

Game of CORPORATES

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

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WINTER IS HERE

There's no doubt about it: the Game of Corporates has never been more dangerous. Advancing armies of tax inspectors, misinformed journalists and opportunistic politicians are looking for an easy kill, and they can smell weakness. Like the White Walkers in Game of Thrones (and perhaps certain of your colleagues joining your Christmas lunch), they are a terrifying and formidable force.

Some indisputable facts:

1. The recent 'Paradise Papers' scandal involving the theft of over 13.4 million confidential electronic documents relating to offshore investments, and the equally scandalous purchase and publication of the stolen records by supposedly reputable organisations such as Süddeutsche Zeitung and the BBC, shows that it is unsafe to rely on ideals of privacy or even confidentiality.

2. Ignorance of the law has never been an excuse, but the exponential increase in the volume and complexity of tax regulation makes it almost impossible for experts, let alone laypeople, to keep up. As Sam Mitha CBE (formerly of HMRC's Central Tax Policy Group) convincingly argued in a recent Tax Journal article, there are no votes for politicians in tax simplification, because it

is easy for most voters to comply with their tax obligations. Not so for corporates. Even healthy processes like consultation can add to complexity, by identifying anomalies and suggesting exemptions.

3. Of all the areas of tax compliance, transfer pricing is recognised as one of the most complex, because it involves reconciling the needs and demands of different tax administrations and supranational bodies such as the OECD. An adjustment at one end of a transaction will necessarily have an impact at the other end. Tax administrations recognize this, and are becoming increasingly aggressive in raising transfer pricing challenges.

4. Few tax administrations choose to prioritise resources for arrangements such as Advance Pricing Agreements (APAs), which can provide more certainty for taxpayers. Canada, for example, concluded only 26 APAs in 2016. This was ahead of the UK, which agreed 19 in the year 2016/2017, and China, which signed 14 in 2016.

5. The significance of intangible assets is increasing and, by definition, it is impossible to understand intangible assets without clarity on the legal rights and obligations involved. A report issued by the World Intellectual Property Organization (WIPO) on 20 November 2017 found that income from intangibles increased by 75% from 2000 to

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2014 in real terms, amounting to USD 5.9 trillion in 2014. Dealing with these intangible assets appropriately represents a huge challenge for corporates, tax administrations and other interest groups.

We have chosen 'Game of Thrones' as the theme for this newsletter to symbolize the metaphoric perils that exist for all of us as professionals in the corporate world, arising out of the complex web of legal, regulatory, tax, commercial and governance issues – and the fact that none of us are safe unless we work with specialists in each of the disciplines involved, to create structures which meet the needs of all stakeholders.

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Paul Sutton
Co-Founder,
LCN Legal





QUOTE OF THE MONTH

"Many human beings say that they enjoy the winter, but what they really enjoy is feeling proof against it."

Richard Adams

How to negotiate with the White Walkers (Tax Inspectors) By 'Maester' Ian Barron



Whenever I was asked what I did for a living, I occasionally just answered "I work in tax" without saying which side of the tax fence I worked, and I'd then smile. I must admit that my motive was mischievous as most people then thought "oh dear (or words to that effect) I think he is a tax inspector" and promptly moved away!

At the beginning of my career, I was far from comfortable dealing with inspectors but my then boss was quite right in saying:

- they are just human beings doing a difficult job
- some are good, some are clever, some are highly experienced, and others are young and ambitious – no different to any other organisation
- aim for mutual respect
- be open and honest
- be politely firm but fair
- negotiate when necessary, but never compromise yourself nor your client.

This advice has stayed with me and I applied it in all my dealings with global tax inspectors. I found that by engaging properly, major practical agreements could be reached which helped both sides.

My first success as a junior manager related to a very wealthy client who seriously hated writing cheques for his own personal taxes. Clearly we needed to keep the client compliant but, recognising his paranoia, we managed to get the local tax office to agree to collect the top tax rate from his directorships. This more than covered the tax due on his other income as well.

Although unconventional, it worked a treat. Everyone was happy, particularly the client who was fully aware of what was being done – a great practical solution.

During my time as an in-house tax person, I found most tax inspectors to be pretty reasonable – but we had to do our homework first and make sure we provided good information. Nothing was worse than having to go back to them admitting that the data supplied was incorrect.

What was paramount though was understanding the way tax inspectors in different countries operated. Preparatory work finding this out was always a big plus, as was trying to find out the background of the particular tax inspectors on our case.

I think tax inspectors as a group are unfairly maligned, although one valid criticism is their general lack of practical commercial awareness and understanding of how businesses actually work. In my view, there is a gap in their training which I believe can be helped by in house tax leaders and their teams providing the necessary practical insight. I tried to do this in several countries but my offer was rarely accepted as it was not the then usual practice in the country

concerned. However, I tended to start tax audits with a wide overview to give the tax inspectors an insight into our business, approach etc. which proved to be invaluable.

One progressive jurisdiction has been the UK where several years ago the Customer Relationship Manager ("CRM") initiative was introduced. I found it so refreshing to be able to spend quality time explaining how we operated as a company. Successive CRMs and their teams commented on how these explanations and training sessions enhanced their ability to perform their duties. For our part, we could freely discuss issues with HMRC, knowing they'd be treated properly in a collaborative manner.

I sincerely hope that this kind of open, collaborative approach can be maintained in the UK and adopted internationally in the BEPS compliance era. We'll need tax authorities and in house tax teams working together in practical training sessions.

I would like to think that global tax inspectors are looked upon in a positive manner in future because they are human beings... aren't they?

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My first experience of transfer pricing and the impact of legal issues was in the early 2000s, shortly after I had joined KPMG in London. I was asked to advise on the company law issues associated with a proposed APA which was likely to create ongoing losses for a particular subsidiary – could such an arrangement be properly approved by the subsidiary's directors? In my previous nine years of legal practice, I had never considered such a question. I had mainly focused on M&A and commercial law advice for German and Swiss clients, and it had never occurred to me there could be such a strong connection between tax governance and legal structures for multinational groups. The more I worked alongside tax professionals on international structures, the more I became fascinated by the process – and with bridging the gap between the worlds of "law" and "tax". It's a passion that continues now – and hopefully we can continue to work together to survive, at least until Series 99.

Can you re-write history and not get your head chopped off?

Asks Lord Eddard Stark

Many of us wish we could have done things differently. For me, questioning the Royal lineage of Joffrey Baratheon was perhaps not the greatest idea. When I changed the dying King Robert's will and got him to sign it, I may as well have been asking him to sign my own death warrant.

In the world of corporate structures, you may well be tempted to re-write history, and my friends at LCN Legal are often asked whether a particular intra-group agreement can be backdated. The short answer is 'no'. Giving a document a date which is earlier than the date when it was actually signed, will almost certainly constitute fraud and may result in your decapitation. Similarly, from a Transfer Pricing perspective, it is doubtful whether any attempt to re-allocate contractual risk after the event will be effective. As is highlighted in the 2017 edition of 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."

Clearly, it's better to put in place appropriate intercompany agreements before the relevant supplies are made. But if that didn't happen, it's better to act now, and set things straight. Doing nothing only increases the gravity of the problem: every day of inaction increases the period for which your tax filing positions are put at risk by inconsistent intercompany agreements.

So what actions should you take? Your options in relation to any given supply will depend on the proposed terms of that supply, and the conduct of the relevant group entities so far.

Documenting arrangements which are already in operation

One possible scenario is that the relevant supply arrangements are already in operation, but they have not been documented. For example, a subsidiary may have provided marketing services to the parent from a particular historic date, as reflected in the transfer pricing functional analysis. In this situation, it may be possible to create a document after the event which recites what actually happened, and which records the key terms on which the services have been made – including ownership of intellectual property. The document should be dated when it is actually signed, but it can refer to the historic 'effective date' of commencement of the relevant supply. This approach may be harder to justify where the arrangements are unusual or where a particular contractual risk profile is intended which is not clearly evidenced by the conduct of the relevant parties, such as in limited risk distribution arrangements.

Documenting new arrangements

In other cases, it may not be possible to say that the contractual terms you want are

already in operation. In that case you need to make a decision: either to put in place an agreement which purely covers the period from now onwards (and probably be open with tax inspectors about the fact that your previous transfer pricing position was not supported by the legal terms of the supply),

or put in place agreements now, with a historic 'effective date'. Any such agreements would be dated when actually signed, but would state that the parties have agreed to act as if the documented arrangement had been in place from the earlier effective date, and to allocate revenue, liabilities and rights accordingly.

Whenever any form of backdating is proposed, it is important to review the facts carefully. Additional due diligence should be considered in order to manage the risk of any unintended liabilities being triggered, and to ensure that the legal effect of the relevant arrangements is as intended.

To request your free copy of our briefing on How to Put in Place Effective Intercompany Agreements for Transfer Pricing, email us at info@lcnlegal.com.

"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."

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Are you fit to rule like a Queen?

Asks Mother-of-Dragons Danaerys 'Stormborn' Targaryen
Take our quiz to discover your leadership style:

You are asked to lead a group reorganization project. Do you ...

- A** Write a comprehensive plan?
- B** Call all the colleagues and advisers you know?
- C** Fret about how your colleagues may be affected?
- D** Spend a week in a corporate retreat to work out what to do

Your new team has lost focus and is demotivated. Do you...

- A** Call a meeting to allocate new responsibilities?
- B** Take them to the park to discuss the issues?
- C** Sit down with each individual, one-to-one, to talk through the problem?
- D** Analyse what happened on the last reorganization you were involved in?

Your boss asks you to coach another colleague. Do you...

- A** Tell them how to succeed in business and in life?
- B** Phone them every day to keep their spirits up?
- C** Provide a listening ear whenever they want to talk?
- D** Secretly doubt whether coaching makes any difference?

The group is sending its senior managers on a retreat. Do you...

- A** Go along purely to be seen to do the right thing?
- B** Look forward to catching up with your colleagues?
- C** Make it your aim to get to know them better?
- D** Appreciate having some distance from your day-to-day issues?

You have a great idea which will transform the effectiveness of your group, but your boss is not interested. Do you...

- A** Address her objections head on, and try to convince her?
- B** Talk to everyone who she respects, and ask them to help you?
- C** Put your idea on ice, because your priority is to have a good relationship with your boss?
- D** Take your time to assemble more facts to support your cause?

Mostly A's:

You are a 'Targaryen':
You are focused, results-orientated and a natural organizer. You may need to improve your listening skills.

Mostly B's:

You are a 'Tyrell':
You love to get others on board, and to have fun with your team. You may find it difficult to focus if you have to deal with a lot of detail and facts.

Mostly C's:

You are a 'Stark':
Your main priorities are looking after your team and living up to your values. You may be quietly outgoing or even reserved.

Mostly D's:

You are a 'Lannister':
Your cool style of leadership is characterized by calm and careful planning. You may find it difficult to accept others' ideas.

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

Tyrion Lannister asks:

Are you Risking your Neck because your Transfer Pricing is Not Supported by suitable Intercompany Agreements?

Don't leave it to the tax inspectors to write your agreements for you. Email us now at info@lcnlegal.com to request a free, confidential consultation with one of our senior lawyers.

The LCN Legal Interview: Jon Snow

How did you get into law?

I found my previous line of work bordering on stressful, plus I started to get RSI in my right arm from all the sword-fighting. Seeking justice is important to me so law was a natural transition.

Who has been the most influential role model for your professional life?

My father, Ned Stark, has been a great influence in my life – he taught me how to treat others, even enemies, with dignity and respect. He lived a full and interesting life and certainly had a good head on his shoulders.

What do you think is the biggest issue facing multinational corporates?

Climate change is taking its toll, it seems that winters are getting colder and lasting far longer than before. Multinational corporates will have higher heating bills. With so many high-value intercompany transactions taking place in the Oil and Gas industry, tax authorities and taxpayers around the globe will become increasingly at odds about what is an arms-length price for related party transactions. I am often told that I know nothing, however, I do know that these corporates will need to have their intercompany agreements in order for when winter arrives.

What is your biggest extravagance?

IKEA faux fur rugs. I quite enjoy wearing them.

In a movie of your life story, which actor would you like to play you?

Kit Harington – he would make a good rugged hero, although I hear he's scared of spiders...

What do you do to relax? When I am not fencing or curling my hair, I enjoy long walks in the woods with my wolf.

What is your favourite holiday destination?

I tend to prefer the southern lands, I hear they are safer and warmer than northern parts.

What piece of advice would you give your 25-year-old self?

Do not always trust your colleagues, some will stab you in the back, plus – try some mindfulness meditation to loosen up a little.

Evolution of a Corporation: Game of Thrones

