國際租稅動向 및 移轉價格稅制에 관한 국제세미나

International Seminar on International Taxation and Transfer Pricing

1995. 6

韓國租稅研究院

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국제세미나의 槪要

14:00～14:10　開會辭

14:10～15:30　第1主題: 國際租稅動向

司會者: 朴宗淇 院長(한국조세연구원)

發表者: I. HUNTER(OECD Consultant)

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張太平 課長(재정경제원 국제조세과)

全周省 敎授(이화여자대학교)

韓萬守 辯護士(김&장 법률사무소)

15:30～15:40　休　息

15:40～17:00　第2主題: 移轉價格稅制

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發表者: A. DIGERONIMO(스위스 재무성 국제국)

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吳大植 課長(국세청 국제조세2과)

17:10～　리셉션(상의클럽)

Trends in International Taxation

I. Hunter

(OECD Consultant)

In this brief introduction to the second half of our workshop I would like to summarise the most important developments in international taxation outside the field of transfer pricing in recent years. My qualifications for doing so, as to quality, you may judge for yourselves, as to quantity they are undoubted since I have been engaged in this field for upwards of 20 years both as an official of the United Kingdom responsible for introducing a large number of items of domestic tax legislation relating to international matters, including in particular the introduction into the UK of anti tax haven legislation of the type normally referred to as controlled foreign companies legislation, and also as a member of a number of the OECD committees charged with providing guidance for member states on these matters. In this capacity I took part in the preparation of a number of the OECDs series of guidance notes, including those relating to tax treaties, to thin capitalisation, to permanent establishments, and to the handling of tax havens. More latterly I was Chairman of the OECD committee which considered the United States proposed legislation on transfer pricing, whose report, I am happy to say, was very influential in leading to modifications of the original American proposals. In the latest few years since my retirement from the British Public Service I have been acting as a consultant to the OECD and I have also had an opportunity of seeing things more directly from the tax payers point of view by acting as a consultant to Messrs Price Waterhouse.

Looking back over the last 20 years I think my predominant feeling is that there has been a steady movement towards the internationalisation of the problems of international taxation. When I first started officials dealing with the taxation of multinationals really tended to regard the problem as one to be solved primarily by domestic legislation. Countries passed what tax laws they liked and, if they did not seem to work very well, they then added to them anti abuse provisions in domestic law. It had of course long been recognised that it was desirable to avoid economic double taxation because otherwise the free movement of goods and services worldwide was impeded, and inward and outward investment would be hampered. But in those days there were very considerable other impediments to the free movement of goods and services. In particular 20 years ago most countries still had exchange control, in one form or another, and the global markets in financial products which we have today were still in the future. Nor was it generally recognised that there was an equal and opposite problem to that of double taxation, that is, the problem of non-taxation. It was generally seen as a matter for each country to raise such taxes as it thought fit and if some profits fell outside the scope of those taxes, well then, there was nothing to worry about. An exception to this fairly relaxed approach was the United States, which was not surprising, since the United States had long being operating in a much freer world economy than had most European or Asian states, because they invested worldwide and were not subject to exchange control.

In the financially freer world, which developed during the 1970's, it was the OECD which tried to grapple with the emerging tax problems. The overall objective was to encourage the free movement of goods, services and capital and it gradually came to be seen that the tax obstacles to this were twofold. It was obvious that excessive taxation, as when two jurisdictions taxed the same profit, would discourage cross border investment but it gradually became clear that there were equally serious dangers in non-taxation. If the emerging multi-national enterprises were not subjected to tax on their profits in one jurisdiction or another, then this would distort their economic activities and would also place them in a stronger position than entities engaged in trading activity within a single jurisdiction.

Accordingly, the OECD has sought, through the Committee of Fiscal Affairs, to deal with both problems. It has sought on the one hand to refine the provisions of its treaties and above all in the field of transfer pricing to uphold the arm's length principles which are necessary primarily to avoid economic double taxation. Equally it has given considerable attention to the possibilities of international avoidance of taxation. Accordingly most of its reports urge on member states the necessity of levying what might be called sensible taxation. It has advised on its members, and those seeking its guidance, as for example, the newly emerging Eastern European states, that they should not levy arbitrary taxation on profits arising within their boundaries, and should not seek to unduly maximise the taxation

on such profits. On the other hand they should be extremely careful that their tax legislation is sufficiently precise and comprehensive so that their law can not be exploited in order to avoid taxes which are reasonably imposed by other countries. Thus the OECD has considered very carefully both the problems of tax havens, where they have issued reports on base and conduit companies, and problems arising from the improper use of double taxation agreements, by which bilateral agreements are exploited so as to provide unintended tax benefits for third parties. The result of this has been the issue of several reports which are required reading for those engaged in international tax matters, particularly those who have to devise domestic legislation to counter problems.

The first specific area of international difficulty, which I should mention, is that of the tax treaty. As you know the OECD has prepared a model agreement, which it revises from time to time, and which is accompanied by a commentary which is of considerable international authority as to the meaning of treaties. Most bilateral treaties between individual countries are based on this model. 20 years ago treaties were perhaps seen primarily as bargains between two sovereign states by which they divided the taxing rights on crossborder investment between them so that double taxation was avoided, and a reasonable share of the international tax take was given to each country.

The chief problem with treaties over the last twenty years has been the growing tendency

for them to be exploited by tax planners. There are two main types of exploitation. The first is dependent on the terms of the treaty itself - some treaties have perhaps not taken into account as clearly as they should the need to avoid non-taxation and there were a number of instances where countries in the pursuit of a double taxation agreement were prepared to give up a taxing rights to the other jurisdiction which it did not in fact exercise, by reason of its domestic law. The result of this was of course arrangements specially put in place to exploit these provisions, so that profits fell through the holes between the taxation systems of two countries.

The other main type of exploitation was the creation of artificial persons such as subsidiary companies for the specific purpose of exploiting treaty reliefs and allowing funds to flow through a number of countries with the objective of taking treaty benefits as the funds flowed through. This is the phenomenon known as treaty shopping. Since treaties are a bargain between two sovereign states, they are not really intended to provide benefits for third parties. To deal with these problems is not simple because it is not easy to take away rights under treaties from people who are not intended to receive them without removing them from people who could reasonably expect to receive them. Two main ways of dealing with this problem have developed. One may be described as the specific legislation route. Under these, precise clauses are included in treaties dealing with particular aspects of the legislation of the two countries concerned which precisely delineate those persons who are

or are not to receive treaty benefits. The other method which has appeared, particularly in treaties agreed by the United States, is a general anti-abuse clause which gives to the competent authorities of the countries concerned discretion to withhold treaty benefits in cases of abuse. The difficulty with the first type of solution the treaties have to last for a long time and it is difficult for the negotiators to bear in mind all the possibilities that may exist whereas the difficulty with the second solution is that it renders the meaning and effect of the treaty uncertain and such solutions are unwelcome to those countries which expect their law to be precise.

Another main development over the last few years has been the spread of certain types of domestic anti-abuse legislation. The main type of legislation is that directed at tax havens which derives from the American sub-part F legislation. This legislation contrasts with transfer pricing legislation. Under transfer pricing legislation certain entities are identified as being residents of the taxing country, and the profits of that resident are increased in accordance with arms length principles if their dealings with non-resident associates depart from the arms length basis. Sub part F legislation proceeds under a different principle. It is not concerned with whether the relationship between the domestic company and its overseas associate is or is not at arms length, but it treats certain activities of the overseas associate as being so closely connected with the activities of the domestic entity that they should be subject to tax as if they were the profits of that entity. This second method of

dealing with overseas profits was necessitated by the growth of artificial entities in tax havens, used primarily for diverting income by means which did not offend arms length principles. There is of course nothing in the arms length principle which inhibits a company in country A from investing money in country B but if that investment is an artificial one, undertaken for tax reasons, rather than for good economic reasons, then it is now generally recognised that the country of the investor has a right to tax the fruits of that investment. While legislation in different countries based on sub-part F legislation varies such regulation in now quite wide spread. I think the latest count is that 12 major countries have such legislation.

Less frequent is legislation directed at thin capitalisation. Thin capitalisation is another departure from economic normality which may be provoked by tax considerations. Generally speaking multinational groups of companies can borrow worldwide, and they have a wide discretion as to whether they finance their subsidiary companies by equity or by debt. If there is a tax advantage to be obtained because, for example, the rates of tax in one country are higher than those in another, debt will be placed in the country where the payment of interest will give rise to the most tax advantage. Legislation to counter this sort of problem is less wide spread than that relating to havens but is increasing - the United Kingdom for instance introduced certain legislation about thin capitalisation this year and Japan has also introduced legislation recently.

The third main type of legislation which has become wide spread is that dealing with asymmetry. As I have mentioned, 20 years ago it was perhaps considered a matter which concerned only individual countries as to how they should arrange their tax system. Country A might, for instance, give interest relief at the time when interest was paid, whereas country B would only tax interest at the point when it was received. Increasingly tax planning has concentrated on exploiting such differences and, for example, arranging that a company in country A should be in debt to an associated company in country B but not actually pay the interest with the result that a deduction will arise in country A but no taxation will occur in country B. Similar asymmetry's commonly arise in relation to allowances for the use of plant and machinery. Some countries give such allowances to the owner, some to the user. This gives scope for exploitation in the form commonly known as the double dip, that is the obtaining of separate allowances in two countries in respect of the same expenditure. In more recently years legislation has become much more wide spread in order to deal with such problems. A characteristic of such legislation is that it has to be underlaid by a considerable understanding by the officials of the legislating country of the effect of legislation in other countries, and this has lead to a considerable increase in international discussion both through the OECD and bilaterally.

Overall I would say that over the last 20 years the chief characteristic of developments in the international tax field been has the increasing consciousness of the interdependence of

the tax systems of various countries. It is increasingly been recognised that it is not sufficient to legislate in one country alone without taking fully into account the effect of what is being done in other countries. The failure to do this will be either to damage international investment flows because of economic double taxation, or to distort economic activity through by tax avoidance. In this new situation, a feature has been the growing importance of the Competent Authorities, that is those officials charged with administering tax treaties. In addition to discussing particular cases and seeking to reach reasonable solutions to them, they are increasingly involved in exchanges of a more general nature explaining the precise effects of the laws of particular countries with the intention of seeking methods of avoiding either double taxation or of non-taxation. Because countries are sovereign and have their own reasons for imposing particular laws it is not reasonable, I think, to expect harmonisation of direct tax legislation. Accordingly it is likely that asymmetry's will continue to arise, but I think that over the last 10 of 15 years has been much more clearly recognised that it is necessary to resolve these asymmetry's and that this forces competent authorities to adopt a position which is responsive to the needs of their partners. It may not always be wise to insist on adherence to ones own domestic law or ones own view of the matter or even to insist on a consistent treatment of similar transactions under your own domestic law if the foreign law of the tax payer concerned differs from your own. It is often much more important to reach a solution which enables double taxation or non-taxation to be avoided then to insist on solutions which are clearly consistent with previous solutions reached by

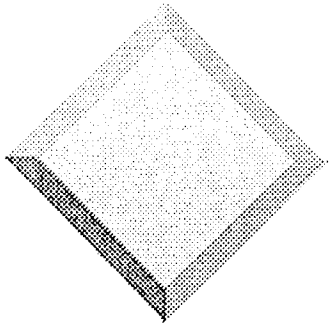
relation to your own domestic law.

In summary therefore I would say that over the last 20 years we have seen a wide expansion of anti-abuse legislation, a deeper concern for the avoidance of double taxation, and a growing recognition that these problems are not ones that can be solved by a country acting on its own. I would expect these trends to continue into the future.

Revised Transfer Pricing Guidelines: A Brief Review

A. Digeronimo

(스위스 재무성 국제국)



REVISED TRANSFER PRICING GUIDELINES

A Brief Review

OECD

Issues Covered

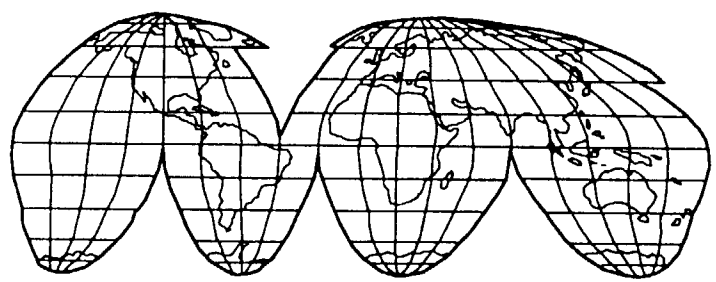
- The Arm's Length Principle
- Traditional Transaction Methods
- Transactional Profit Methods
- Administrative Issues
- Documentation

Arm's Length Principle (Chapter I)

- Rejection of global formulary apportionment
- Guidance for application
  - Recognition of actual transactions
  - Arm's length range
  - Aggregation rules
  - Business strategies

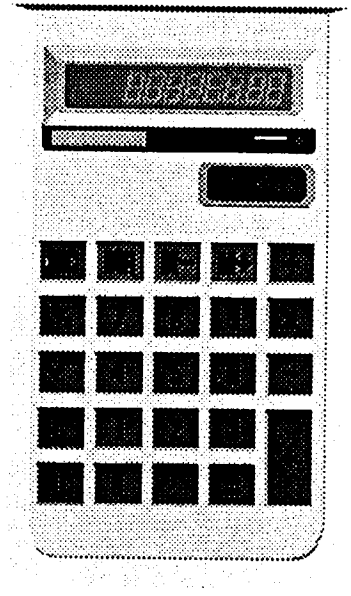
Rejection of Global Formulary Apportionment

- Pre-determined formula is arbitrary and does not account for separate company circumstances
  - loss companies
  - market conditions
  - geographical location



Rejection of Global Formulary Apportionment (2)

- Complex: Need to conform accounting conventions
  - currency differs
  - book and accounting rules differ
  - what is the global tax base



Rejection of Global Formulary Apportionment (3)

- Who is in the unitary group
  - ALP would still be required
  - Commercial, accounting, and tax purposes

Rejection of Global Formulary Apportionment (4)

- Impossible to find an agreed formula
  - proper weight for wages, assets, sales
    - possible bias in favor of developing countries
  - how can intangible property be valued
- Assumes too much international coordination

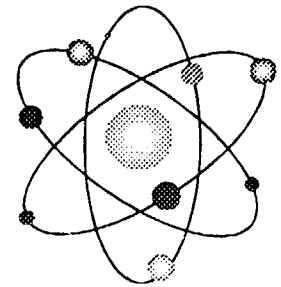
Recognition of Actual Transactions

- Cannot disregard or restructure transactions unless exceptional circumstances
- Exceptional cases:
  - economic substance differs from form
  - form would not have been used by independent enterprises AND
  - actual structure practically impedes the tax administration from determining an appropriate transfer price

Aggregation Rules

- Aggregation permitted where separate transactions are so closely linked that they cannot be evaluated on a separate basis
- Examples
  - Range of closely linked products when individual pricing is impractical
  - Cross-rights to use intangible property
  - Licensing of know-how and supply of components

Arm's Length Range



- TRANSFER PRICING IS NOT AN EXACT SCIENCE!
- May arise when there is more than one comparable
- May arise from the application of more than one method (e.g., resale price and cost plus)

Traditional Transaction Methods (Chapter II)

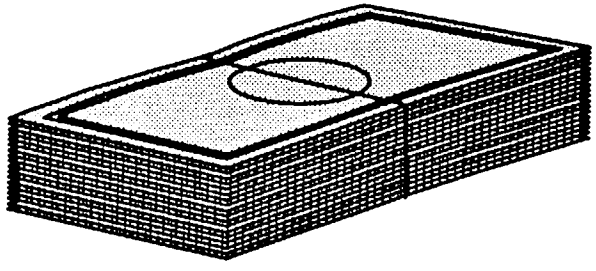
- Comparable Uncontrolled Price
- Cost Plus
- Resale Price

Transactional Profit Methods (Chapter III)

- Based on the profits that arise from particular controlled transactions
- Two: Profit Split and Transactional Net Margin
- Profit methods prohibited unless consistent with these two

Transactional Net Margin Method

- Examines net margins based on, e.g., cost, sales, assets **for the controlled transaction** (aggregation rules apply)
- No industry averages allowed
- Must be applied in a manner consistent with resale price/cost plus



TNMM comparability standard

- High standard that considers management efficiency and competitive position
- Consistency in measuring net margins is important

TNMM compared to CPM (July Discussion Draft)

- No comparison of global profit
- Need comparable uncontrolled transactions
- Looks first to taxpayer's own uncontrolled transactions
- Application consistent with cost plus/ resale price: determines transfer pricing

TNMM compared to cost plus/ resale price

- CP/RP use margins computed after direct and indirect costs
  - no clear line, allowing for some variation in practice, but generally excludes most operating expenses
  - E.g., selling, general, and administrative expenses would be excluded
- TNMM is a fully net method; margins computed after all operating expenses

TNMM: when used??

- Not often!!
- Where gross margins cannot be identified
- Where net margins can overcome difficulties in adjusting for functional differences or measurement consistency in computing gross margins

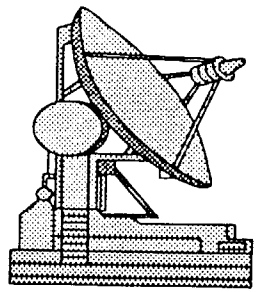
Limitations on Profit Methods

- TRANSACTIONAL
- Comparability
- Last resort
- Monitoring
- Looseleaf publication subject to future revision
- Transfer pricing compliance practices

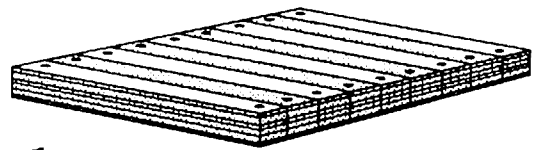
Last resort cases

- Insufficient or unreliable data
- Still must ask whether transactional profit method can be reliably applied

Monitoring



- Examine country practices, MAP, and actual cases
- Loose-leaf publication with intention to revise

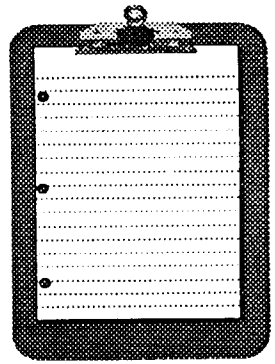


- Most effective way to prove if the transactional profit methods are not workable

Transfer Pricing Compliance Practices (Chapter 4)

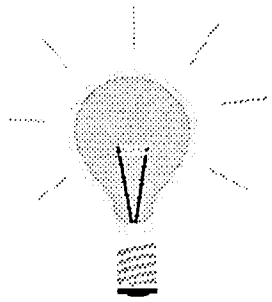
- Examination practices
- Burden of proof
- Penalties

Examination practices



- Recognize that transactional profit methods are not used by taxpayers to set prices
- Begin with taxpayer's method
  - Take account of taxpayer's commercial judgment
  - Don't demand precision
- Important that corresponding adjustments can be calculated

Burden of proof



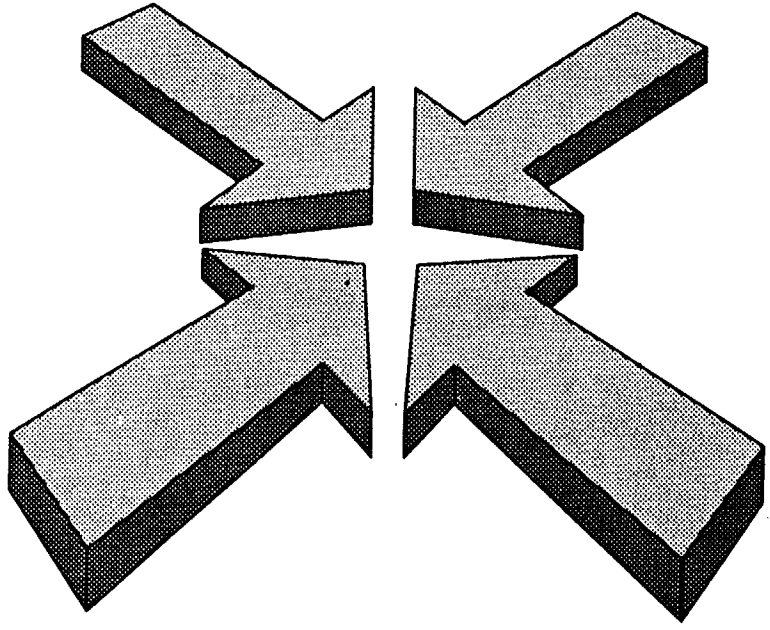
- use restraint in relying on burden of proof during examination
- tax administration (and taxpayer) should be prepared to make a good faith showing
- tax administration that makes primary adjustment has burden of demonstrating validity of adjustment in MAP

Penalties

- should take account of uncertain nature of transfer pricing problems
- should be proportionate to offense
- good faith behaviour should be acknowledged, tying into principles in the Guidelines

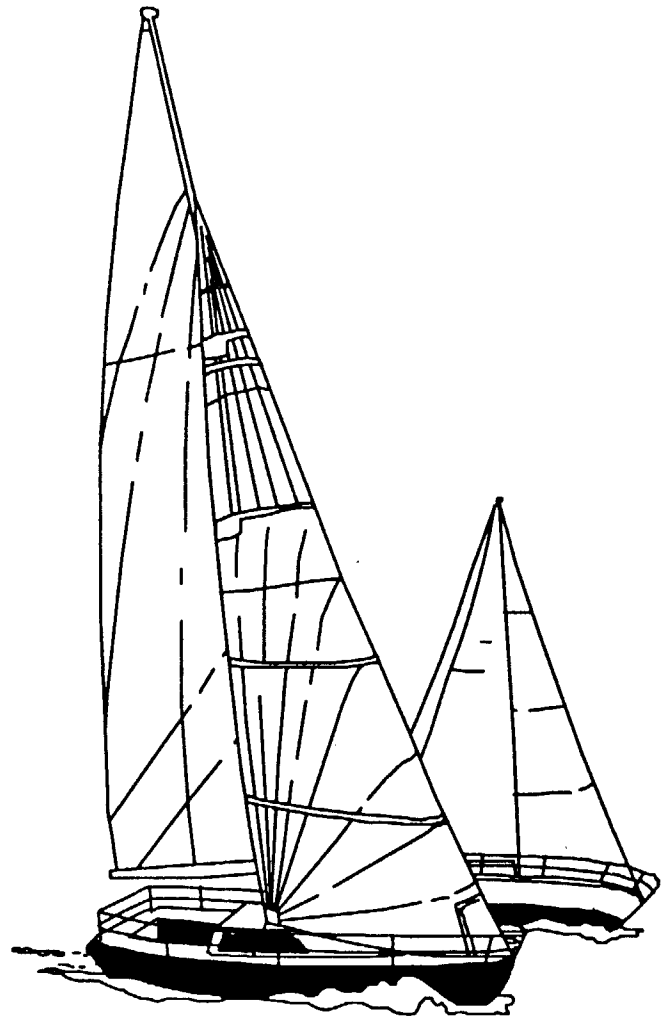
Additional topics in Chapter 4

- Safe harbours
- APAs
- Arbitration



Safe Harbours

- Rejected!



Advance Pricing Arrangements

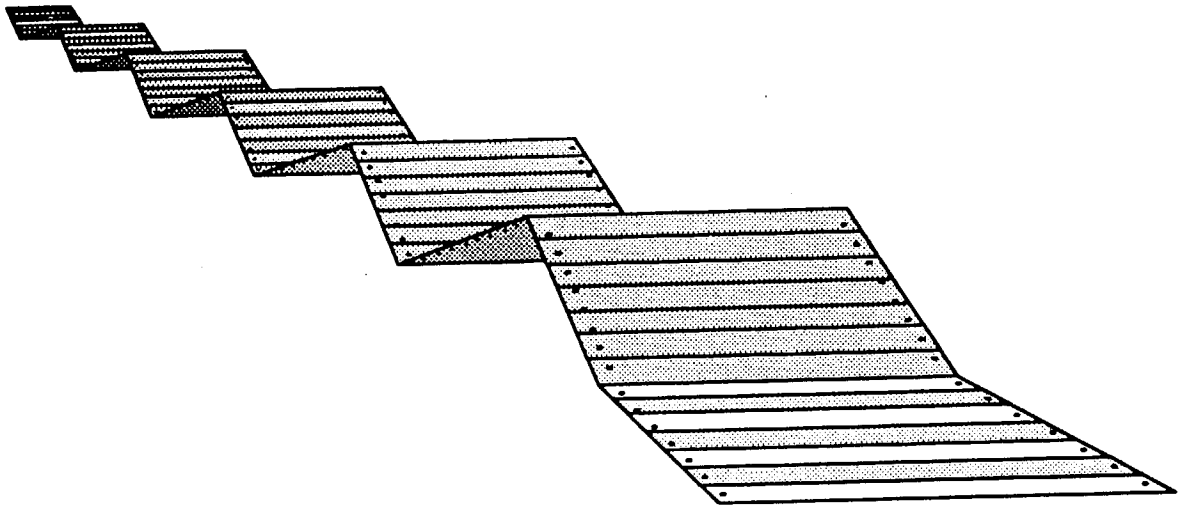
- great care needed to extend beyond methods
  - examine critical assumptions and reliability of predictions
- should be bilateral whenever possible
- should be administered in a manner that protects taxpayer rights

Arbitration

- Committee on Fiscal Affairs will continue to study
- Monitoring may be useful interim measure

Documentation (Chapter 5)

- Taxpayer tries to apply ALP when pricing is set.
- How much effort?



Standard of Documentation

- determined under same prudent business management principles that would govern the process of evaluating a business decision of a similar level of complexity and importance.
- required documents should not impose costs and burdens disproportionate to the circumstances

Forthcoming Part II:
Intangible Property

1. Production Intangibles

- patents
- know how
- designs, models
- trade secrets

2. Marketing Intangibles

- trademarks
- tradenames
- customer lists
- distribution channels

Intangible Property and its Differences

- Production intangibles

  → risky, costly R&D with future recovering via sales/licensing over a defined period

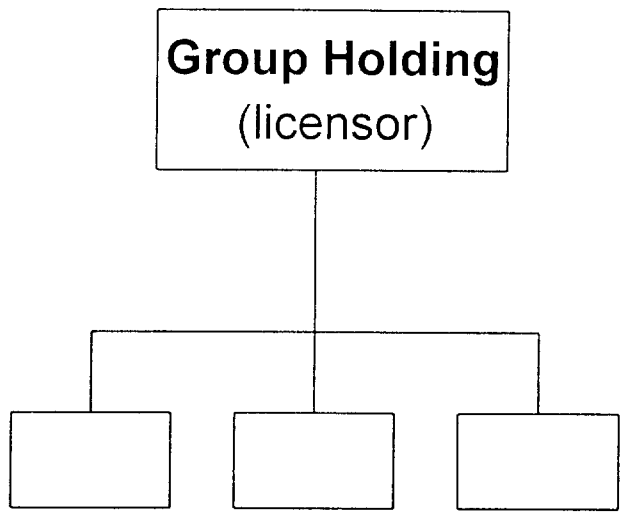
- Marketing intangibles

  → often low costs for legal creation; cost for promotion, defense etc. parallel to use and use (often) unlimited

Intangible Property and its main Issues

- Intangibles as part of Goods/Services
  → turnkey plant
- "Bundled intangibles"
- "Comparables" and NPV
- Costs vs. benefits
- periodic adjustments

Group Trademark Fee System



- licensees pay royalties
- licensees contribute to local marketing companies

➡ ***licensees sharing royalty income?***

Forthcoming Part II:

Corporate Services: Stewardship vs. Shareholder Costs

1. Activities relating to the juridical structure of the shareholding company itself (meetings of shareholders, issuing of shares)

2. Activities to satisfy statutory reporting requirements of the shareholding company (including the consolidation of reports).

3. Raising of funds for the acquisition of new group members.

➡ ***Activities with Group benefits chargeable***

Forthcoming Part II:

Features of Cost Contribution Arrangements

- "Joint Productions" and acquisitions of intangibles and services
- Separate legal entities as "service providers" (e.g. contract research)
- Separate legal ownership
- Allocations using costs defined under international GAAP versus national GAAP
- Setting up of the "pool" arrangements along business-lines
- business judgement in requiring "buy-ins" and "buy-outs"

Principles for Cost Contribution Arrangements

1. The method is laid down in clearly formulated and binding contracts, concluded in advance.

2. These contracts are observed consistently over several years (although giving due regard for the need for flexibility in start-up years).

3. The contracts apply to those associated enterprises which will benefit, or from an ex ante point of view may be expected to benefit, from the activities.

4. The costs of the relevant activities are determined on the basis of generally-acceptable accounting principles (such as those underlying the consolidated group's annual report), and details of auditing provision for the calculation of costs and for their allocation.

Principles for Cost Contribution Arrangements (cont'd)

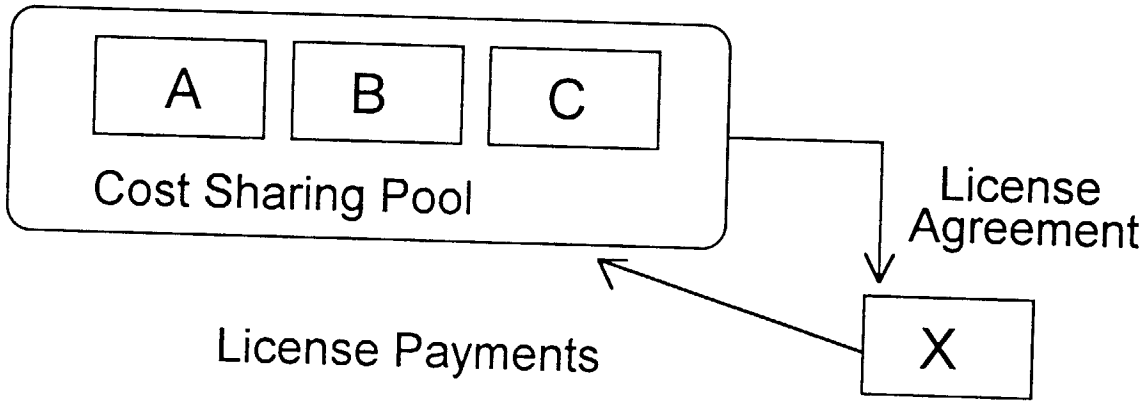
5. The group members which share the costs have full access to the activities concerned.

6. The contracting group members do not pay for the intangibles or services concerned in any other way.

7. Alterations in the responsibilities and activities of group members which influence their benefit position are to be taken into account as soon as possible in the contracts (changes in profitability would not normally justify amendments of the contract).

8. The contracts address the consequences of a participant entering or withdrawing from the cost contribution arrangement.

Cost-Sharing "classical" Pool - model A



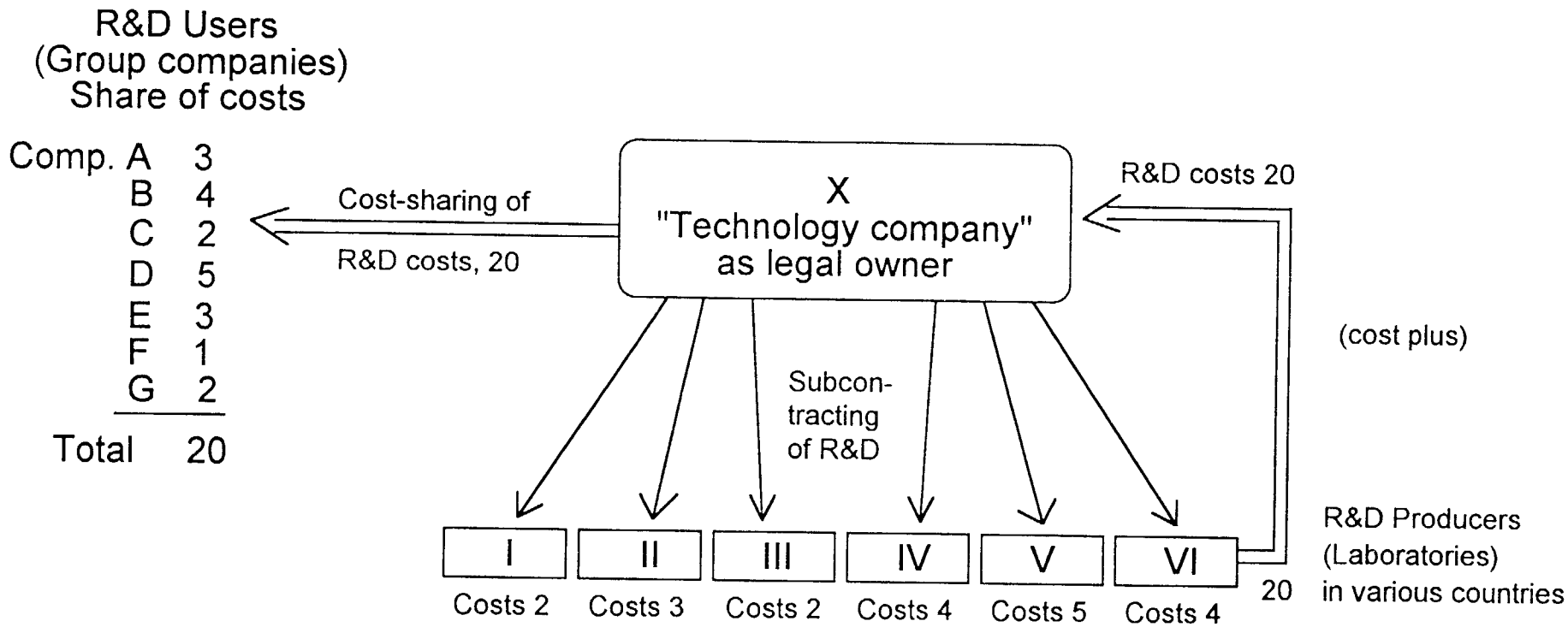
Pool companies (A, B, C)

- share actual R&D costs
- have free use of patents, know how
- share license income
- legal ownership by such company doing R+D or by one member

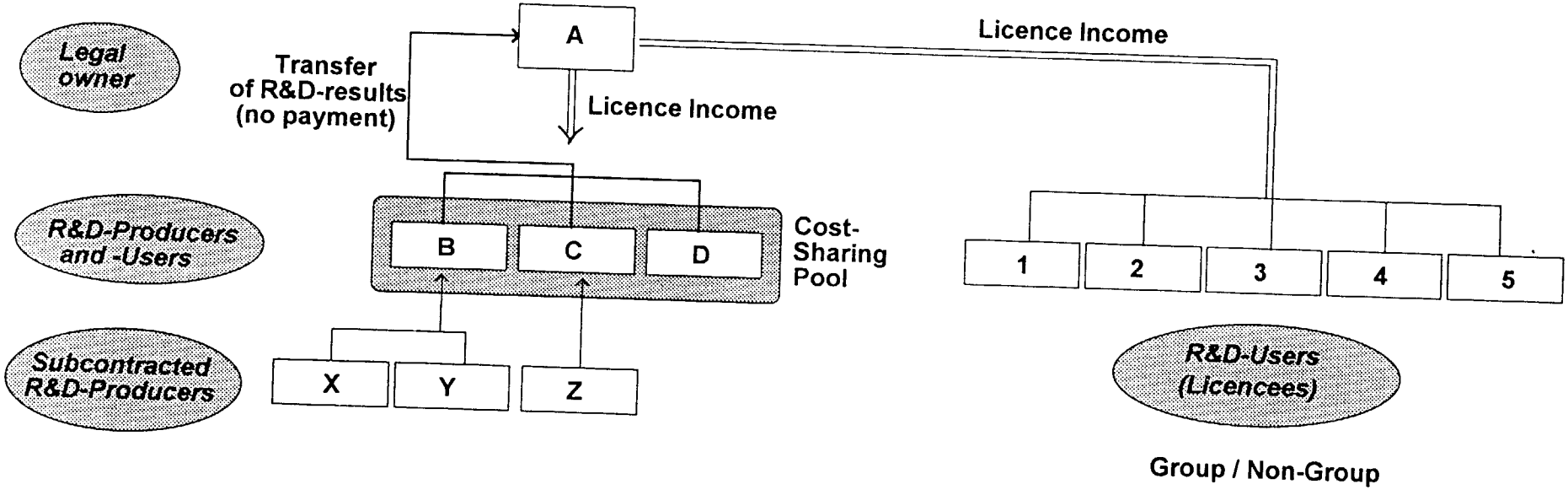
Non-pool companies
(Group or Third party companies)

- conclude license agreements
- pay license fees

R&D Financing (Cost-Sharing) - model B



Cost-Sharing Pool / Licence - with Technology Company as legal owner - model C



Company A

- legal owner (patent registrations etc.)
- not entitled to financial benefits above "service fee"
- licensor on behalf of pool companies (licence fees to be redistributed to the pool partners)

Basic Model

Parent Company X

• Direct Manufacturing Expenses	8 Million
• Indirect Manufacturing Expenses (including interest)	6 Million
• Allocable Overheads	4 Million
• Technical Legal and Mercantile Assistance within the Group	5 Million
• Allocable R&D expenses	17 Million
Total	40 Million
+ Profit Markup of 12.5%	5 Million
= ***Lowest Transfer Price***	***45 Million***

Subsidiary Z

• Sales	131 Million
• ./. 40% Gross Margin ☆	(52 Million)
• ./. 1125,5% of the assembly expenses of 16 Million	(18 Million)
= ***Highest Transfer Price***	***61 Million***

☆On the basis of conditions of the markets where it operates, the subsidiary would normally expect a net profi of 7 Million from the marketing function.

Example A

Subsidiary Z

• Sales	131 Million
• ./. Transfer Price	- 57 Million
• ./. Marketing Expenses	- 45 Million
• ./. Assembly Expenses	- 16 Million
Total	***13 Million***

The consolidated profit is 30 Million (=131 Sales - 40 EP - 61 ES); a share of 43.3% is taxed in the country of the subsidiary.

Example B

Subsidiary Z

• Sales	131 Million
• ./. Transfer Price	- 57 Million
• ./. Marketing Expenses	- 40 Million
• ./. Assembly Expenses	- 16 Million
Total	***18 Million***

The consolidated profit is 35 Million (=131 Sales - 40 EP - 56 ES); a share of 51.4% is taxed in the country of the subsidiary.

Example C

Subsidiary Z

• Sales	131 Million
• ./. Transfer Price	- 54.5 Million
• ./. Marketing Expenses	- 50 Million
• ./. Assembly Expenses	- 16 Million
Total	***10,5 Million***

The consolidated profit is 25 Million (=131 Sales - 40 EP - 66 ES); a share of 42% is taxed in the country of the subsidiary.

Extraordinary events in the country of

Subsidiary Z

• Sales	131 Million
• ./. Transfer Price	- 50 Million
• ./. Marketing Expenses	- 53 Million
• ./. Assembly Expenses	- 16 Million
• ./. Extraordinary Expenses	- 6 Million
Total	***6 Million***

The consolidated profit is 16 Million (=131 Sales - 40 EP - 75 ES); a share of 37,5% is taxed in the country of the subsidiary.

a) 10% Increase of Currency Z ☆

	Consolidated profit in currency X ☆☆	Profit of the subsidiary (in currency x)
• Sales	144,1 Million	144,1 Million
• ./. E Par.	- 40,0 Million	
• ./. Transfer Price		- 57,0 Million
• ./. E Subs.	- 67,1 Million	- 67,1 Million
Total	***37,0 Million***	***20,0 Million***

The consolidated profit is 37 Million (a share of 54.1 % is taxed in the country of the subsidiary)

	Profit of the subsidiary (in currency Z)
• Sales	131,0 Million
• ./. Transfer Price	- 51,8 Million
• ./. E Subs.	- 61,0 Million
Total	***18,2 Million***

The profit in the country of the subsidiary Z improved by 40%

☆ Currency Z = currency used in the country of the subsidiary
☆☆ Currency X = currency used in the country of the parent company

b) 10% Decrease of Currency Z ☆

	Consolidated profit in currency X ☆☆	Profit of the subsidiary (In currency x)
• Sales	119,1 Million	119,1 Million
• ./. E Par.	- 40,0 Million	
• ./. Transfer Price		- 57,0 Million
• ./. E Subs.	- 55,5 Million	- 55,5 Million
Total	***23,6 Million***	***6,6 Million***

The consolidated profit is 23,6 Million (a share of 28 % is taxed in the country of the subsidiary)

	Profit of the subsidiary (In currency Z)
• Sales	131,0 Million
• ./. Transfer Price	- 62,7 Million
• ./. E Subs.	- 61,0 Million
Total	***7,3 Million***

The profit in the country of the subsidiary Z decreased by 43,8%.

☆ Currency Z = currency used in the country of the subsidiary
☆☆ Currency X = currency used in the country of the parent company