

# Digitalisation of Business Models and Transfer Pricing: the New Frontier of Business Restructurings?

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# Who are we talking about?



# Digital Maturity Index

	ERP systems	CRM systems	Market & integration	Social media	Overall digital maturity
<b>Industry <sup>(1)</sup></b>					
Information and communication	0,54	0,52	0,25	0,34	0,34
Wholesale and retail trade	0,63	0,53	0,32	0,11	0,25
Other services	0,54	0,44	0,17	0,16	0,22
Manufacturing	0,72	0,37	0,23	0,09	0,20
Utilities	0,47	0,35	0,17	0,12	0,19
Accommodation and food services	0,47	0,34	0,24	0,06	0,16
Real estate activities	0,59	0,40	0,11	0,08	0,14
Transport and storage	0,50	0,15	0,28	0,03	0,12
Construction	0,45	0,17	0,14	0,04	0,10
<b>ICT-sector <sup>(2)</sup></b>					
ICT-using sectors	0,72	0,55	0,35	0,27	0,37
ICT-sector	0,68	0,59	0,22	0,21	0,29

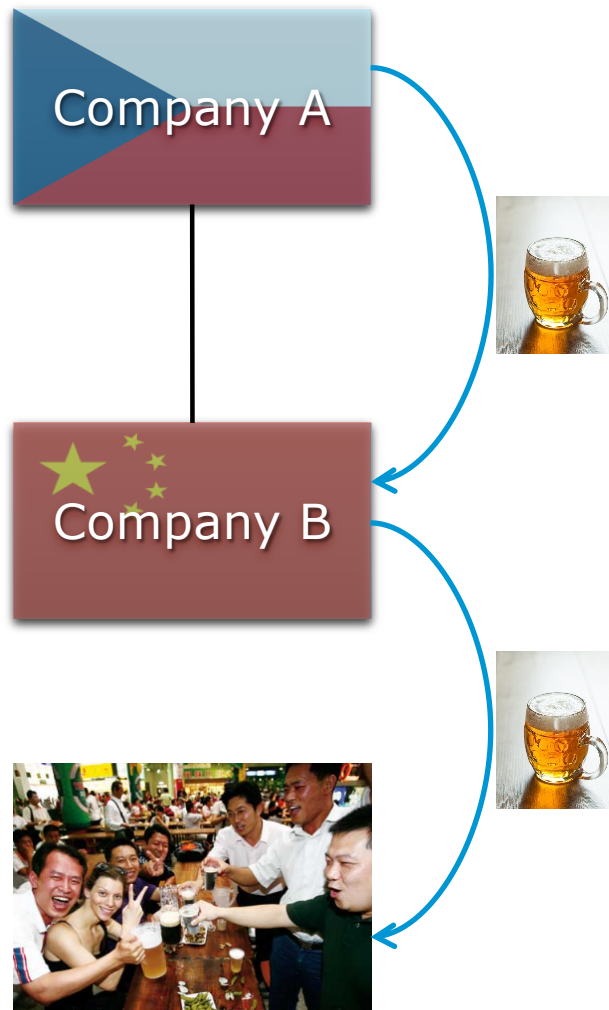
More digitally mature



Less digitally mature

Source: OECD: Measuring Digital Intensity of Firms, Working Party on Measurement and Analysis of the Digital Economy, Directorate For Science, Technology And Innovation Committee On Digital Economy Policy, Dsti/Cdep/Made(2017), 2-3 November, Paris;

# The issue



- Group ABC is a Czech group **producing and selling beer**
- **Company A**, resident in the Czech Republic, is the parent company of the group. It **produces** the beer in its own breweries and **sells** it around the world
- **Company B**, resident in China, is a **full fledged distributor** of the group. Buys the beers from Company A and sells them in the local market, undertaking all mayor related risks
- Group ABC is considering **digitalizing its sales activities**.
  - The local **marketing** functions will be performed mostly by a new AI system able to understand the tastes of local customers and translate them into marketing outputs
  - The local **distribution** functions will be performed by drones and self-driving vehicles
  - **Warehousing and logistics** will be performed by robots
- The above digital systems will be **run** partially from China and partially from Czech Republic
- As a consequence, **most of employees** in Company B will be dismissed

# What is a business restructuring?

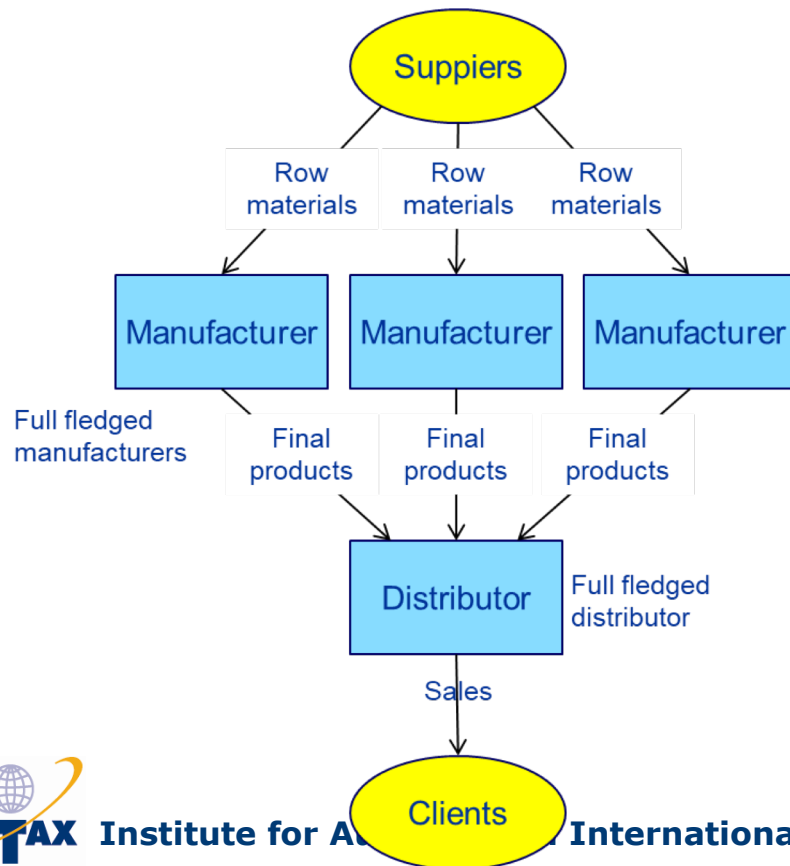
*the **cross-border reorganisation** of the **commercial or financial relations** between associated enterprises, including the **termination or substantial renegotiation of existing arrangements***

...

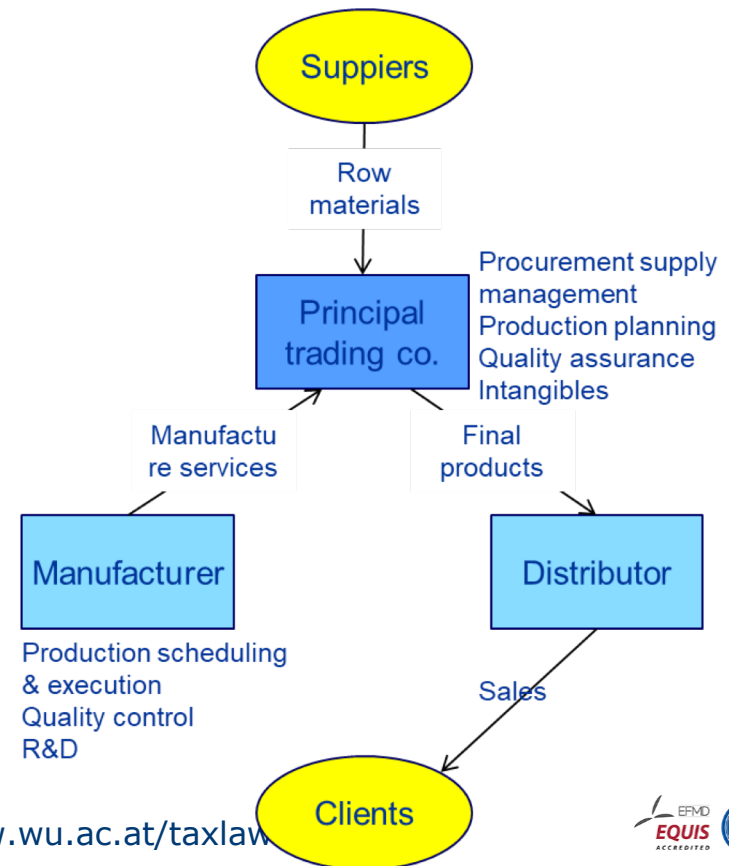
*associated to **profit (loss) potential***

# Typical example

## Pre-restructuring



## Post-restructuring



# Steps

1. Identification of commercial and financial relations



2. Recognition of the actual delineated transaction



3. Reallocation of profit potential as a result of a BR



4. Transfer of something of value



5. Indemnification of the restructured entity

# 1. Identification of commercial and financial relations

Contractual  
terms

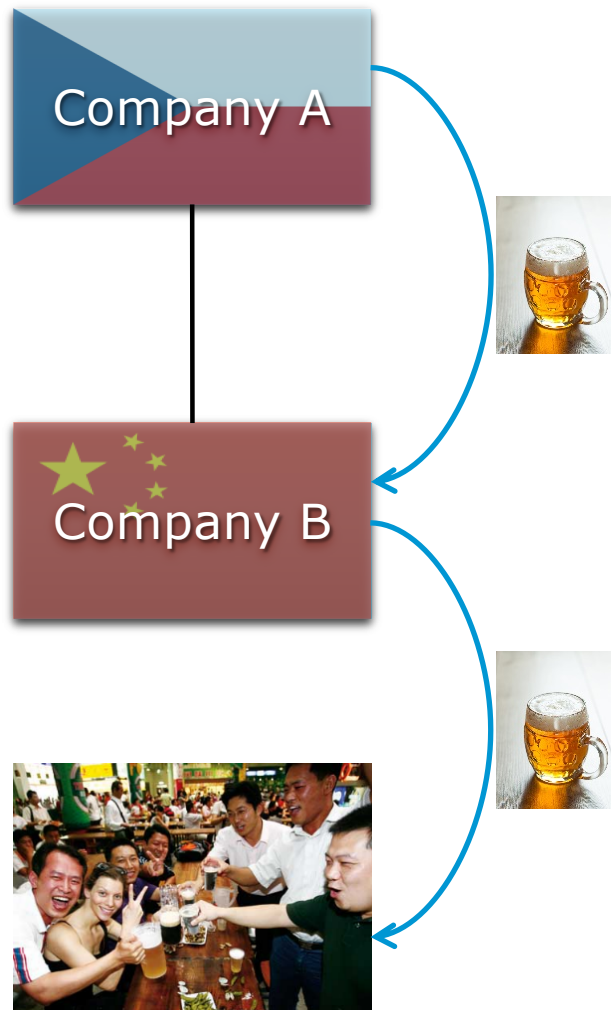
Functional  
analysis

Economic  
circumstances

Strategies

- **Business reasons** for and the expected benefits, incl. synergies (es. procurement co.)
- Other **options realistically available**

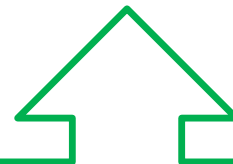
# 1. Identification of commercial and financial relations



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## 2. Recognition of the actual delineated transaction

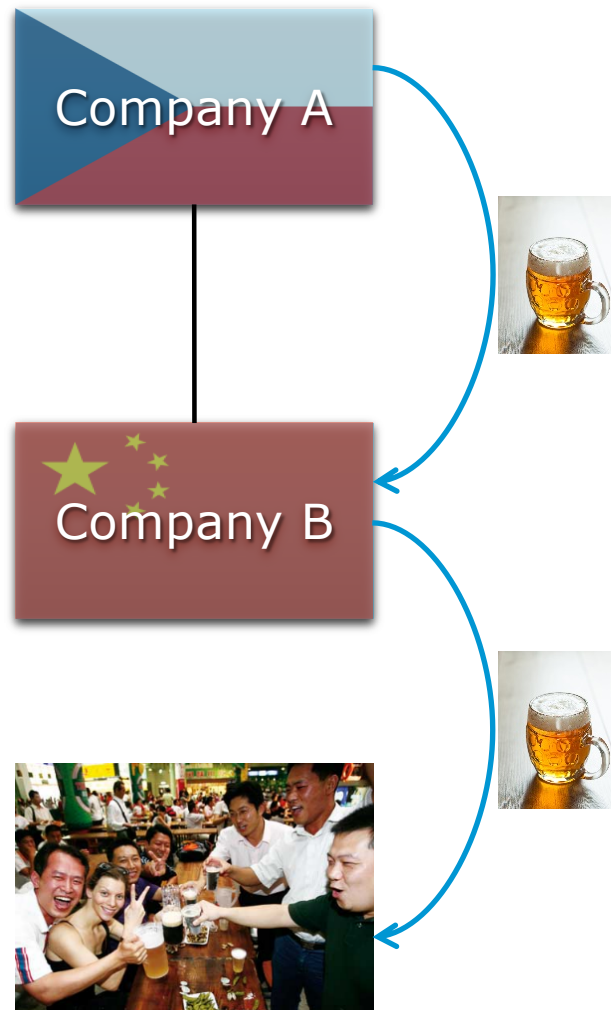
- MNEs are **free to organise their business operations** as they see fit. Tax administrations do not have the right to dictate to an MNE how to design its structure or where to locate its business operations.
- Tax administrations, however, **have the right to determine the tax consequences of the structure** put in place by an MNE... This means that tax administrations may make, where appropriate, **adjustments to profits** ... and other types of adjustments allowed by their domestic law (e.g. under general or specific anti-abuse rules).



### **Commercial rationality** of the restructuring as a whole

- Sometimes, specific transaction
- Motivation of the group vs. separate entity approach
- Impact of the tax factor

## 2. Recognition of the actual delineated transaction



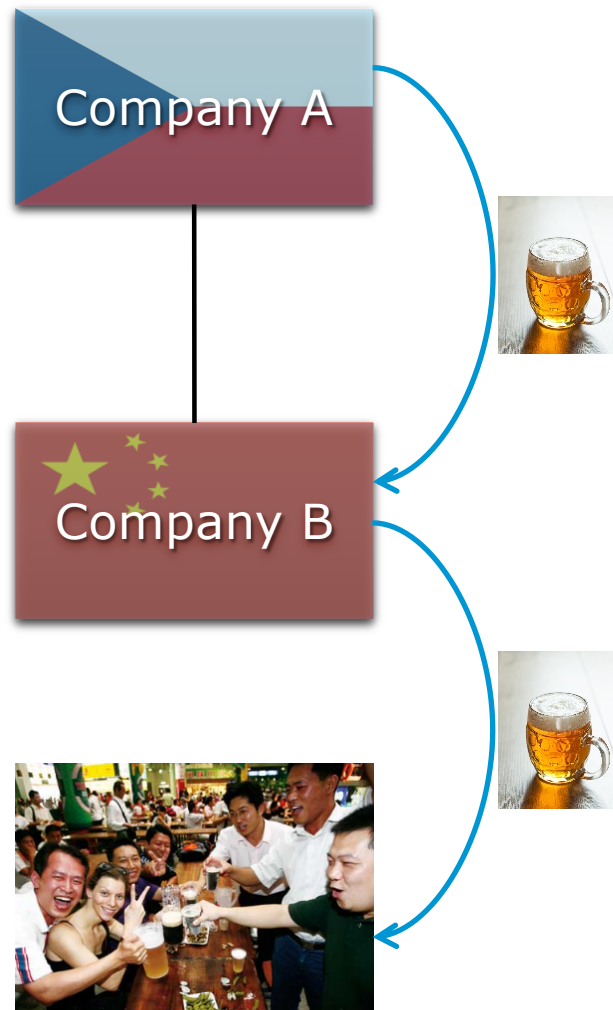
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**Does the transaction have commercial rationality?**

### 3. Reallocation of profit potential as a result of a BR

	Scenario 1	Scenario 2	Scenario 3
<b>Full-fledged distributor</b> <b>Historical</b> profitability data (last 5 years)	Year 1: <b>-2%</b> Year 2: <b>4%</b> Year 3: <b>2%</b> Year 4: <b>0%</b> Year 5: <b>6%</b>	Year 1: <b>5%</b> Year 2: <b>10%</b> Year 3: <b>5%</b> Year 4: <b>5%</b> Year 5: <b>10%</b>	Year 1: <b>5%</b> Year 2: <b>7%</b> Year 3: <b>10%</b> Year 4: <b>8%</b> Year 5: <b>6%</b>
<b>Full-fledged distributor</b> <b>Projected</b> profitability (over remaining term of agreement)	<b>(-2)% to 6%</b> With significant <b>uncertainties</b> within this range	<b>5% to 10%</b> With significant <b>uncertainties</b> within that range	<b>0% to 4%</b> With significant <b>uncertainties</b> within that range (due to new competitive pressures)
<b>Limited risk distributor</b> Projected profitability (next three years)	<b>2% per year</b>	<b>2% per year</b>	<b>2% per year</b>

# 3. Reallocation of profit potential as a result of a BR



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**Is there a loss of profit potential?**

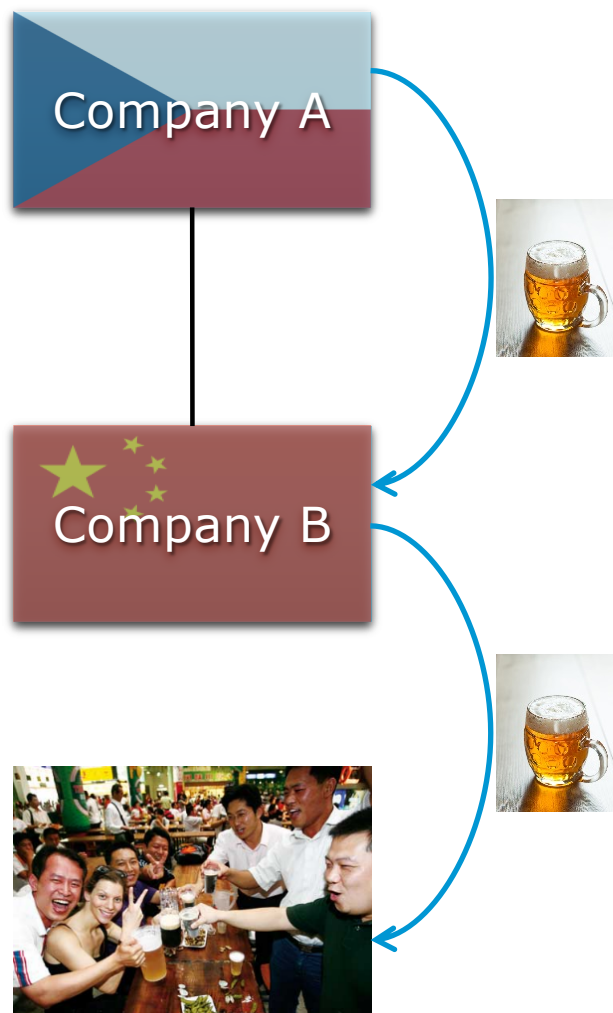
## 4. Transfer of something of value

**Tangible  
assets**

**Intangible  
assets**

**Ongoing  
concern**

# 4. Transfer of something of value



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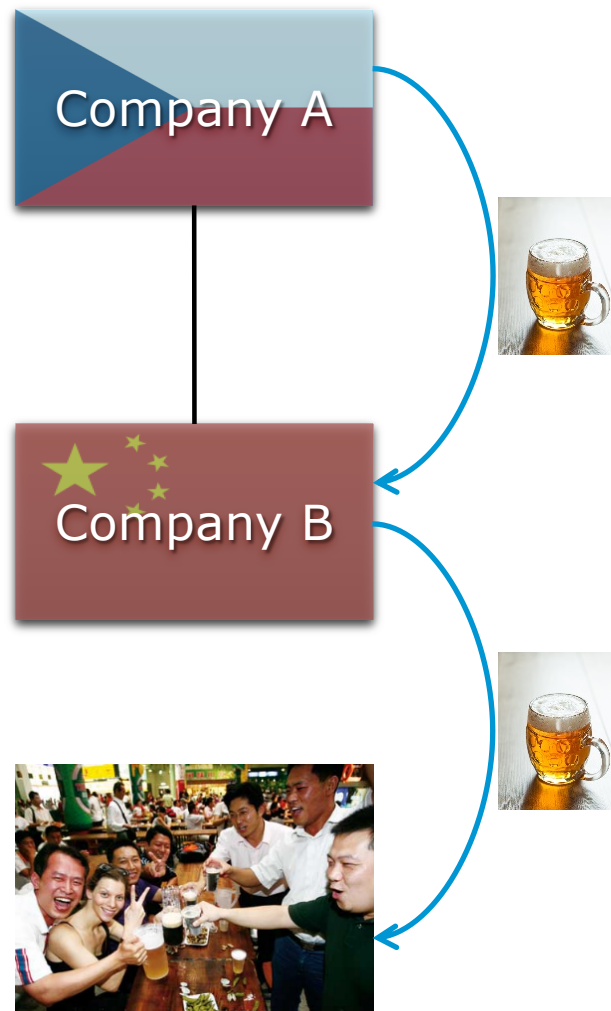
**Is there an assets or ongoing concern transfer?**

# 5. Indemnification of the restructured entity

Whether the restructured entity, at arm's length, should receive **compensation**, in the form of indemnification, **upon the termination or substantial renegotiation of its existing arrangements**, which may or may not involve a transfer of something of value (addressed in the previous section).

For the purpose of this chapter, **indemnification** means any type of compensation that may be paid for **detriments suffered** by the restructured entity, whether in the form of an **up-front payment**, of a **sharing in restructuring costs**, of **lower (or higher) purchase (or sale) prices** in the context of the post-restructuring operations, or of any other form.

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**Should Company B be indemnified?**

# What else?

Post-restructuring?

Location specific advantages?

Synergies?

Domestic anti-abuse rules?

VAT and indirect taxes?

# Conclusions

- Many challenges in **applying TP analysis** to digitalization of business models
- **Complex** topic and currently **no extensive guidance**
- **Wording of TPG** making reference to concepts such as “functions”, “actual conduct of the parties”, ... need to be revised?
- How about **PEs** (and “significant people functions”)?
- From functional analysis to **process analysis**?
- Tsunami of **disputes**
- Dispute **avoidance/resolution** mechanisms needed

# Contact details



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