

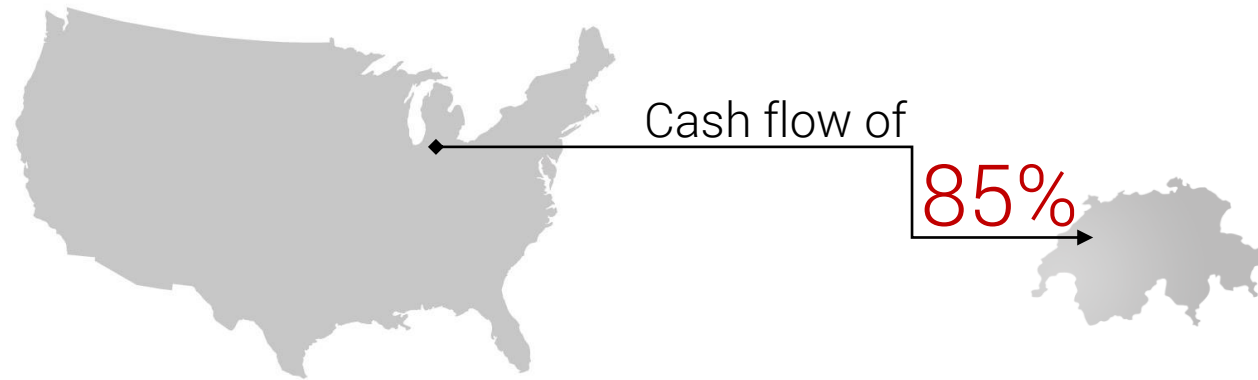
Tax Risk Management

THE POST-BEPS TAX WORLD

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14 June 2018

Introduction – The Caterpillar case

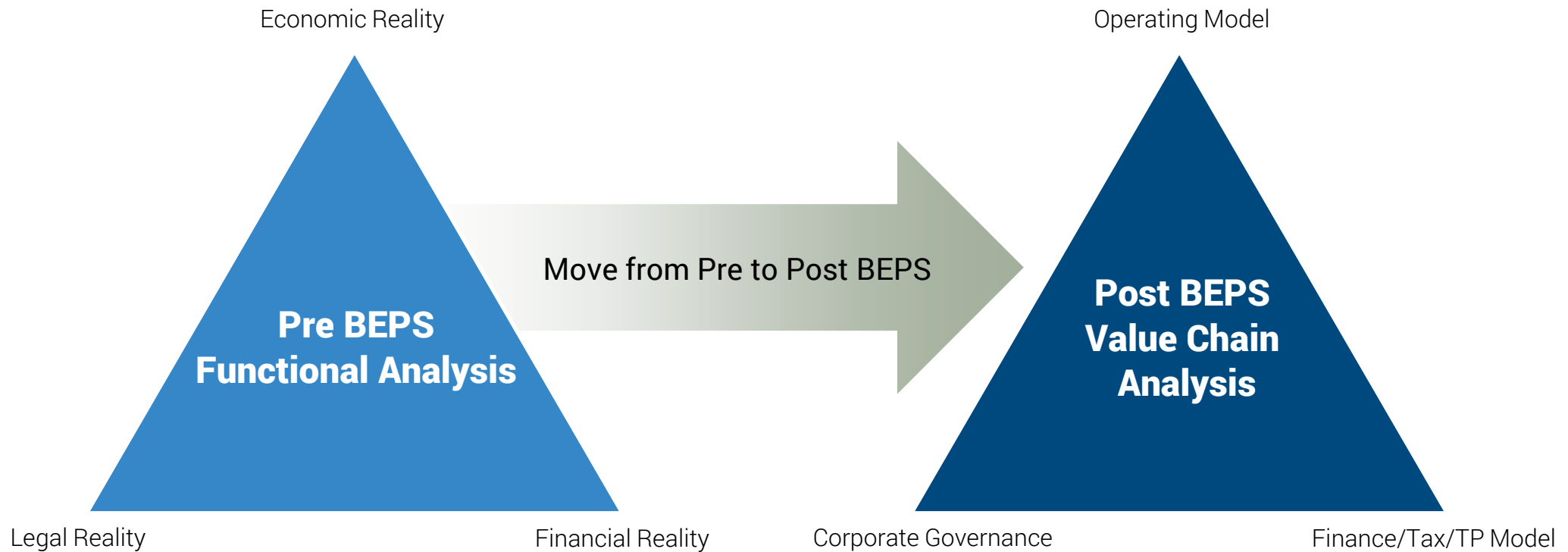


	The United States	Switzerland
No. of employees	52,000	400
No. of manufacturing facilities	54	0
Capital spent on R&D	80%	< 10%

The (Tax) World is changing rapidly

- OECD issued BEPS Reports in 2015 – High Level Political Support
- OECD is moving fast in areas of Exchange of Information, Analysis of CbC data for Tax Authorities
- OECD's Efforts to tax Digital Economy (3% taxation on topline!?)
- EU Commission is moving probably even faster
 - ATAD 1 and 2 (BEPS implementation, Disclosures)
 - CCTB and CCCTB
 - Public CbC disclosures
 - Reporting of "Aggressive Tax Arrangements by advisors / internal tax department.
- Local Tax Authorities issue all sorts of (conflicting) legislation (PE definitions, TP documentation requirements)
- Tax Authority's approach has become even more "aggressive" applying inconsistent approaches ("big cake syndrom")
- Etc.

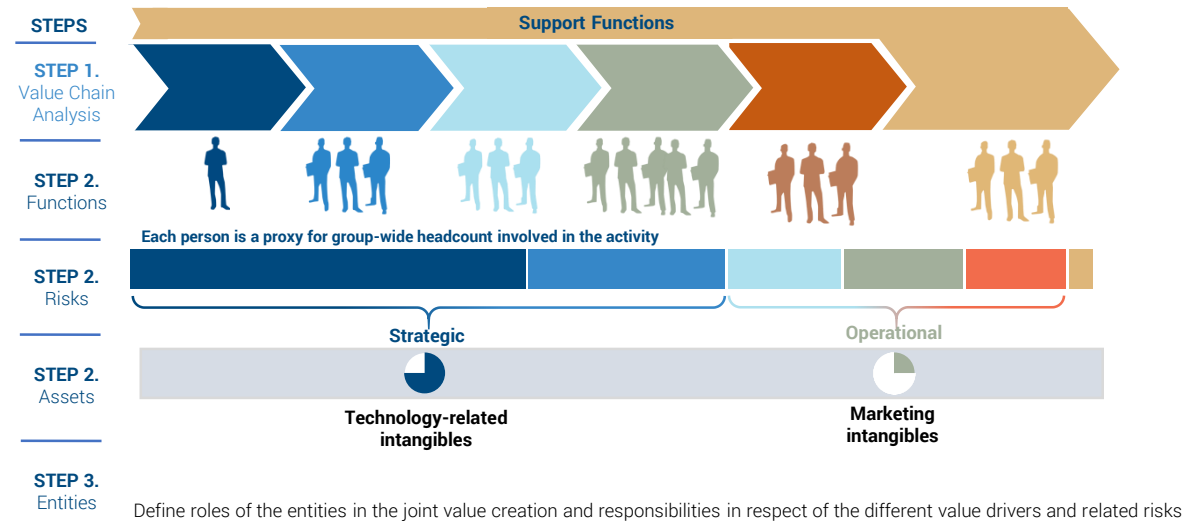
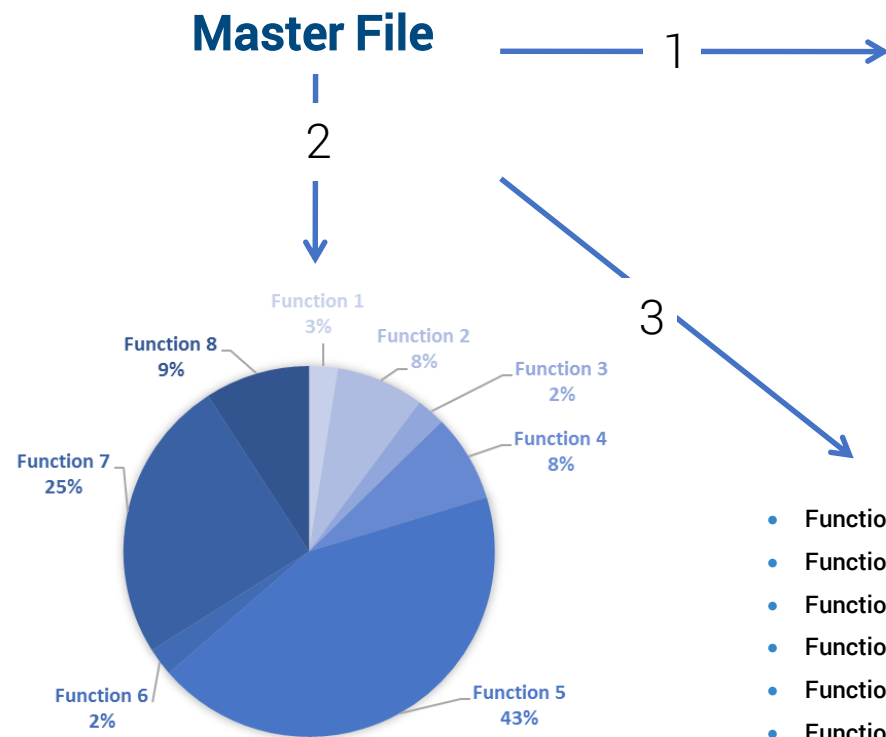
Transparency, Economic Reality and Analysis



Implication of BEPS Insights into the “people function” factor

- “People functions” - what does this mean?
- “Significant people functions” - how do you measure this?
- “Significant digital presence” - is this a same/similar concept like “significant people functions”?
- DEMPE concept links “people functions” to “intangibles”- is this a recipe for spreading economic ownership of intangibles?
- 3 Layered risk concept links “people functions” to “a matchmaker role on flows of goods and services”
- Does this ban the allocation of residual profits to activities involving no/low level “people functions”?

Implication of BEPS “people function” factor



- **Function 1**: approximately 63 FTEs are located in Country A, 7 FTEs in Country B, 9 FTEs in Country C and the rest are spread across the world;
- **Function 2**: approximately 85 FTEs are located in Country A, 22 FTEs in Country D and the rest are spread across the world;
- **Function 3**: approximately 45 FTEs are located in Country A, 10 FTEs in Country B, 8 in Country E and the rest are spread across the world;
- **Function 4**: approximately 24 FTEs are located in Country A, 58 FTEs in Country F, 28 in Country E and the rest are spread across the world;
- **Function 5**: approximately 280 FTEs are located in Country A and the rest are spread across the world;
- **Function 6**: approximately 54 FTEs are located in Country A, 9 FTEs in Country F and the rest are spread across the world;
- **Function 7**: approximately 74 FTEs are located in Country A and the rest are spread across the world;
- **Function 8**: approximately 85 FTEs are located in Country A, 99 FTEs in Country G, 75 FTEs in Country F, 46 FTEs in Country D and the rest are spread across the world.

- **Master File:**
 - Functional Analysis
 - Value Chain Analysis
 - Intellectual Property
 - Financing
- **Local File:**
 - Functional facts
 - Management / organization
 - Intercompany transactions (2-sided)
- **Country-by-Country Report:**
 - EBIT per country
 - Cash tax paid / tax accrued
 - FTE's

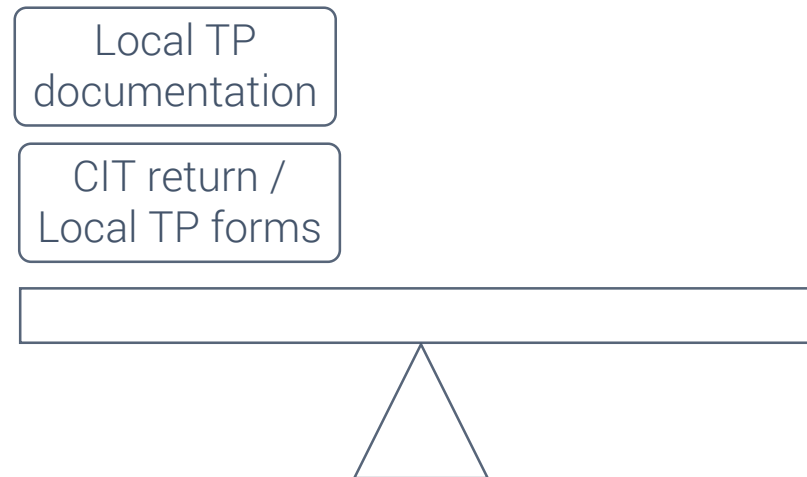
BEPS Action 13 – Dutch context Example

- **Country-by-Country Report:**
 - EUR 750 million consolidated group revenue
 - FY2016 filed by 31 December 2017
 - May apply for Dutch Constituent Entity if Ultimate Parent Entity has no filing obligation
- **Master File and Local File:**
 - EUR 50 million consolidated group revenue (even if Dutch entity is very small)
 - See Appendix A for the information to be included under the MF/LF

The view of the tax inspector

What will the tax inspector receive after the end of financial year?

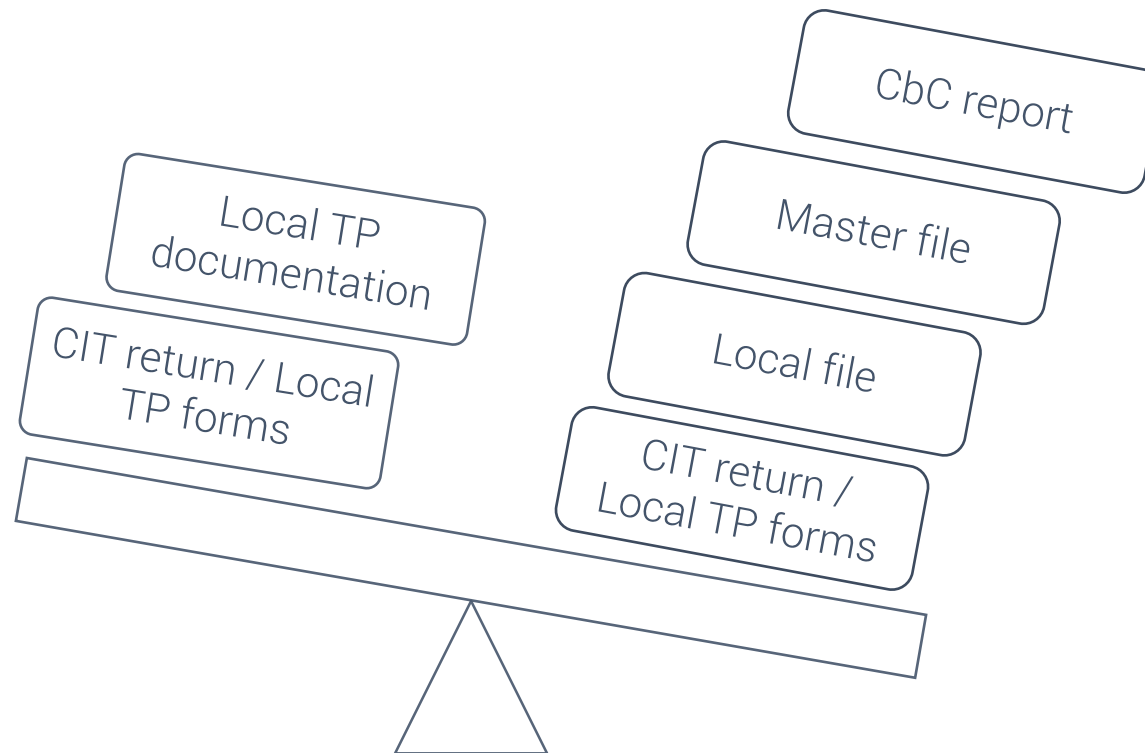
Prior FY2016



The view of the tax inspector

What will the tax inspector receive after the end of financial year?

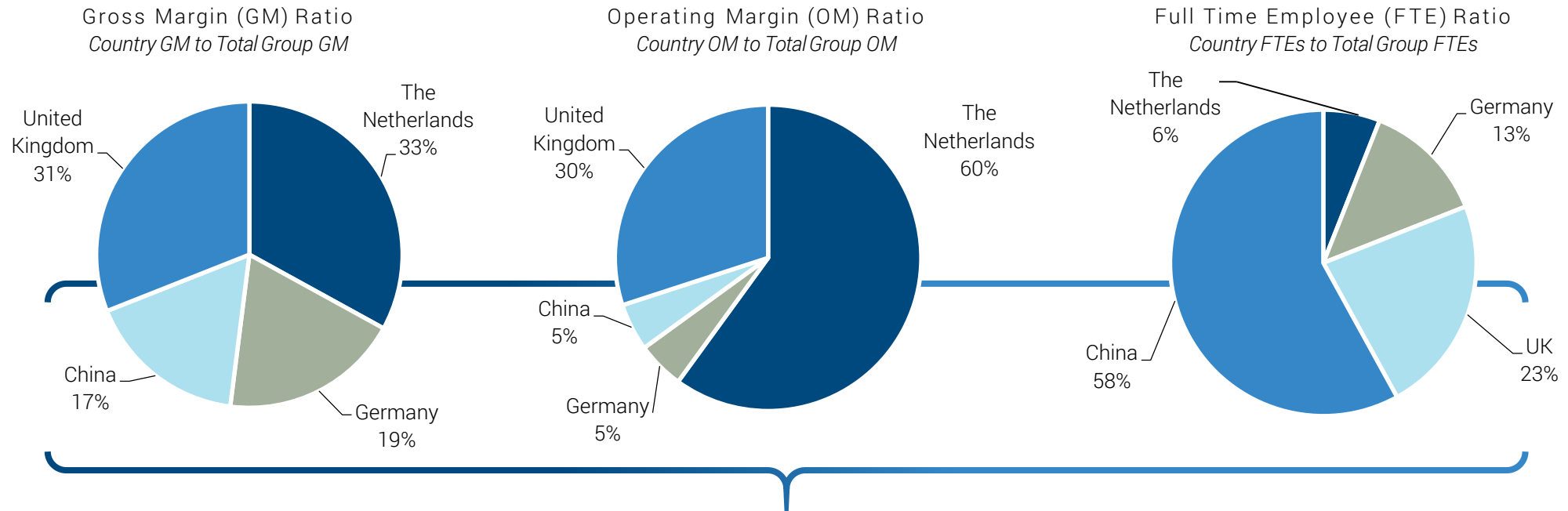
After FY2016



The view of the tax inspector - CbC

Alignment Between Gross Margin, Operating Margin, and FTEs

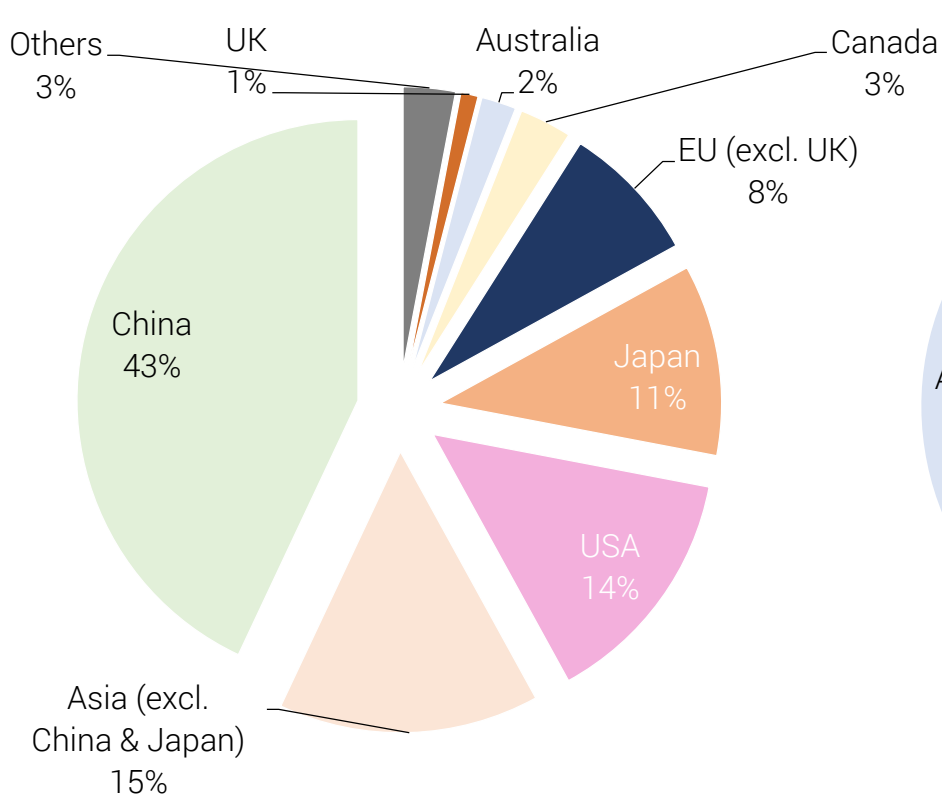
Illustrative



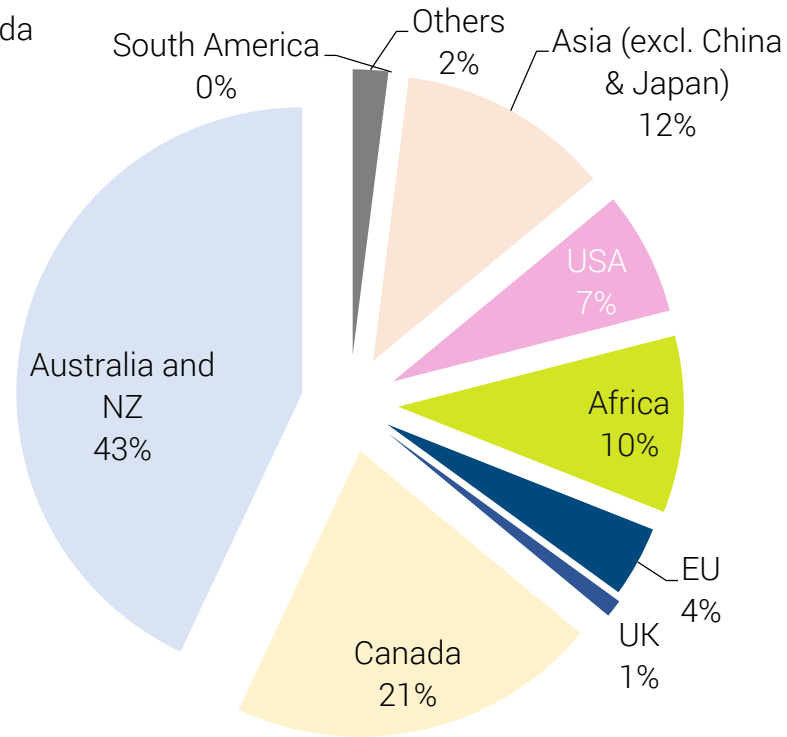
Misalignment is visible when expressed as the ratio of country and total group for gross margin, operating margin, and FTEs. The higher the delta, the greater the need to provide explanations to the Tax authorities.

The view of the tax inspector - CbC

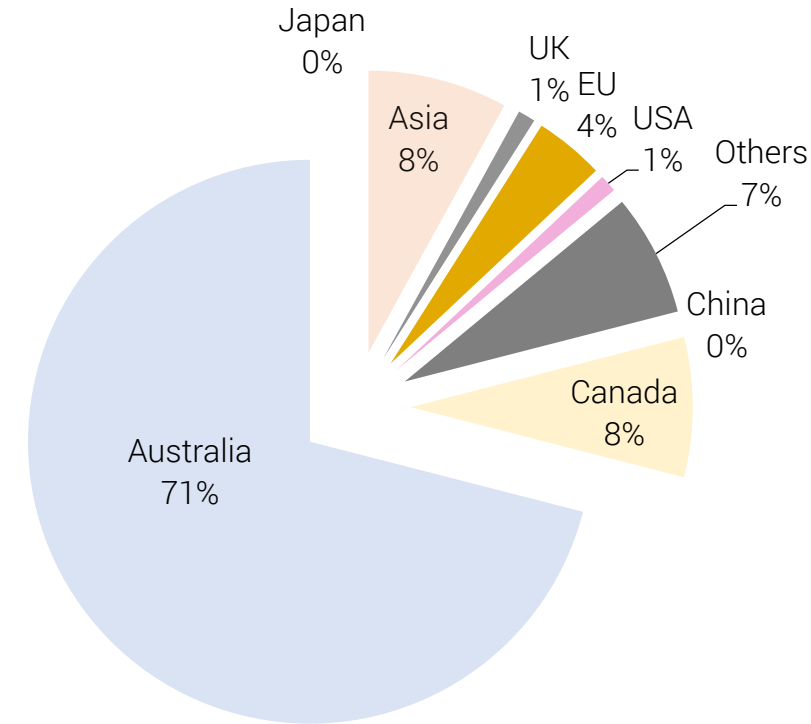
Example: Rio Tinto



Sales revenue by location



FTEs by location



Tax paid by location

CbC Report for the tax inspector¹

- What methods do tax authorities use to assess whether a MNE is involved in BEPS related activities?
- OECD Handbook on Effective Tax Risk Assessment
- 19 Tax Risk Indicators to detect under the Country-by-Country Report
- Using Country-by-Country alongside data from other sources

	Potential tax risk indicator	What this could mean
1.	The footprint of a group in a jurisdiction	A group with a small footprint may have less potential to pose significant tax risk
2.	A group's activities in a jurisdiction are limited to those that pose less risk	A group's activities in a jurisdiction may be of a type that are subject to a lower level of tax (e.g. where dividends and gains earned by a holding entity benefit from a participation exemption)
3.	There is a high value or high proportion of related party revenues in a particular jurisdiction	A high value or proportion of related party revenues might mean that even a small transfer pricing error could have a significant tax impact.
4.	The results in a jurisdiction deviate from potential comparables	Differences between a jurisdiction and the chosen comparable could be driven by BEPS
5.	The results in a jurisdiction do not reflect market trends	Results may be being distorted by BEPS activity
6.	There are jurisdictions with significant profits but little substantial activity	Profits may have been shifted away from the jurisdiction where the underlying economic activity is occurring
7.	There are jurisdictions with significant profits but low levels of tax accrued	A low effective tax rate to indicate that a group is using BEPS to shelter taxable income
8.	There are jurisdictions with significant activities but low levels of profit (or losses)	Profits that are attributable to a jurisdiction may be being shifted to a jurisdiction where they are taxed more favourably
9.	A group has activities in jurisdictions which pose a BEPS risk	A group may be engaged in a known BEPS-related activity

CbC Report for the tax inspector¹

	Potential tax risk indicator	What this could mean
10.	A group has mobile activities located in jurisdictions where the group pays a lower rate or level of tax	A group may have shifted mobile activities to a jurisdiction to benefit from a favourable tax regime
11.	There have been changes in a group's structure, including the location of assets	Changes in a group's structure may be an opportunity for a group to engage in BEPS and could mean a need to revisit existing transfer pricing policies and methodologies, and re-consider the identification and pricing of related party transactions
12.	IP is separated from related activities within a group	Valuable IP may be used to strip taxable profit from other jurisdictions
13.	A group has marketing entities located in jurisdictions outside its key markets	Marketing entities could be earning profits that are not attributable to the jurisdictions where they are resident
14.	A group has procurement entities located in jurisdictions outside its key manufacturing locations	Procurement entities could be earning profits that are not attributable to the jurisdictions where they are resident
15.	Income tax paid is consistently lower than income tax accrued	A group may be making high tax accruals for uncertain tax positions, which could indicate BEPS-related behaviour
16.	A group includes dual resident entities	Dual resident entities can be used for a number of BEPS purposes
17.	A group includes entities with no tax residence	No residence entities can be used for a number of BEPS purposes
18.	A group discloses stateless revenues in Table 1	Stateless revenue may indicate a BEPS risk if the revenue is not taken into account for tax purposes in any jurisdiction
19.	Information in a group's CbC Report does not correspond with information previously provided by a constituent entity	This could question the accuracy of both the CbC Report and the information previously provided by a constituent entity

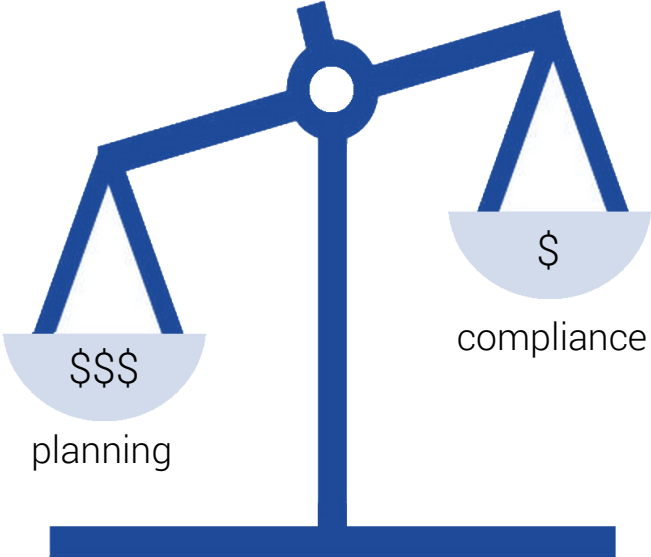
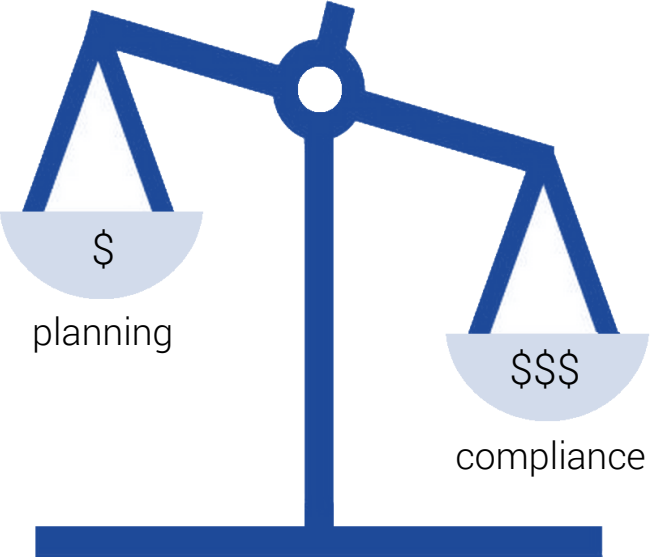
CbC Report for the tax inspector1



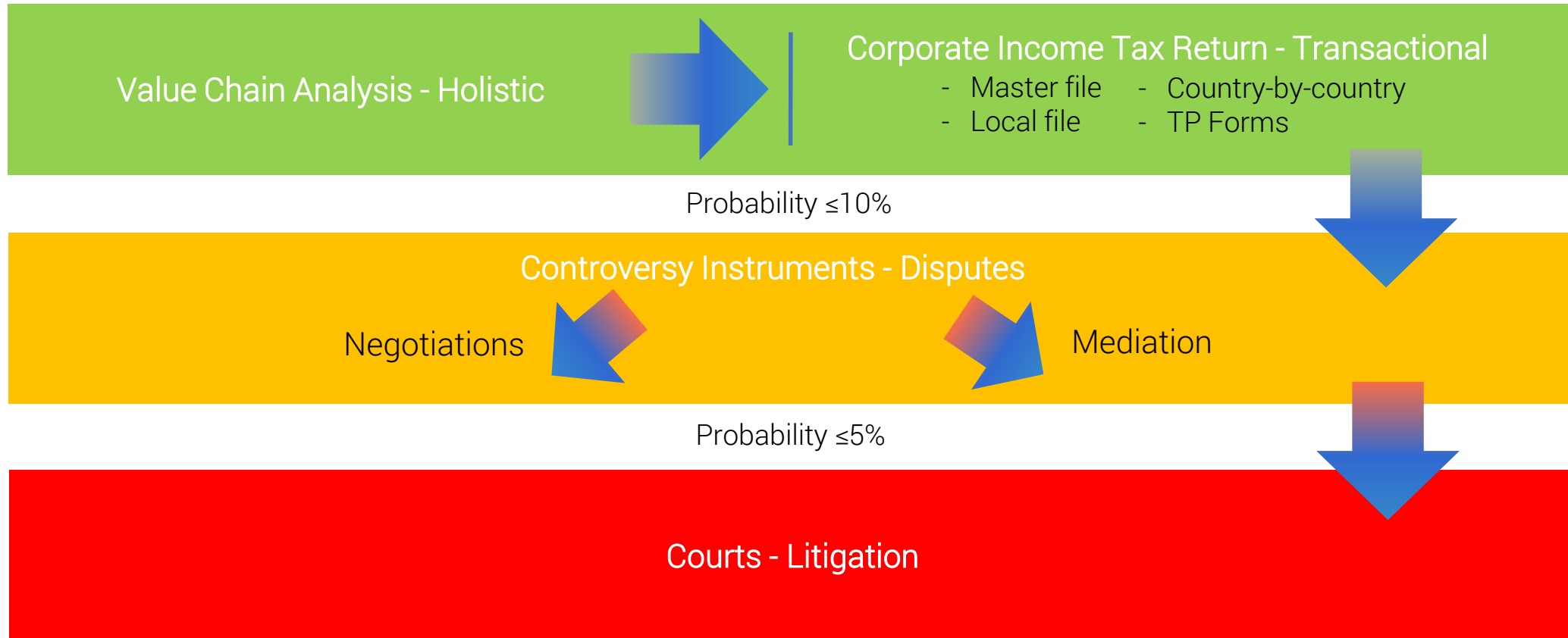
	Proportion of revenues from unrelated parties	Proportion of revenues from related parties	Revenues generated per employee	Pre-tax profit generated per employee	Revenues generated per EUR of tangible assets	Pre-tax profit generated per EUR of tangible assets	Pre-tax return on equity	Post-tax retrun on equity	Profit margin	Effective tax rate
Tax Jurisdiction	Unrelated Party Revenues / Total Revenues	Related Party Revenues / Total Revenues	Total Revenues / Number of employees '000	Profit before tax / Number of employees '000	Total revenues / Tangible assets '000	Profit before tax / Tangible assets '000	Profit before tax / (Stated capital + retained earnings)	(Profit before tax - Income tax accrued) / (Stated capital + accumulated earnings)	Profit before tax / Total Revenues	Income tax accrued / Profit before tax
A	54%	46%	126	13	1.29	0.13	21%	14%	10%	34%
B	99%	1%	114	14	4.97	0.62	19%	12%	12%	33%
C	25%	75%	1,691	220	24.80	3.22	21%	18%	13%	15%
D	30%	70%	130	14	0.99	0.11	28%	20%	11%	28%
E	91%	9%	114	12	6.47	0.65	16%	13%	10%	22%
F	55%	45%	124	14	1.08	0.12	24%	18%	11%	25%
G	90%	10%	163	17	6.18	0.66	19%	17%	11%	11%
H	3%	97%	92	2	0.58	0.01	11%	8%	2%	30%
I	2%	98%	562	22	7.25	0.28	11%	9%	4%	16%
J	92%	8%	119	13	5.08	0.56	13%	11%	11%	16%
K	34%	66%	172	24	1.31	0.18	30%	25%	14%	16%
L	98%	2%	101	10	6.52	0.63	26%	17%	10%	36%
M	40%	60%	108	10	1.26	0.12	28%	19%	10%	35%
N	16%	84%	3,629	1,714	86.72	40.97	425%	425%	47%	0%
O	91%	9%	103	9	7.73	0.69	23%	17%	9%	25%
P	99%	1%	105	12	6.23	0.70	31%	23%	11%	24%
Q	47%	53%	129	13	0.85	0.09	27%	18%	10%	35%
R	99%	1%	112	6	9.62	0.51	20%	15%	5%	27%
S	39%	61%	111	5	12.89	0.62	20%	15%	5%	25%
T	10%	90%	696	226	15.29	4.97	102%	97%	33%	5%
U	5%	95%	1,027	598	8.86	5.16	278%	267%	58%	4%
V	31%	69%	108	6	1.28	0.07	24%	17%	5%	29%
W	95%	5%	142	5	17.42	0.57	23%	16%	3%	31%
X	82%	18%	152	7	10.57	0.48	22%	17%	4%	23%
Y	89%	11%	135	5	10.51	0.41	17%	12%	4%	33%
Z	2%	98%	2,200	642	10.44	3.05	172%	152%	29%	12%

Tax Governance & Risk Management

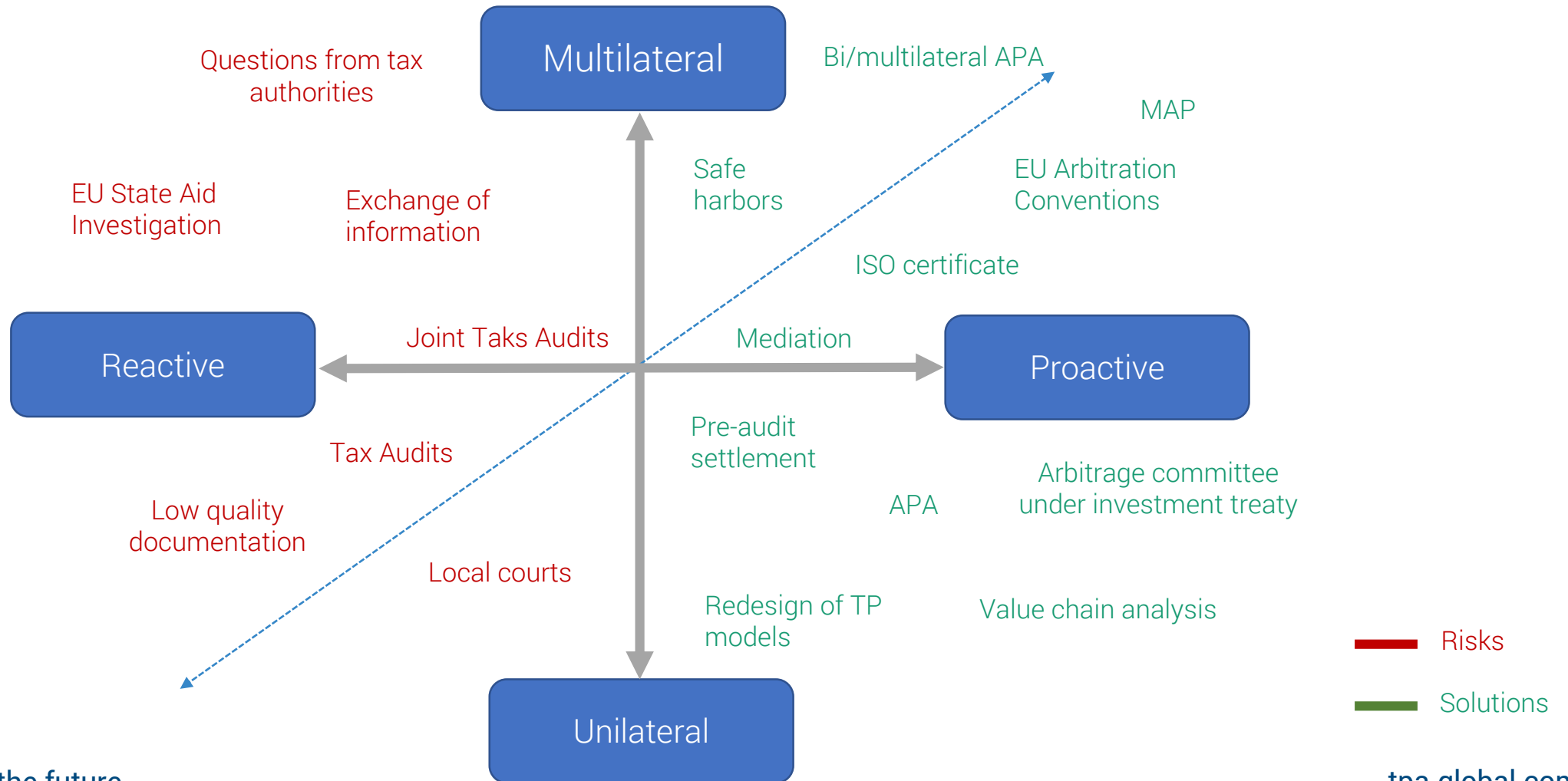
BEPS has changed the Tax World

Tax Department's role Before	Taks Department's role Now
Planning -> Compliance	Compliance -> Risk and opportunity management
Limited automation	Search for process efficiency and automation
<p style="text-align: center;">CFO's perspective</p> 	<p style="text-align: center;">CFO's perspective</p> 
Tax and TP function = profit center	Tax and TP function = "cost center"!?

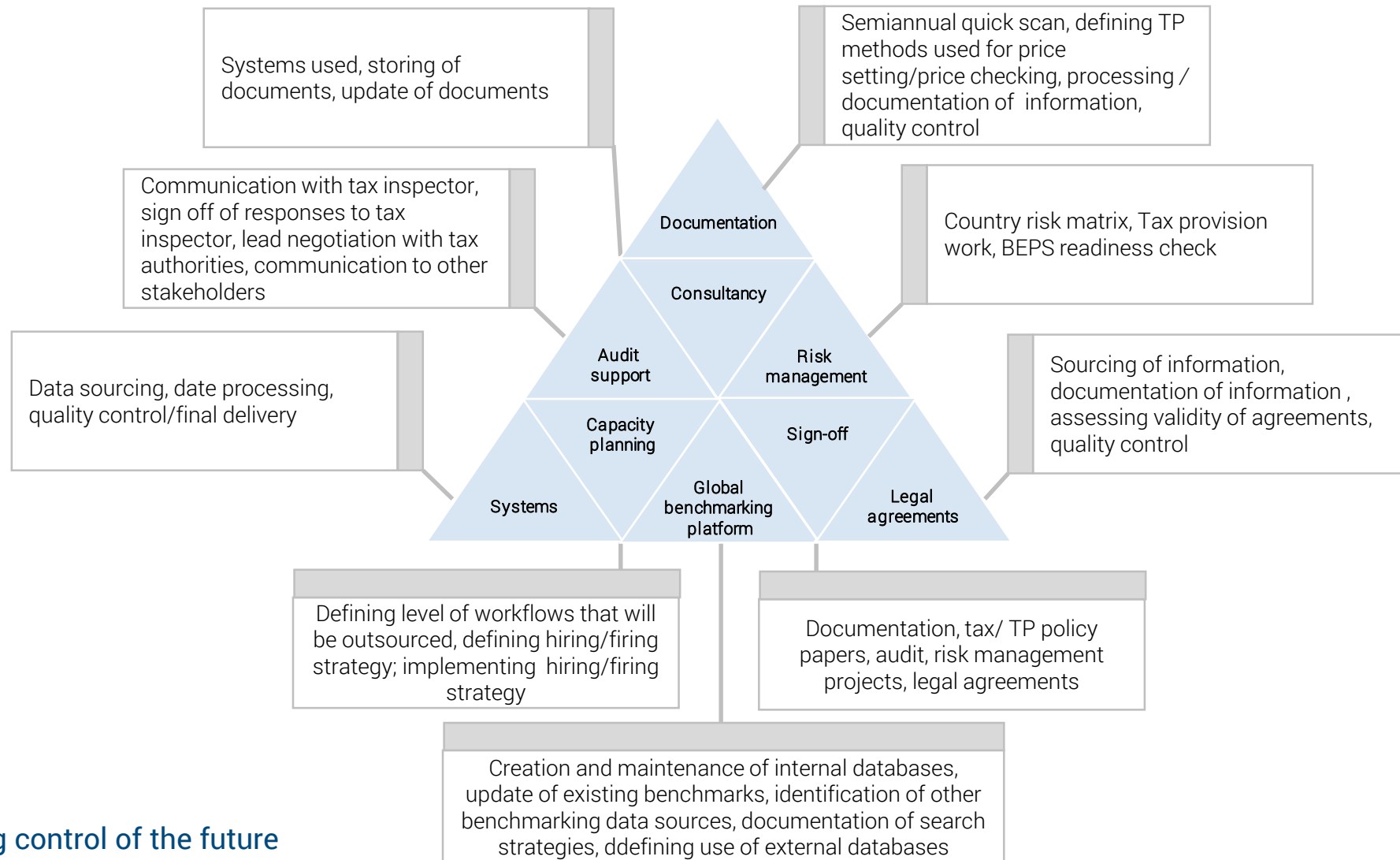
From “staying out of trouble” to being “fully in control”



Controversy management instruments



Example: Nine building blocks of a successful transfer pricing function

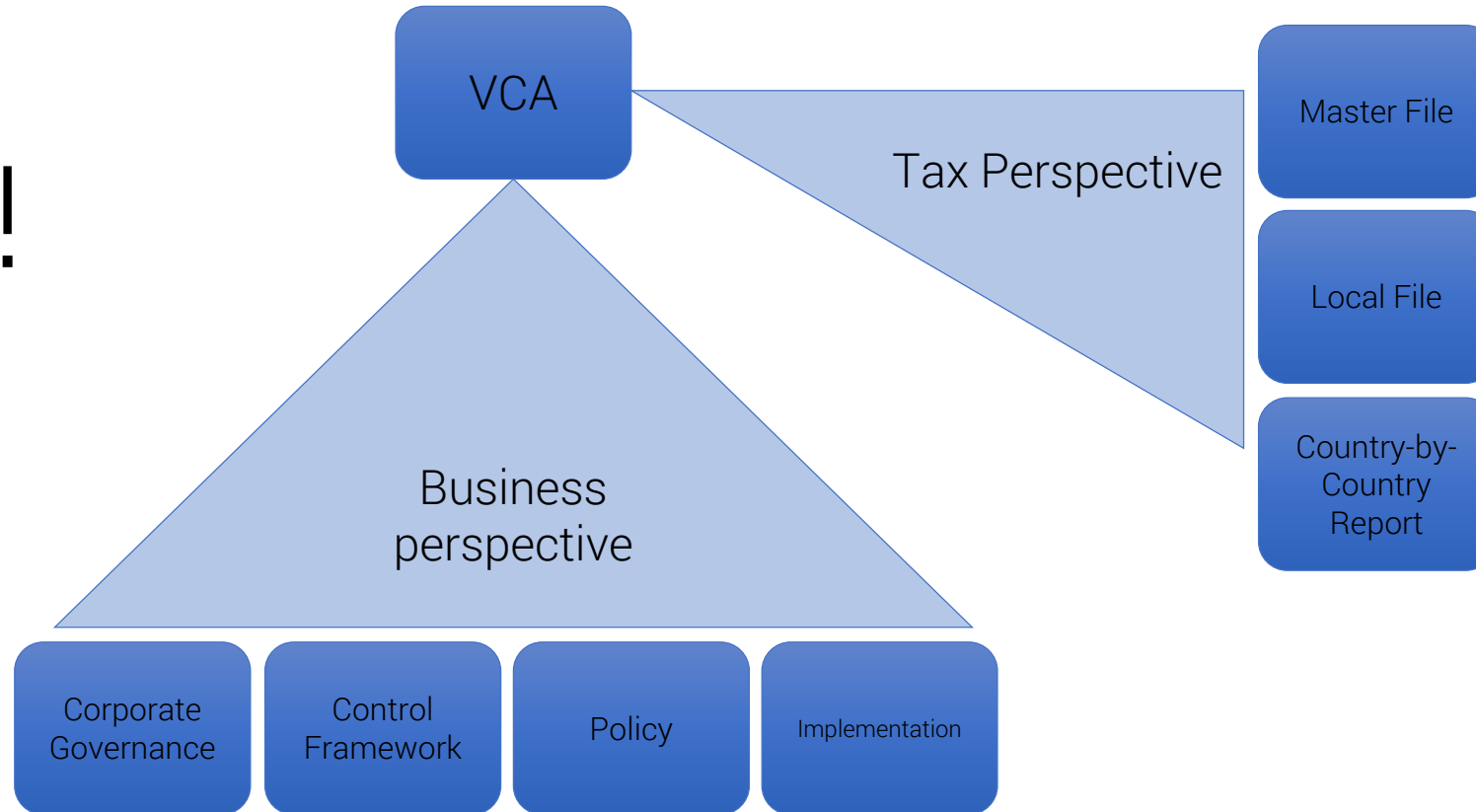


Example - Transfer pricing governance model (RACI)

	Lead Group Tax	VP Group Tax	Head TP	Group Controlling	Group Accounting	Group Legal	Group Treasury	Segment Controlling	Local Management	Local Finance	Business Team	External Consultants
1. Consultancy – Advisory and implementation	A/R	A/R		I	I		R/C	I			R	C
2. Development/maintenance of TP documentation	A/R	R						C	R	A/R		C
3. Risk Management	A/R	A/R		R/I	R/I			R		R		C
4. Audit support	A/R	A/R		I	I				I	A/R		
5. Systems (central data management & retrieval)	A/R	A/R			R/I			R		R		C
6. Capacity planning – Insource/ outsource	A/R	A/R								A/R		
7. Global benchmarking platform (outsourced to third parties)	A	A						I		R/I		C
8. Sign-off TP documents	C/I	C/I							A	A		
9. Legal agreements- set up and implementation	A/R	A/R			I	I				I		

How to manage tax risks?

Align!



BEPS has changed the Tax World – Summary

- Compliance and thus Transparency Increased
- Data Consistency needs to be managed closely (qualitative as well as quantitative)
- Chance of Detection / Tax Audit adjustments increased
- Risk Mitigation through proper alignment of Business Operating and Tax Operating Model (VCA)
- Contemporaneous Documentation and Maintenance of Audit Trail Info is essential
- Governance of Tax Department to be aligned with the above (incl. Financial Tax Controlling)

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