

# International Corporate Structures

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

October 2017

## How to fix the documentation gap



“Unfortunately, multinational groups are not similarly blessed with the ability to re-write history.”

It's a curious contradiction: the rule of law prescribes that members of a society (including those in government) are equally subject to publicly disclosed legal codes and processes.

Laws with retrospective application violate this principle, since a person cannot know and comply with a law that has not been promulgated. And yet case law - or judge made law - is always retroactive because, by definition, a judgment always relates to circumstances in the past. And of course there are numerous examples of retrospective legislation, especially in tax matters.

Transfer pricing is a case in point, including the recent Chevron case in Australia. The arm's length principle can mean that historic structures which were created 30 years ago or more are now open to re-interpretation by tax authorities, so as to disregard the effect of arrangements which they consider would not have been established between independent enterprises.

Unfortunately, multinational groups are not similarly blessed with the ability to re-write history. Very often, intercompany supplies and even intra-group restructurings may be undocumented, either because the arrangements were put in place in a hurry, or because a lower standard of documentation was required at the relevant time.

Here are some suggested general principles for dealing with a lack of formal legal documentation.

**1. The first step is to be clear about what is the end result to be achieved, and why.**

What are the arrangements which need to be documented? What are the drivers for this, the sanctions for non-compliance and the deadlines involved? Is it necessary to re-create documentation for historic arrangements and transactions, or is it sufficient to put in place contracts to regulate new arrangements or transactions going forward? As is made clear in the OECD's Transfer Pricing Guidelines, "The purported assumption of risk by associated enterprises when risk outcomes are certain is by definition not an assumption of risk, since there is no longer any risk." It may therefore not always be possible to document a contractual allocation of risk after the event.

**2. As for any other project, it is essential to identify who needs to be involved in the project, and who needs to be consulted.**

For example, the documentation of intercompany supplies may impact on a number of different issues such as corporation tax, VAT, customs duties, treasury, legal, regulatory, HR issues and so on. (A generic project planning form with a checklist of potential stakeholders is available at <http://lcnlegal.com/guides/project-planning-form-intercompany-agreements-for-transfer-pricing/>. You can also request a free copy by emailing us at [info@lcnlegal.com](mailto:info@lcnlegal.com))

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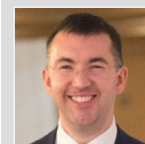
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**3. Depending on the circumstances, it is often necessary to establish the current state of affairs from a legal perspective, based on whatever contemporaneous documentation is available.** A lack of formal legal documentation does not mean that there is a blank slate as to how the arrangements are contracted between the relevant parties now. Legal rights and obligations will have already arisen between the parties, and unless they are properly identified and analysed, any subsequent documentation or restructuring will be open to challenge. This is independent of any transfer pricing analysis or tax adjustments, which can never affect the underlying legal reality.

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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

Quote of the month  
"This report, by its very length, defends itself against the risk of being read."  
Winston Churchill



## Tax audits... when quantity prevailed

By Ian Barron

During my career, I approached tax audits with a core strategy which I adapted to fit the particular country and the type of tax inspector handling the audit. One particular audit in a major European country demonstrates the need to adapt to local circumstances – however idiosyncratic they may be. Let me explain.

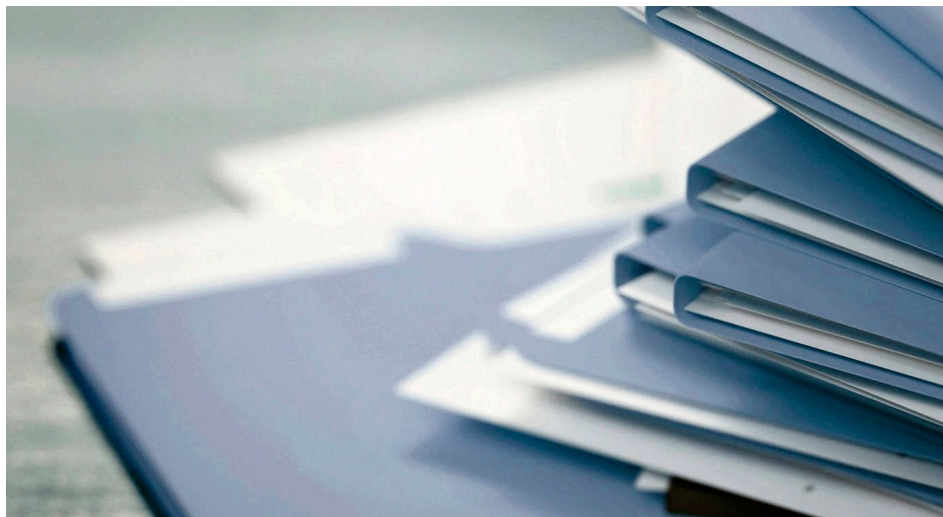
The audit was being conducted by an experienced tax inspector who had been given a deadline to close the audit. Throughout the process he only spent one day a week maximum in our local office.

During the first few weeks he asked for a business overview, which my local colleagues produced based upon the detail contained in the global consolidated financials. My local finance colleague told me that the inspector never actually read anything but just reacted negatively to the number of pages provided to him. We later realised that he lacked commercial awareness and as the overview was business driven he could not relate it to tax. He was more concerned with volume.

I asked for a call to be set up between him, my local finance colleague and me. We deliberately did not involve our tax advisers as there was nothing for them to do, although I did ask them to try to find out some background information on the tax inspector. They gave me some helpful information but said that local tax inspectors never agree to regular telephone meetings.

We had the call and I realised the tax inspector knew the areas he wanted to focus on (primarily intercompany transactions and agreements), but he didn't want to work excessively himself. I explained to him that I would be more than happy to speak with him weekly to ensure he received the requested information and answers to any questions. However, I could only do this by phone as I had no budget to cover the cost of regular weekly trips from the UK. He was aware that our local people were finance specialists and not tax, so he agreed.

During our weekly calls we established precisely what he needed and provided him with written support where necessary. We recognised that he would be looking to receive:



- a written detailed global business overview with a link to the local activity;
- a local market transfer pricing report including details of intercompany transactions and their economic support;
- copies of intercompany agreements; and
- flow charts of the various financial systems

In those pre BEPS days we generally prepared the information on an 'as requested' basis, except in relation to certain major countries for which we produced information in advance.

Our tax inspector appreciated the information provided, especially the intercompany agreements for the major transactions. Incidentally, the inspector's report requested we should have agreements for all intercompany transactions and not just the majors.

The inspector required everything in hard copy and in binders. To maximise the number of binders I asked my colleagues to print everything single sided. Maybe not eco friendly but it met his requirements as evidently his superiors would judge him on quantity as well as quality!

During the weekly calls with the tax inspector we developed a mutual trust and respect which is crucial in closing an audit amicably. They also enabled me to learn some things about him:

- he was technically strong;
- he lacked commercial awareness and needed help to understand the business context;
- he was a stickler for the process he needed to go through; and
- he was almost as obsessed with volume of information as with quality.

We handled the audit accordingly, negotiated where needed and achieved a successful conclusion with minor adjustments.

Oh and our tax advisers couldn't believe we'd actually held regular tax audit meetings over the phone. Just proves if you don't ask...

**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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**4. The final step involves defining the proposed contractual arrangements, and the means of getting from A to B.** At its simplest, if the facts and the legal analysis support the existence of the intended ongoing arrangements, it may be possible to put in place agreements which confirm and document the arrangements which are already in place. More complex situations may require an analysis of different options for getting from A to B. Such options may involve the termination of existing (undocumented) contractual arrangements, the transfer of assets and staff, the restructuring of share capital or membership interests, and the removal or merger of legal entities, for example.

# What on earth is the GDPR?

GDPR stands for “General Data Protection Regulation”, a new regulation of the European Union which takes effect on 25 May 2018. It has been described by the Financial Times as “[the] most sweeping overhaul of regulations on personal information for two decades.”

The GDPR is significant for finance and tax professionals in two respects: firstly, the new levels of fines involved are economically significant, raising the issue of how associated risks should be allocated between group entities. Secondly, intra group contractual provisions between data controllers, data processors and subcontractors need to be integrated with the treatment of intercompany agreements for transfer pricing purposes.

“Data controllers must ensure that the processing of personal data complies with the GDPR.”

## Which organisations are caught by the GDPR?

The GDPR applies to ‘data controllers’ and ‘data processors’. A ‘data controller’ determines the purposes and means of the processing of personal data. A ‘data processor’ processes personal data on behalf of a data controller. As personal data includes pretty much any information of a personal nature, most companies will be data processors and/or data controllers.

Controversially, the GDPR does not just apply to data controllers and data processors within the EU. It also catches data controllers and processors outside the EU whose activities relate to the offering of goods or services (even if for free) to EU data subjects (individuals), or monitoring the behaviour of such individuals. A spokesperson for the American Bankers Association has been quoted as saying “From an architectural perspective, I think companies are going to assume everyone they’re dealing with is a European Union citizen.”

## What obligations does the GDPR impose?

The GDPR contains stringent new conditions on data controllers to obtain valid consent from data subjects. These include conditions that:

- the controller must be able to demonstrate that the individual has consented to the processing; and
- the individual must have the right to withdraw consent at any time and it must be as easy to withdraw consent as to give it.

Data controllers must ensure that the processing of personal data complies with the GDPR. In addition, the GDPR introduces new standards of accountability, including obligations to:

- keep certain records;
- notify most data breaches to the relevant national data protection authority within 72 hours of becoming aware of them and, in some cases, to the data subjects affected “without undue delay”;
- conduct a data protection impact assessment for certain types of data processing; and
- in some cases, designate a ‘Data Protection Officer’ as part of their accountability programme.

## What sanctions are there for breach?

The GDPR allows for fines of up to the higher of 4% of annual worldwide turnover and EUR20 million.

## What impact does this have on multinational enterprises?

Multinational groups must review the basis on which they collect and use personal data, including their privacy notices and related policies. They will need to put in place procedures to ensure they can react quickly to data breaches, and establish an overall accountability framework. The handling of cross-border transfers of data to countries outside the EEA remains a key issue, and the increased level of fines makes it even more important to do this correctly, even when the transfer is intra-group. This involves imposing appropriate contractual safeguards, either through intercompany agreements or so-called ‘Binding Corporate Rules’. Intercompany agreements relating to intra-group transfers of personal data form part of our suite of intercompany agreements that we offer clients at LCN Legal, including in our popular Toolkit for Intercompany Agreements for Multinational Enterprises.



## NEW SPECIAL REPORT: Essential Briefing on Transfer Pricing for In-house Legal Counsel

*“Importantly, ex ante contractual assumption of risk should provide clear evidence of a commitment to assume risk prior to the materialisation of risk outcomes. Such evidence is a very important part of the tax administration’s transfer pricing analysis of risks in commercial or financial relations, since, in practice, an audit performed by the tax administration may occur years after the making of such up-front decisions by the associated enterprises and when outcomes are known.”*

OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 2017 edition, p 63 (emphasis added)

Intercompany agreements are an essential part of transfer pricing compliance documentation. But transfer pricing is by no means the only driver. Intellectual property enforcement, the General Data Protection Regulation (GDPR), corporate governance, ring-fencing of liability risks and other regulatory requirements may all trigger a need for intercompany agreements. Unless tax functions pro-actively engage with legal functions and the group as a whole, the group’s transfer pricing position may be

undermined by agreements which do not take into account tax compliance objectives.

LCN Legal has produced a special report to help tax functions engage with legal colleagues on this issue. It’s an essential briefing on transfer pricing compliance for legal counsel, and includes:

- Selected extracts from the 2017 edition of the OECD Transfer Pricing Guidelines, illustrating the role which legal analysis and documentation plays in transfer pricing compliance
- A two-page executive briefing on transfer pricing for legal counsel
- A simplified case study illustrating a typical flow of intra-group supplies and related intercompany agreements
- A checklist of the main areas of legal input required for transfer pricing compliance
- General principles for the preparation and implementation of intercompany agreements
- An in-house tax view: ‘Are intercompany agreements really necessary?’ by Ian Barron
- A list of additional free resources from LCN Legal

To request your free copy, email us at [info@lcnlegal.com](mailto:info@lcnlegal.com), or call us on **+44 20 3286 8868**



### Intercompany Agreements Toolkit

LCN Legal is one of the very few independent law firms with a dedicated focus on helping multinational groups to put in place effective intercompany agreements. Because we don’t give tax or transfer pricing advice, we are able to work collaboratively with corporates and their existing internal or external tax teams to get the job done as smoothly as possible.

#### We offer three levels of support:

- **Toolkits of tried and tested template intercompany agreements**, with telephone support from senior lawyers who specialise in this area. Our templates provide the peace of mind of working from documents which have been specifically created for the purpose and refined over a number of years, rather than hand-me-downs or freebies with no assurance of quality or relevance
- **Template agreements tailored for each applicable group**, using our standard documents and following a streamlined procedure to minimise the time spent by clients and their tax advisers to finalise the documents
- **Full service legal support**, including aligning the legal design of intercompany agreements with regulatory, corporate governance and risk objectives, hands-on support with due diligence and implementation, and assistance with setting up ongoing processes and reviews of intercompany agreements and the corporate structures to which they relate

For more information, email us at [info@lcnlegal.com](mailto:info@lcnlegal.com), or call us on **+44 20 3286 8868**.

### Evolution of a Corporation: Royal Dutch Shell

**1833** Shopkeeper Marcus Samuel expands his London business from selling antiques to also selling shells from the far East

**1890** Royal Dutch Petroleum Company is founded to develop an oilfield in North Sumatra

**1890s** The Samuel family business starts to export machinery, textiles and tools

**1897** The Samuel brothers rename their company from The Tank Syndicate to the Shell Transport and Trading Company

**1939** The outbreak of WWII means tankers come under government control; Shell losses are heavy, totalling 87 ships

**1929** Shell Chemicals is founded to advance the refinement of chemicals from oil

**1907** Shell Transport merges with Royal Dutch Petroleum to compete globally with Standard Oil. The new firm operates on a dual-listed basis.

**1904** The scallop shell or pecten replaces Shell Transport’s first marketing logo, a mussel shell

**1949** Shell draws its own first subsea oil in the Gulf of Mexico

**1950** Shell forms a partnership with Ferrari in Formula One

**1990s** Shell develops its liquefied natural gas (LNG) business

**2005** Royal Dutch and Shell Transport and Trading are unified under Royal Dutch Shell plc

**2013** Shell’s revenues are equivalent to 84% of the Netherlands’ \$556 billion GDP

### Testimonial for LCN legal

*“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.”*

**Brian Sturtz**, Former Director of International Tax and Transfer Pricing at Walmart Stores, Inc., commenting on template Intercompany Agreements created by LCN Legal