

International Corporate Structures

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

February 2018



Is your group structure ready for the tax inspectors? *I mean, really ready?*

If you are a regular reader of this newsletter, and of our regular emails, publications, legal resources and guides, you will know that we are advocates of effective intercompany agreements and related structures for multinational groups. Of course we are; a group without intercompany agreements is like a human being without integrity – you may achieve sporadic results, but consistent success (however you define it) is not available to you.

The reason for this is very simple: a corporate group exists as the inter-relationship between the individual group companies. To respect those relationships, and to respect the personal duties of the directors and officers of those companies, requires close attention in defining each of those relationships (not only the elements relating to pricing), and creating an ecosystem in which governance, assets, people, risks and risk mitigation are aligned. The only way to do this in a transfer pricing compliance context is to put in place effective intercompany agreements that reflect the group's operations, intercompany charging

structure and, of course, its transfer pricing policies and related documentation.

This may seem like a *'thick faced'* and harsh message. But as you will learn from the book review on page 3, *'thick face'* is a shield to use when speaking the truth – something my wife Xiaofang has no problem using when speaking the truth about my lamentable DIY skills at Chateau Sutton, to my great discomfort. But the truth is the truth.

One of the justifications we sometimes hear for procrastinating about intercompany agreements is that they have not been a major focus of tax inspections of that particular group. What's missing at the end of that sentence is a big 'YET'. The truth is that you will be betrayed by your own lack of inner peace. Oprah Winfrey defines true success as 'peace'. I agree totally. Of course, integrity is a matter of personal choice, but if you choose peace and integrity, then positive action inevitably follows.

The same applies to the content of the intercompany agreements themselves. It's easy to pay lip-service to the principles of governance and legal substance – just as it's easy to pay lip-service to diversity and gender

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Intercompany agreement review service for multinational groups

equality on pay – and produce contracts as a tick-box exercise. But substance always wins in the end. That's why, as part of the support we provide our multinational clients, we help them by reviewing the intercompany agreements they already have, and detailing the changes needed to make them fit for purpose, as well as filling the gaps where intercompany agreements are missing.

For more information about arranging a healthcheck for intercompany agreements, email us at info@lcnlegal.com.

It's no secret that LCN Legal is half Chinese, so naturally this newsletter is all about celebrating the new Year of the Dog and to sharing some of our favourite things about China. Enjoy!



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



Transfer pricing in China

Why a holistic approach is key

With **Martin Ng, WTS China**



Quote of the month



"A man rises in the world exactly to the same degree that he fears his wife. The peasant treats his wife like a dog or a horse. As a consequence, he is little more than a beast himself. A man who fears his wife will conduct his life properly in order to please her. By conducting his life properly, he will rise in the world. To such a man, his wife becomes a source of strength and a refuge from the misfortunes of the world."

Li Zong Wu, author of 'Thick Black Theory'

We recently had the very good fortune to catch up with Martin Ng, the highly experienced, Shanghai-based Managing Partner of WTS China, to pick his brains about Transfer Pricing and related risks for foreign corporates in China, and also to uncover some of the personal motivations behind his professional role.

The extract below is a small part of the interview he kindly gave. We highly recommend reading the full interview on our blog at www.lcnlegal.com.

LCN: What do you see as the biggest mistake which multinational corporates make in managing transfer pricing risks in China?

MN: The biggest mistake is the lack of a holistic control over the TP risk in China's circumstances in which tax, foreign exchange and customs administrations are much inter-related. Decisions are often made by overseas headquarters without due consideration to TP impacts to their Chinese subsidiaries. Some even do not have a centric TP policy for guiding the group's pricing towards their Chinese subsidiaries' functions and risks. Post-transaction compensations are often abused to beautify the gaps. The situation would simply go from bad to worse, as the compensation would reflect that the Chinese subsidiaries' value contribution is under-estimated.



Decisions are often made by overseas headquarters without due consideration to TP impacts to their Chinese subsidiaries.

Sometimes, it may trigger not only tax audit but also jeopardize cross-border fund flow.

LCN: Which types of supply tend to be most sensitive from a Chinese transfer pricing perspective?

MN: Service and royalty charges have become the spotlight of tax investigation in China. The Chinese tax authorities would assess, from BEPS perspectives, how the service is actually provided, how the royalty is granted, how the Chinese subsidiaries can benefit, how they match with the China entity in terms of functionality, risk level, business cycle, and whether the charges are reasonable, etc. For any cases involving a payment over USD 50,000 in one single remittance, the Chinese entity would need a tax settlement certificate before it can wire any funds overseas. In other words, if these intercompany charges are not well structured, they can be a major stumbling block to the Chinese operation.

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

MN: A Japanese chef in a medium-sized restaurant in Shibuya of Japan where I interned as a co-chef in 1989. It is no exaggeration to claim that his kitchen management style helped me define an early concept of "team working" and equipped me with the basic soft skill that I still find useful nowadays. The restaurant was right in front of one of the busiest train stations in Japan, and earned a soaring popularity among the non-stop commuters. Its kitchen was run in three shifts a day, with each shift of ten staff.

They had their unique way of churning things out at a tongue-tied speed. For example, they always paired two guys together to serve a simple task. The twin could in one accord produce three banana splits in six seconds. In every six hours, the whole team was replaced by another shift of staff - noodles were still in the pan and soups were still boiling. Without any computer or message board, I see no sign of any interruption. It was a show of concentration, artful skills and sincere respect to the job.

Tax practice is no exception an operation of team working and processes. It requires the similar techniques in leadership and process management.

Martin Ng can be contacted by email at martin.ng@wts.cn or by telephone on +86 21 50478665.

“ Many of us were taught that when someone slaps you, you should turn the other cheek. This is not always the best course of action. There is a time to submit to being slapped, and there is a time to hit back twice so you will not be slapped again.

 **BOOK REVIEW**

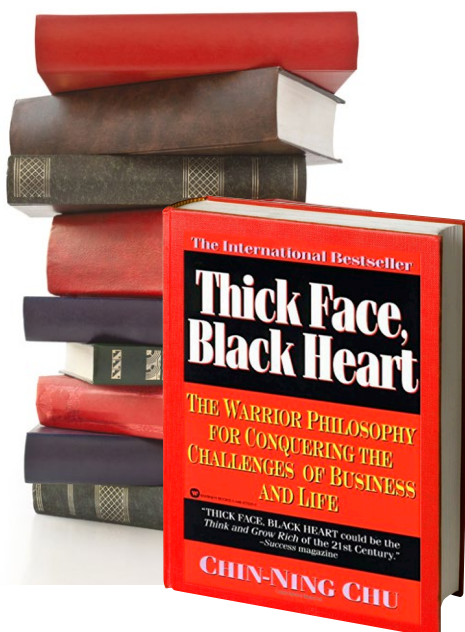
Thick Face, Black Heart

By **Chin-Ning Chu**

‘Thick Face, Black Heart’ (subtitled *‘The Warrior Philosophy for Conquering the Challenges of Business and Life’*) is more than just another self-help or business book. It is entertaining, enlightening and darkly fascinating. It combines Eastern philosophy with stories from ancient China, many of which make Game of Thrones look anaemic.

The author, Ms Chu, was born in Tianjin, China in 1946. She grew up in Taiwan and emigrated to the USA in 1969. She became a successful business consultant and business management writer, and died in 2009.

Chu’s book is based on a philosophical treatise called *“Thick Black Theory”* which was written by Li Zong Wu and was first intended to be published as a series of essays in The Chengdu Daily in 1911. In fact, the adverse reaction to the first instalment was apparently so intense that the rest of the series was cancelled. *“Thick Black Theory”* describes the ways used to obtain and hold on to political power: *“thick face”* (shamelessness), and *“black heart”* (ruthlessness).



The detail is breathtaking in its nakedness – such as ‘six ways to obtain an official position’, which are summarized as follows:

1. **Emptiness:** empty your mind of anything that does not relate to your appointment to the position you seek.
2. **Worming in:** take every little opportunity to advance your prospects.
3. **Self-praise:** constantly seek to bring your qualifications to the attention of those who can help you.
4. **Flattery:** ingratiate yourself with those who can help you, through flattery to their faces and to others.
5. **Threats:** make people understand that it might be unfortunate for them if they did not co-operate, and you ended up in a superior position to them. But be very subtle in your threats.
6. **Bribery:** use small bribes to create a sense of obligation, and large bribes to seal the appointment.



Chin-Ning Chu has taken the concepts of *‘thick face’* (which she describes as a shield) and *‘black heart’* (which becomes a spear), and used them as the core of a collection of principles for personal and business success, illustrated by stories of historical figures such as Abraham Lincoln and emperors in ancient China, as well as stories from the author’s own business life.

According to Ms Chu, we attain success in life by cultivating our warrior spirit and dedicating ourselves to expressing our own unique nature and in-built killer instincts. She challenges accepted wisdom: “Many of us were taught that when someone slaps you, you should turn the other cheek. This is not always the best course of action. There is a time to submit to being slapped, and there is a time to hit back twice so you will not be slapped again. ... If you turn the other cheek because you are afraid to hit back, it does not mean you are morally superior. It simply means you are a coward.”

Many of the principles in the book are essentially amoral, even criminal – and sometimes horrifyingly so. However, she also adds another key element: Dharma, meaning ‘duty’ or ‘right action’. According to Chu, all beings have their own Dharma and all situations and circumstances have a specific Dharma. Dharma is not determined by the mind, but is already there – inbuilt – as part of the way the universe works. The choice is simply whether we adhere to it or not. Chu’s prescription is to recognize your duty, and to fulfil it with dedication and duty. For example, an employee’s Dharma is simple: to support the employer wholeheartedly.

Thick Face, Black Heart is a fascinating read on at least two levels – one as an insight into Chinese culture, and another as a practical tool for guarding our values and achieving a peaceful state of mind. Highly recommended.

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Our top 5 off-the-beaten-path ancient sites to visit in China



1. White Horse Temple
The first Buddhist temple in China, established in 68AD



2. The Longmen Grottoes
The finest examples of Chinese Buddhist art



3. Shaolin Temple
Including its 'Pagoda Forest' of 240 tombs commemorating abbots and monks



5. Kaifeng
The ancient capital of Song Dynasty and the subject of China's most famous painting 'Along the river during the Qingming Festival'



4. The temple of The Yellow Emperor
Dedicated to the founder of Chinese civilisation, said to be the ancestor of all Chinese people



Intercompany agreement review service for multinational groups

We help you to spot and correct issues in your existing documentation (including identifying gaps) before they become a problem for you, by reviewing your existing template agreements, and giving you feedback as to how they can be improved.

Our healthcheck review can cover all of the intercompany agreement templates you currently use, or can instead focus on those template agreements which you consider to carry the highest risk.

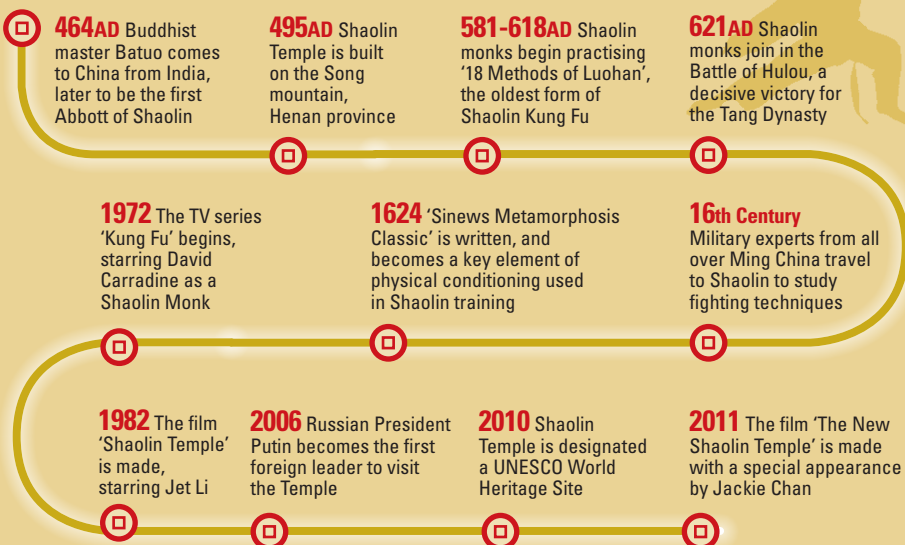
Email us at info@lcnlegal.com to arrange a consultation with one of our experts.

2018
YEAR
OF THE
DOG



Born in the year of the Earth Dog you are likely to be: **Communicative, serious, and responsible in work.**

Evolution of an Institution: Shaolin Temple



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