	9%	8%	-10%
Comparable Co. E	15%	12%	3%
Upper Quartile	**11%**	**10%**	**2%**
Median	**9%**	**8%**	**-5%**
Lower Quartile	**5%**	**6%**	**-8%**
Taxpayer's results	**10%**	**9%**	**-3%**
Conclusion (at Medium)	**Arm's length**	**Arm's length**	**?**

Will IRB accept loss-making comparable companies?

How to support the loss-making position of the Company?

OECD Guidance

Losses and the Allocation of COVID-19 Specific Costs

Loss-making comparable companies

What is the TP Risk?

- Your company may suffer extremely low profits or make losses in 2020 due to Covide-19. How do you support this financial position from a TP perspective.
- Can you rely on existing set of comparable companies? Companies are comparable if their functional profiles are similar to your company and satisfy independent test.
- Traditionally, IRB may **reject loss-making comparable companies** on grounds of non-comparability. Given this, the resulting arm's length range of profits of remaining comparables will be higher.

How to Manage TP Risk?

- Provide qualitative and quantitative analysis on the effects of MCO and Covid-19 on your results.
- Ensure the right comparable companies are in place to support your company's profit or loss position. It is anticipated that third party companies in similar businesses may tend to suffer losses given the overall unfavorable economic conditions.

OECD Guidance

Losses and the Allocation of COVID-19 Specific Costs

Special analysis for loss making entities

Considerations

- Companies affected by the Covid-19 pandemic should carry out a special factor analysis where all **legal, commercial rationales and justifications** are in place to establish a defensible position.

Key Takeaways

- A sound transfer pricing position is to be supported by a set of **contemporaneous transfer pricing documentation** setting out the specific business factors, contractual and financial analysis as evidences of the loss making position.

Contractual analysis

(i) Review contractual terms,
(ii) Obligations under the contract,
(iii) Document the costs incurred.

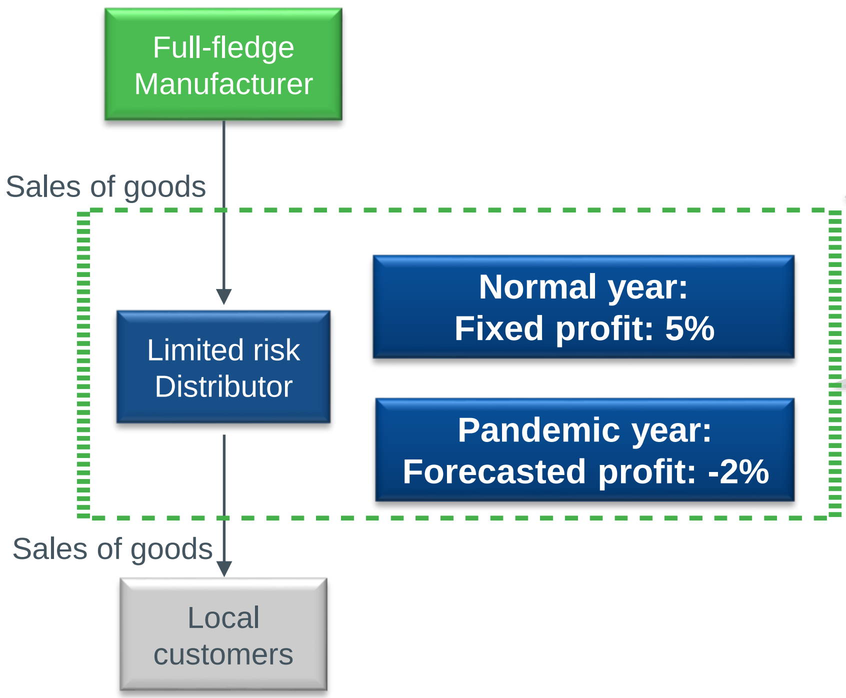
Loss factor analysis

(i) Specific reasons for losses,
(ii) Financial analysis,
(iii) Documentation.

Segregated period analysis

(i) Covid-19 affected period,
(ii) Transition period,
(iii) Resumption period.

Special analysis: An Example



Contractual analysis:

- Force majeure clause: compensation due to unforeseen crisis

Loss factor analysis:

- Special factor: significant drop in demand

Segregated period analysis:

- Covid-19 affected period: 100% drop in demand
- Transition period: 50% drop in demand
- Resumption period: 10% drop in demand

Can Entities Operating Under Limited Risk Arrangements Incur Losses?

- The acceptance of losses for limited risk entities depends on the facts and circumstances of each case and in how such have been documented in previous transfer pricing analyses and intercompany agreements.
- Taxpayers should carry out a detailed review of their related party arrangements (including legal agreements, but also conduct of the parties and what independent parties would have agreed to in similar circumstances) to determine, with appropriate evidence, the degree to which related entities bear risks.
- If it is found that entities are truly no risk in legal form and (more importantly) commercial substance, and this can be supported by referring to how independent parties would structure their arrangements, then such entities should not incur losses.
- However, in the majority of cases, it is likely that related entities will be found to be risk bearing at least to some extent and, as such, it is possible that they may incur losses, or share in the losses of the value chain. This conclusion can be supported by observations of short-term loss-sharing behavior by independent parties seeking to keep their global value chains intact during the COVID-19 pandemic.

OECD Guidance

Losses and the Allocation of COVID-19 Specific Costs

Limited risk operators: Explanation

Full-fledged manufacturer

- R&D
- Production
- Sales & distribution
- Is entitled to residual profit

Contract manufacturer

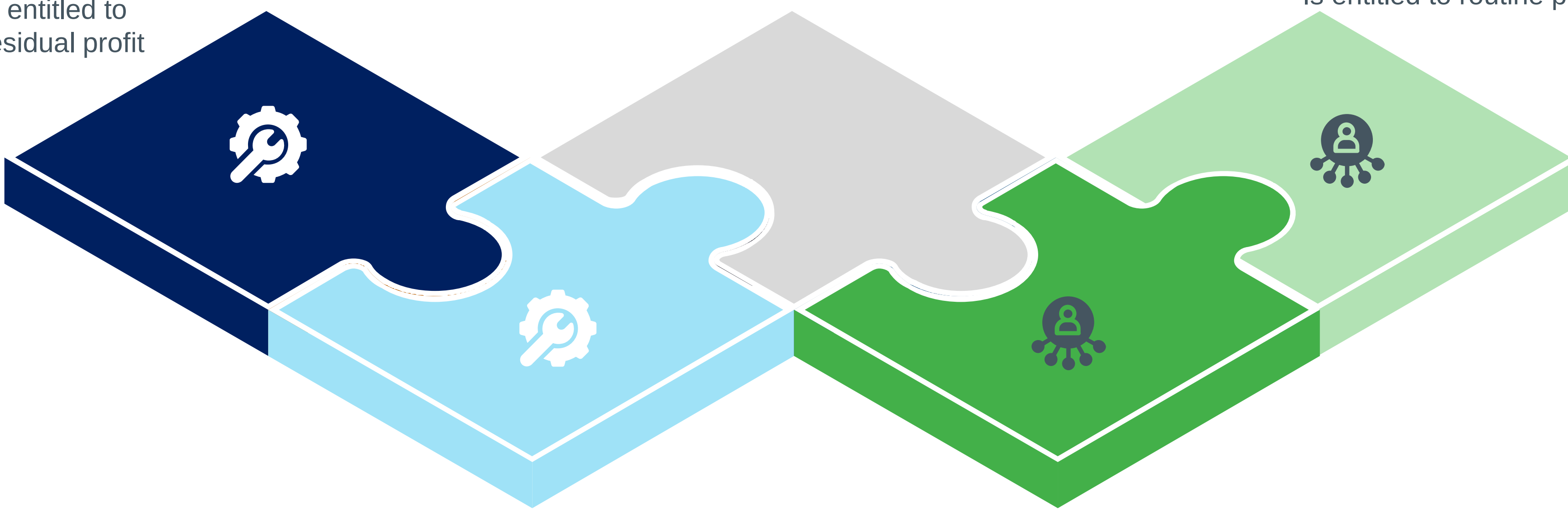
- Produces based on orders
- No direct distribution
- Is entitled to routine profit

Full-fledged distributor

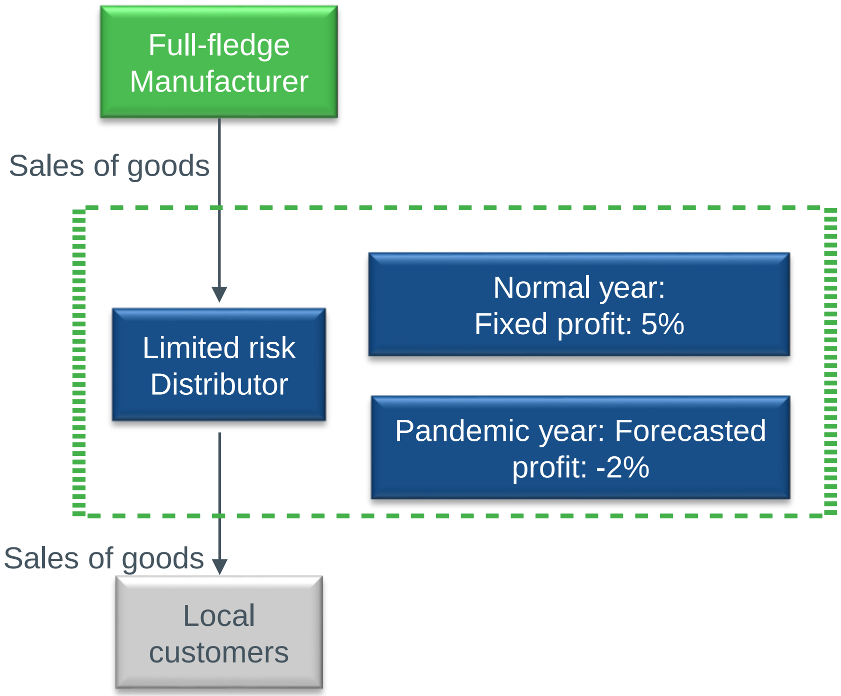
- Buy & sell
- Stock obsolescence risk
- Products warranty risk
- Is entitled to residual profit

Limited risk distributor

- Buy goods and market them to customers
- No stock obsolescence risk/ products warranty risk
- Is entitled to routine profit



Limited risk operators: Example



How to support the loss-making position of the Company?

What supporting documentation is required?

OECD Guidance

Losses and the Allocation of COVID-19 Specific Costs

Limited risk operators

Considerations

- Manufacturing, distribution and service operators structured using a **limited risk model** – limited functional profile and conferred with limited decision-making power.
- In the eyes of the IRB, limited risk operators should **earn routine profits**, **notwithstanding the ups and downs** of the economy. As such, the IRB may **dispute the loss making positions** for these limited risk operators.

Key Takeaways

- Companies may choose to continue with the current transfer pricing policy set under the limited risk structure, i.e. earning a targeted routine return.
- Alternatively, companies may wish to **review the current transfer pricing policies** by seeking for a reduced target margin for the remaining part of the year.
- Either way, it is important to document the treatments adopted that commensurate with the current economic trend, to be defensible during a transfer pricing audit.

OECD Guidance

Losses and the Allocation of COVID-19 Specific Costs

Under What Circumstances May Arrangements Be Modified to Address the Consequences of COVID-19?

- Arrangements between related parties can be modified, or rather should be modified, if it can be shown that independent parties would have done so in the same or similar circumstances.
- For example, if an independent distributor would seek discounts on the supply of goods, and an independent supplier would agree to such discounts to ensure the continued survival of the distributor and hence the entire value chain, then such discount could or should be granted between related party suppliers and distributors.
- This is driven by the facts and circumstances in each case.

OECD Guidance

Losses and the Allocation of COVID-19 Specific Costs

How Should Operational or Exceptional Costs Arising From COVID-19 Be Allocated Between Related Parties?

- Reference should first be made to the legal agreement to ascertain what has been agreed between the parties.
- This can provide guidance but is not determinative, as the real question is what would third parties have agreed to in similar circumstances?
- Again, this depends on the facts and circumstances.

OECD Guidance

Government Assistance Programs

- Government assistance programs can be monetary or nonmonetary programs where a government or other public authority provides a direct or indirect economic benefit to eligible taxpayers.
- These programs potentially have transfer pricing implications. In their discussion, the OECD covers certain aspects to consider when analyzing the potential impact of government assistance on the pricing of a controlled transaction.
- Further, the OECD notes that it may be necessary to similarly take into account the impact of government assistance on potential comparable companies, but this may be difficult in practice given the lack of public availability of such information for comparable companies.

.

OECD Guidance

Government Assistance Programs

Does the Receipt of Government Assistance Affect the Price of Controlled Transactions and Allocation of Risk Within Those Transactions? (or Perhaps How Should It) ?

- It is expected that the benefit of the payments received will be retained by local entities and should not result in a change to the transfer price. For example, in the case of a service provider paid on a cost-plus basis, that cost should be gross cost before the government subsidy.
- As a result, such government assistance would or should have no impact on the pricing of controlled transactions.

OECD Guidance

Advance Pricing Agreement

How should taxpayers address difficulties meeting terms of existing APAs?

- For existing APAs, the terms and conditions should be respected, maintained and upheld, unless a condition leading to cancelation or revision to the APA has occurred such as a breach of a critical assumption.
- It is possible that the market or economic conditions due to COVID-19 classify as a breach of critical assumptions, but this should be analyzed on a case by case basis, taking into account the individual circumstances of the taxpayer and commercial environment.

How should taxpayers proceed with APAs currently under negotiation?

- For APAs currently under negotiation, including those intended to cover fiscal year 2020, the OECD suggests that taxpayers and tax administrations adopt a flexible and corroborative approach to take into account the current economic conditions.
- APAs are intended to provide certainty for all parties involved and can be just as beneficial, if not more so, in times of uncertainty such as the COVID-19 pandemic

Part 3

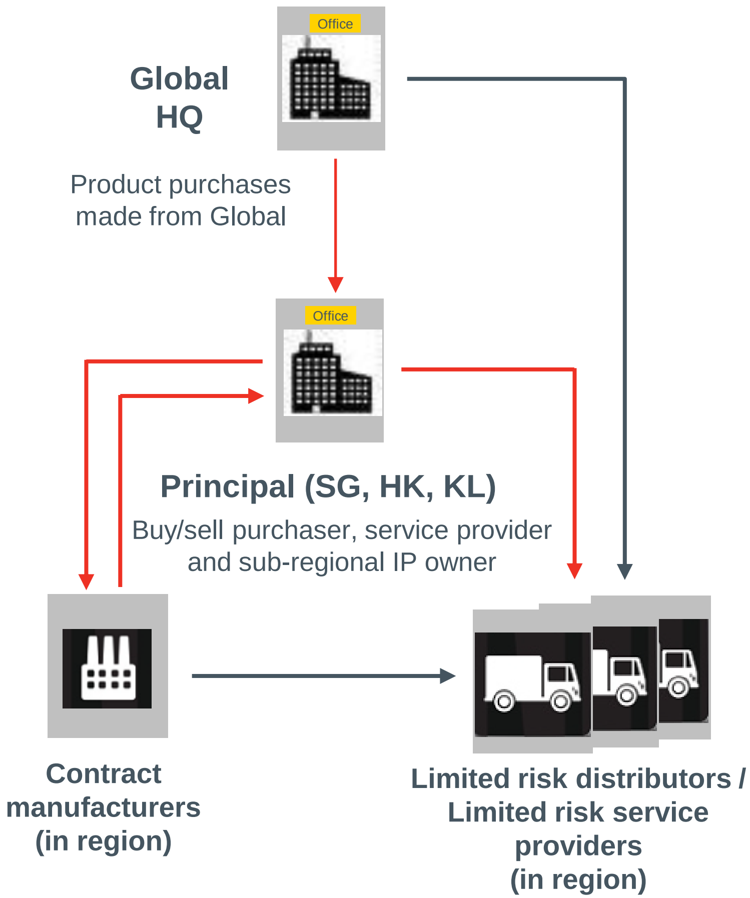
Common transfer pricing arrangements and its transfer pricing implications

Presenter

Douglas Fone

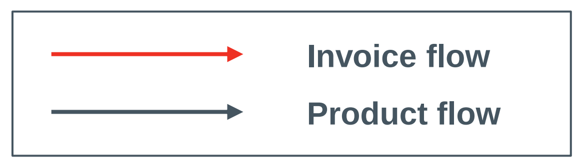
Overview of operating models in Asia:
Transactional Principal model

Transactional Principal model

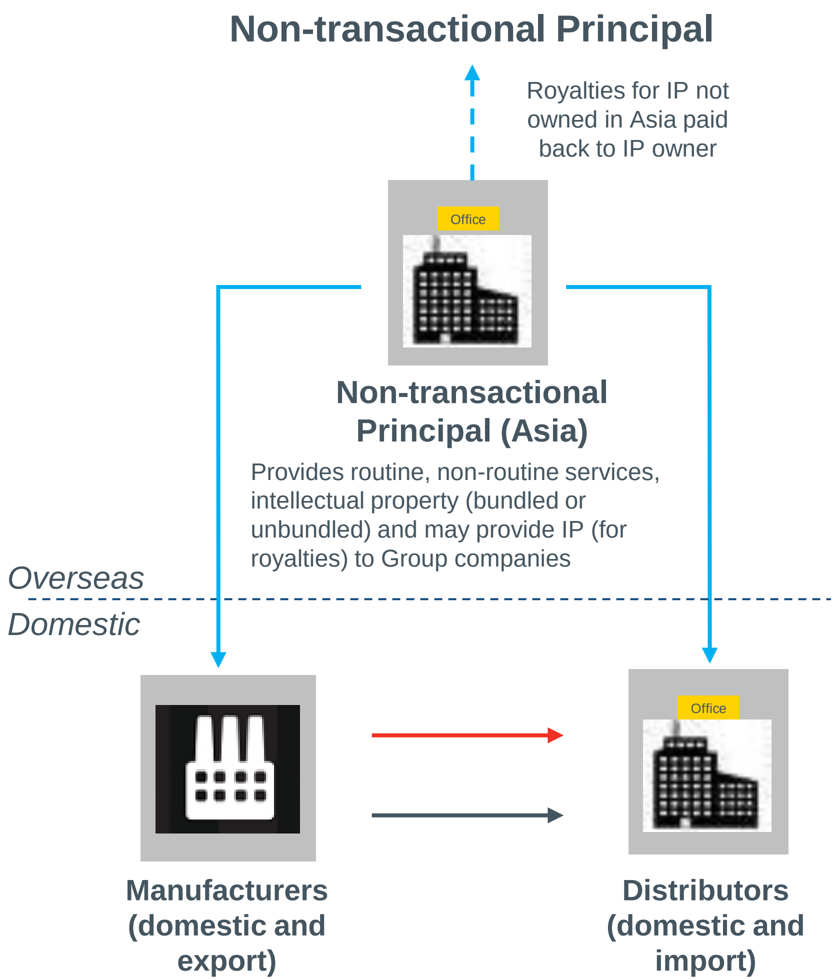


Model description and tax considerations

- A Principal is implemented in key locations (Singapore, Kuala Lumpur and/or Hong Kong) and functions as a sub-regional HQ
- The Principal books revenue and earns a portion of residual profits for regional coordination
- Distributors are converted to Limited Risk Distributors and manufacturers to Contract Manufacturers. They operate on a limited risk basis and earn limited risk returns
- Intellectual Property can be centralized in the Principal, with contract R&D providers being located in the region

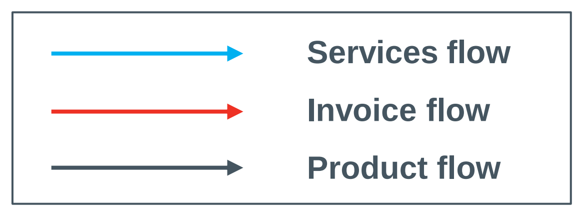


Overview of operating models in Asia:
Value added services Principal model

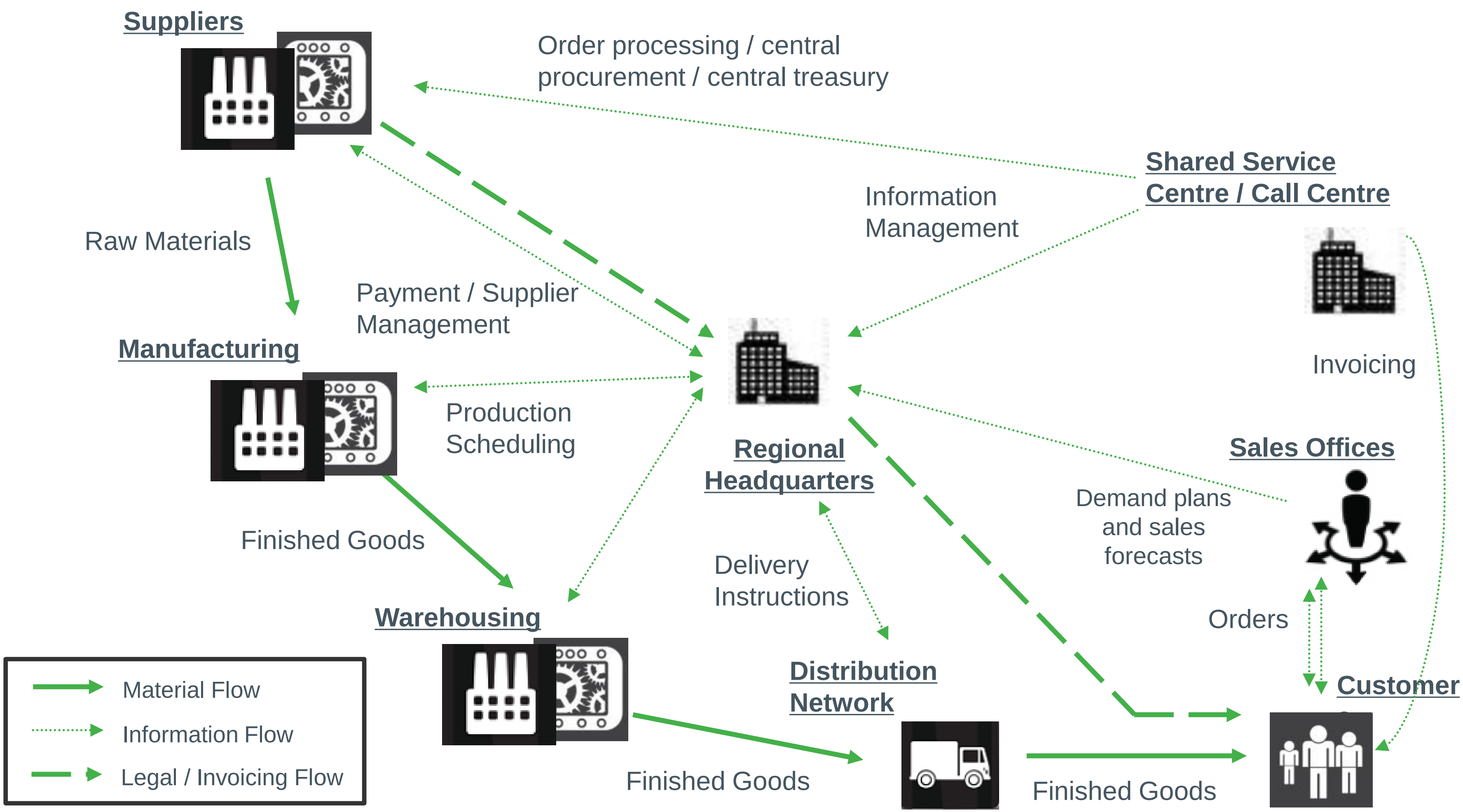


Model description and tax considerations

- The Non-transactional (services) Principal provides value-added services and IP to manufacturers and distributors for value-based service fees and royalties
- The Principal is located in a favorable tax jurisdiction for the company
- Incremental substance added through managing the services and IP transactions may reduce the Effective Tax Rate further
- Important considerations include:
  - Subpart F – ensuring income is not caught as Foreign Base Company Services Income
  - PE and transfer pricing considerations
  - Deductibility of services fees
  - Indirect tax and customs duty concerns
  - Exchange control issues
  - Withholding tax

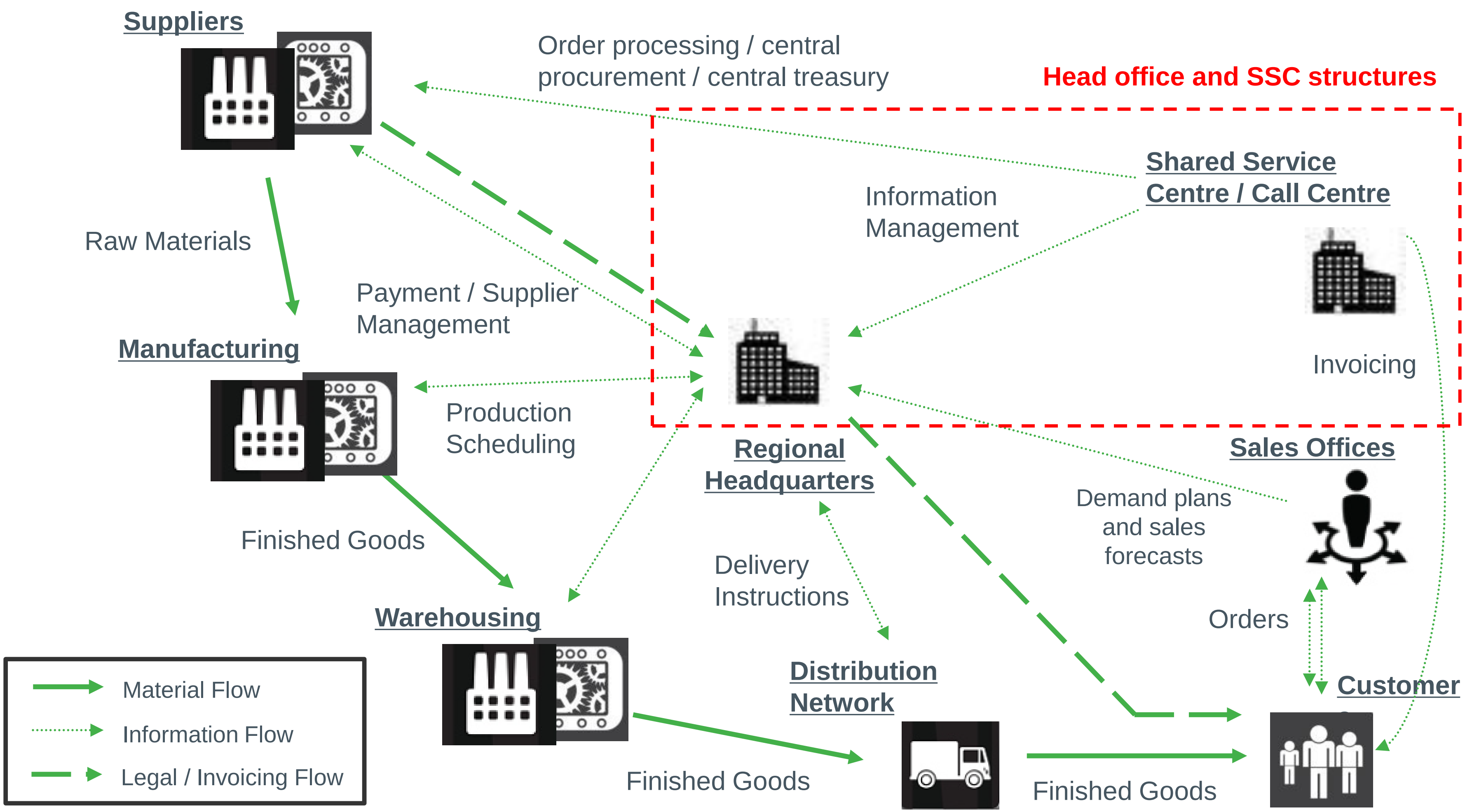


Typical regional structure

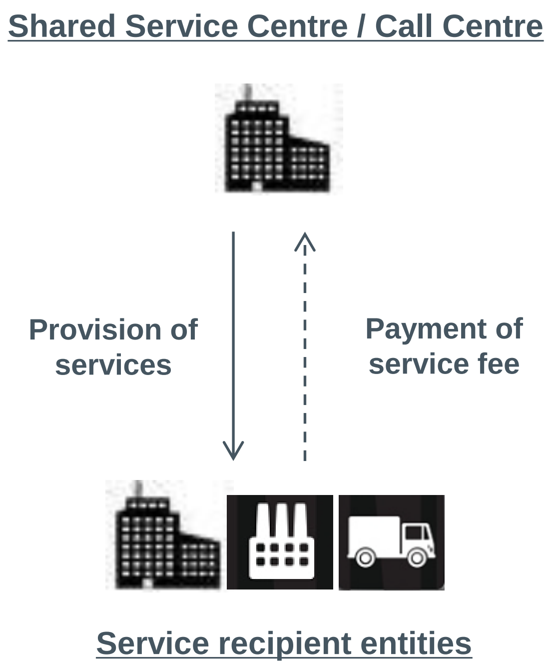


Typical regional structure and associated options:

Head office and shared service centre structures



Typical regional structure and associated options:
HQ and/or shared service centres (1/2)



Service provider perspective

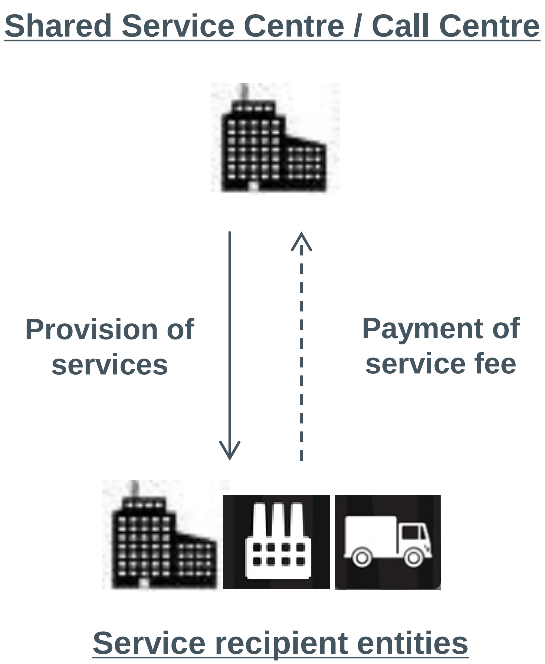
- Allocation of direct service costs to individual service recipient
- Apportionment of indirect service costs on a fair and reasonable basis depending on the nature of the expense, e.g. headcount for HR services, number of IP addresses for IT services – based on a user-pays principle
- Add an arm's length mark-up but only on value-add (non-pass through) costs

Service recipient perspective

- Are benefits received from the services provided?
- Are the benefits received commensurate with the charge made by the SSC?
- If the services are not received from the SSC, would the service recipients have to source the services from elsewhere or carry out those services in-house?
- Are there any cheaper alternative service providers realistically available?

Typical regional structure and associated options:

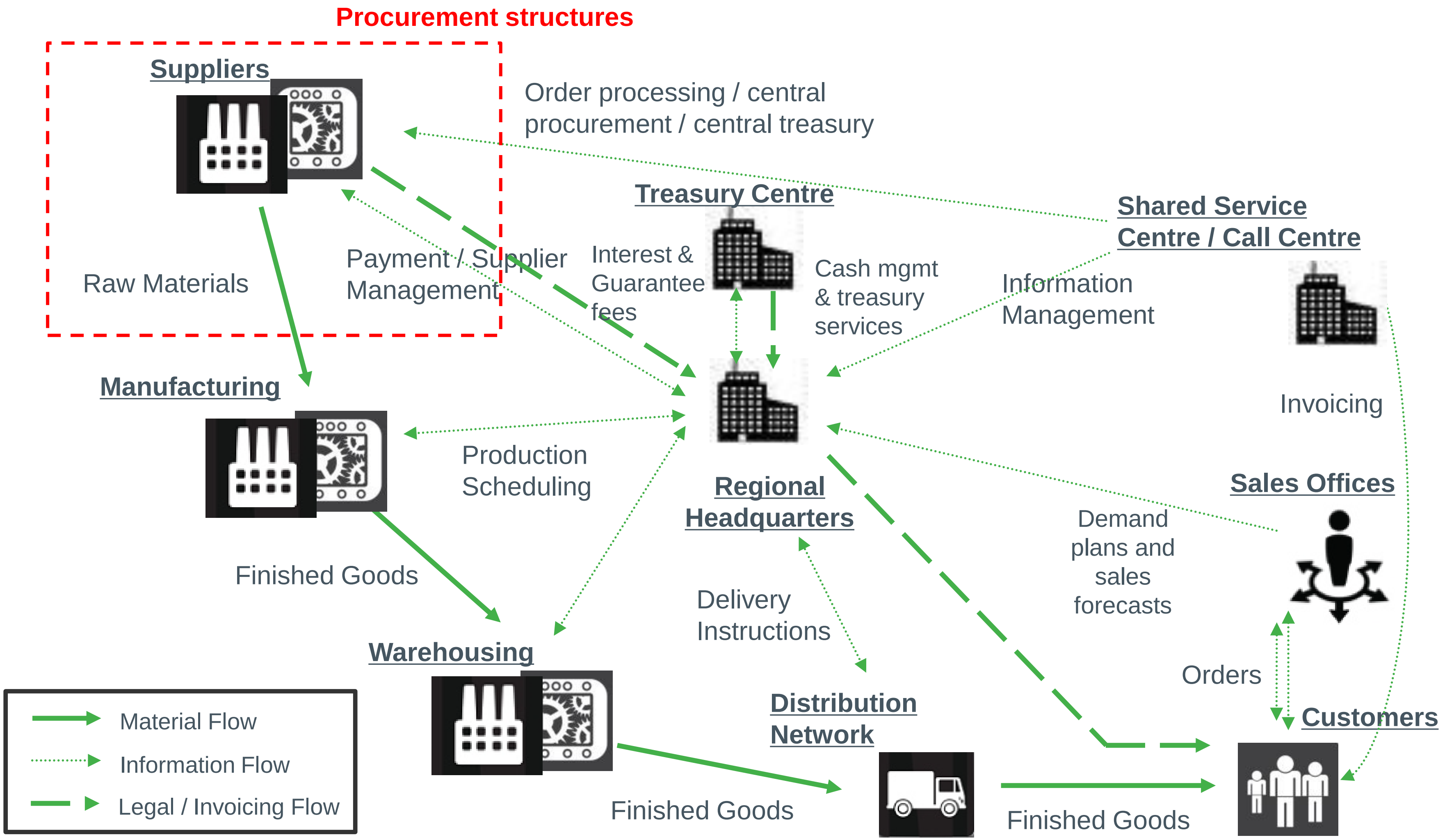
HQ and/or shared service centres (2/2)



Issues to consider:

- Deductibility of service charges for payers
  - Need for evidence of benefit derived – costs saved or income increased
  - Amount of charge should be commensurate with benefit received
  - Detailed break down of cost base required (e.g. including copy invoices)
  - Allocation bases used – not necessarily revenue based
  - Thorough legal documentation required
  - Transfer pricing documentation – core and local country
- Withholding taxes and how to avoid – beneficial ownership test
- Exchange controls on remittance of funds e.g. China
- What mark-up to apply to value-add costs
- How to deal with location savings e.g. India, China
- Availability of suitably trained staff e.g. Philippines, India
- Availability of tax incentives for location of service centre e.g. Singapore
- Lifestyle issues for senior management e.g. schooling etc.
- Potential PE issues

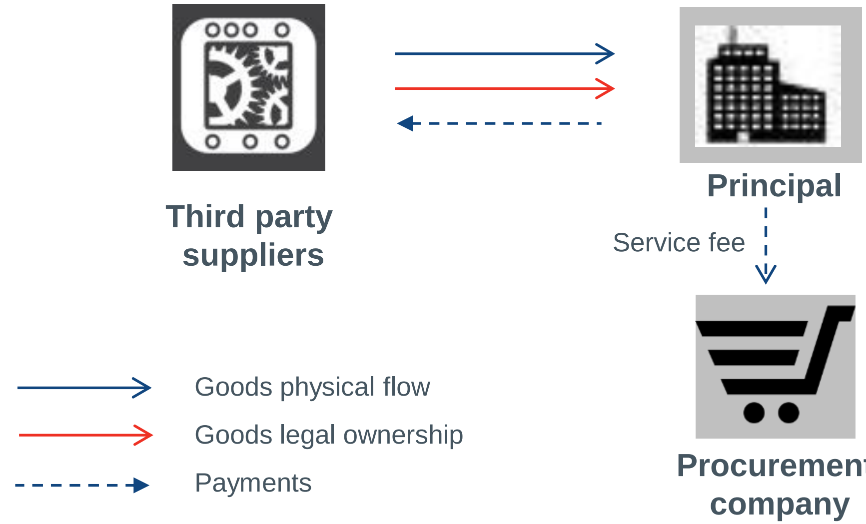
Typical regional structure and associated options:
Procurement structures



Typical regional structure and associated options:
Procurement structures

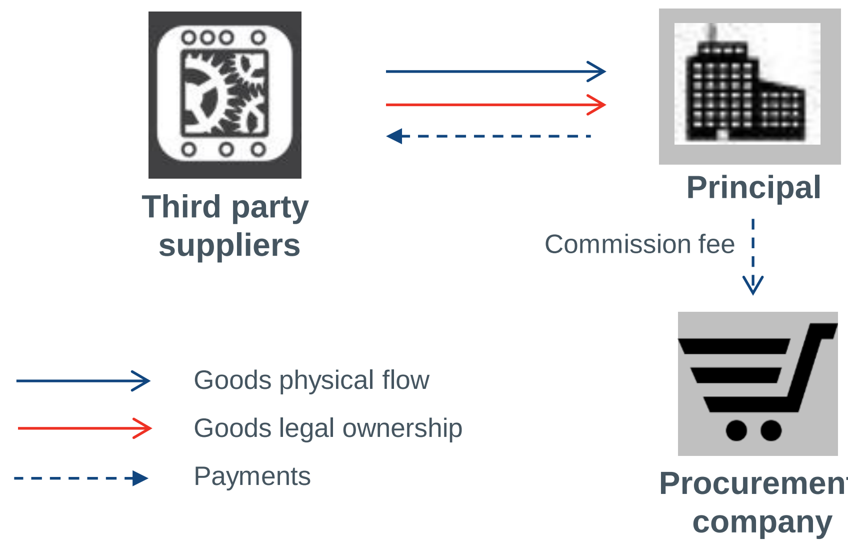
Service model

- Procurement Co performs only coordination and support services
- Does not take ownership of the materials and assumes a low level of risks
- Service fee based on cost plus on OPEX only
- Typically around 7-12%



Commission model

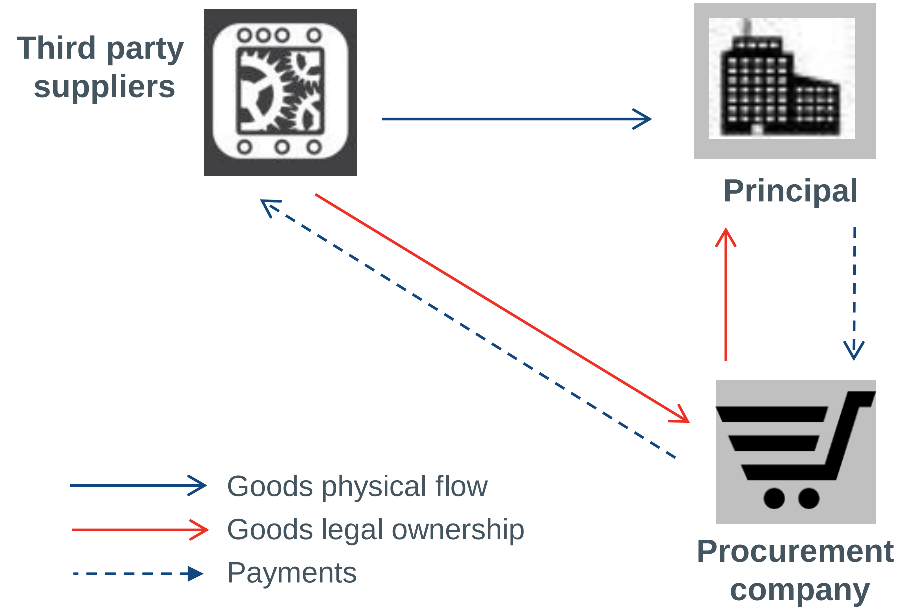
- Procurement Co undertakes activities with some value added, generally related to market intelligence
- Procurement Co does not take ownership and risks are low
- The TP policy is based on a commission fee calculated as a percentage of the purchase value



Typical regional structure and associated options:
Procurement structures

Buy Sell model

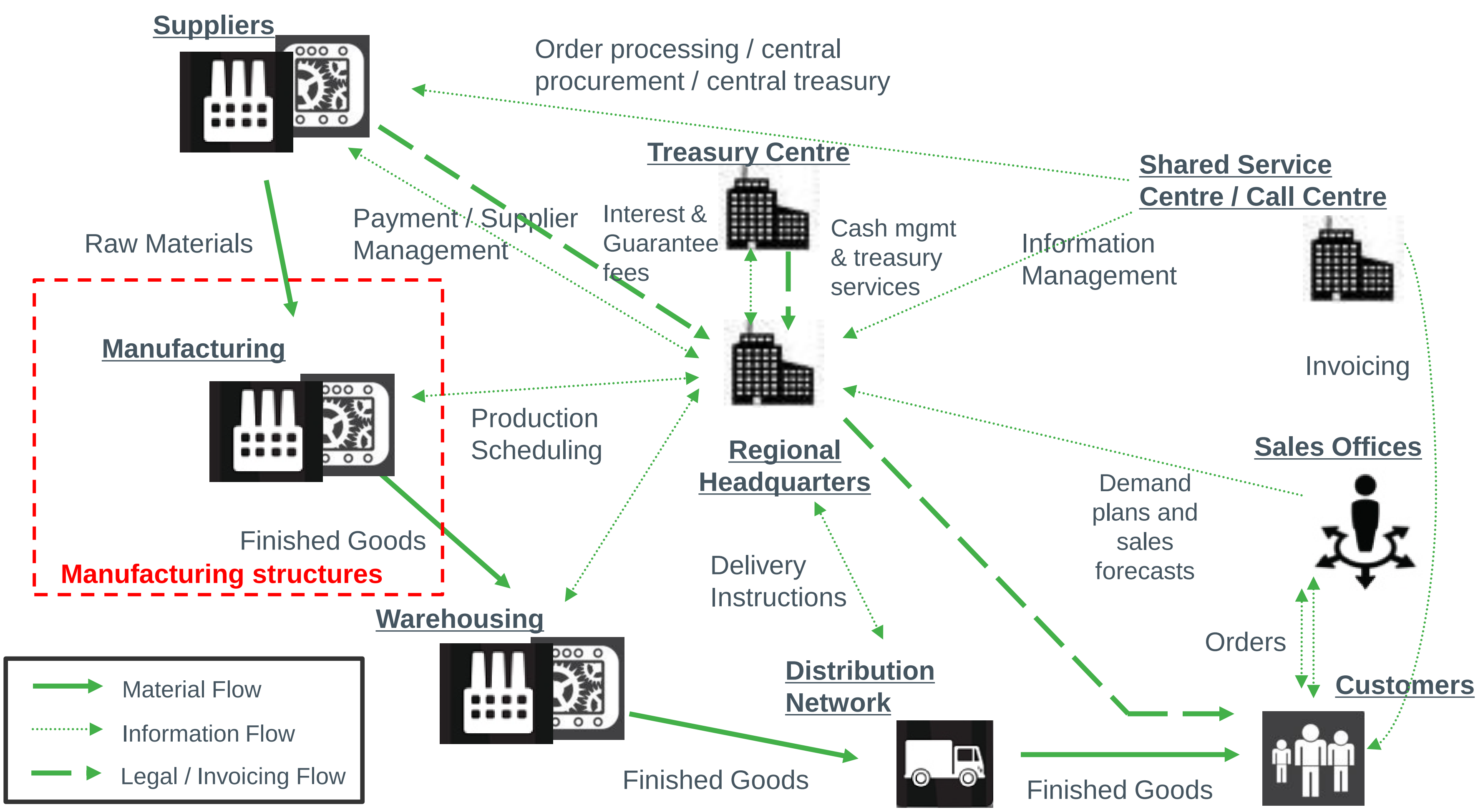
- Procurement Co performs activities with a high added value, such as market intelligence, inventory and manufacturing management, quality control, finance and logistics
- Procurement Co takes ownership of materials purchased and usually assumes inventory, exchange and logistics risks
- The transfer pricing policy is designed with reference to savings achieved and based on operating margin at lower end of distributor spectrum



Conclusions

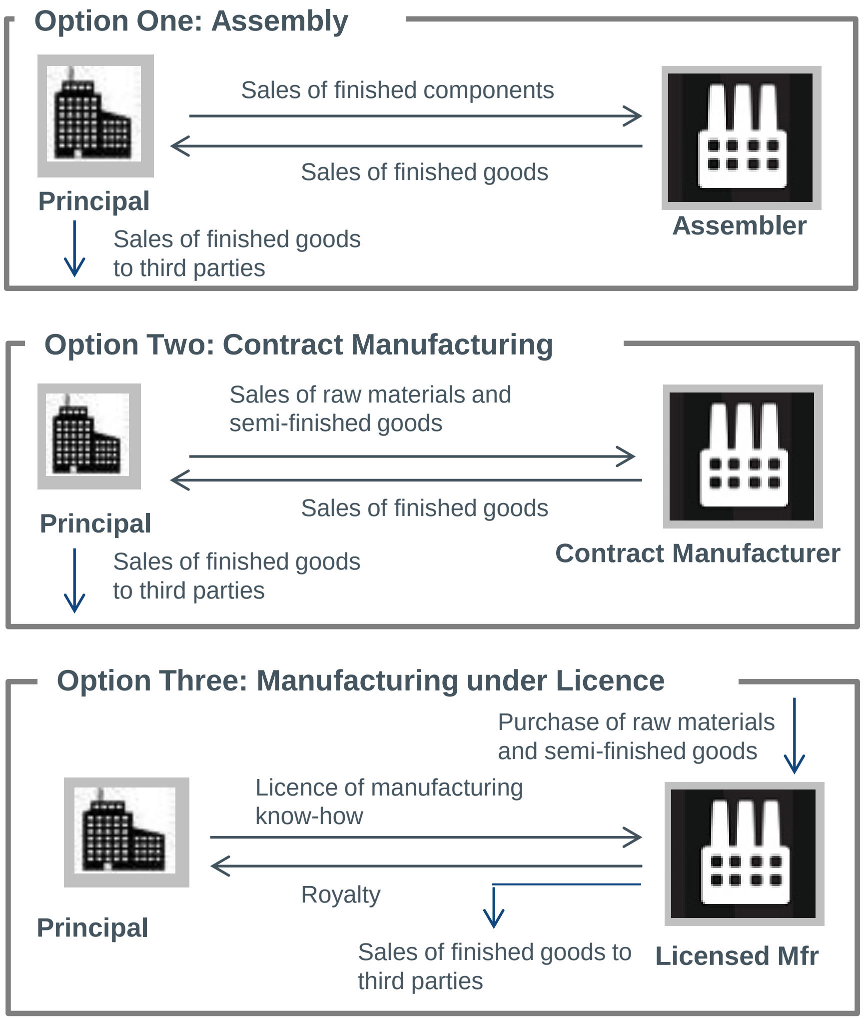
- Need to match the TP model with commercial reality
- Need to ensure profit in Procurement Co reflects functions, assets and risks and role that it plays in the value chain
- Need to avoid location savings argument
- Need to use correct method selection and benchmarking strategy

Typical regional structure and associated options:
Manufacturing structures



Typical regional structure and associated options:

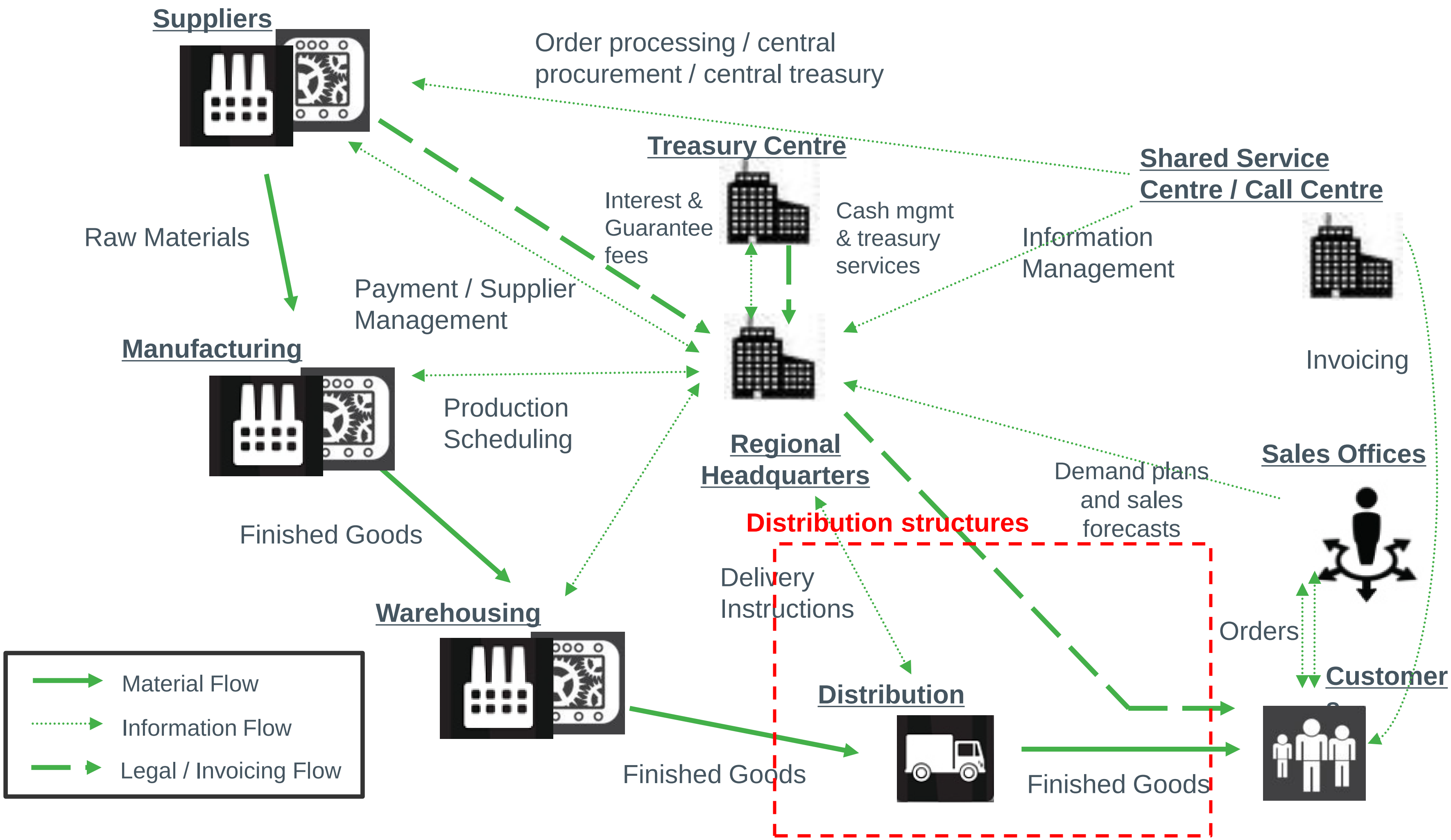
Manufacturing in Asia



Issues to consider:

- IP protection – available?
- Deemed transfer of ownership of IP to local entity after number of years
- Deductibility of royalties for payer – deemed dividend?
- How to prove arm's length nature of the royalty?
- Regulatory restrictions of payment of royalties
- Exchange controls limiting payment of royalties
- Withholding taxes and availability of treaty relief
- Customs duties and GST/VAT issues
- Degree of sales into domestic market
- Tax incentives available for production activities, including Special Economic Zones/Bonded Logistics Parks
- Manufacturing expertise availability
- Operating expense savings, location savings
- Availability of sufficient numbers of suitably trained staff

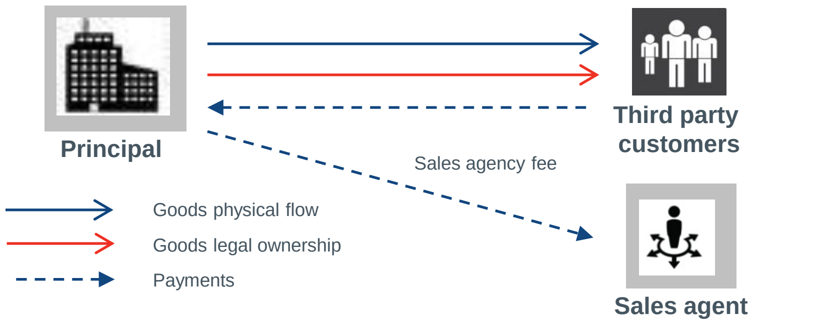
Typical regional structure and associated options:
Distribution structures



Typical regional structure and associated options:
Distribution structures

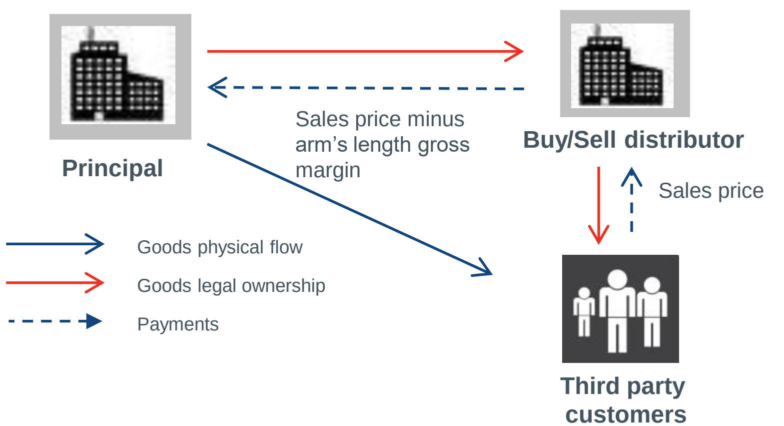
Sales agent model

- Sales agent receives a cost plus service fee or a commission on sales sufficient for it to earn an arm's length net margin



Buy/Sell model

- Buy/sell distributor receives a gross margin on the sales made to third party customers, sufficient for it to earn an arm's length net margin

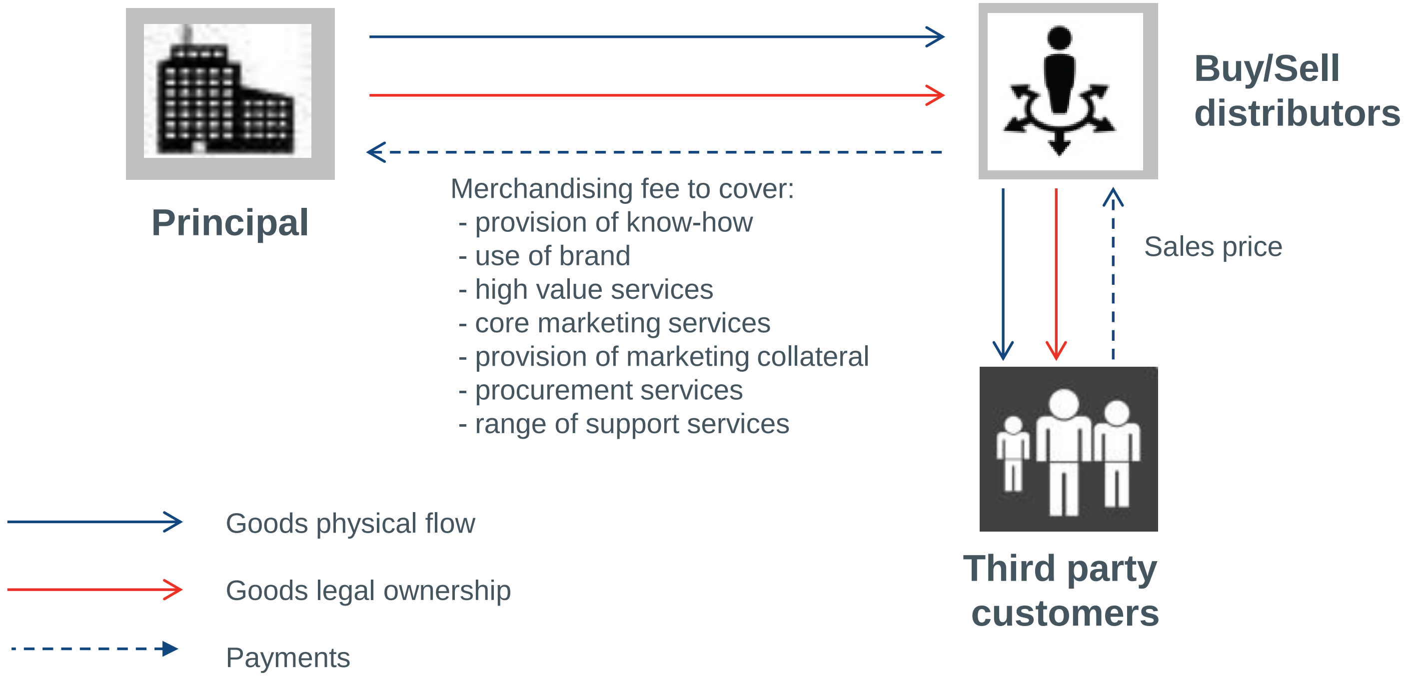


Issues to consider:

- Arm's length profitability to be earned by each routine entity
- Documentation and benchmarking strategies
- Withholding taxes and availability of treaty relief
- Restrictions on remittance of funds
- Availability of sufficient numbers of suitably trained staff
- Customs duties and GST/VAT issues
- Tax incentives available for regional principal trading company
- Operating expense savings, location savings
- Lifestyle issues for senior management to relocate e.g. schooling

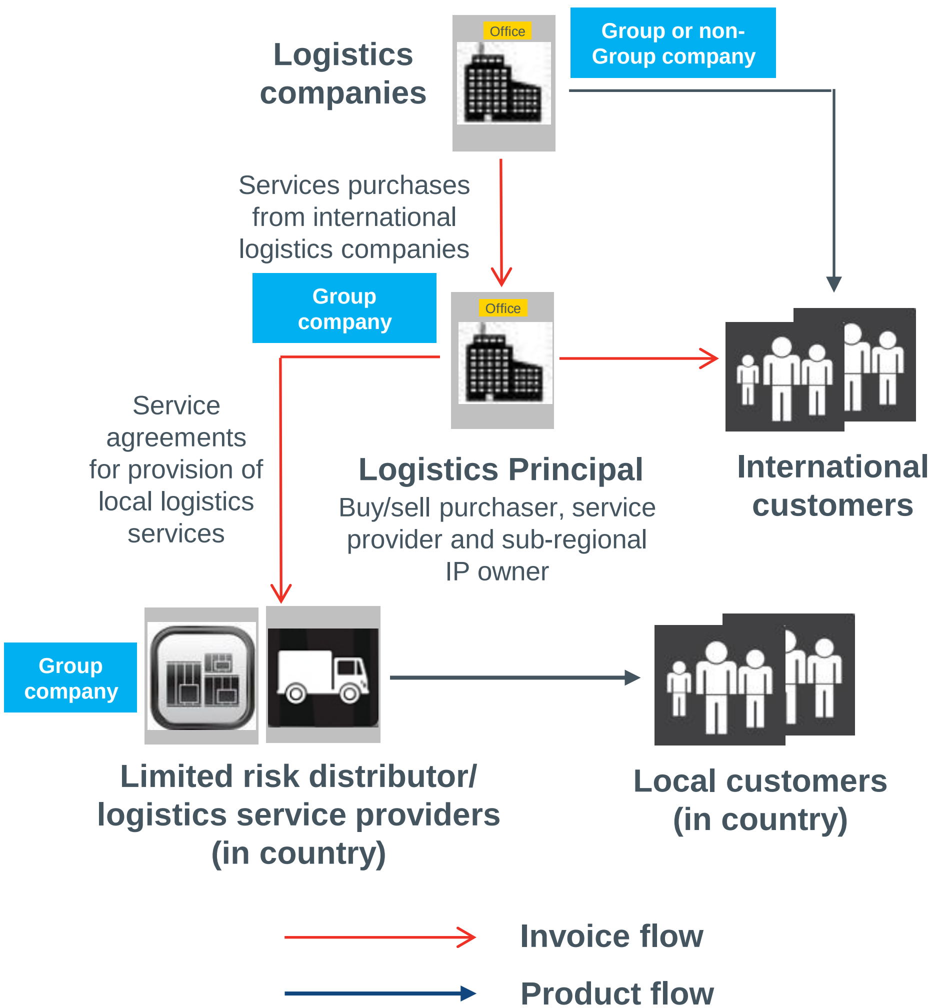
Typical regional structure and associated options:
Distribution structures – Centralised merchandising

Centralised merchandising models



Typical regional structure and associated options:
Centralised logistics principal

Logistics Principal model



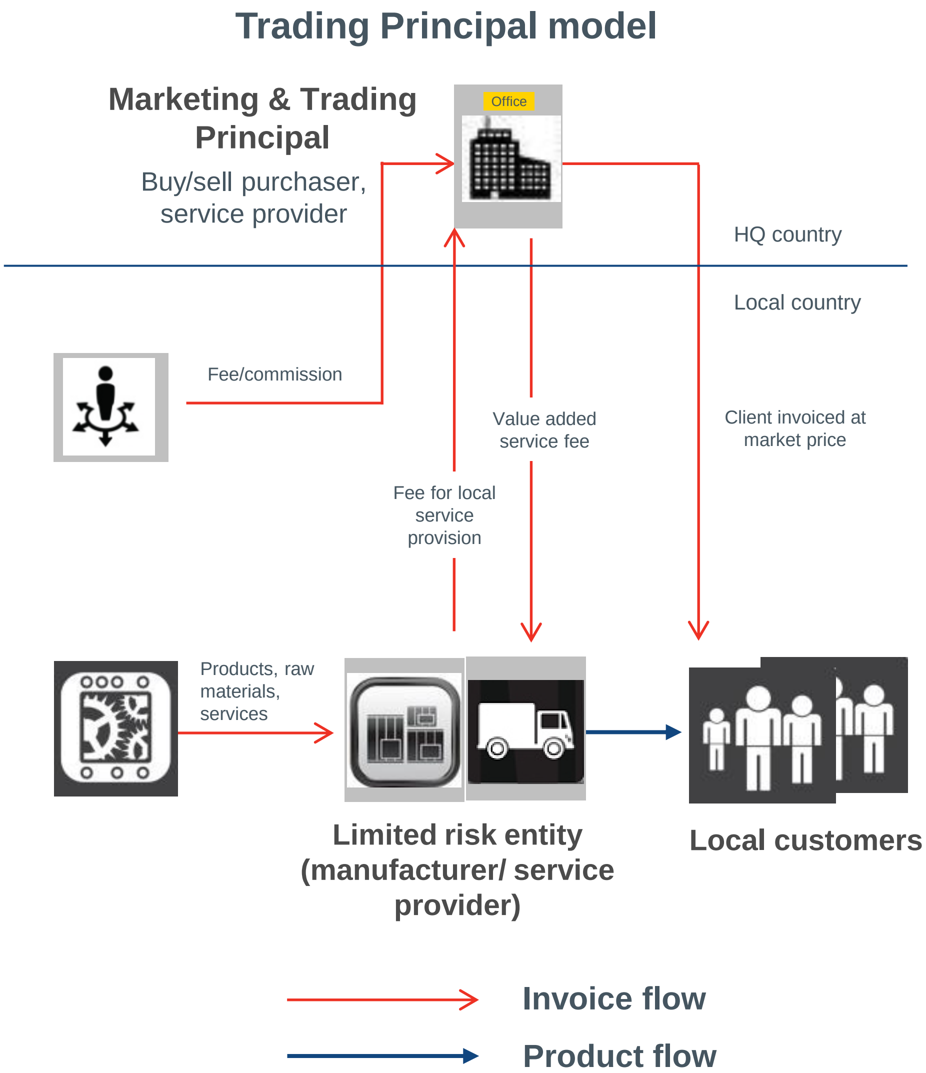
Transactions:

- The logistics principal is an IP or principal licensor
- It is responsible for R&D, provision of logistics solutions to country entities (including procurement of logistics services) and may provide other, related services. It brings economy of scale to procurement of logistics services
- The principal provides logistics support directly to international clients. It also provides freight management and handling services to group entities in countries, through service agreements, in return for a fee for service. It bears handling and credit risks, and may bear inventory risks where supply is vendor-managed
- The country entities are limited risk distributors or limited risk logistics service providers, which source local low-risk handling services for a routine return

Issues to consider:

- Substance at the logistics principal
- Available incentives
- PE risk associated with in country entities providing warehousing, staging or distribution activities

Typical regional structure and associated options:
Centralised trading principal

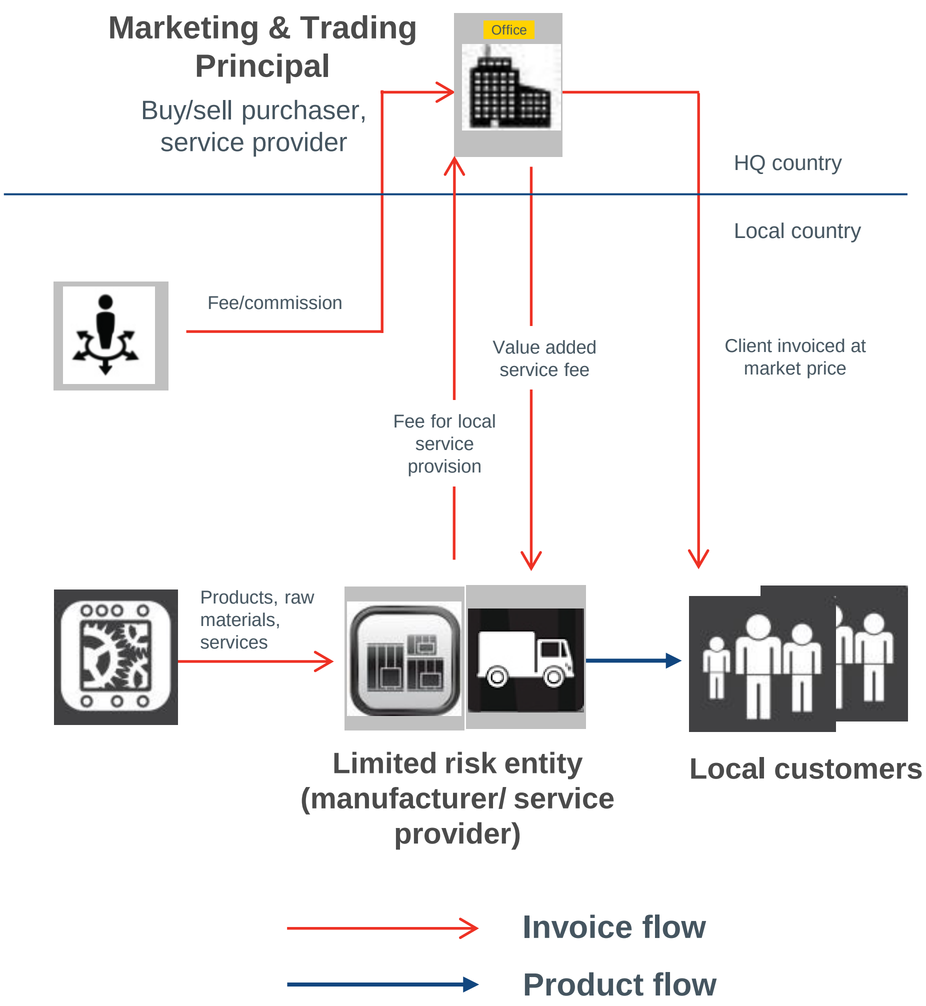


Issues to consider:

- The marketing and trading principal is a centralised entity, responsible for
  - inventory management
  - demand/sales planning and aggregation
  - Sales & marketing strategy
  - Pricing policies
- The principal bears the price, market, credit and inventory risks and receives a value-added services fee from local country entities
- The local country entities are limited risk/contract entities that procure products, raw materials and services from local suppliers at market prices
- They provide manufacturing or other services to the principal for a routine return
- Local entities ship product to local customers, who are invoiced by the trading principal
- Local sales entities provide sales & marketing services for a return on a cost plus or commission basis

Typical regional structure and associated options:
Centralised trading principal (cont)

Trading Principal model



Issues to consider:

- Substance required at the principal location to support the split of profit – is it in line with value creation?
- Is the model sustainable by virtue of being in line with how the business actually operates?
- Characterisation of services provided by marketing & trading principal to local entities – what are the benefits received, and how to evidence?
- Perception of location of the marketing and trading hub in a tax effective jurisdiction to manage tax position, may attract an audit in some local countries
- Is the return achieved by the local sales entities in line with the value that they create?
- Potential additional PE risk for the principal due to activities of local sales entity
- Customs valuations
- Perceived local IP (market & customer knowledge), underpinning a claim for a higher, local return
- Business restructuring and implementation issues

Part 4

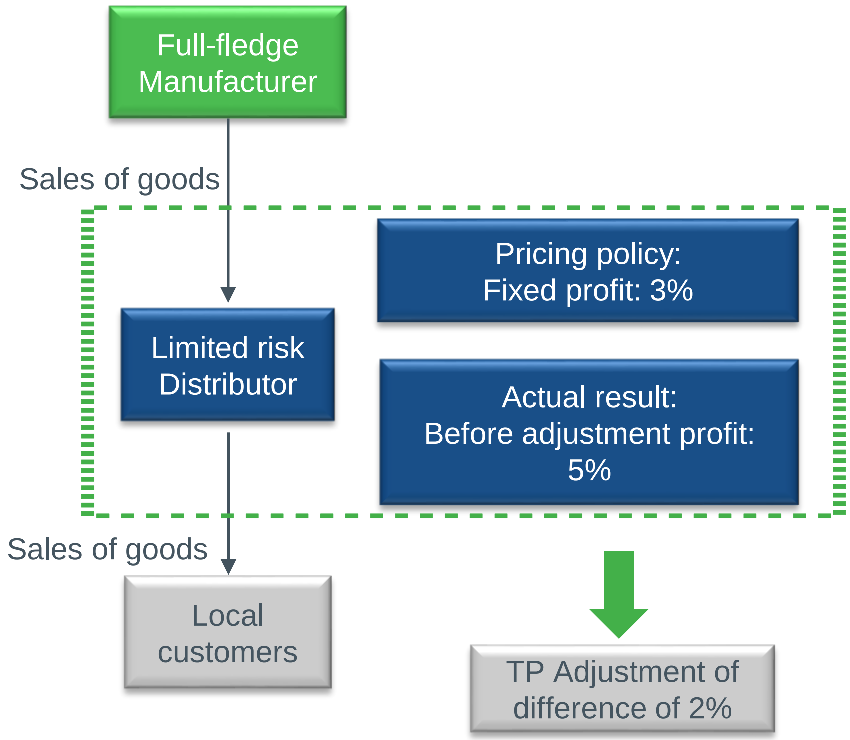
Questions & Answers

Presenters

Becky Nguyen
Douglas Fone

Case Study 1

Transfer pricing adjustment: Example



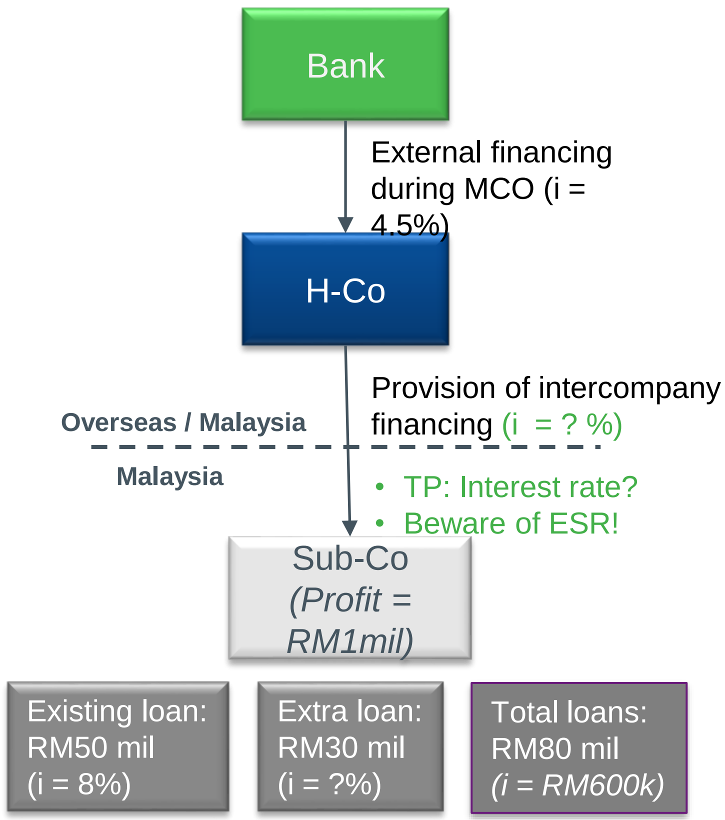
- A transfer pricing adjustment is often made at the year end, and can be either an upward or downward adjustment depending on the **actual profit vis-à-vis targeted profit.**

- It is a highly disputed area with the IRB especially in a situation involving a downward adjustment.

- In making a transfer pricing adjustment, various **commercial considerations** have to be taken into account such as:
  - Specific issues on supply chain management.
  - Extra financial risks assumed by the company.
  - Overall Group policies that warrant local companies to bear additional costs.

Case Study 2

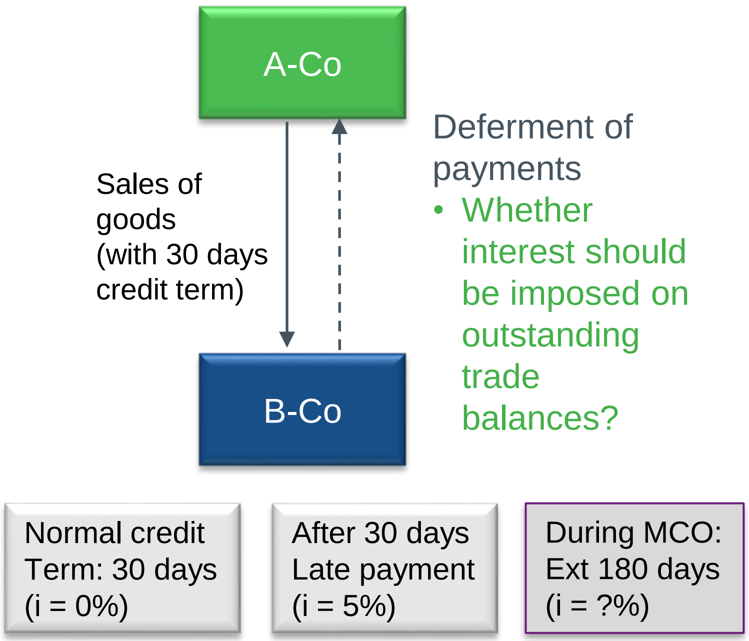
Obtaining New Financing For Working Capital



- Parent companies may obtain external financing with cheaper interest rates, and on-lend to related companies who require new funds for working capital.
- **Example:** Sub-Co borrows from H-Co.
  - Existing loan = RM50 mil @ interest rate of 8%
  - Additional loan during MCO = RM30 mil @ ***interest of ?%***
- **Interest rate on the new RM30 mil loan obtained during MCO:**
  - 0%, 4.5%, 8.0% or other interest rates?
- **Arm's length principle**: The intercompany financing by H-Co to S-Co must be at arm's length interest rate. The loan should not be granted free of interest.
- **Earnings Stripping Rules (ESR):** Interest expenses **exceeding RM500,000** in a year of assessment payable / paid to associated person outside Malaysia will be restricted if above 20% of Tax-EBITA.

Case Study 3

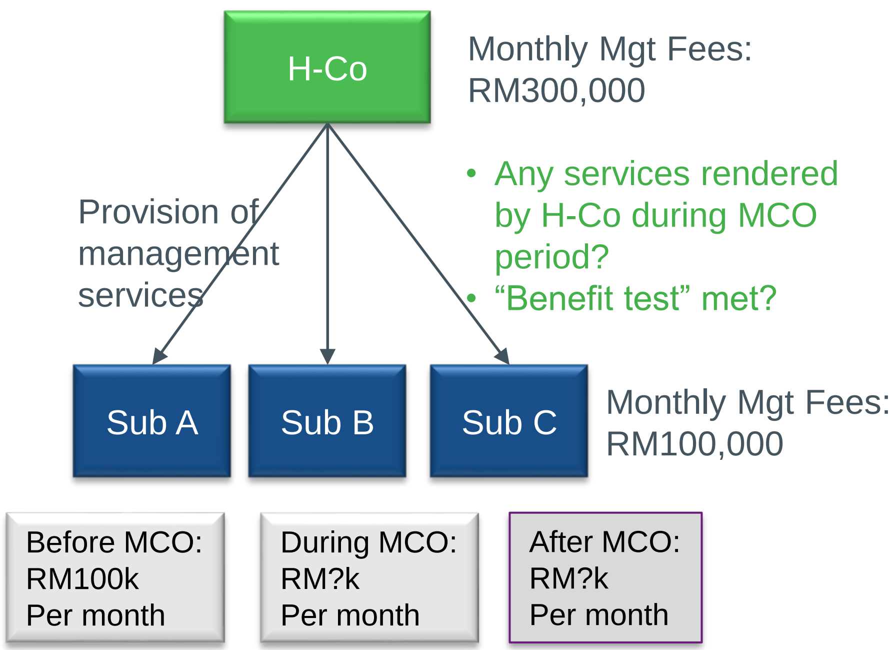
Extended Trade Financing



- Co-A and Co-B are related companies. Co-A sells electrical goods to Co-B at **normal credit term of 30 days**. During normal credit terms, it was agreed that there is no late payment interest imposed. Otherwise, a **5% late payment** interest is imposed
- During MCO, Co-B is experiencing shortage in cash. One solution is for Co-B to ask for extended credit terms from Co-A. Let us assume Co-B asks Co-A for the credit term be extended to 12 months, and Co-A agrees an **extended credit term of 6 months or 180 days**.
- Extended credit terms: Should Co-A impose late payment interest of 5% during the MCO period or 0% because an extension is granted?
- **Deferment of payments** for outstanding trade balances extended beyond a reasonable credit term may give rise to transfer pricing complication.
- Consistent with third party arrangements, follow the market - **whether interest imposed** by the trade creditor to Co-B.

Case Study 4

Review of Intercompany Service Charges



- Under the existing management services agreement between H-Co and Sub-A, Sub-B and Sub-C, it was agreed that H-Co shall provide various services e.g. HR, legal, accounting, R&D, IT, procurement and marketing services to A, B and C.
- In return, H-Co receives RM100k per month each from A, B and C. Total management fee income = RM300k for H-Co.
- During MCO, the scope of services provided by H-Co reduced substantially. Only accounting and HR services were being provided by H-Co.
- Should H-Co continue to charge RM100k per month to A, B and C during MCO? To meet "benefit test".
- These transactions should be reviewed to ease cash flow positions of A, B and C.
- A, B and C should be cautious in readily accepting charges for intercompany services in the event that such **benefits are no longer provided** to them during and post MCO period.

Case Study - Takeaways

1. **Arm's length principle:** The transfer prices for IGS must be conducted relying on the arm's length principle.

2. **TP Methodology:** Apply an appropriate TP method in setting up the transfer prices, i.e. Identify cost base, impose an arm's length profit mark-up, employ allocation keys.

3. **Benefit Test:** Key assessment to justify the reasonableness of service fees between service providers and service recipients.

4. **TP Documentation:** To defend a TP audit, need to keep proper documentation to comply with TP rules and avoid penalties.

5. **Covid-19 TP Risks and Analysis:** Circumstances changed and so do TP model. Review / revisit the IGS charges and explain changes using economic analysis for the financial year 2020 / 2021.

For more information, please contact:

Becky Nguyen
Director, Transfer Pricing

Duff & Phelps Malaysia Sdn Bhd
Level 30, Menara Prestige,
1 Jalan Pinang,
50450 Kuala Lumpur, Malaysia

M +601 8329 2883

becky.nguyen@duffandphelps.com
www.kroll.com

Douglas Fone
Managing Director, Transfer Pricing

Duff & Phelps Singapore Pte. Ltd.
Ocean Financial Centre
10 Collyer Quay, #05-04/05
Singapore 049315

M +65 9022 0247

douglas.fone@duffandphelps.com
www.kroll.com