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New horizons of transfer pricing - regulation change updates, current context analysis and new technology outlook

转让定价新境界——法规现况全解析，科技创新畅远景

pwc

普华永道

Agenda

1. Regulation update
2. Tax administration point of view
3. China transfer pricing focuses
4. Technology TP Compliance Solutions — Segmentation Tool
5. TP Data Analytics
6. Using data analytics approach to address global growth issue

Regulation update

1

BEPS, UN and other perspectives

1990s

The **UN** issues Model Taxation Convention and Manual

OECD issues Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations

Global Forum on Transparency and Exchange of Information for Tax Purposes

2007-2009

The Fall of Lehman Brothers

The Great Recession

2010

UN issues Draft Practical Manual on TP for Developing Countries

2011

The **UN** issues the Model Taxation Convention between Developed and Developing Countries

2012

The **G20** launches BEPS project — potential magnitude of annual losses generated by the BEPS problem was estimated to be from 4-10% of global CIT revenues

2013

The **OECD** introduces the BEPS Action Plan

The UN establishes the Subcommittee on BEPS Issues for Developing Countries

2014

The **OECD** issues its report on the impact of BEPS on low income countries

2015

The **UN** issues the first handbook on protecting the tax base of developing countries

The **UN** and **OECD** launch TIWB

OECD issues toolkit on incentives for investments for low income countries

2016

The **OECD, IMF, UN and WB** launch the Platform for Collaboration on Tax

The OECD launches the Inclusive Framework

2017

OECD issues toolkits on accessing comparables data and taxation of offshore indirect transfers

MLI is signed by 70+ countries

Recent update from OECD and UN

OECD/BEPS Update

1

- 2017 edition of the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
- the updated guidance on the implementation of Country-by-Country Reporting under BEPS Action 13
- Country-by-Country Reporting: Handbook on Effective Implementation
- Country-by-Country Reporting: Handbook on Effective Tax Risk Assessment

United Nations Update

2

- UN Practical Manual on Transfer Pricing for Developing Countries (2017)
- 15th Session of the Committee of Experts on International Cooperation in Tax Matters
  - The digitalized economy: selected issues of potential relevance to developing countries

Three-pillar anti-avoidance administration framework in China in post-BEPS arena

- **Investigation**: SAT Public Notice [2017] No. 06 — Administration Measures of Special Tax Investigation Adjustments and Mutual Agreement Procedures, effective as of 1 May 2017
- **Administration**: SAT Public Notice [2016] No. 42 — Refining the Filing of Related Party Transactions and Administration of Contemporaneous Transfer Pricing Documentation, effective of 1 January 2016
- **Services (APA)**: SAT Public Notice [2016] No. 64) — Refining the Administration of Advance Pricing Arrangements, effective as of 1 December 2016

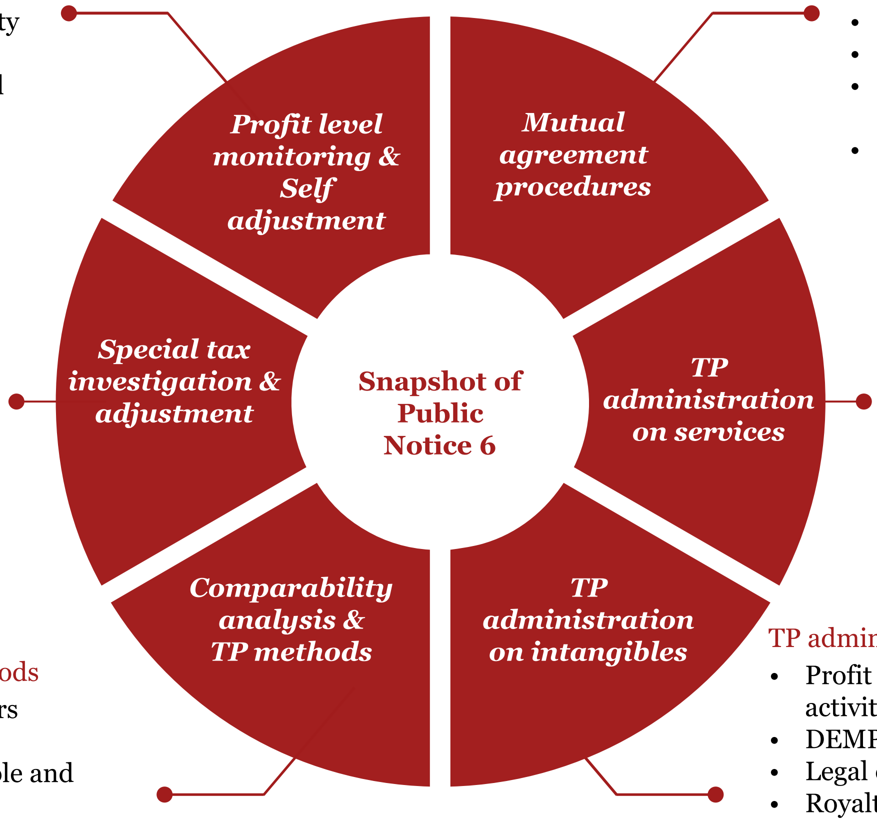
Snapshot of Public Notice 6

Profit level monitoring & Self adjustment

- Risk assessment by tax authority through RPT disclosure, documentation, and profit level monitoring
- Self-adjustment by taxpayer

Mutual agreement procedures

- Applicants and applications
- Acceptance or rejection
- Submission of information
- Procedures of initiation, suspension, and termination
- Implementation of agreement



Special tax investigation & adjustment

- Investigation targets: 9 types
- Investigation process
- Information submission & burden of proof
- Special transactions or issues
- Conclusion of case & tax collection

TP administration on services

- Non-beneficial services: 6 categories
- Benefit tests
- Indirect charges

Comparability analysis & TP methods

- Comparability analysis: 5 factors
- TP methods
- Valuation methods for intangible and equity transfer
- ~~“Value contribution attribution method”~~

TP administration on intangibles

- Profit allocation in line with economic activity and value creation
- DEMPE + Promotion
- Legal ownership vs. economic ownership
- Royalty rates should be adjusted in a timely manner

Highlights of Public Notice 6

What's reaffirmed?	What's New?	What's dropped?
• Guaranteed profit for single function entity (Circular Guo Shui Han [2009] No 363) • Voluntary self-adjustment (Public Notice [2004] No 54) • Outbound payments of service fees and royalties (Public Notice [2015] No 16) • Toll processor • Location specific advantages	• Profit monitoring system • Non tax resident enterprise as special tax audit target • Disregarding offset transactions or concealed transactions • DEMPE + Promotion concept to recognize the China contribution in promotion of intangibles • Exemption of APA applicants from audit investigation • Valuation methods	• Value Contribution Attribution Method (?) • Secondary adjustment — for now

Our observations

— More pressure for taxpayers to make self adjustments

Profit monitoring system, "Big data" and other analytics

Self-adjustments through filling in the "Special Tax Adjustments Self-Payment Form";

Tax authorities retain the right to launch special tax investigation adjustments on taxpayers who have made self-adjustments;

Confirmation of tax position proposed by taxpayers trigger audits;

Self-adjustments made on transactions from 1 January 2008 will be subject to interest levy.

No mutual agreement procedures

Our observations

— More pressure for taxpayers to provide overseas information

More overseas information can be requested by China tax authorities (Master File, CbCR, financials of value chain participants, etc.)

Emphasis to select the entity with relatively less complex functions as the tested party

Refusal to provide or provision of false or incomplete information during investigation may lead to deemed taxable income

Deemed taxable income

Reflection: what is the new rule?

- New principle: Profits should be taxed where economic activities take place and value is created (G20, 2013).
- What does the new rule mean?
  - How to define the profits?
  - Does it mean that profits should be taxed - and only be taxed - where economic activities take place and value is created?
  - Does economic activities and value creation are the necessary nexus for taxation right?
  - Whether does the host country have the taxation right when value is created in this country but the relevant economic activities creating the value are performed outside country?
  - How to reconcile the value chain analysis and the arm's length principle analysis (e.g. CUP method)?

Tax administration point of view

2

Tax administration point of view

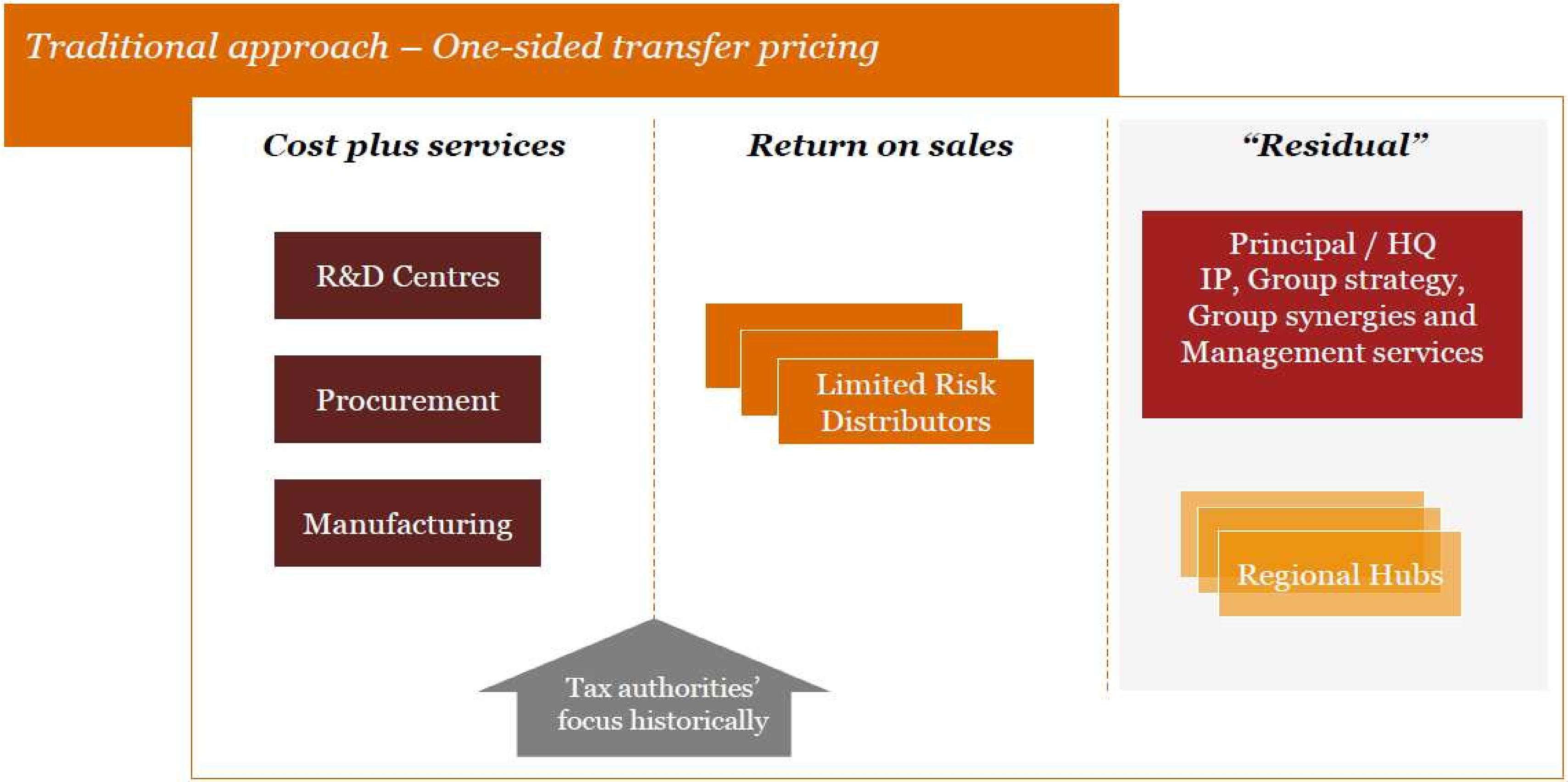
China transfer pricing focuses

3

Value chain analysis

3.1

Why are we discussing VCA?

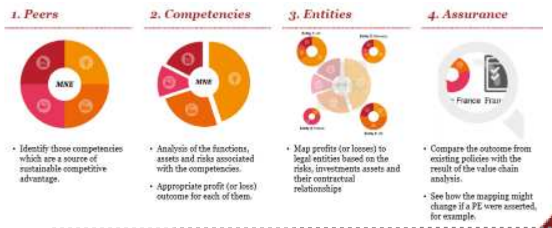


Why are we discussing VCA?

Five VCA approaches

Comprehensive – Both external and internal data analysed

Method 5: Empirical VCA approach

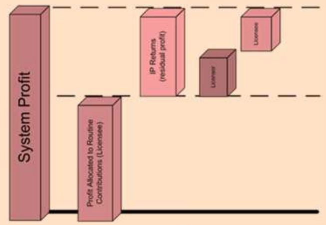


Intermediate – Internal data explored

Method 3: Function and risk approach

Function	Contribution of function in the value creation and profit generation	Co-1	Co-2
Design	3	5	0
Assortment planning	3	5	0
Production	3	5	0
Logistics	2	3	2
Pricing	2	4	1
Expansion/Display	2	4	1
Marketing/Information/Sustainability	3	4	1
PR Activities and communications	2	4	1

Method 4: Profit split approach (e.g. expense allocation)



Method 2: Industry approach (internal / industry expert perception)

Basic – Descriptive

Method 1: Michael Porter styled VCA

Complexity and uncertainty increasing

Management Efforts increasing

Typical issues of VCA

- Too general and not entity specific (in particular when you have group entities in China)
- VCA only shows static picture (which omits heritage and future trend)
- How to weight value (value judgment) is a subjective exercise (different tax authorities may have different views)
- VCA may not be reconciled with arm's length analysis (e.g. CUP method)

Intangible transactions

3.2

Intangible transactions

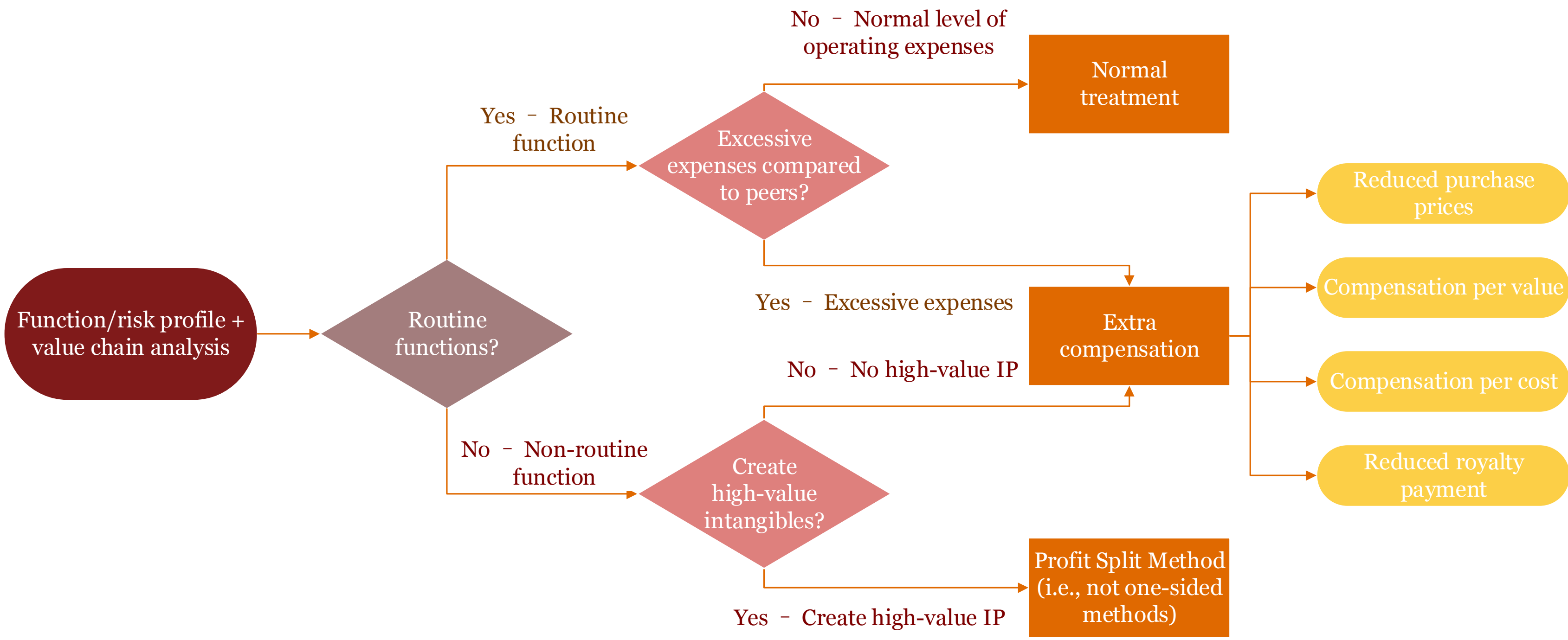
"Allocation of income generated by intangibles shall be commensurate with the commercial activities and contribution to its value creation"

- Return for entities only providing funding without substantial functions performed/risks assumed in relation to intangibles: only a reasonable return on the funding cost
- Chinese tax authorities may make special tax adjustments on royalties that are ***not commensurate with the economic benefit*** *and result in a* ***reduction in the taxable gross income or taxable income*** of enterprises or their related parties.
  - Royalties to an overseas related party only with the legal rights of the intangible asset, without any contribution to its value creation
  - Royalties to a related party for incidental benefits arising from financing or public listing activities
- Chinese tax authorities **do not allow balancing payment.**

What are the "local intangibles" – an India example

Marketing related intangibles	trademarks, trade names, brand names, logos
Technology related intangibles	process patents, patent applications, technical documentation such as laboratory notebooks, technical know-how
Artistic related intangibles	literary works and copyrights, musical compositions, copyrights, maps, engravings
Data processing related intangibles	proprietary computer software, software copyrights, automated databases, and integrated circuit masks and masters
Customer related intangibles	customer lists, customer contracts, customer relationship, open purchase orders
Engineering related intangibles	industrial design, product patents, trade secrets, engineering drawing and schema-tics, blueprints, proprietary documentation
Contract related intangibles	favourable supplier, contracts, licence agreements, franchise agreements, non-compete agreements
Human capital related intangibles	trained and organised work force, employment agreements, union contracts
Location related intangibles	leasehold interest, mineral exploitation rights, easements, air rights, water rights
Goodwill related intangibles	institutional goodwill, professional practice goodwill, personal goodwill of professional, celebrity goodwill, general business going concern value
And also…	methods, programmes, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data

China considerations on local intangibles



- Technology related intangibles: R&D expenses super-deduction? HNTE tax incentives? TASE tax incentives?
- Marketing related intangibles: Chinese tax authorities look closely at local intangibles created, advertising and promotion (A&P) expenses incurred by Chinese subsidiaries

Intra-group services

3.3

Intra-group services

Duplicative services;	Services that benefit solely for being part of the group;	Services that have already been compensated;
Services that are unrelated to the functions undertaken and risks assumed by service recipients, or related party services that are not required in the operations of the service recipients;	Other related party services that do not provide economic benefits, or that an unrelated party would not have been willing to pay for or to perform itself.	Shareholder activities;

Challenges to multinational corporations

A macro group lens

HQ Tax Authorities

- HQ services are beneficial to subsidiaries
- HQ bears large amounts of service costs on behalf of subsidiaries
- Centralized service model is necessary for MNCs' effective operation as a group

A micro entity lens

- Whether centralized service provides actual benefits to subsidiaries
- How to validate the service cost incurred by HQ
- How to justify the allocation method

Local Tax Authorities

- Project management
- Sales management
- Controlling
- Supply chain management
- Corporate support, e.g., HR, IT, finance, legal, etc.

Location specific advantages

3.4

Location specific advantages

Location saving

- Location savings are the net cost savings derived by a multinational company when it sets up its operations in a low-cost jurisdiction. Net cost savings are commonly realized through lower expenditure on items such as raw materials, labour, rent, transportation and infrastructure even though additional expenses (so-called dis-savings) may be incurred due to the relocation, such as increased training costs in return for hiring less skilled labour. (Section D.2.4.4.3 of UN Manual)
- Focused industry: manufacturing, service, etc.

Market premium

- Market premium relates to the additional profit derived by a multinational company by operating in a jurisdiction with unique qualities impacting on the sale and demand of a service or product. (Section D.2.4.4.4 of UN Manual)
- Focused industry: consumer products, automobiles, etc.

China's four-step approach on LSA

01 Identify if a LSA exists

02 Determine whether the LSA generates additional profit

03 Quantify and measure the additional profits arising from the LSA

04 Determine the transfer pricing method to allocate the profits arising from the LSA

Technology TP Compliance Solutions
— Segmentation Tool

4

What we observe in filing segment financials

Unpunctuality

Annual Related-party Financial Reporting Form

No.	Account	January 1st, 2016		till	December 31st, 2016	
		Overseas Related party transaction	Overseas Non-related party transaction	Domestic Related party transaction	Domestic Non-related party transaction	Total
		1	2	3	4	5=1+2+3+4
1	1) Operation Income					
2	Including: Income from Main Operation					
3	Less: Cost of Operations					
4	Including: Cost of Main Operations					
5	Business Tax and Surcharges					
6	Including: Business Tax and Surcharges for Main Operations					
7	Selling Expenses					
8	Administrative Expenses					
9	Financial Expenses					
10	Assets Impairment Losses					
11	Add: Gain/Losses due to the Changes in Fair Value (Loss should be shown with "-")					
12	Investment Income (Loss should be shown with "-")					
13	Including: Investment Income from Associates and Joint Ventures					
14	2) Operating Profit (Loss should be shown with "-") = 1-3-5-7-8-9-10+11+12					
15	Add: Non-operating Income					
16	Less: Non-operating Expenses					
17	Including: Loss on Disposal of Non-current Assets					
18	3) Profit Before Tax (Loss should be shown with "-") = 14+15-16					
19	Less: Income Tax Expenses					
20	4) Net Profit after Tax (Loss should be shown with "-") = 18-19					
	Description of Allocation Method					

Statement of Comprehensive Income
For the Year Ended December 31, 2016
(Denominated in CNY unless otherwise stated.)

	Note	2016
1. Revenue from operations	18	*Not Available*
Less: Cost of operations	18	
Taxes and surcharges		
Selling and distribution expenses		
General and administrative expenses		
Financial expenses	19	
Impairment of assets	20	
2. Profit from operations ("-" for loss)		
Plus: Non-operating income	21	
Less: Non-operating expenses	22	
3. Profit before tax ("-" for loss)		
Less: Income tax expenses	23	
4. Net profit ("-" for loss)		

- The filing deadline (i.e. May 31^{st}) sometimes passes before the completion of statutory audit report

What we observe in filing segment financials

Commonly-observed issues

- A mismatch of segment income and cost per column
- The add-up of numbers per column not equivalent to the total amount

1 **Inaccuracy**

- Failure in submission of complete financials, especially operating expenses and assets impairment losses

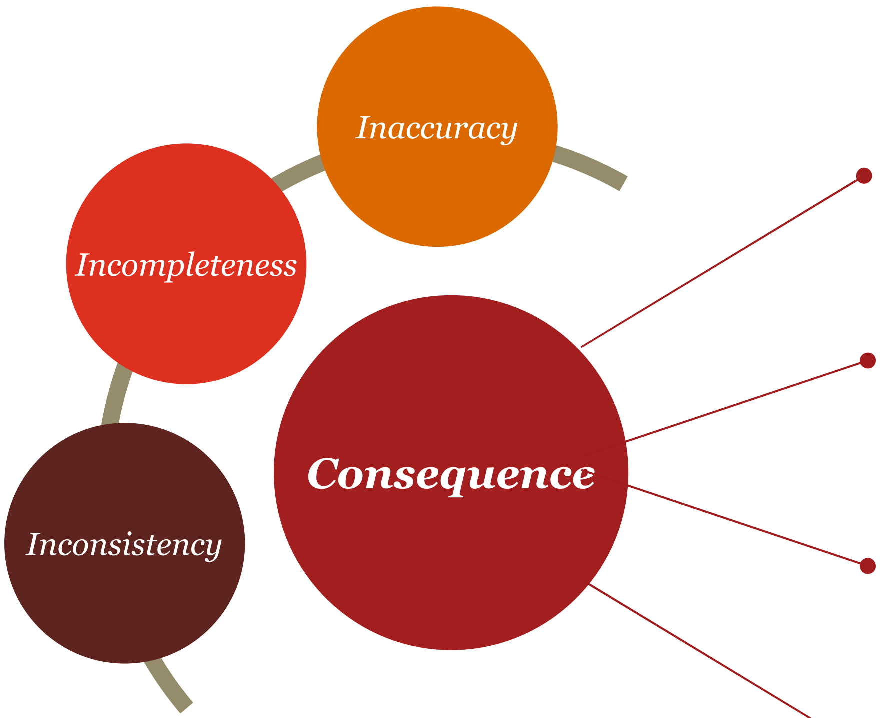
2 **Incompleteness**

- Variance between the 22 forms and disclosure in the local file report/audit report

3 **Inconsistency**

What we observe in filing segment financials

Possible consequences



- The tax authorities may not care about the quality. Is it true?
- Inconsistency in compliance reporting leads to a suspicion on the accuracy of any disclosure
- Companies with low TP risks may become the targets for further investigation by the tax authorities
- The risk of national TP audit may be increased due to inconsistent reporting among Chinese subsidiaries of the same group

A different angle — the implication of RPT filing

Digitalization of related-party transactions

A comparison among the three versions, respectively released 1) with income tax of enterprises with foreign investment, 2) in 2008 and 3) in 2016

Increasing complexity in RPT filing

A different angle — the application of RPT filing

Relevant Data Collection

- Collection of data at both national and provincial/municipal level
- An overview of overseas investment, cash flow, market condition, etc.

Macro Analysis

- Detection of erosion of the jurisdictional tax base by any related-party transaction, and its manifestation (i.e. key related-party risk exposure)

Micro Analysis

- The compliance of arm's length principle at entity level

A different angle — how to reduce the risk of assessment/investigation

False declaration or decline of RPT filing ?

Well-prepared & supported RPT filing is recommended.

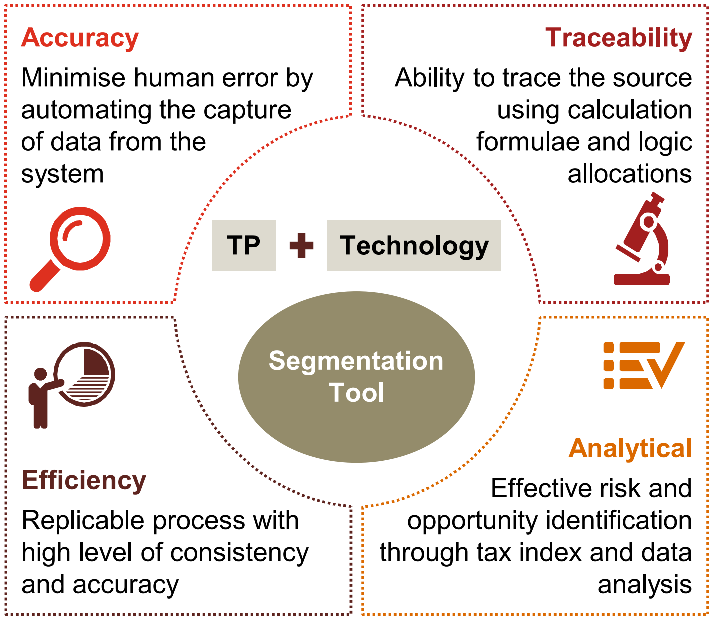
A new tool for TP compliance — what is the Segmentation Tool?

A **tailored solution** to automatically capture the data to form the segmented financial table in the required format

We have a strong team of PwC transfer pricing (TP) professionals and technology experts in China who can provide you with in-depth industry insights, professional knowledge and tax technology support, to unlock the power of data and achieve the best outcome

Please refer to the following video for a better understanding of the Segmentation Tool.

Item	yy/mm/dd - yy/mm/dd				
	Overseas Related Party Transactions	Overseas Non-related Party Transactions	Domestic Related Party Transactions	Domestic Non-related Party Transactions	Total
	1	2	3	4	5=1+2+3+4
1. Revenue					
Including: Income from Main Operations					
Less: Cost of Operations					
Including: Cost of Main Operations					
Business Tax and Surcharges					
Including: BusinessTax and Surcharges for Main Operations					
Less: Selling Expenses					
Less: Administrative Expenses					
Less: Financial Expenses					
Assets Impairment Losses					



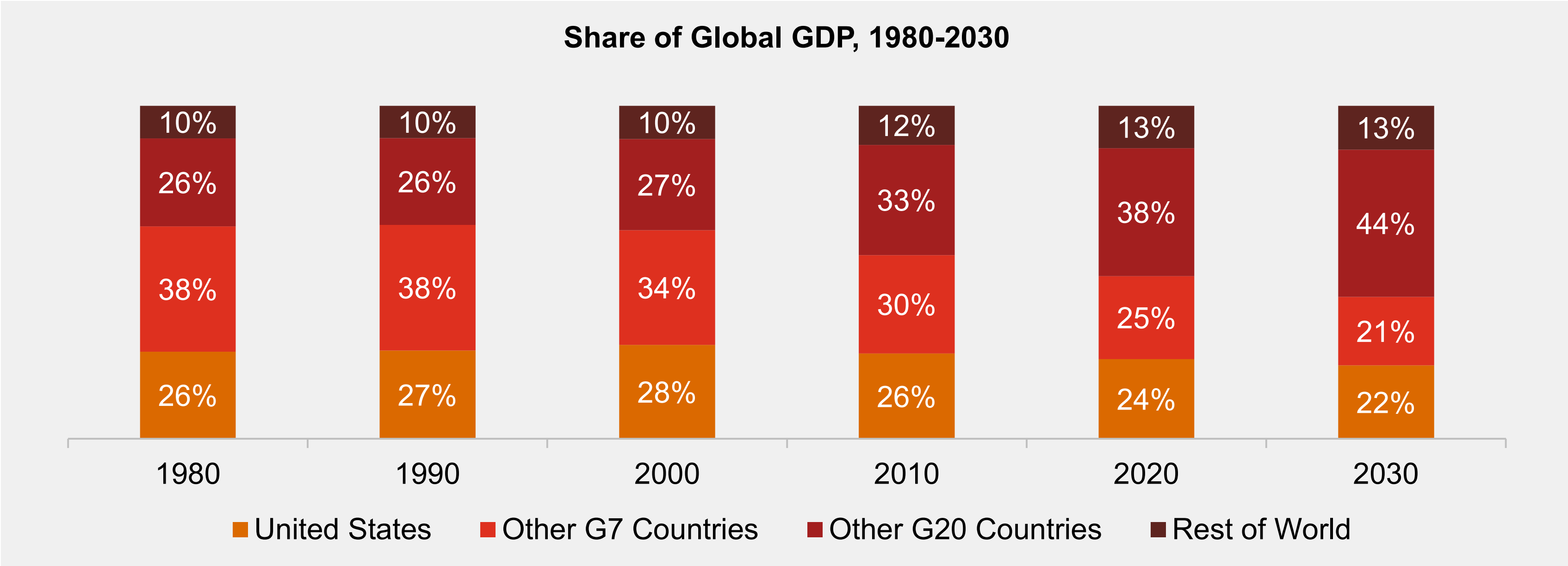
TP Data Analytics

5

Transfer pricing challenges we are facing…

Companies were once able to secure a large share of the global market by investing in few and familiar countries…

… today, however, competing for a similar share of the global marketplace requires that companies maintain presence in a larger and more diverse set of countries.



Transfer pricing challenges we are facing…

Companies are spending more resources to address global and local compliance requirements…

CbCR
Global view of multinational's operation in a fast changing economic environment

RPT forms
Detailed disclosure of annual related party transactions and organizations involved

TP documentation
Master File, Local File and Special Issue File

Non-TRE tax filing
Stringent filing and information disclosure requirements

Outbound remittance
Increasing controversy in outbound remittance requires robust supporting documents to justify substance

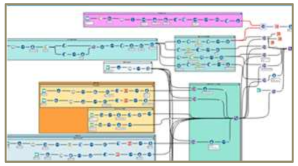
Management report
Continuous monitoring and control of transfer pricing related issues

Technology driven tax administration is on the way – one size fits all solution?

Maturity

Excel

- Most flexible
- Struggles with changing data, and large volumes



Alteryx data aggregation solution + Analytics

- Alteryx Designer
- Direct visibility to data sources, blending and reports
- Direct export to data visualization tools
- Easy to deploy

Custom database solution + Analytics

- Microsoft Access/SQL
- Simple tables and queries to manage data and calculation
- Direct export to data visualization tools
- Customize for clients
- Easy to deploy

ORACLE SAP

Fully embedded ERP/BI solution

- SAP/PCM; Oracle/HPCM
- Integration at source data level
- Most robust implementation, but highly complex as an 'after added' feature

Time to implement

Is Analytics approach a right solution?

Keys to success

01
Discovery

Observations to information

Find value in internal and external, structured and unstructured data. Automate data discovery, data cleansing, and analysis as much as possible.

02
Insights

Information to insights

Apply new techniques on existing and new data to generate insights. Create a test-and-learn environment for continuously harnessing the insights.

03
Actions

Insights to decisions & actions

Link insights with decisions and actions to deliver quick wins. Compete with faster and more sophisticated decisions and actions.

04
Outcomes

Decisions & actions to outcomes

Unlock value by transforming business function, business unit or industry.
Recruit and train talent to deliver improved financial, market and risk metrics.

Using data analytics approach to address global growth issue

6

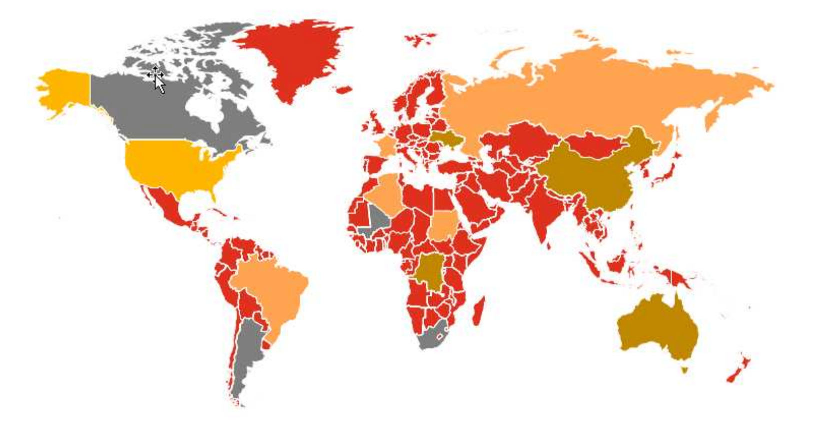
The Global Growth Radar (GGR) is an analytic app that helps companies make country prioritization decisions

Is the business beginning its global growth journey… or is it looking to rebalance existing geographic focus or options? Either way, the GGR can help.

Beginning the global journey…

Illustrative Scenario — A $500M biotech firm wants to get maximum value out of its recently patented anti-obesity drug. The firm already has an aggressive North American growth strategy, but needs help architecting a comparably ambitious expansion overseas.

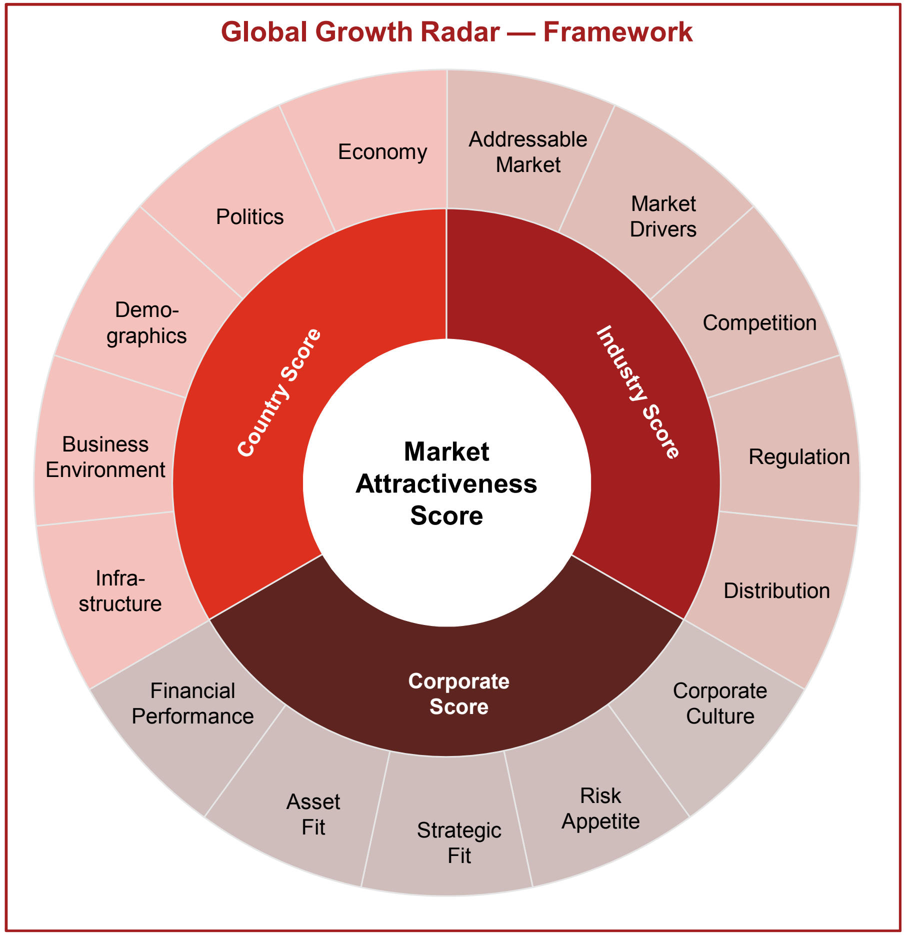
Optimizing an existing footprint…



Illustrative Scenario — A $110B food and beverages firm has a presence in 60 countries. Lately, growth has slowed, and the firm knows it needs to shift focus to some higher-growth emerging markets. It needs an approach to support a tough re-allocation decision.

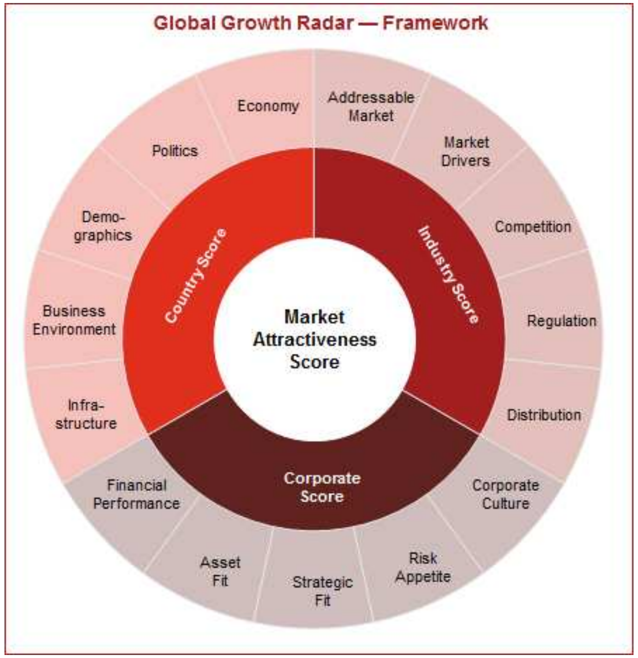
The Radar calculates attractiveness scores for countries, based on the aggregation of Country, Industry, and Corporate metrics

- The Global Growth Radar is based on a complex but logically intuitive analytical model that enables **a structured, heuristic prioritization of countries.**
- **The Radar is built on the foundation of dozens of Metrics,** some of which may be derived from qualitative analysis.
- **The metrics feed into 15 Dimensions** (seen on the outer wheel) (e.g., Economy, Politics, Business Environment, etc.).
- The dimensions roll up into three **Scores: Country, Industry, and Corporate scores.**
  - The weighted average of the three categories is the **Market Attractiveness Score.**



The Radar's 15 dimensions cover the full range of global growth considerations, across Country, Industry, and Corporate dynamics

The Radar helps clients drive country prioritizations based on nuanced, multi-dimensional considerations. ***No key questions need to be left unasked.***



Country-level Considerations

Economy	Is current economic growth likely to continue?
Politics	Will the government carry out needed policy reforms?
Demographics	Is the 65+ population growing faster than other age group?
Business Environment	Is corruption getting better or worse?
Infrastructure	How easy is it to move products into smaller cities?

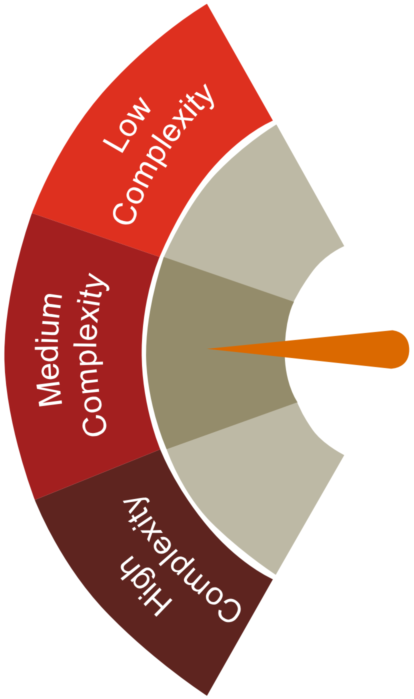
Industry-level Considerations

Addressable Market	How big is the local market for my products?
Market Drivers	What is the population of my preferred customer segments?
Competition	How strong is the local competition?
Regulation	How efficient are local regulatory entities?
Distribution	To what extent do people use the Internet to buy products?

Corporate-level Considerations

Financial Performance	What were our sales in the country last year?
Asset Fit	Are we able to leverage offices in nearby countries?
Strategic Fit	Would an investment in this market fit with our growth strategy?
Risk Appetite	Are we comfortable with a big play in emerging markets?
Corporate Culture	Should we target Francophone countries?

How to start our TP analytics journey?



Data Blending

- Directly link and aggregate data from variety of sources
- Seamlessly compile standardized data collection packages
- Map disparate data from system to system to normalize across platforms

Process Automation

- Re-perform discrete calculations via an automated and systematic process
- Automate workpapers by compiling all data sets in stored repeatable processes
- Enable diagnostics to increase control, improve review and reduce risk

Modelling and Visualization

- Results are extracted to analytic dashboards
- Enhanced audit trail for complex calculations
- Visualization of diagnostics across multiple iterations
- Comparison of various scenarios to determine ideal planning opportunities
- Store both source data and calculation results in a centralized location
- Enable easy access to data for audit support and planning
- Tax control of data is fundamental to developing efficient processes
- Facilitates improved reporting and forecasting

Join PwC TP analytics academies to explore more…

TP Analytics Academies provide an introduction to the practice of data analytics and data visualization, as well as hands-on training with tools that enable tax departments to start the journey with TP Analytics.

The combination of low-cost, user-friendly "drag and drop" interfaces enable tax professionals to harness data while automating burdensome processes. The analytics provide insights for monitoring, planning, forecasting and decision automation.

Value to the tax professionals

Efficiencies — reduce the time and money spent on tax compliance and utilize the time savings to drive enterprise value

Enhanced reporting — access centralized data in a simplified and flexible fashion with the ability to create ad-hoc reports & queries

Increase collaboration — share centralized data in a format that invites collaboration and shortens decision timelines

Business agility — automate the identification of exceptions and over/underperforming areas

Holistic TP footprint view — see tax operations and global tax liabilities in a new light

Analyze large data sets — display a variety of data points and measures in a way that makes it easier to analyze large volumes of data

Thank you!