International Corporate Structures

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

July 2017

The two fears standing between you and the group structure you deserve

In this issue...

Picture the scene: a meeting room in central London, just off the Marble Arch end of Oxford Street, 5 years ago. A slightly younger me has been called in to facilitate a workshop on legal entity reduction projects for a well-known corporate group with assets of over US$ 20 billion. The four or five delegates who are participating in the session are very pleasant, polite and interested, but clearly not particularly happy with having been charged with the task of removing over a thousand unnecessary subsidiaries. They have been doing this for a number of years already, as an addition to their 'day jobs', and they have no dedicated resource. They seem to have little in the way of senior support or recognition. They are using tired, incomplete checklists. They have managed to strike off a subsidiary which held a major asset – we're talking a value of a few hundred million. (Of course, this kind of thing happens to the best of teams, but they seemed to have little motivation to improve their processes as a result.) If a meeting could personify the phrase "project fatigue" this would be it.

So what can we learn from this? Of course, there are the usual points: engage director-level support to articulate the aims and importance of the project and to help escalate issues appropriately. Sort companies into batches and create deadlines for each batch to complete defined stages. Ensure that all stakeholders are engaged. Hire a team who knows what they're doing (like us) to create additional accountability and to ensure that the processes, approaches and documents correspond to best practice. But ultimately, something deeper is at stake.

"Getting one's house in order" has a powerful psychological impact, whatever the context. (For the domestic equivalent of this, see the book review on page 3 of this newsletter.) In a manufacturing group with gleamingly clean factory floors, uncovering a shoddy corporate structure would be as disappointing as meeting Jamie Oliver in person and finding out he's not actually a "good bloke". (I'm sure he is!)

At an institutional level, and at a personal level, there are two fundamental fears which stand in the way of any project to streamline a corporate group and create a clean, functional and compliant structure. One is the fear of losing a valuable asset. The other is the fear of triggering a significant liability. The root cause of both those fears is the "corporate memory" risk – the lack of reliable information about what any given entity in the group structure has done in the past. Typically, this state of affairs stems from factors such as staff turnover, historic acquisitions followed by the departure of a significant proportion of the workforce of the acquired group, and of course weak governance in the first place.

In fact, the remedy to the corporate memory issue is straightforward. It simply involves the application of a consistent due diligence process, with a clear materiality threshold. However, where a group lacks leadership which has confidence that the risks of corporate memory can be overcome and which implements the necessary organisational and procedural steps to do so, it is no surprise to see a half-hearted and indecisive streamlining project failing to achieve the clean and clear structure intended.

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

Are Intercompany Agreements really necessary?

By **Ian Barron**

I first experienced crossborder intercompany agreements ("ICAs") over 30 years ago and, having just joined a multinational group from a purely domestic UK tax background, I had difficulty understanding why they were needed, who wants them and who cares?

The answers were made clear very quickly, but I was mystified by my non-tax colleagues' lack of interest in ICAs and the comment we frequently heard of "when I feel the pain from having no agreements, I'll help you resolve your tax problem." Not a collective problem but one for the in-house Tax team alone!

Moving forward to 2017, does this sound at all familiar? If it does and you are a responsible for a multinational with crossborder charges, get ready to feel the pain over the next few years when BEPS related tax audits start kicking in to larger and ultimately smaller groups.

My first few European tax audits soon proved that ICAs were crucial support for major intercompany charges. That has never changed and will continue to apply. We were fortunate in having experienced US tax lawyers in the global tax department who had taken on the responsibility for drafting ICAs for all the major intercompany items. These agreements covered licensing, royalties, group funding and technology as well as the high value global back office services.

Tax inspectors then (and now) pay close attention to intercompany charges and the first request we encountered on audit was always to provide them with ICAs. They seemed happy to receive an operating overview from us and documentation covering the major high value items. What influenced them was clearly:

- the existence of agreements;
- consistency with other countries having similar operations and charges; and
- the same agreement terms applied whether a country had high, low or no taxes.

During subsequent years, tax audits still concentrated on intercompany charges but requests for copies of ICAs were no longer confined to major value charges.
This presented two significant challenges:

- historical gaps, as there were few (if any) ICAs for low value charges; and
- nobody in-house had the resources to draft large volumes of agreements and nor was there a budget for outsourcing to external legal specialists.

We couldn't fix the gaps for the past as the charges had been going on for years so we decided to fix them going forward in the hope that the 'pain' for the past would be tolerable, which fortunately it proved to be.

We faced the issue head on, suffered some relatively minor administrative fines but no tax adjustments. I think the regional tax inspectors appreciated the fact that:

- we had ICAs for the majors;
- we could support the minors economically, albeit without producing a contract; and
- we were open about the issue.

However, we were then under a commitment to fix the gap(s) going forward. As the global regulatory environment was changing with increased focus on good corporate governance and brand protection, a multifunctional team was established with appropriate resources and budgets to fix the gaps and deal with future ICAs. The team included tax, finance, business representatives, internal audit and internal control amongst others, all led by legal. External resources were used as required and automated solutions were sought wherever feasible. The team reported into senior management and subsidiary boards.

Good governance and brand image protection apply to all multinationals as do the tax risks associated with compliance failings. Current and future tax audits will increasingly focus on basic compliance requirements like appropriate documentation, including ICAs.

In my experience, ICAs for (major) transactions have always been crucial and in this BEPS world, documentation compliance is paramount and should not be ignored. The last thing any company wants is to be classified as high risk because of compliance deficiencies.

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.

Book Review:

The Life-Changing Magic of Tidying

By **Marie Kondo**

There's a lot of received wisdom about tidying and clutter around the home. One is the idea of 'storage solutions' – clever ways to create more storage space: boxes under beds, sucking the air out of quilts, extra hooks on the backs of doors, fitting cupboards into corners, loft conversions, and so on. Obviously the homeware and home improvement industry has a huge vested interest in continuing to sell this idea.

Another idea is that of tidying 'little and often'. Or the inevitability that, after you have 'tidied up', things will soon get back to their messy state again.

Here's a book which directly contradicts all that received wisdom: The Life-Changing Magic of Tidying. It's by Marie Kondo, a Japanese organizing consultant who apparently started her business at age 19 when she was sociology student at Tokyo Woman's Christian University.

It's not a new book (it was first published in Japan in 2010), but it is both eye-opening and endearing. Kondo says: "Putting [your] house in order positively affects all other aspects of [your] life – including work and family." It's not difficult to believe this is true.

Part of Marie Kondo's message is obvious. For example: unless you discard things, you will keep accumulating more and more possessions. So no matter how much storage you have, eventually you will run out of space. Therefore Step 1 in decluttering is to decide which possessions to keep, and to discard the rest. She says she's never encountered a home which does not have enough storage for the things the owners actually want to keep. Most 'storage solutions' are just a way to put clutter out of sight, not to actually deal with it.

Famously, Kondo's criterion for deciding whether to keep something is whether it 'sparks joy'. In order to apply this, she tells us to tidy category by category (not one room at a time). For each category – such as books – take out all your books, wherever they are in your home, and put them together on the floor. Then take each book in hand, and decide whether or not it sparks joy in you.

According to Kondo, there is a wrong and a right order to tackle your possessions. The 'right' order is: clothes, books, documents (paper), miscellaneous items, and mementos or other sentimental items.

One of the most useful things about the book is that it provides a way of thinking to help you let go of things which don't spark joy, but which often seem difficult to give or throw away. Such as presents you don't much like, which were given by well-meaning relatives. Kondo says that a gift serves its purpose at the moment it is received. If the gift no longer gives you joy, then it is no longer serving its purpose, and it should be allowed to move on. She is similarly ruthless about old instruction manuals, books you think you may want to read in the future, reference materials which may be useful "one day", and electrical cords for unidentified appliances.

Once you have decided what to keep, Step 2 is to decide where to put it. Everything must have its 'home'. Similar things should be kept together, and not distributed in different places around the home.

One of Kondo's less obvious messages is this: if you tidy "little and often", you'll be tidying forever. Her advice is to tidy quickly and to aim for perfection. Once people experience a clutter-free life, she says, they will never want to go back.

All this takes courage. The courage to confront your past, as represented by the possessions you have accumulated. "The space in which we live should be for the person we are becoming now, not for the person we were in the past."

It's not difficult to see the parallels with legal entity reduction projects. Why not aim for perfection – a clutter-free, distraction-free structure? Many of us spend a significant portion of our lives working on corporate structures. Why shouldn't we create ones that spark joy?

Quote of the month

"I disagree with everything I used to say."

Vivienne Westwood,
British Fashion Designer

LCN Legal in the news

News and commentary featuring LCN Legal in other publications include:

- **Transfer Pricing Week:** Top 10 pitfalls when implementing intercompany agreements for transfer pricing
- **Financial Director:** Why CFOs must have robust intercompany agreements

> "Putting [your] house in order positively affects all other aspects of [your] life – including work and family. It's not difficult to believe this is true.

How **you** can make us give more money to our charity partners XLP, and the difference it will make to young people at risk of educational failure, gang culture, knife crime and drug abuse.

LCN Legal has pledged to donate US$1,000 in cash to youth work charity XLP for every qualifying instruction in 2017 (see lcnlegal.com/csr/ for details). You can make us give more by recommending us for legal projects in our specialist areas of group structures and intercompany agreements, where we are acknowledged as experts. Just send us the details by email to info@lcnlegal.com, or call us on +44 20 3286 8868.

Here's a message from Michael Horsley, Corporate Partnerships Manager at XLP.

XLP is a charity which helps to create positive futures for young people living in nine of London's most deprived boroughs. Every week, we work with 1,500 children, either on a 1-2-1 basis or in small groups.

Over time, through mentoring and direct intervention, XLP builds relationships with the young people, helping them to see, and fulfill, their true potential. Crucially, we help young people to realise that there are positive alternatives to the dangers, such as educational failure, gang culture, drug abuse and knife crime, which can destroy young lives.

Through our partnership with LCN Legal we are able to make a real difference in the lives of the children and young people we help. Here are some examples of how XLP uses our resources – including the money raised by LCN Legal:

Community Bus Project: £12,850 could pay for XLP to run its Community Bus Project on a deprived estate for a year
Mentoring: £2,600 could provide an at-risk young person with 1-2-1 mentoring for one year
Arts Showcase Project: £18,000 could enable us to run an XLP Arts Project (Showcase event, performance and life/employability skills training) in one borough for one year
X-Mobile Recording Studio Van: £11,000 could enable us to operate the X-Mobile recording studio van across 4 boroughs for 3 months

Beth, 18, has been involved with XLP since 2009 when she attended a Camden bus project.

Beth: "When I was younger I started self-harming because there was just so much pressure to achieve and I kept having failure after failure. I had blades hidden all over my room in boxes and under pillows. I went from cutting myself to punching walls and I ended up breaking bones. XLP changed my life. I went from being broken down to being built right up - back to being the person I was before the self-harm. I had dropped out of school but I went back and then took a college course. I feel like a better person now because I can help other people."

At XLP, we're hugely grateful for the support that LCN Legal, and their clients, are providing. Together, we are enabling more young people, like Beth, to realise their potential and access more of the opportunities that life has to offer.

Evolution of a Corporation: Alibaba

1964 Jack Ma is born in Hangzhou, China

1988 Jack Ma graduates with a degree in English and becomes an English teacher

1995 Jack Ma creates his first website. He, his wife and a friend create a business called "China Yellow Pages" to build websites for companies

1999 Jack Ma leads a group of 18 friends to found Alibaba, a China-based B2B online marketplace

1999 to 2000 Alibaba attracts US$25 million in foreign venture capital investment

2003 Alibaba founds Taobao Marketplace, China's largest consumer-to-consumer online shopping platform

2004 Online payment platform Alipay becomes a separate business within the Alibaba group

2014 IPO on the NYSE raising US$25 billion, making it the largest IPO in history

2016 Alibaba becomes the world's biggest retailer, surpassing Walmart and with a greater gross merchandise volume than Amazon and eBay combined

New: LCN Legal Intercompany Agreements Toolkit for Transfer Pricing

- Imagine that all your intercompany charges were supported by easy-to-read intercompany agreements which reflected international best practice.
- Imagine the peace of mind you will have, knowing that those agreements actually reflect the reality of how your group operates.
- Imagine that you had instant access to a well-organised and comprehensive online archive of signed agreements, whenever you need to respond to requests from tax authorities, regulators or auditors.
- Imagine having a clear roadmap to achieve all this, without unnecessary fuss or complication.

Our new toolkit is for international corporate groups which have the internal capability to review and tailor intercompany agreements themselves. It enables you to implement appropriate agreements far more quickly, avoiding the typical pitfalls which expose groups to unnecessary Transfer Pricing risks.

A 20% discount is available for LCN Legal clients and subscribers.

For more information, email us at info@lcnlegal.com, or call us on **+44 20 3286 8868**.

Testimonials for LCN intercompany agreements

"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