

Train the Trainers Event on Transfer Pricing

Module 3 – Session 5 Intra-group Services

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Types of Intra-Group Services

- Administrative, technical, financial and commercial for specific group
- Management, coordination and control functions for the whole group
- Costs borne initially by:
 - Parent
 - Another group member
 - Group service centre

Types of Intra-Group Services

- Usually include services ordinarily performed internally (central auditing, financing advice, training of personnel)
- Often include services that are typically available externally from independent enterprises (such as legal and accounting services)



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Rendering of Intra-Group Services

- Sometimes linked to transfer of goods or intangible property
- Aggregation or segregation of transactions may be necessary (Chapter 3)
 - e.g. higher price for product because of R&D instead of separate charge



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TYPICAL ARRANGEMENTS



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Typical Arrangements

1. Parental service arrangements
2. Centralised service companies
3. Cost contribution/sharing arrangements



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Typical Arrangements

1. Parental Services

Provided by the parent company – often on cost recovery basis, i.e. with no profit element.

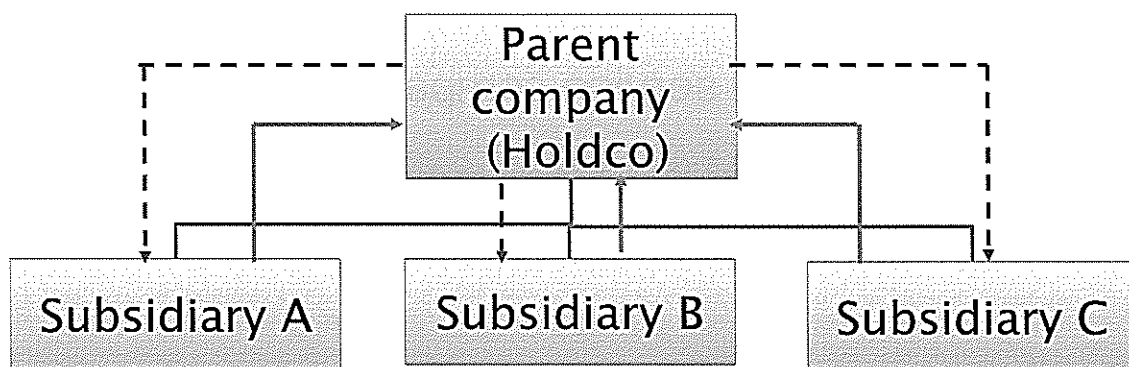
Examples:

- Group finance
- Group tax
- Legal



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Parental services



-----> Provision of services

—————> Management fees



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Typical Arrangements

2. Centralised Services

Provided by a service company in the group
– usually on a cost plus basis, i.e. including a profit element

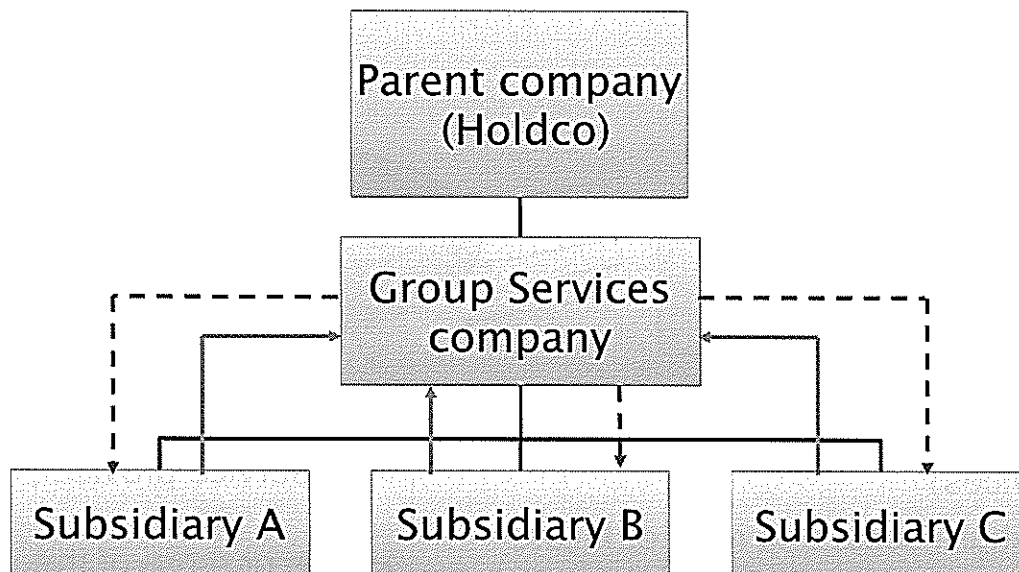
Examples:

- IT support
- Technical
- Finance and treasury



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Centralised services



-----> Provision of services

-----> Management fee



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Typical Arrangements

3. Cost Contribution / Sharing Arrangements

Joint funding or sharing of costs and risks for obtaining services

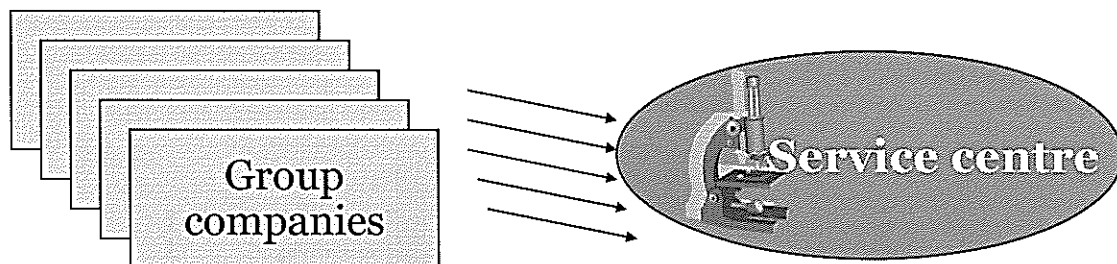
Examples:

- Pool resources for acquiring centralised management services
- Development of advertising campaigns common to the participants' markets



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Cost Contribution Arrangement (CCA)



- All provide funding (finance the services)
- All share costs and risks of failure
- May include development of high value services

Can be

- a service provider,
- or
- one or more of the CCA members



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TWO MAIN ISSUES REGARDING INTRA-GROUP SERVICES



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1. Has a service been rendered and does it provide a benefit?

- Have services actually been provided by one member of an MNE group to other members?
 - Has the service provided a respective group member with economic or commercial value to enhance its commercial position (benefit test)?
- If so, what is an arm's length price for those services?



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1. Has a service been rendered and does it provide a benefit?

- Has an activity of one group member provided another group member with economic or commercial value?
- Would an independent enterprise in comparable circumstances be willing to pay for the activity at arm's length?
- If not, no intra-group service
- Facts and circumstances test
 - sometimes simple
 - *e.g. repair of machines*
 - sometimes complex
 - *e.g. activities for group as a whole*



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Intra-Group Services

- Often
 - OECD Guidelines para 7.14: planning; co-ordination; budgetary control; financial advice; accounting; auditing; legal; factoring; computer services; financial services; assistance in the fields of production, buying, distribution and marketing; recruiting and training.
- But not for incidental benefits as a result of economies of scale and other synergy effects
 - Criterion: service recipient willing to pay
- Same for advantages just by being part of a group; there must be a specific activity



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No Intra-Group Services

Shareholder's Activities

(OECD Guidelines paras. 7.9 – 7.10)

- Costs that are related to the structure of the parent company
 - Shareholder's meeting
 - New shares in parent company
 - Costs of board meetings
- Costs related to reporting requirements
- Costs related to raising funds for acquisitions of shares



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Actual Payment Not Determinative

- Existence of actual payment is useful, but not proof
- Mention of “management fee” is not prima facie evidence of management services
- Absence of payment does not necessarily mean that no services were rendered



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2. Determining Arm's Length Charge for the Service

- Direct charge method
- Indirect charge method



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Direct Charge Method

- Can provide CUP if same services provided to third parties
- But often difficult to apply in practice
- The group members are charged for specific services → great practical convenience for tax administrations



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Examples – Direct Charge

- R&D performed by the central R&D department for a specific company or client.
- Marketing from the central department provided for a specific market or region.
- Trademark violation in a specific market that was dealt with by the legal department.



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Indirect Charge Method

- Should be connected to reasonably foreseeable benefit, sensitive to commercial realities, and have safeguards against abuse
- Used where proportion of the value of services rendered to each entity cannot be exactly quantified
- Can use factors, such as turnover, staff, etc. as allocation keys where appropriate



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Indirect Charge - Allocation Keys

Services	Allocation Key
Central purchase of raw materials	Cost of goods (only manufacturers)
Central R&D	Per unit /expected sales (only manufacturers)
Strategic product planning	Cost of goods for each group of product
Financing, accounting	Sales, total balance sheet
Human resource (HR)	Number of persons employed
Marketing	External sales (only distributors)
IT	Number of IT-users
Rental charges	Square meters

An indirect charge method may need some adjustments to achieve an arm's length price. Combination of allocation keys is sometimes useful.



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The Arm's Length Price

- Consider perspectives of both
 - provider and
 - recipient of the service
- Provider
 - How much does the service cost?
- Recipient
 - How much is the service worth?
 - How much would it cost to provide the service in-house?
 - How much would an external service provider charge?



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(Profit) Mark-Up

- Normally mark-up (comparison with independent enterprises)
- In some cases no mark-up necessary (OECD Guidelines paras. 7.33-7.37):
 - The costs are in proportion to the expected profit in the company (agent: low profit – low cost)
 - The costs are already equivalent to the market price
 - Strategic reasons
 - Unreasonable administrative burden



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The Arm's Length Price

- Generally, methods of Chapter II are appropriate
- CUP used when a comparable service exists
- Cost plus (or TNMM based on costs) used where nature of activities, assets and risks are comparable
- Also a combination of methods, or profit split (e.g. high value services rendered by two or more group members)



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The Arm's Length Price

- **Cost base** very important!
- Cost base often more material than mark-up
- Functional analysis
- Example in OECD Guidelines para. 7.36: mere intermediary service



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Quiz

Activity	Service	No Service
R&D administration		
Management of interest and exchange risks		
Issuance of parent's shares		✓
IP protection	✓	
Raising funds for own new acquisitions		
Financial advice		✓
Supervision of cash flows		✓
Interview for director candidates of subsidiaries	✓	✗
Obtaining high credit rating for belonging to MNE group	✗	✓



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Thank you !

Questions ?

“Train the Trainers” Event
30 November – 5 December 2015
Seoul, Korea

Module 3 – Session 6
Case Study 3
(Intra-Group Services)

INTRA-GROUP SERVICES - MANAGEMENT FEE FOR CENTRALISED ADMINISTRATIVE SERVICES

Company Y in State Y (Europe) is the headquarters of an MNE group that manufactures and sells electrical household products. Related companies Company A in State A (Asia) and Company B in State B (Latin America) produce most of the products. State A and State B are emerging market economies. Their low labour costs make them an attractive location for multinational manufacturers. All products produced by Company A and Company B that meet the pre-determined quality requirements are bought by Company Y. Some products (tailor made to meet consumer wishes) are manufactured by Company X in State X (Europe). These products are sold in Asia, Europe and the Americas. Y itself distributes the products in the northern half of Europe; X takes care of distribution in the southern half of Europe. The distribution in Asia is done by Y Asian Distributors and in the Americas by Y Americas Distributors.

Company Y acts as the central management company for the MNE group and is the owner of the manufacturing and marketing intangibles. Further, Y provides a variety of services to its group companies.

According to the service agreement the charges are based on costs allocated fairly and equitably among the relevant group members. The basis for the cost allocation are the physical and tangible costs incurred by Company Y. These costs include but are not limited to the following categories:

- Legal and consulting costs
- Trademark protection and litigation costs
- Company secretarial services costs
- Audit and accounting costs
- Commonly shared personnel costs
- Insurance costs
- Staff travel and personnel deployment costs
- Office supplies, equipment, computerisation costs
- Office rents, utilities, telephone, fax and postage costs
- Corporate finance costs and bankers' charges
- Negotiations for credit lines costs
- Marketing and promotion costs
- Advertising costs
- Corporate logo design and production costs
- Costs involved in sourcing of new products
- Other commonly group related costs as may be applicable

Under the service agreement all group companies have to pay their share of the costs incurred by Company Y. This is determined by an allocation key based on the estimated sales of all the group companies in a year. The group companies will make monthly instalment payments. For the year 2014 the fee is set at 5% of the expected sales. This is based upon the following expectations:

Estimated costs incurred by Company Y for intra-group services for the year 2014: \$10.500.000

Estimated sales for the year 2014:

Company A	\$16.500.000
Company B	\$18.000.000
Company X	
(tailor made products according to consumer wishes)	\$ 9.500.000
(Sales southern half Europe)	\$30.000.000
Company Y	\$35.000.000
Company Y Asian Distributors	\$49.000.000
Company Y Americas Distributors	\$74.000.000

Total estimated group sales year 2014 \$232.000.000

Question 1: What are your initial thoughts?

Question 2: Would you consider this general service agreement suitable for all group members?

Question 3: How would you determine whether the services are being rendered?

Question 4: Do you consider the allocation key appropriate from the perspective of being the tax inspector of the service recipient?

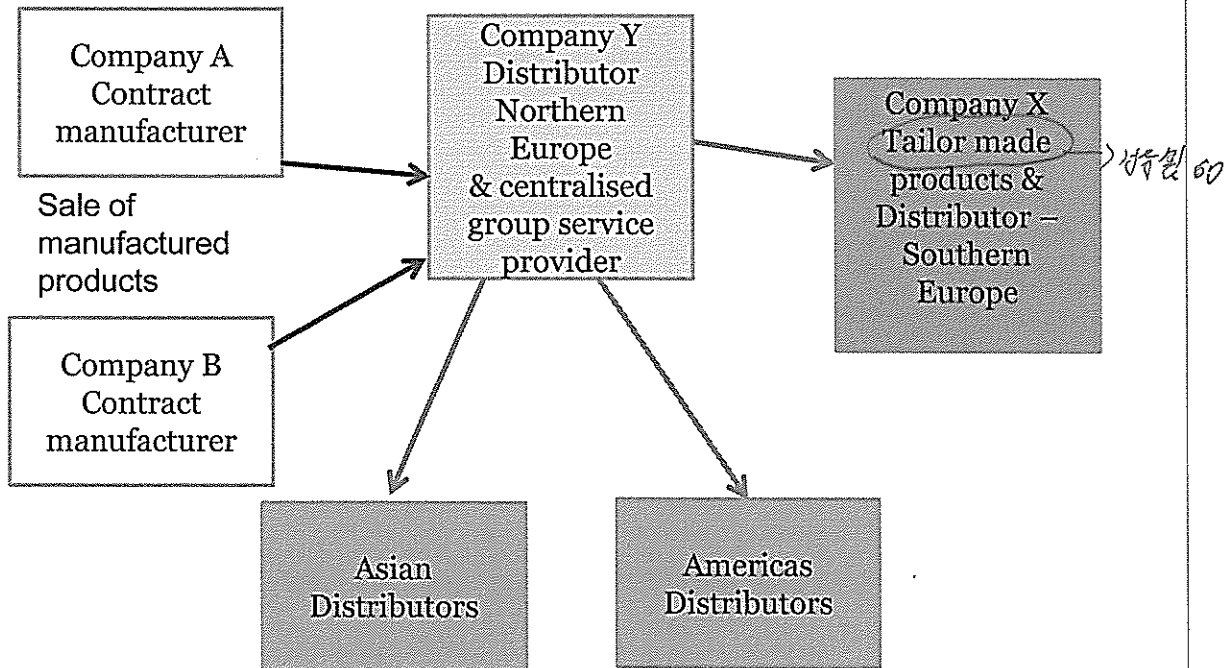
Question 5: Do you consider the allocation key appropriate from the perspective of being the tax inspector of the service provider?

Module 3 - Session 6

Case Study 3

(Intra-Group Services)

Centralised Services



Services provided

Service	(Contract) Manufacturing	Distribution	Shareholder
Legal and consulting	(X)	X	(X)
Trademark protection and litigation		X	
Company secretarial services			X
Audit and accounting For benefit of HQ			X
For benefit of local entities	X	X	
Commonly shared personnel	?	?	?
Insurance	?	?	?
Staff travel and personnel deployment	(X)	X	
Office supplies, equipment, computerisation	?	?	?
Office rents, utilities, telephone, fax & postage	?	?	?
Corporate finance	?	?	?
Negotiations credit lines	(X)	X	
Marketing & promotion		X	
Advertising		X	
Corporate logo design & production		(X)	X
Sourcing new products		X	
Other group related costs	?	?	?

Train the Trainers Event on Transfer Pricing

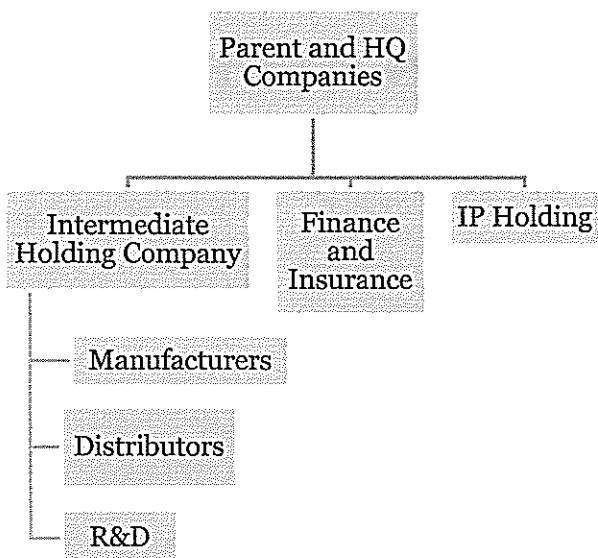
Module 4 – Session 7 Issues on Auditing Cross-Border Transactions

1

MAIN FEATURES OF MULTINATIONAL ENTERPRISES

MNE international structure

Group structure and functions



– MNEs are made up of separate taxable entities that are connected by share ownership

– Functional organisation does not necessarily match legal organisation

– Changing business structures: from traditional to centralised business model:

- From businesses organised around countries or geographic regions with their own functions, to business organised on a more global or regional scale with functions performed for global markets rather than country market



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Changing business structures

Trend in last decade for multinational enterprise groups to move to a more centralised business structure, with global or regional:

- strategy and management
- products and brands
- customers
- manufacturing
- sales and distribution networks
- functions - such as procurement

..... as we shall see, this provides opportunities for multinational groups to plan in which company – and so in which country – they recognise their income.



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Traditional business model – Decentralised

Businesses organised around countries or geographic regions with their own:

- customers and suppliers
- manufacturing facilities
- sales and distribution network
- R&D facilities
- brands and products
- management



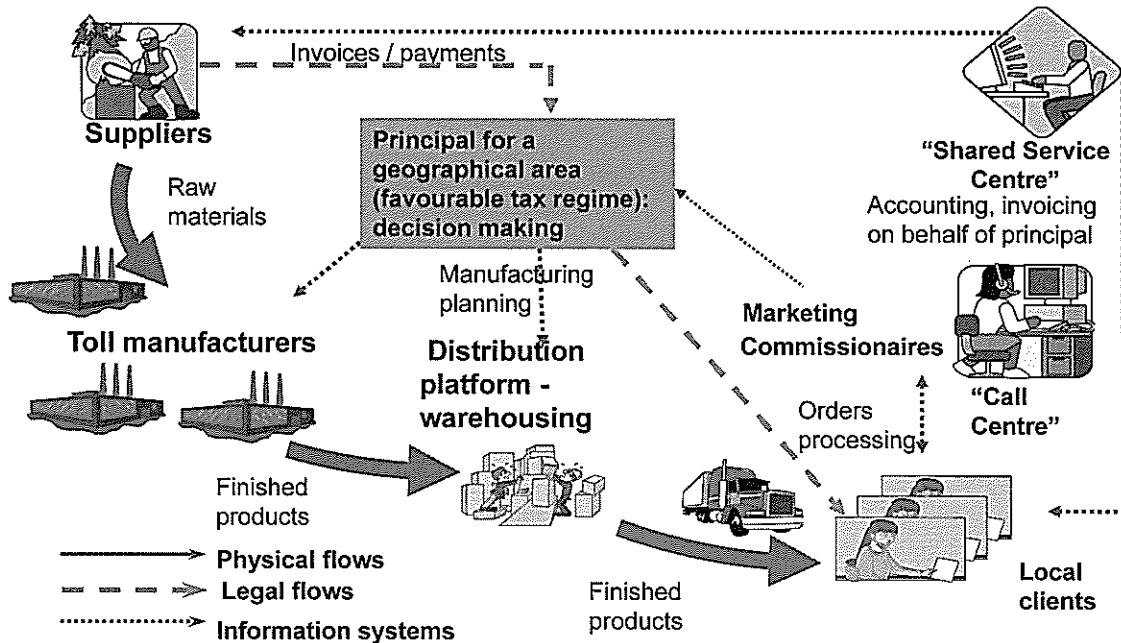
Centralised business model

The business is undertaken on a more global or regional scale with:

- International brands
- Global goods
- Manufacturers producing for a global rather than a country market
- International sales and marketing networks – with global customers
- Centrally owned intellectual property
- Centrally managed supply chain



Illustration: global business model



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Centralised business model

... increases business efficiency in a globalised economy

... but also provides more scope for MNEs to plan where they earn their profits.



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KEY TOOLS FOR INTERNATIONAL TAXATION



Tax features of Multinational Enterprises

- Each company in the group will have a residence for taxation purposes (perhaps more than one)
- Tax administrations view tax on a jurisdictional basis - that is, they will tax those group companies that are resident in their jurisdiction (in fact, they may sometimes also seek to tax all or part of the income of other group companies)
- Distinguish between:
 - Companies, which have their own legal identity and residence status, and may be organised in sub-groups
 - Branches, which are legally a part of a company and do not have their own legal entity (and may be permanent establishments for tax purposes)



Key tools for international taxation

1. Country taxing rights and tax treaties
2. Residence rules
3. Permanent establishment rules
4. Anti-avoidance rules
 - a. Controlled foreign companies
 - b. Thin capitalisation
5. Transfer Pricing



Country Taxing Rights and Tax Treaties

- Countries may tax on a residence basis or a source basis:
 - Residence = tax all income of a resident wherever earned
 - Source = tax all income sourced in the country (interest, rent, dividends etc) irrespective of residence of owner of income
- Many countries tax on both bases
- Tax Treaties exist to ensure that the same income is not taxed twice



Tax Treaties

- Most of tax treaties rely on the OECD Model Tax Convention on Income and on Capital (MTC)
- Overview of the OECD Model Tax Convention:
 - Treaty applies, in principle, to residents of the Contracting States (article 1)
 - Taxes covered by Tax Treaty: taxes on total income and elements of income, alienation, wages taxes, capital gains taxes (article 2)
 - Other issues addressed: residence (article 4), permanent establishments (article 5), associated enterprises (article 9), dividends/interest/royalties/capital gains (articles 10 to 13)



Residence

- Countries normally determine where a company is resident according to:
 - formal criteria e.g. place of incorporation, registration etc
 - factual criteria e.g. place of effective management, principal business location



Resident: Article 4

- Purposes of the Article:
 - To provide a definition of “resident of a contracting state” for the purposes of applying other provisions such as Article 1 (Persons Covered)
 - To provide a solution to cases where a person (individual or other) is considered as a resident of both treaty countries (so-called “tie-breaker” rule for “dual residents”)



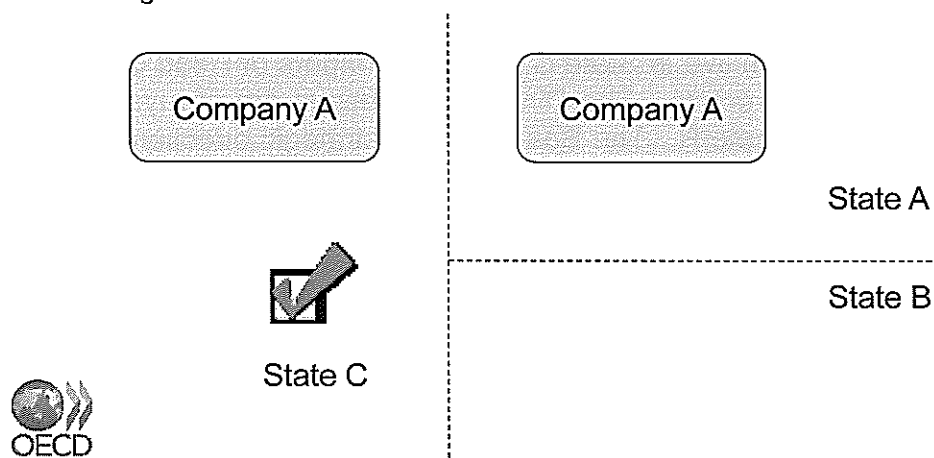
Resident: Article 4 (Overview)

- **Paragraph 1:** “resident of a contracting state” is defined as a person who is subject to worldwide taxation in the state on the basis of certain criteria
- **Paragraph 2:** tie-breaker rule for individuals
- **Paragraph 3:** tie-breaker rule for other persons



Liable To Tax

- Company A is incorporated State A and pays tax in State A.
- However Company A has its place of effective management in State C
- State C's tax legislation states that a company is tax resident in State C if incorporated in State C or has its place of effective management in State C
- The A-C double tax treaty states: Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated.



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Tie-breaker for Entities (Article 4 (3))

- OECD and UN Models adopt place of effective management
 - Where the key management and commercial decisions are in substance made
 - Ordinarily where the most senior person or persons (the board?) make those decisions
 - Where the actions to be taken by the entity as a whole are taken
 - Look at all facts and circumstances
- Common alternatives:
 - Place of incorporation
 - Central Management and Control

Residence of a Company: The Directors' Meetings

Example

Basic facts

Sub Corp is wholly owned by the public company, Head Corp, a resident of State R. Sub Corp is incorporated in State S but has no staff or premises in State C. Its registered address is the offices of a local Solicitor.

Sub-Corp's Board of Directors includes Sub-Corp's Chief Executive and Chief Financial Officer who both live in State C, senior managers of Head Corp and some of Head Corp's directors. The Director's meetings are always held at Head Corp's offices in State R. The Board set the strategic direction of Sub-Group.



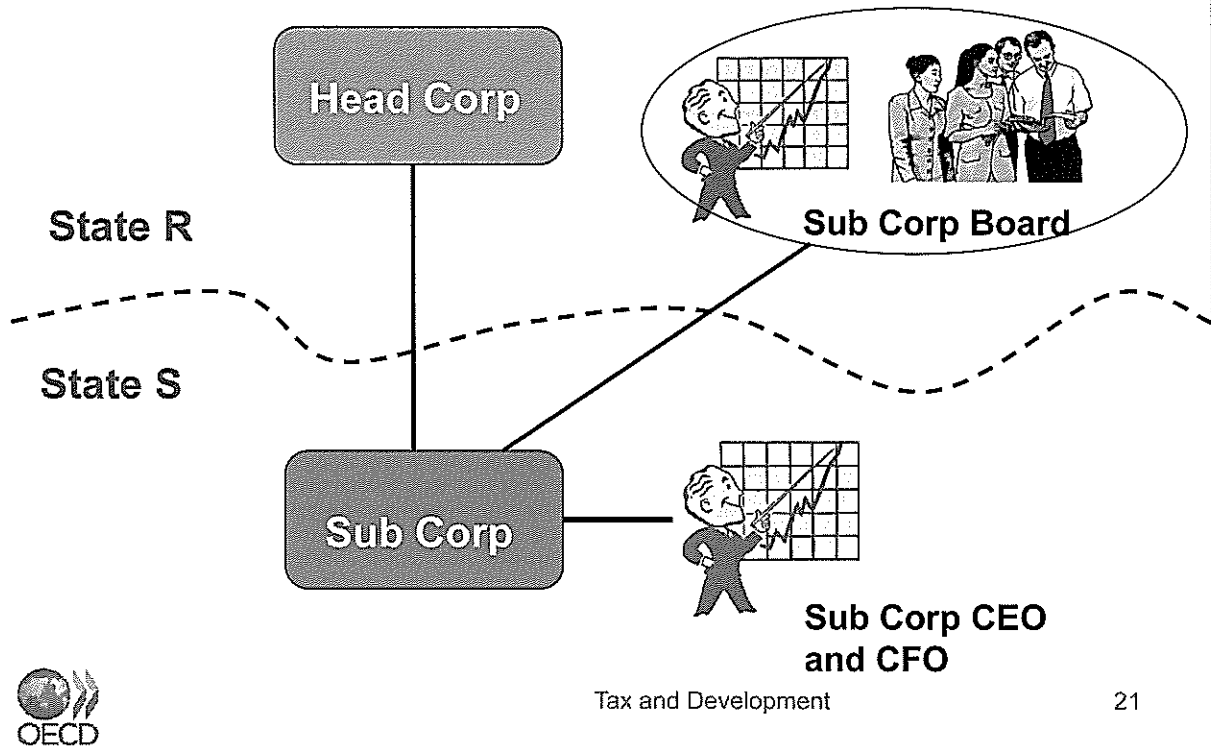
Residence of a Company: The Directors' Meetings

Relevant tax law

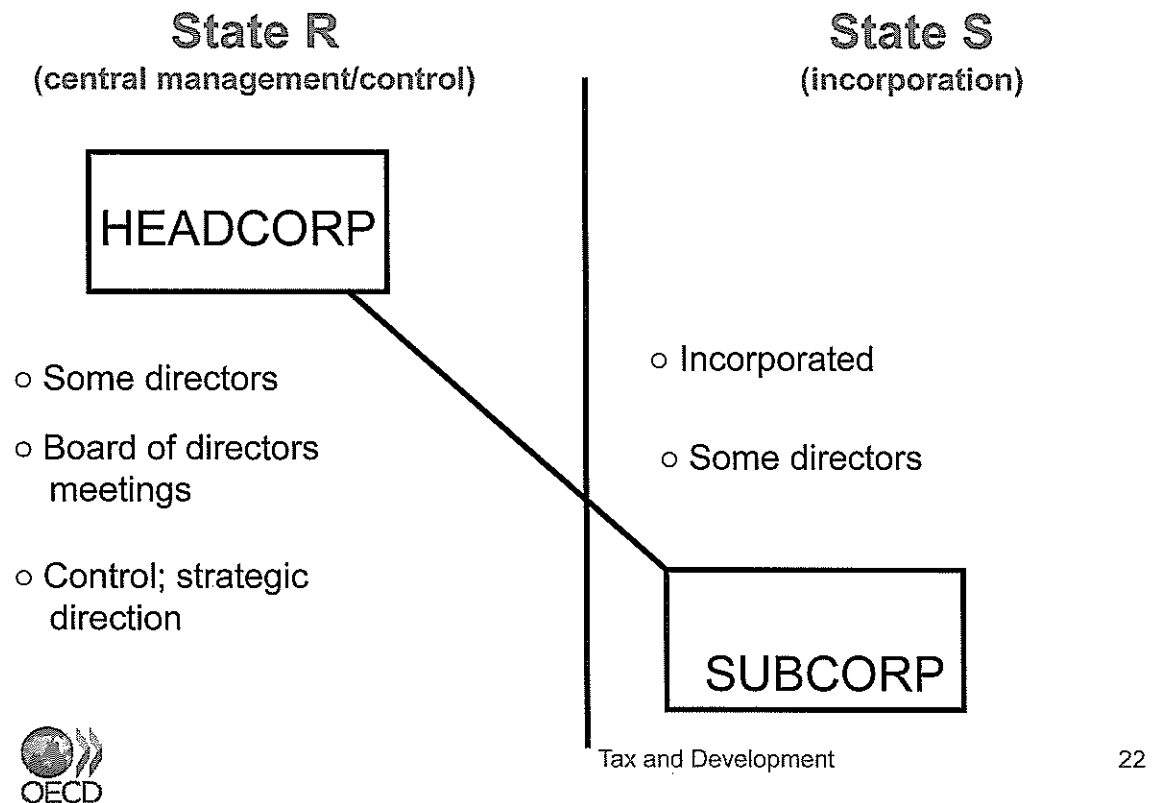
As a result of Sub Corp's incorporation in State S and the Director's meetings in State R, it is a tax resident of both States under their respective domestic law. Both States R and S tax the world-wide income of residents and the locally sourced income of non-residents. Double taxation is unilaterally relieved using the credit method. The Double Tax Convention between States R and S follows the OECD Model Tax Convention.



The Directors' Meetings



The Directors' Meetings



Issues for Discussion

1. To which State would the place of effective management tie-breaker allocate residence for the purpose of the treaty?
2. What factors do you consider are important in applying the place of effective management test?



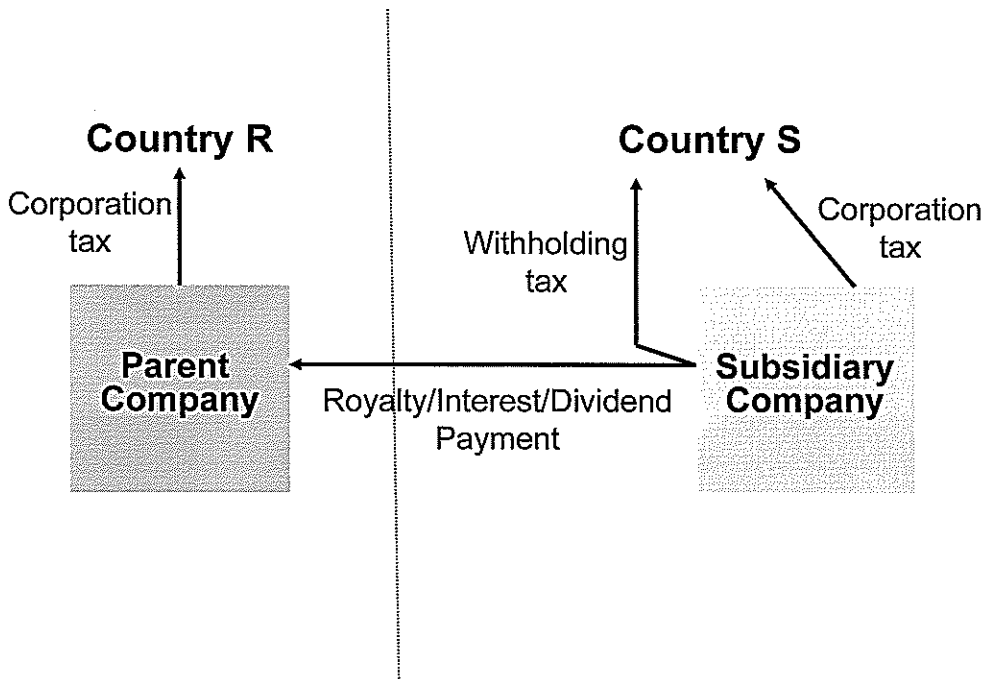
Permanent Establishments

Two key issues:

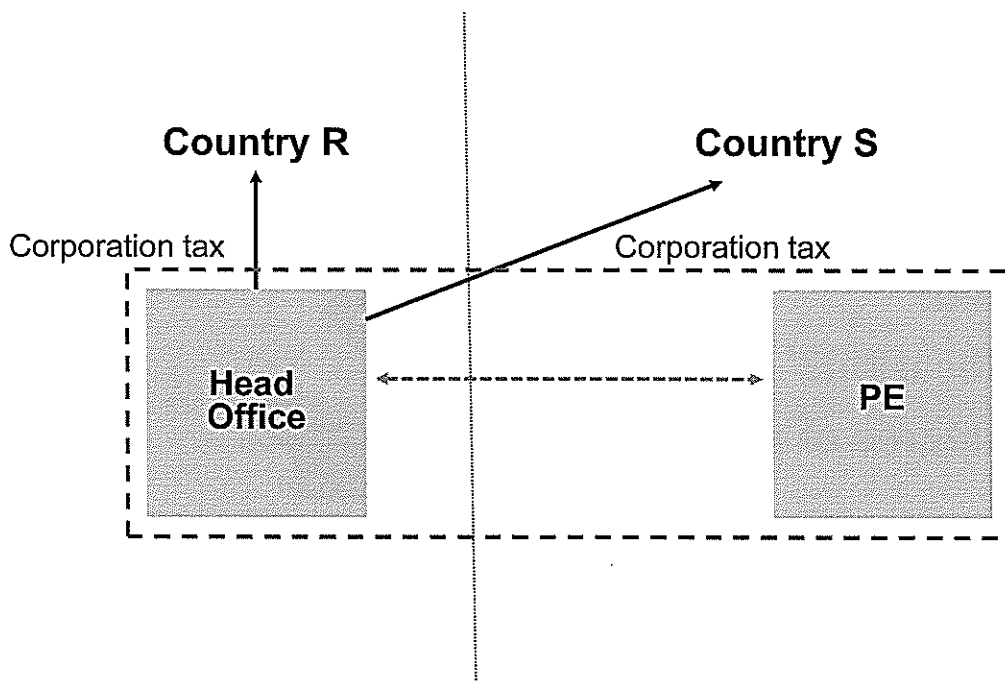
1. Is there a permanent establishment of a resident of one country in another?
(Article 5 of MTC)
1. If there is such a permanent establishment, how much profit should be attributed to it and thus be subject to host-country taxation?
(Article 7 of MTC)



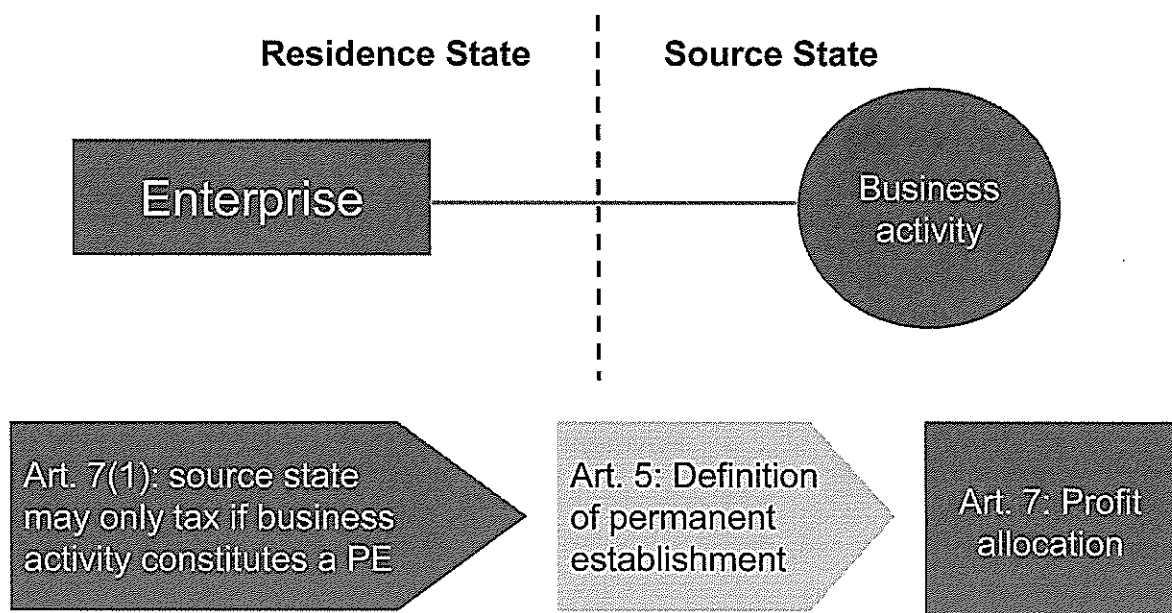
Taxation of Subsidiary



PE Taxation



OECD – Taxation of Business Income







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Does a PE exist?

- Place of business 
- Fixed:
 - location? 
 - degree of permanence? 
- Business carried on through the fixed place? 



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Types of PEs

Fixed place of business PE

- Does the non-resident have a place of business in the host country?
- Is it fixed, in both geographical and time senses?
- Does the non-resident carry out its business through the fixed place?



Types of PEs

Dependent Agent PE

- A resident of Country A will have a permanent establishment in country B where :
 - ... a person in country B
 - ... acts on behalf of the enterprise
 - ...and has, and habitually exercises, authority to conclude contracts in the name of the enterprise.
 - .. and is not an independent agent



Types of Permanent establishments

Construction PE

- A building site, construction or installation project constitutes a PE only if it lasts for more than 12 months



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BETTER POLICIES FOR BETTER LIVES

Attribution of Profits to a PE

The Authorised OECD Approach (AOA)

Tax and Development

Date

Functionally separate entity approach

- Profits of a PE are determined as if the PE were a **distinct and separate enterprise**.
- Justification Article 7 (2) OECD MTC:
“... shall be attributed to that permanent establishment the profits which it might be expected to make if it were a **distinct and separate enterprise** engaged in the same or similar activities under the same or similar conditions.....”
- Attribution of profit to a PE generally possible even if enterprise (as a whole) makes a loss (and vice versa)



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Anti-avoidance rules

- Treaties and legislative General and Specific Anti-avoidance rules
- Many states have general anti-avoidance rules that allow them to disregard or recharacterise transactions that are primarily tax motivated
- Approaches vary between countries
- Examples of specific anti-avoidance rules



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Controlled foreign companies

- Country CFC rules seek to attribute some or all of the profit of a company to its shareholders
- The effect is that CFC rules allow countries to tax the profit of a subsidiary in a parent company
- Anti-avoidance rules normally restricted to subsidiaries in a tax haven and to geographically mobile passive income



What is thin capitalisation?

- Companies can be funded with a mixture of debt and equity
- Outside of intragroup context there are commercial pressures dictating the appropriate blend of debt and equity
- In an intragroup context those pressures may be absent
- Subsidiary may be fully debt-funded



What is thin capitalisation?

- **Example 1**

- Company A has debt of 100 equity of 100
- Interest rate of 5% = total interest cost of 5
- Operating profit of 20
- Post interest profit of 15

- **Example 2**

- Company A had debt of 200, equity nil
- Interest rate of 5% - total interest of 10
- Post interest profit = 10



Thin capitalisation

- Thin capitalisation rules tackle manipulation of debt-equity borderlines for tax reasons
- Approaches vary between countries:
 - Many countries have “thin capitalisation” rules that typically restrict the interest payable by a company on loans from, or guaranteed by, shareholders
 - They are normally based on “debt to equity” or similar financial ratios

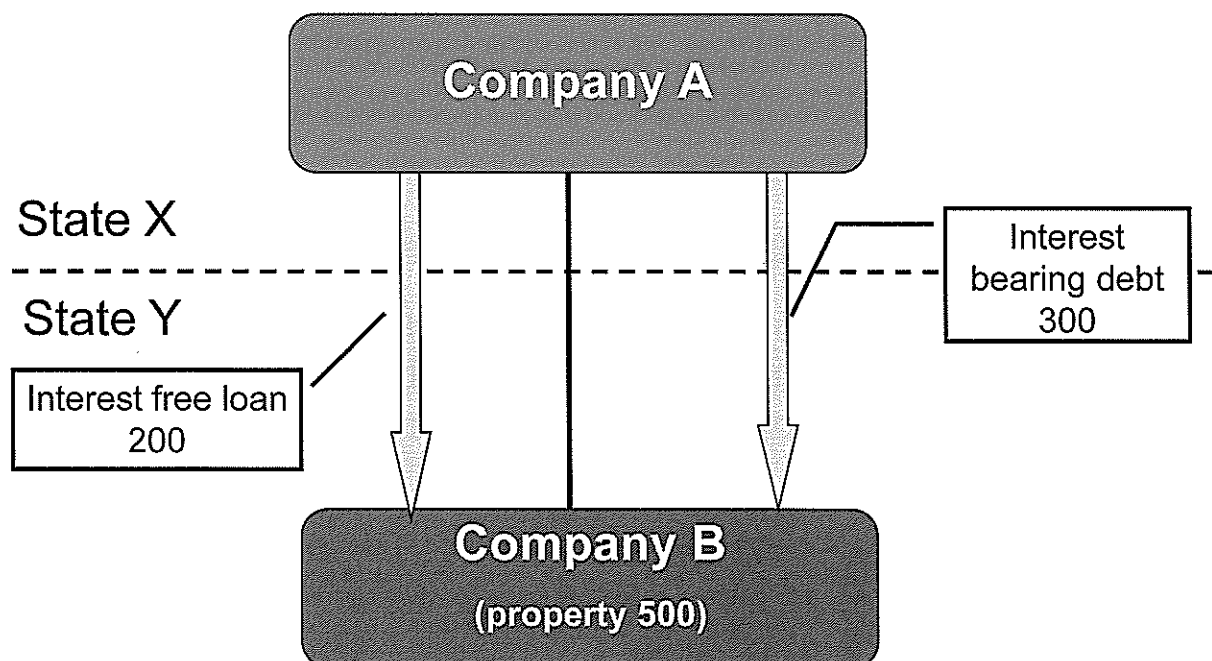


Thin capitalisation rules

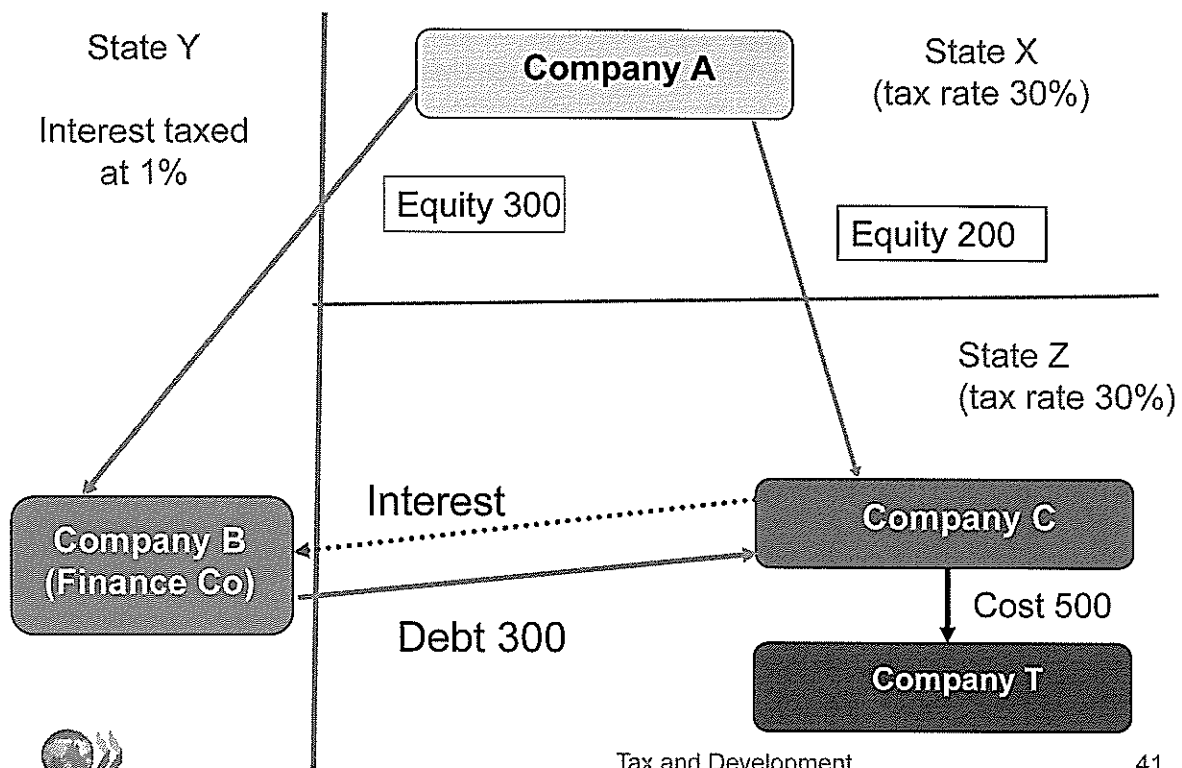
- Rules to restrict the interest paid by subsidiaries of MNEs
- Interest can be excessive
 - Too much debt
 - Too high a rate of interest
- Thin capitalisation rules are about restricting the amount of debt.



CASE STUDY (1)



CASE STUDY (2)



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Transfer Pricing

- Transfer pricing concerns the pricing (and other terms) that companies use when carrying out transactions with members of the same group
- This pricing will influence where profit or loss will be recognised:
 - TP rules rely on the arm's length principle (article 9 of MTC), and
 - Are designed to produce reasonable allocation of income within the MNE
- Tax authorities have introduced legislation to regulate transfer pricing for taxation purposes

**“Train the Trainers” Event
30 November – 5 December 2015
Seoul, Korea**

**Module 4 – Session 8
Case Study 4
 (“Cool Co”)**

Global group activities

Cool Co is a large MNE that develops, manufactures and sells designer clothing.

The structure of the group includes:

- a) Head Office in Paris;
- b) An intellectual property holding company in Switzerland;
- c) Manufacturers in a number of Asian countries;
- d) Three regional logistics-management subsidiaries, including one in the Cayman Islands – Cool Co (Cayman Islands);
- e) A sales centre and supply-chain management company in Ireland – Cool Co (Ireland).

Audit and investigation

The tax authority in Country X is notified that a branch of Cool Co Cayman Islands has been established in Country X for at least two years.

As a result of this notification, you request some information from the company. The company's response is contained in the letter in Annex 1.

After receiving this information, Country X tax authority instigates an audit. During the course of this audit, the tax administration requests further information, and holds two fact-finding meetings.

Annex 2 provides Cool Co (Cayman Islands) response to the Cayman Islands' tax administration in response to a TIEA request for information

Annex 3 contains notes taken to record a fact-finding meeting.

Annex 4 contains notes taken to record a supplementary fact-finding meeting

Annex 5 summarises the relevant domestic law and treaty provisions

1. Permanent Establishment

Country X tax administration has concerns that the branch gives rise to a taxable presence (Permanent Establishment) of Cool Co (Cayman Islands) and/or Cool Co (Ireland) in Country X.

Cool Co (Cayman Islands) claims that its branch in Country X is not a PE because its activities are no more than “preparatory and auxiliary” (Article 5 (4)). They claim that the branch does no more than arrange delivery of goods to customers (shops and wholesalers in Country X) on behalf of Cool Co (Ireland).

Having considered all of the facts:

- 1) Do you consider Cool Co (Cayman Islands) has a taxable presence (PE) in Country X?**
- 2) Do you consider that Cool Co (Ireland) has a taxable presence in Country X?**
- 3) Provide the reasons for your conclusions**

2. Residence

The tax legislation in Country X states that a company is resident in Country X for tax purposes if the company is incorporated in Country X or if its business is effectively managed in Country X.

Under the TIEA between Country X and the Cayman Islands the tax auditors in Country X asked for further information on Cool Co (Cayman Islands), which is summarised in Annex 2. From that information it is established that Cool Co (Cayman Islands) has 5 Directors. The names of the 5 Directors are obtained and it is established that the CFO (Mr A) and the Company Secretary (Mr B) of Cool Co (Cayman Islands) live in the Cayman Islands but the CEO (Mr C), and the 2 other Directors, live in Country X.

Further investigation establishes that since Cool Co (Cayman Islands) was incorporated the 3 Directors (including the CEO) who live in Country X have never been to the Cayman Islands but the CFO and Company Secretary have also never been to Country X.

It is established that Board meetings are held by videoconference with the Directors dialling in from the branch offices located in Country X. The Board minutes are prepared by the Company Secretary and circulated electronically for approval by all of the directors. All key strategic decisions are made during the videoconferences.

Further facts are obtained by Country X tax administration through letters and fact-finding meetings. These are set out in Annexes 1 to 4.

Based on all the facts:

- 4) Do you consider Cool Co (Cayman Islands) is tax resident in Country X?**
- 5) Provide the reasons for your decision**

ANNEXES

Annex 1: Cool Co's answer to Country X's request for information

To:
Country X Tax Administration

13 March 2014

Re: Request for information

Dear Sir,

Following your request for information, please find below the answers to your questions.

1. Background

As notified to you, a branch of Cool Co (Cayman Islands) is established and registered in Country X; the branch occupies 3 floors of an office building near the centre of the capital of Country X.

Cool Co (Cayman Islands) is the group logistics and support company for Central and South America - its role is to organise delivery logistics, and provide support to Cool Co (Ireland), throughout Central and South America. It has one branch and that branch is situated in Country X.

I should explain that the sales function for the Cool Co group is centralised in Cool Co (Ireland). The group does not sell directly to final customers, but to third party retailers and wholesalers, who purchase directly from Cool Co (Ireland). Sales are generally made by telephone (through a call centre in Ireland) or from Cool Co (Ireland)'s web site.

All sales contracts are thus between Cool Co (Ireland) and the customers in each country.

2. Management

The ultimate management of Cool Co (Cayman Islands) is conducted from the Cayman Islands. All the Directors of Cool Co (Cayman Islands) were hired by Cool Co (Cayman Islands) and are under an employment contract with Cool Co (Cayman Islands). Their contracts specify that all the duties and functions performed by the Directors relate solely to the business activity of Cool Co (Cayman Islands).

3. Activity of the branch:

Sales: The Branch performs the following functions

- market research,
- assessments of how the market is structured,
- and preparation of surveys.

As you see, the branch provides research activities to support the sales activity of Cool Co (Cayman Islands). It is important to note that the branch does not engage in sales activities. When a customer wishes to purchase stock, he/she contacts Cool Co (Ireland) directly, and the sales contract is signed by Cool Co (Ireland) and the customer. The branch has no contractual role in the sales process.

All sales are carried out by means of telesales from the call centre of Cool Co (Ireland) in Ireland. The process is the following: Call centres "cold-call" shops, warehouses, etc., and arrange delivery of catalogues; staff in the branch of Cool Co (Cayman Islands) visit potential customers and provide samples and, if relevant, marketing materials; actual sales are conducted through the call centre, which arranges delivery by means of a third party logistics firm; staff in the branch assist with the delivery and deal with, for example, customs issues and problems with delivery; invoices to customers are issued directly from Cool Co (Ireland).

Decisions on financial issues relating to the contracts signed with customers are also made by Cool Co (Ireland)

Stock: The Branch has entered into a rental contract with a third party on behalf of Cool Co (Ireland). This provides warehouse space in the third party's warehouse in order to store the stock of clothes intended to be transferred to the customers. Cool Co (Ireland) has ownership of, and is responsible for, the stock housed in the warehouse.

After sales servicing: The Branch staff are responsible for this service, as they are located close to the customer. Its role is to liaise between Cool Co (Ireland) and the customer in the event of any problems. This might include delivery problems or returns of surplus or damaged stock.

Annex 2: Cool Co (Cayman Islands) answer to the request for information from the tax administration of the Cayman Islands under the TIEA, 9 April 2014

Cool Co (Cayman Islands)
George Town

9 April 2014

Re: Request for information

Dear Sir,

Following your request for information, please find below the answers to your questions in respect of residence issues.

Directors' meetings occur by videoconference for practical reasons. This ensures that all 5 of the Directors are available to participate in directors meetings. As they travel frequently and can rarely be at the same place at the same moment, videoconference is the most efficient means for them to be able to "meet" and discuss business issues.

Despite the necessity to set meetings by videoconference, the running of the company is conducted primarily by Mr. A, the CFO who is in charge of the financial affairs of Cool Co (Cayman Islands).

Three of the five Directors (including the CEO) live in Country X. But, as I am sure you agree, their personal residence should not affect the residence of the company itself, especially as key Directors are in the Cayman Islands and they are responsible for the day to day financial management of Cool Co (Cayman Islands), and the company is governed by the laws of the Cayman Islands.

Annex 3: Notes of the first fact-finding meeting, 2 May 2014

Outcome of the meeting with Mr C (the CEO) of Cool Co (Cayman Islands), 2 May 2014

Role of the branch in the business process/Functions performed by the branch:

Sales:

50 people work in the branch office in Country X and there are no employees of Cool Co (Cayman Islands) who work in the Cayman Islands apart from the two Directors.

Mr C has overall management responsibility for all the branch staff. He is responsible for the effective co-ordination of the different departments in the branch and works in partnership with the Director that has specific responsibility for each department.

Branch staff carry out research on potential customers and provide names and contacts to Cool Co (Ireland). The Branch meets with customers and potential customers on all relevant matters. At these meetings, they may demonstrate samples, and they also discuss prices based on the price list provided by Cool Co (Ireland). The Branch staff are allowed to negotiate a discount from the list price on a customer by customer basis (e.g. reduction of price, timing of payment). In practice, we discovered that the Branch has considerable leeway to negotiate the discount given.

When the customer is ready to make a purchase, he/she is asked to phone the call-centre in Ireland to confirm. Cool Co (Ireland) then issues the relevant invoices for the customer to sign and return to Cool Co (Ireland).

Financial and legal arrangements

In practice, the key terms of the sales contracts are agreed between the Branch staff and customers. This is closely supervised by Mr C with assistance from the Legal Director, who is located in Country X and leads a team of 4 lawyers located in the branch. Once these are agreed, they advise the sales department in Cool Co (Ireland) before the latter confirms with the customer and issues the relevant sales contract.

The branch sales team also discusses with each customer the credit terms of the sale.

Advertising:

A team of 10 employees located at the Branch direct advertising campaigns. They are provided with an advertising budget from the IP holding company, which meets the cost of the campaign. Within that budget, they have discretion to design an advertising strategy - centred on the Cool Co brand and trademarks - for Country X. In practice, there is limited oversight of this activity from the IP holding company.

Distribution:

In respect of the stock, the Branch staff liaise directly with the warehouse lessor. The orders to the group's manufacturers to ship clothes to Country X comes from the Branch, and the shipping contract to Country X is negotiated by the Branch staff. It therefore appears that the day-to-day management of the stock is subject to the Branch's supervision. A significant stock of goods is held locally at a third party warehouse rented in the name of Cool Co (Ireland). The rental agreement was negotiated by Branch staff. The branch has control over the amount, and type, of stock held at any time.

Stock remains in the legal ownership of Cool Co (Ireland) until the time of the sale to the customer.

Logistics

Whenever a problem occurs in the delivery of the clothes, the customer rings Cool Co (Ireland) to report the problem. Cool Co (Ireland) then informs the customer complaints department at the Branch who deals with the problem. This might involve offering to exchange the products or agree a discount if necessary.

Annex 4: Notes of the additional fact-finding meeting, 16 May 2014

Outcome of the second meeting with Mr C (the CEO) of Cool Co (Cayman Islands), 16 May 2014

1. Further information provided :

- On advertising: Participations in fairs and exhibitions in Country X are negotiated and organised by the Branch staff, and the cost borne by the IP holding company. The advertising team, and its head, are employed in the Branch by Cool Co (Cayman Islands) and do not have to give account of their actions to the IP holding company. However the Branch staff have to comply with the group's marketing policies, as designed by the IP holding company.

- after-sale servicing: After sales servicing is also the responsibility of staff in the Branch. Despite the warranty conditions provided for in the contract with Cool Co (Ireland), the performance of after-sales servicing is wholly devolved to the Branch and a team of employees was specifically hired in Country X to meet this objective. Furthermore, if the after-sales contract between Cool Co (Ireland) and the customers has expired, the branch still provides after-sales servicing to the customer's products at a charge.

2. Summary on the residence issue:

Cool Co (Cayman Island) has no office in the Cayman Islands. Mr A and Mr B work from their own private residence and videoconference in for Board meeting from their homes.

In respect of exchanges of information between all the Directors, except the videoconference meetings, all exchanges are by emails and the Directors have never met physically in the Cayman Islands or in Country X. Mr C makes all of the key decisions for the day to day running of the business and updates the other Directors on those decisions during the videoconferences

In Country X, the 3 Directors are located in an office with the other Branch staff. They have their own office/own telephone lines, and use the office's computer and videoconference equipment.

Annex 5: Legal provisions

Domestic legislation

Permanent establishments

Country X domestic legislation provides that a non-resident company is liable to taxation in Country X on its profits if it conducts a business through a “permanent establishment” in Country X. For domestic purposes, a permanent establishment is defined in accordance with the definition in the OECD Model Convention.

If a non-resident company conducts a business through a permanent establishment in Country X, it is liable to tax on the amount of profit that is attributed to the permanent establishment.

Residence

Country X domestic legislation provides that a company is a resident of Country X for tax purposes if it is incorporated in that country or if it has its place of effective management therein. The legislation states that the term place of effective management is to be construed in a manner that ensures consistency with Article 4 of the OECD Model Tax Convention.

Bilateral Treaties

Country X does not have a treaty with the Caymans Islands, but has entered into a Tax Information Exchange Agreement (TIEA).

Country X has entered into a double taxation agreement with Ireland, which is in line with the OECD Model Convention.

Articles 4 and 5 of the OECD Model Convention

For information, **Articles 4 and 5 of the OECD Model Convention** are reproduced below.

ARTICLE 4

RESIDENT

1. For the purposes of this Convention, the term “resident of a Contracting State” means any person who, under the laws of that State, is liable to tax therein by reason of his domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof. This term, however, does not include any person who is liable to tax in that State in respect only of income from sources in that State or capital situated therein.

2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then his status shall be determined as follows:

- a)* he shall be deemed to be a resident only of the State in which he has a permanent home available to him; if he has a permanent home available to him in both States, he shall be deemed to be a resident only of the State with which his personal and economic relations are closer (centre of vital interests);
- b)* if the State in which he has his centre of vital interests cannot be determined, or if he has not a permanent home available to him in either State, he shall be deemed to be a resident only of the State in which he has an habitual abode;
- c)* if he has an habitual abode in both States or in neither of them, he shall be deemed to be a resident only of the State of which he is a national;
- d)* if he is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, then it shall be deemed to be a resident only of the State in which its place of effective management is situated.

ARTICLE 5

PERMANENT ESTABLISHMENT

1. For the purposes of this Convention, the term “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

2. The term “permanent establishment” includes especially:

- a)* a place of management;
- b)* a branch;
- c)* an office;
- d)* a factory;
- e)* a workshop, and
- f)* a mine, an oil or gas well, a quarry or any other place of extraction of natural A building site or construction or installation project constitutes a permanent establishment only if it lasts more than twelve months.

4. Notwithstanding the preceding provisions of this Article, the term “permanent establishment” shall be deemed not to include:

- a)* the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;
- b)* the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;
- c)* the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;
- d)* the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise;
- e)* the maintenance of a fixed place of business solely for the purpose of carrying

on, for the enterprise, any other activity of a preparatory or auxiliary character;
f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

5. Notwithstanding the provisions of paragraphs 1 and 2, where a person — other than an agent of an independent status to whom paragraph 6 applies — is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that paragraph.

6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

7. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

Extract from the Commentary on the provisions of the Article 4

Paragraph 3

21. This paragraph concerns companies and other bodies of persons, irrespective of whether they are or not legal persons. It may be rare in practice for a company, etc. to be subject to tax as a resident in more than one State, but it is, of course, possible if, for instance, one State attaches importance to the registration and the other State to the place of effective management. So, in the case of companies, etc., also, special rules as to the preference must be established.

22. It would not be an adequate solution to attach importance to a purely formal criterion like registration. Therefore paragraph 3 attaches importance to the place where the company, etc. is actually managed.

23. The formulation of the preference criterion in the case of persons other than individuals was considered in particular in connection with the taxation of income from shipping, inland waterways transport and air transport. A number of conventions for the avoidance of double taxation on such income accord the taxing power to the State in which the “place of management” of the enterprise is situated; other conventions attach importance to its “place of effective management”, others again to the “fiscal domicile of the operator”.

24. As a result of these considerations, the “place of effective management” has been adopted as the preference criterion for persons other than individuals. The place of effective management is the place where key management and commercial decisions that are necessary for the conduct of the entity’s business as a whole are in substance made. All relevant facts and circumstances must be examined to determine the place of effective management. An entity may have more than one place of management, but it can have only one place of effective management at any one time.

24.1 Some countries, however, consider that cases of dual residence of persons who are not individuals are relatively rare and should be dealt with on a case-by-case basis. Some countries also consider that such a case-by-case approach is the best way to deal with the difficulties in determining the place of effective management of a legal person that may arise from the use of new communication technologies. These countries are free to leave the question of the residence of these persons to be settled by the competent authorities, which can be done by replacing the paragraph by the following provision:

3. Where by reason of the provisions of paragraph 1 a person other than an individual is a resident of both Contracting States, the competent authorities of the Contracting States shall endeavour to determine by mutual agreement the Contracting State of which such person shall be deemed to be a resident for the purposes of the Convention, having regard to its place of effective management, the place where it is incorporated or otherwise constituted and any other relevant factors. In the absence of such agreement, such person shall not be entitled to any relief or exemption from tax provided by this Convention except to the extent and in such manner as may be agreed upon by the competent authorities of the Contracting State.

Competent authorities having to apply such a provision to determine the residence of a legal person for purposes of the Convention would be expected to take account of various factors, such as where the meetings of its board of directors or equivalent body are usually held, where the chief executive officer and other senior executives usually carry on their activities, where the senior day-to-day management of the person is carried on, where the person’s headquarters are located, which country’s laws govern the legal status of the person, where its accounting records are kept, whether determining that the legal person is a resident of one of the Contracting States but not of the other for the purpose of the Convention would carry the risk of an improper use of the provisions of the Convention etc. Countries that consider that the competent authorities should not be given the discretion to solve such cases of dual residence without an indication of the factors to be used for that purpose may want to supplement the provision to refer to these or other factors that they consider relevant.

Also, since the application of the provision would normally be requested by the person concerned through the mechanism provided for under paragraph 1 of Article 25, the request should be made within three years from the first notification to that person that its taxation is not in accordance with the Convention since it is considered to be a resident of both Contracting States. Since the facts on which a decision will be based may change over time, the competent authorities that reach a decision under that provision should clarify which period of time is covered by that decision.

Module 4 - Session 8

Case Study 4

("Cool Co")

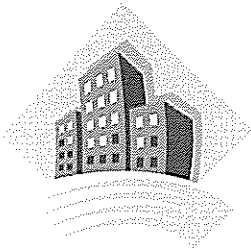
Cool Co Group

**Cool Co
(Ireland)
Sales company**

**Cool Co
(Cayman Islands)
Logistics and
support centre**



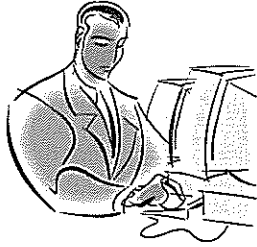
Country X



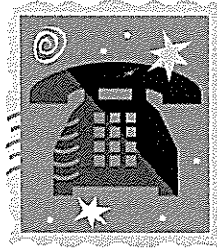
- Cool Co (C.I.) occupies 3 floors
- 50 employees work in this office
- Meet with customers and potential customers. They can discuss prices based on the price list provided by Cool Co (Ireland) and negotiate a discount.
- Customer phones the call-centre in Cool Co (Ireland) to make purchase.

Cool Co (Cayman Islands)

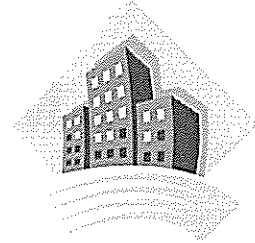
Cayman Islands



CFO and
Company Secretary



Country X



CEO plus 2 other Directors

