

International Corporate Structures

The monthly newsletter for clients and friends of LCN Legal and for anyone involved in creating and maintaining corporate structures.

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The diagram above is adapted from the teachings of Werner Erhard, the American personal development thinker. The circle on the left represents the realm of "reality" or "facts"; what actually happened. The circle on the right represents our stories about what happened.

As non-stop "meaning-making-machines", our minds are programmed to create stories, or "meanings" around facts ("he or she didn't call because..." or "I didn't get that promotion because..."). We become emotionally attached to those meanings. Our stories and the underlying facts merge into a single mass of perceived facts, judgements, accusations and excuses. It feels like there is not much space for freedom of action.

It seems that we can't switch off our "meaning making machines", but we can become more aware of how they work. It can be very liberating to de-clutter our thinking about particular situations, by separating out the facts from the "meanings", deciding which "meanings" are helpful to us, and choosing which of them to adopt. Does not driving the right car, not living in the right house or not sending our children to a

certain school mean that we have failed? No, this is just a disempowering interpretation we have created for ourselves.

There is a similar opportunity for clarity in the world of corporate structuring and transfer pricing. There is a tendency to regard a corporate group as an undistinguished "blob". The world inside that blob is a mass of economic theory, mixed with "do's and don'ts" for dealing with particular tax authorities. It is said that legal documents are all very well, but they are 'trumped' by functional analysis, and the internal workings of an enterprise can be whatever you say they are. A transfer pricing strategy becomes a statement of what might have been, if it had actually been created.

One helpful distinction here can be that of "legal reality" vs "fiction". (Of course, this is not the only distinction.) The legal relationship between the members of a corporate group is a matter of legal reality. Corporations are creatures of law – and they only exist as legal persons (with the benefit of limited liability for shareholders) to the extent that they satisfy the requirements of the laws under which they are established. Where services or goods or financial support are provided by one group company to another, legal rights and duties

arise, whether or not a contract is reduced to writing. The officers of legal entities are subject to personal duties, for which they can be held personally accountable. This legal reality becomes decisive whenever a matter involves third parties. If trade marks need to be enforced, it's not the "group" that brings a claim. It's the registered proprietor and/or licensee of the mark in the relevant countries. If a health and safety incident occurs, the potential criminal prosecution is not against the "group", it is against the relevant legal entity ... and its directors.

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Paul Sutton is co-founder of LCN Legal and a corporate lawyer with over 20 years' experience of international corporate structures, including as a Director of KPMG's law firm in the UK and as a corporate partner in international law firm Pinsent Masons. He has lead the legal aspects of group reorganisation projects involving assets totaling over US\$25 billion and is a contributor to the LexisNexis online Transfer Pricing resources.



Paul Sutton
Paul Sutton
Co-Founder, LCN Legal

How to create an in-house tax function By Ian Barron

I was lucky in my career. I got to build my own in-house tax team, virtually from scratch, with the freedom to choose roles and individuals to fill them – all within pre-negotiated budgets.

This article focuses on tax teams for general industrial and commercial companies. The additional requirements for specialist industries like financial services or property are not covered here.

Let's visualise a growing international company which has always outsourced the tax function. Now the CFO wants to establish an in-house tax function. What should that function look like?

The goal should be a team that collectively and individually has the following attributes:

- Technically strong and highly commercial business advisers
- Knowledgeable about the company's business, products and systems
- Collaborative
- Willing to learn and cope with change
- Good negotiation and communication skills
- Capable and enthusiastic users of technology
- Users of logic and common sense

Clearly, this will require an investment of time and effort. In my opinion, the team should consist of individuals with different backgrounds and levels of experience. Just hiring tax technical people with only theoretical knowledge is not a good basis for any in-house tax team.

I think externally-trained tax people mixed with internal hires is likely to create the right balance. When I built my team, I deliberately included more internal candidates with finance backgrounds from different departments such as legal entity reporting, management accounting and treasury. This cross-section proved invaluable when dealing with tax audits – we were not just tax people but had direct hands-on experience of other relevant areas. I decided it was easier to teach them tax rather than trying to teach external tax advisers about the company. All were encouraged to take professional tax exams, and the company provided financial support and appropriate study leave. Later additions included external hires to add to the then existing expertise.

Ongoing training of a tax team is crucial, not just in technical matters but also in automation opportunities. Appropriate tax

software to increase efficiency, avoid errors and simplify processes should be a high priority for any company. The costs to comply are greatly outweighed by the negative impact of bad publicity from tax defaults.

The roles an in house tax team should perform will be determined by the nature of the company's business and the countries it operates in, but should cover:

- Tax policy development
- Tax audit management and resolution
- Tax governance and risk management
- Corporate Tax and Transfer Pricing – planning and compliance
- Tax accounting
- VAT – planning and compliance with 100% VAT recovery returns prepared within Finance and reviewed by Tax
- Other indirect taxes – depending on the nature of the taxes involved and only if Tax has direct input to provide
- Global mobility and employee taxes – better suited under Payroll and HR but with a link to Tax on policy and tax audit issues.

The importance and relevance of each of these roles will not only be driven by the company's business but also by its global tax strategy and attitude towards compliance.

The efficiency and competency of an in-house tax team will generally be determined by the qualities of the appointed Head of Tax who should ideally have the following main attributes:

- Technically sound but not blinded by detail
- Strong leadership skills
- Good communicator with tax- and non-tax people
- Commercial, proactive and innovative
- In conjunction with other key stakeholders, able to develop and achieve the company tax strategy
- Ability to influence peers, teams and colleagues of all levels of seniority.

The Head of Tax is crucial, not only for building and developing a strong tax function but also in acting as a business adviser and providing support to the CFO and senior management team.

Ian Barron is a strategic tax consultant to LCN Legal. Prior to this, Ian had a long tax career at American Express where he was Vice President and Head of Corporate Tax for the EMEA Region for 19 years.

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Without an understanding of the actual legal relationship between group companies, including the ownership of assets, any statement as to the allocation of risk between the parties is fiction. It is a story which may or may not be supported by the facts. A proper legal analysis is part of functional analysis, and is fundamental to the concept of comparability. Intercompany agreements and corporate structuring are two of the tools available to shape the legal reality, and to create a firm foundation for good governance, regulatory compliance and transfer pricing compliance.

10-point checklist for reviewing Intercompany Agreements

- 1 **Parties** – correctly described?
- 2 **Consistency with functional analysis** – especially as regards subject matter, pricing and risk
- 3 **Term and termination** – consistent with the parties' ability to bear risk
- 4 **Ownership of intellectual property** – for pre-existing IP and IP created in the performance of the agreement
- 5 **Vertical consistency** – where the agreement forms part of a chain of supplies
- 6 **Horizontal consistency** – where the supply needs to be aligned to, or differentiated from, other similar supplies
- 7 **Payment, default interest and currency** – consistent with actual / intended practice
- 8 **Administrative and reporting provisions** – consistent with actual / intended practice
- 9 **Governing law and formal requirements**
- 10 **Corporate benefit** – the arrangements as a whole should make commercial sense for each of the participating entities

Quote of the month

"In anything at all, perfection is finally attained not when there is no longer anything to add, but when there is no longer anything to take away."

Antoine de Saint Exupéry



Are corporations evil?

A review of "Let My People Go Surfing" by **Yvon Chouinard**

I would like to think of myself as a student of business autobiographies. This one is as thought-provoking and challenging as any I've read.

The author, Yvon Chouinard, is the founder and owner of Patagonia, a company which makes clothes for sports such as climbing, skiing, snowboarding, surfing, fly fishing and trail running. The book's subtitle describes him as a 'reluctant businessman'. Chouinard considers limited liability corporations 'born to be bad', due to their in-built profit motive and disregard for the environment. He believes that all products cause damage to the environment. And yet he has become a billionaire by creating a corporate group which turns over hundreds of millions of dollars annually and employs thousands of people.

This might seem a paradox, or even hypocrisy, but instead the account presented in his book feels natural and principled.

This book is in two parts. The first part is an account of the beginnings of Chouinard Equipment (which produced tools for climbers) and Patagonia (the far more profitable clothing retailer). It describes his introduction to rock climbing at the age of 14, through the

Southern California Falconry Club of which he was a member – Chouinard and his fellow members would climb down cliffs to collect bird of prey eggs from their nests.

Chouinard's passion for climbing (and surfing) lead to him making his own 'pitons', metal spikes which are hammered into rocks and used to support climbers and their ropes. He made the pitons by hand, using his own anvil. Most of his tools were portable, so he could load up his car and travel the California coast from Big Sur to San Diego, surfing. This gradually developed into a business with employees and catalogues of products. This in turn spawned a second business making clothes for adventure sports, which began when Chouinard brought back rugby shirts from a climbing trip to Scotland; the rugby shirts were hardwearing, and their collars kept the hardware slings from cutting into the neck. *(See the "Evolution of a Corporation" infographic about Patagonia on the back page of this newsletter.)*

The second part of the book is a description of the "philosophies" on which the ongoing operations of Patagonia are based. These philosophies cover product design, production, distribution, image, finance, HR, management and also the group's support for environmental activism. Here are some of the most interesting themes of the book from my perspective:



He believes that all products cause damage to the environment. And yet he has become a billionaire by creating a corporate group which turns over hundreds of millions of dollars annually and employs thousands of people.

1. The company's mission to "build the best product", not merely the best at a particular price point. This involves defining what "best" actually means – for example, durable, multifunctional, washable, and creating the least environmental damage not just in manufacture but also in distribution and in use.
2. The commitment to donate a specified proportion of revenue to charitable causes, not the usual wishy-washy promise to donate an unspecified percentage of profits. This has led to Patagonia's pledge to donate 1% of sales or 10% of profits, whichever is the greater, as well as the creation of the "1% for the Planet" alliance.
3. The idea of "natural" growth, and of not attempting to create unnatural demand for the company's products by appealing to customers' vanity. "We want customers who need our clothing, not just desire it."
4. A family-friendly office environment, including on-site child care "because we know parents are more productive if they're not worrying about the safety and well-being of their children."
5. The idea of going beyond a legal view of compliance, which is based on interpreting legislation and doing the minimum needed to satisfy its requirements... and instead adopting a self-directed approach of defining principles (such as reducing environmental damage) and developing a deeper consciousness of areas for action.
6. A culture of creating long-term relationships with a small number of suppliers and contractors (and distributors): "To work effectively on a single endeavour with so many other companies, with no compromise in product quality, requires a level of mutual commitment much deeper than the traditional business relationship. Mutual commitment requires nurture and trust, and those demand personal time and energy."

So are corporations inherently evil, as Chouinard suggests? I don't believe so. I'm not a religious person, but I believe that humans are made in God's image. And corporations are made in humans' image, with all their ambitions and the natural desire for survival and growth. It's open to us to shape corporations through our own consciousness and by genuinely caring about what we do.

“I want my future to be a positive one, one where I can be strong and make a difference to others”.

LCN Legal has pledged to donate US\$1,000 to youth work charity XLP for every qualifying instruction in 2017 (see lcnlegal.com/csr/ for details). Here's an inspiring personal account from **Chelsea**, one of the young people XLP has helped.

I've been involved with XLP since I was eight years old. I'm 16 now and my life feels so different now compared to back then. I didn't know my dad, so it was just me, my mum and my little sister. School was a nightmare. I was a bit chubby in primary school so people used to call me 'fat' and that's around the time the bullying started. As time went on it got worse as more and more people joined in and I became more and more withdrawn apart from the occasional time I'd try and fight back.

My mum did notice that I was going through a hard time as I was making loads of excuses or pretending to be ill so I didn't have to go to school. I just couldn't face the bullies. At one point the teachers got involved and tried to stop it but it actually made things worse – that's when the bullying became physical and I started being hit and pushed around. It was during all of this that I started going to the XLP bus project. It was easy to find – it was a big, bright pink bus and they were parked right outside my school!



I started to feel more confident, talk to people more... I started becoming my real self.

None of the people from my school were there so I felt it was easier to go and make friends. Before going to XLP, I used to be quiet and just shrug if someone asked me a question. But at the bus project there was a lady (XLP staff member), who used to just take time to sit with me, and talk, listen and encourage me to take part in the different activities going on. After a while when I was going to the bus every week, I started to feel more confident, talk to people more... I started becoming my real self.

Without XLP I think I'd still be very quiet and while there are still some days where I look in the mirror and hate what I see, I feel far more confident now about who I am and what I look like and I'm more involved with helping others and just meeting people. I even now help out at the bus project and look after some of the younger kids.

When I think back to the little girl I was at primary school I hardly recognise her. XLP have even helped me decide what I want to do with my future – I am now on a forensic psychology course right now. Lots of young people in my area don't get the same opportunities I've had with XLP – I've seen a young person stabbed outside a shop and there are lots of gangs in my area which means it doesn't feel safe to go out. I want my future to be a positive one, one where I can be strong and make a difference to others.

FREE RESOURCES:

Tax interviews from our blog at LCNLegal.com:

Peter Dobson

Regional Head of Tax at Ferrovial, the global infrastructure group.

Gareth Green

Founder of Transfer Pricing Solutions, a UK company providing specialist advice on transfer pricing and associated international tax issues.

Jennie Rimmer

Group Head of Tax at Aspen, the Global Speciality Insurance and (Re)Insurance Group.

Diary Dates:

FREE Legal surgeries on Intercompany Agreements for Transfer Pricing

LCN Legal offers free telephone surgeries on Intercompany Agreements for tax, Transfer Pricing and legal professionals.

Thursday 11 May 2017

Thursday 25 May 2017

Wednesday 7 June 2017

14.30–16.30 UK Time /

15.30–17.30 CET /

09.30–11.30 EST

To book a session please call us on **+44 20 3286 8868** or email us at info@lcnlegal.com.

Evolution of a Corporation: Patagonia

1953 Yvon Chouinard starts climbing, as a member of the Southern California Falconry Club

1957 Chouinard begins to hand-forge and sell 'pitons' – metal spikes for rock climbing

1965 Chouinard goes into partnership with Tom and Doreen Frost and incorporates 'Chouinard Equipment Co'

1987 Patagonia opens its first European store in Chamonix, France

1973 Patagonia is created as a separate clothing brand

1970 Chouinard Equipment imports rugby shirts from the UK

1989 Chouinard Equipment files for bankruptcy, due to low profits and liability claims. Patagonia opens a store in Tokyo

1991 Recession cuts at Patagonia, including a 20% workforce reduction

1996 Patagonia switches to 100% organic cotton

2013 Patagonia achieves annual sales of US\$ 600 million

Testimonials for LCN seminars, events and materials

"Excellent coverage of a complex topic."
Partner, Tax Advisory Practice

"This was a thought-provoking seminar with great and relevant discussion."
Founder, Tax Advisory Practice

"I really like the format! It is very clear and easy to follow. Can you teach our lawyers to write so clearly? I wonder sometimes if they are being paid by the word."

Director, International Tax and Transfer Pricing, Fortune 500 Company, commenting on our template agreements