

32nd Annual Asia Pacific Tax Conference

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Trade liberalization in Asia

Are we there yet? Tax and trade developments affecting supply chains in the Asia Pacific region, including regional FTAs

Chair: Eugene Lim, Singapore

Simone Bridges, Australia

James Choo, Singapore

Meng Yew Wong, Malaysia

Michael Nixon, Singapore

Thanh Vinh Nguyen, Vietnam

- Update on trade developments in Asia
- Supply chain: interaction between tax, transfer pricing and customs duties
- Key issues:
 - BEPS implications for the supply chain
 - Hub structures: PE and duty preferences
 - INCOTERMS: revenue recognition, indirect tax, FTA implications
 - Impact on supply chain transformation
 - Audit environment
 - Future supply chain trends

Agenda

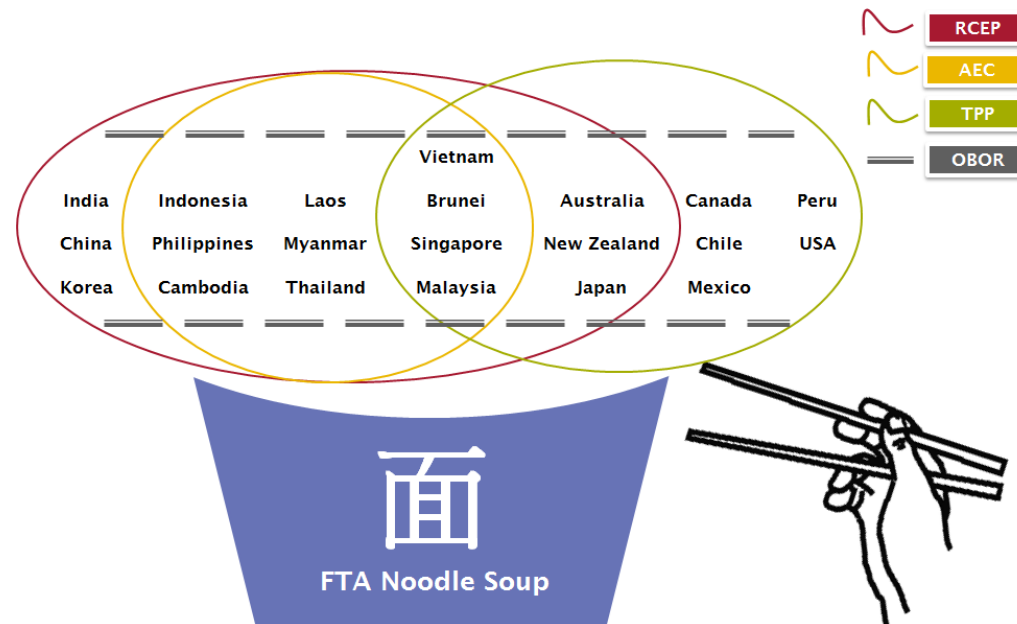
Asian trade developments

Asian Trade Initiatives

New Bilateral Agreements

- Australia – China;
- Singapore – GCC;
- Singapore – EU;
- Malaysia – Turkey;
- Vietnam – Korea;
- Vietnam – EU
- Vietnam – Customs Union of Russia, Belarus and Kazakhstan
- ASEAN – Hong Kong?
- Thailand-UK?

Mega-regional trade agreement



Impact of Brexit... expecting more FTAs???

AEC

Competitive Economic Region

- Competitive policies
- Consumer protection
- IP rights
- Infrastructure Development
- Taxation and E-Commerce

Single Market and Production Base

- Free flow of goods
- Free flow of services
- Free flow of investment
- Free flow of skilled labor
- Freer flow of capital

Region of Equitable Economic Development

- SME development
- Initiative for ASEAN Integration

Region Fully Integrated into Global Economy

- Coherent approach to external economic relations
- Enhanced participation in global supply network



Background to the TPP

- Trade agreement between 12 Pacific Rim countries
- Concluded on 5 October 2015 after 7 years of negotiations
- Draft text published on 5 November 2015
- Signed on 4 February 2016
- 40% of Global GDP, 1/3 Global Trade, population of 800m
- New 21st century free trade agreement
- Open architecture, other countries can join at a later stage



Source: <http://smallgrains.org>



RCEP

- ASEAN + 6 existing FTA partners (Australia, New Zealand, China, India, Japan, and Korea)
- 45% world's population with combined GDP: approx. 1/3 world's GDP
- Key coverage: trade in goods, trade in services, IP, investment, competition, and e-commerce.
- RCEP helps
 - upgrade existing 6 ASEAN + 1 FTAs
 - complement AEC 2025; and
 - harmonise/consolidate various ASEAN + 1 FTAs in one easy-to-navigate FTA
- 95% businesses believed that RCEP will enter into force in 3 to 5 years, after TPP.



OBOR

- OBOR is a development strategy and framework, proposed by China that focuses on **connectivity** and **cooperation** among countries primarily in Eurasia, which consists of two main components:
- It is estimated that the initiative:
 - Involves **65** countries
 - Covers **4.4** billion people (accounting for **63%** of global population)
 - The aggregate economic value of these countries amounts to **US\$21 trillion** (representing around **29%** of global GDP)



Source: Xinhua news agency

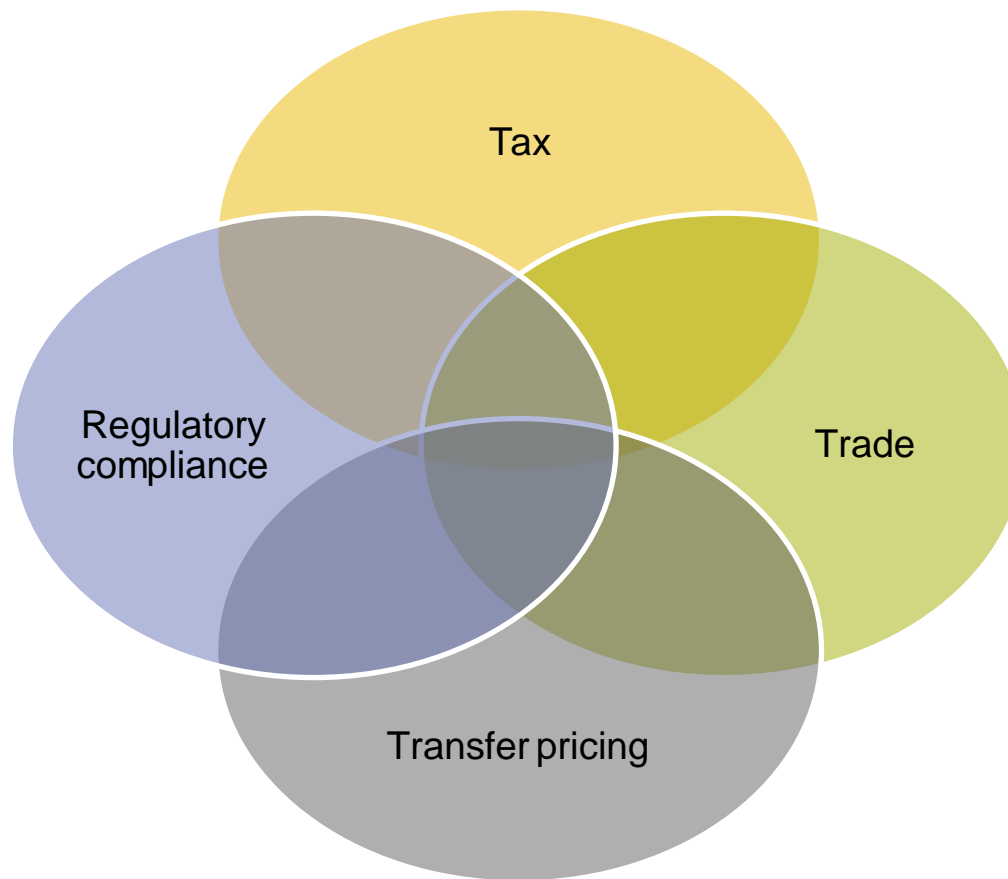
Resource: xinhuanet - Vision and actions on jointly building Belt and Road: http://news.xinhuanet.com/english/china/2015-03/28/c_134105858.htm

Key characteristics

- Free trade agenda increasingly subject to opposition
- Rules of origin increasingly complex
- Movement towards self-certification
- FTAs no longer about tariffs and customs duties
 - Tariff to non-tariff barriers
 - Goods to services, investments, IP, internal regulation, etc.
- FTAs becoming more sophisticated and nuanced!

Supply Chain: tax, trade and
transfer pricing

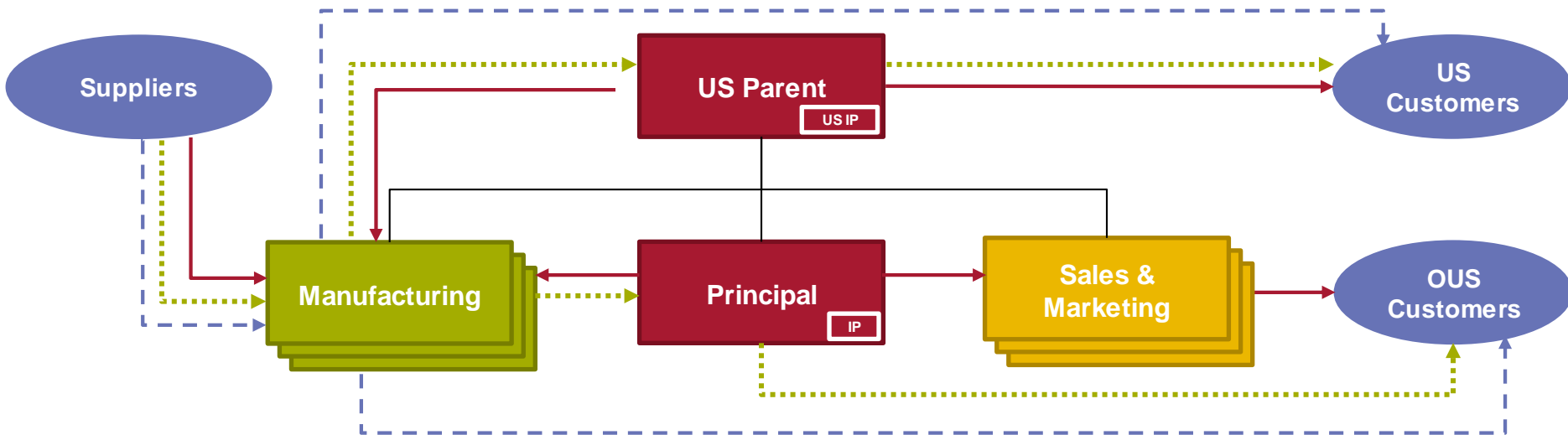
Supply Chain



Typical TP methodologies used in supply chains

- Principal company as the entrepreneur and manager of the supply chain; principal owns or licenses IP
- Routine returns allocated to non-principal entities
 - Manufacturing function
 - Buy/sell arrangement – contract manufacturing
 - Service arrangement – consignment/toll manufacturing
 - Distribution function
 - Buy/sell distributors
 - Sales (commission) agents or commissionaires
 - Sales support service provider
 - Other service providers – contract R&D, shared services

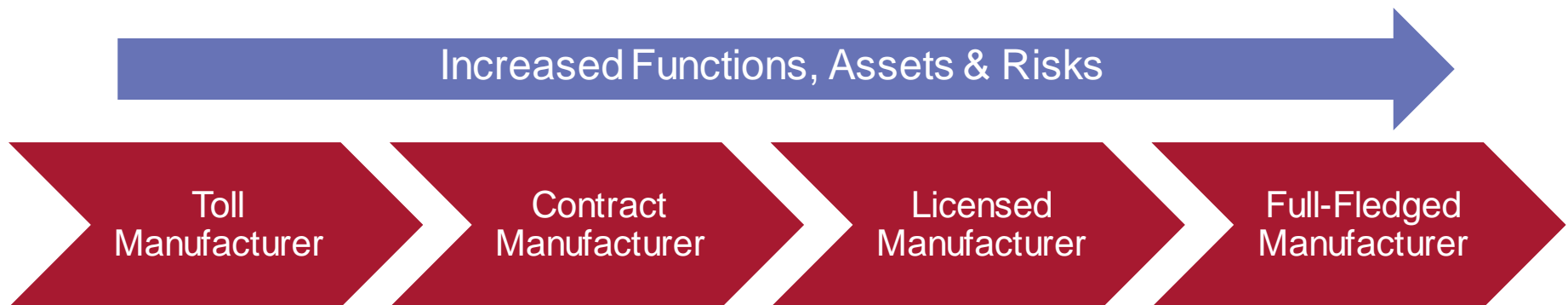
Typical TP methodologies used in supply chains



- Manufacturing and sales entities earning a cost plus (TNMM)
- Possibly a royalty (CUP), cost sharing arrangement between Principal and Parent, or Profit Split



Spectrum of Manufacturing Entities



| | | | |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none">• Performs a toll manufacturing service• Does not own inventory; principal does• Does not own IP• Earns markup only on local costs | <ul style="list-style-type: none">• Performs manufacturing• Owns inventory• Does not own IP• Earns "guaranteed" return on total manufacturing costs | <ul style="list-style-type: none">• Performs manufacturing• Owns inventory• Licenses IP from principal and pays royalty• Earns a return after paying royalty to principal | <ul style="list-style-type: none">• Performs manufacturing• Owns inventory• Owns IP and may not pay any royalty• Earns an entrepreneurial return |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|

Spectrum of Sales & Marketing Companies

Increased Functions, Assets & Risks

Marketing
Service
Provider

Sales
Agent*

Limited Risk
Distributor

Value Added
Distributor

- Performs a marketing service
- Does not own inventory; principal sells directly to customers
- Does not own IP
- Earns markup only on local marketing costs

- Performs selling activities
- Does not own inventory, or may only take flash title
- Does not own IP
- Earns a markup on local costs or a commission

- Buys from principal, takes title, and sells to customers
- Owns inventory
- Does not own IP
- Earns a routine distribution margin

- Buys from principal, takes title, and sells to customers
- Owns inventory
- Owns or licenses IP
- Earns an entrepreneurial return and/or return including profit for local IP

*Could be sales solicitation agent, sales agent (with power to conclude), or commissionaire

Supply Chain – Tax

- Direct Tax
 - Management of effective tax rate
 - Location of principal
 - Location of IP holding company
 - PE risks
 - Upstream (manufacturing) risks
 - Downstream (distribution) risks
 - WHT management
 - BEPS (Actions 5, 7, 13)
- Indirect Tax
 - Management of leakage risk
 - Cashflow management issue

Supply Chain – Trade

- 
- Impact of duties on cross-border movement of goods
 - Dutiable payments – e.g., royalties and assists
 - Managing duties through FTAs and duty preference schemes
 - Bonded arrangements, TCOs and duty drawbacks
 - Non-resident import / export arrangements
 - Import and export licensing requirements
 - Other NTBs: conformity certifications, labelling, marking, etc.

Understanding the interactions

Transfer pricing and tax rate management

Non-resident arrangement issues

Transfer pricing and customs valuation

Implications for ad valorem rules of origin

Industry specific considerations

Customs valuation vs. Transfer pricing

Customs valuation

Transaction Value (CIF)

Transactional value of identical / similar goods

Deductive value

Computed value

Fall-back

Transfer pricing

Comparable uncontrolled price (CUP)

Resale minus value

Cost plus value

Transaction value

Transactional net margin method (TNMM)

Profit split

Customs valuation vs. Transfer pricing

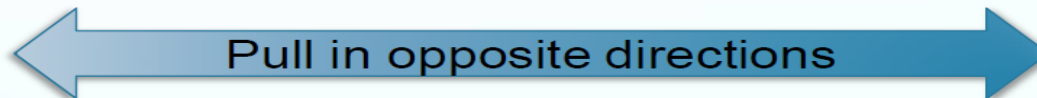
Competing tensions concerning imported goods

Customs authority objective

Ensure all appropriate elements are included in the Customs value and is not understated

Direct Tax authority objective

Ensure the transfer price does not include inappropriate elements and is not overstated



Trade objective

Lower Customs value desirable
= reduced duty liability

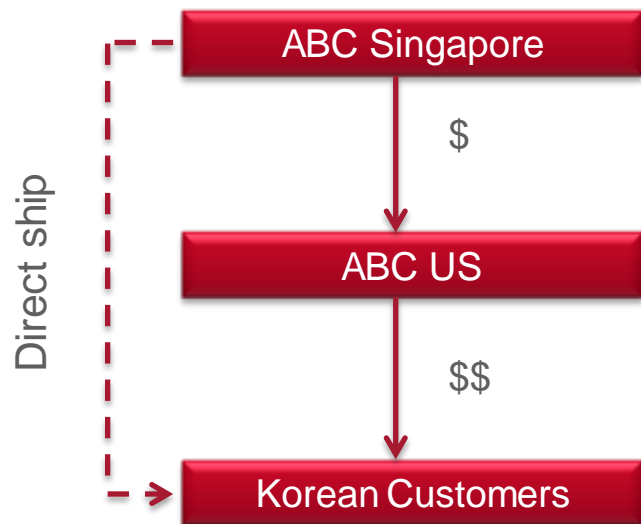
Trade objective

Higher transfer price desirable
= reduced taxable profit

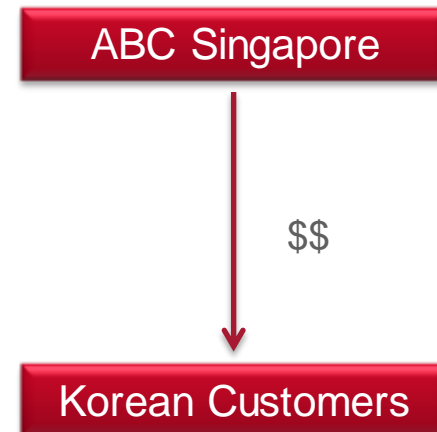
Source: WCO Guide to Customs Valuation and Transfer Pricing, World Customs Organization, 2015

Ad Valorem ROO Case

Indirect sale arrangement



Direct sale arrangement



- Which FOB value (\$ or \$\$) is to be used for RVC determination?
- Does it matter if the sale from ABC Singapore to ABC US is on EXW term? and that between ABC US and Korean Customers is on CPT term?

BEPS implications

Lower PE thresholds

International Tax Developments – Permanent Establishment (PE)



Lower Threshold For Dependent Agent

In the OECD Model Tax Convention, new PE definition will include:

A person acting in a State on behalf of an enterprise and, in doing so, habitually concludes contracts, or habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise, and these contracts are:

- (a) in the name of the enterprise; or
- (b) for the transfer of the ownership of, or for the granting of the right to use, property owned by that enterprise or that the enterprise has the right to use; or
- (c) for the provision of services by that enterprise.

Rationale: Targets commissionaire structures and covers persons whose actions go beyond mere promotion or marketing of goods or services, including persons who convince third parties to enter into a contract (including a standard contract). This applies even if the contract is formally concluded outside of the State / concluded online.

Amendment Of Independent Agent Exception

In the OECD Model Tax Convention, the independent agent exception will be amended to state:

A PE does not apply where the person acting in a State on behalf of an enterprise of the other State carries on business in the first-mentioned State as an independent agent and acts for the enterprise in the ordinary course of that business. Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent.

Whether a person is closely related to an enterprise depends on all the relevant facts and circumstances. It will include a person who possess directly or indirectly more than 50% of the beneficial interest in the other (in the case of a company, more than 50% of the aggregate vote and value of the company's shares or of the beneficial equity interest in the company).

Specific Activity Exemptions

In the OECD Model Tax Convention:

The list of exemptions is found in Article 5(4). This list will be amended such that the exemptions in Article 5(4) apply only if all the listed activities have a preparatory or auxiliary character.

The OECD Commentary to Article 5(4) will also provide a description of preparatory or auxiliary activities. Generally, a preparatory activity is one that is carried on in contemplation of the carrying on of the essential and significant part of the activity of the enterprise as a whole. An auxiliary activity is one that is carried on to support, without being part of, the essential and significant part of the activity of the enterprise as a whole.

New Anti-Fragmentation Rule

In the OECD Model Tax Convention, a new anti-fragmentation rule will be included to provide:

The list of exemptions in Article 5(4) will not apply to a fixed place of business of an enterprise, where:

- (a) that enterprise or a closely related enterprise carries on business activities at the same place or another place in the same State; and
- (b) the business activities constitute complementary functions that are part of a cohesive business operation; and
- a) that place or another place constitutes a PE for the enterprise or closely related enterprise; or
- b) the overall activity resulting from the combined activities of the enterprise or closely related enterprise is not of a preparatory or auxiliary character.

Rationale: To prevent enterprises from fragmenting their business operation into several small operations in order to argue that each is merely engaged in a preparatory or auxiliary activity.

Splitting Up Of Contracts

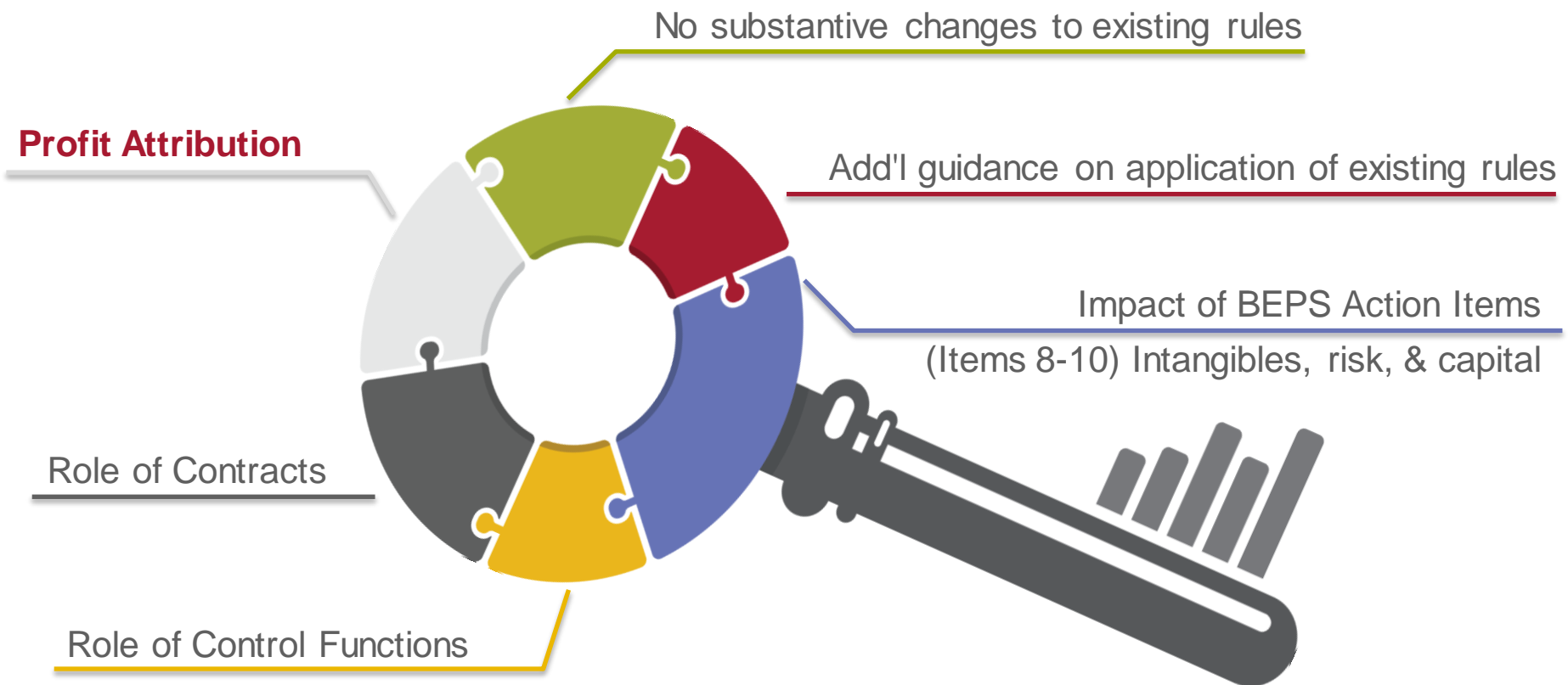
In the OECD Model Tax Convention, the same deeming provision is included, but the time period is 12 months.

The OECD Commentary will be changed to provide that treaties can be amended to include a provision to address contract splitting. For example, connected activities that are carried on at the same building site, construction or installation project during periods of time, each exceeding 30 days, will be added to the period of time during which the enterprise carried on activities at that place.

Rationale: To prevent enterprises from abusing the 12-month threshold by dividing their contracts into several parts, each covering a period of less than 12 months and attributed to a different company, which is owned by the same group.

Attribution of profits to PE's &
TP implications

OECD Discussion DRAFT on PE – KEY Items



OECD Discussion Draft - Scope

- Decided 2 fact patterns particularly needed guidance
 - DAPes, in particular under the form of commissionaire & similar arrangements
 - PEs under Article 5(1) to which exemptions in Article 5(4) do not apply (e.g. Warehouses as fixed place of business PE)
 - What about other scenarios (e.g. purchasing office)?
 - Examples do not deal with IP issues, which are likely to come up in many PE cases.

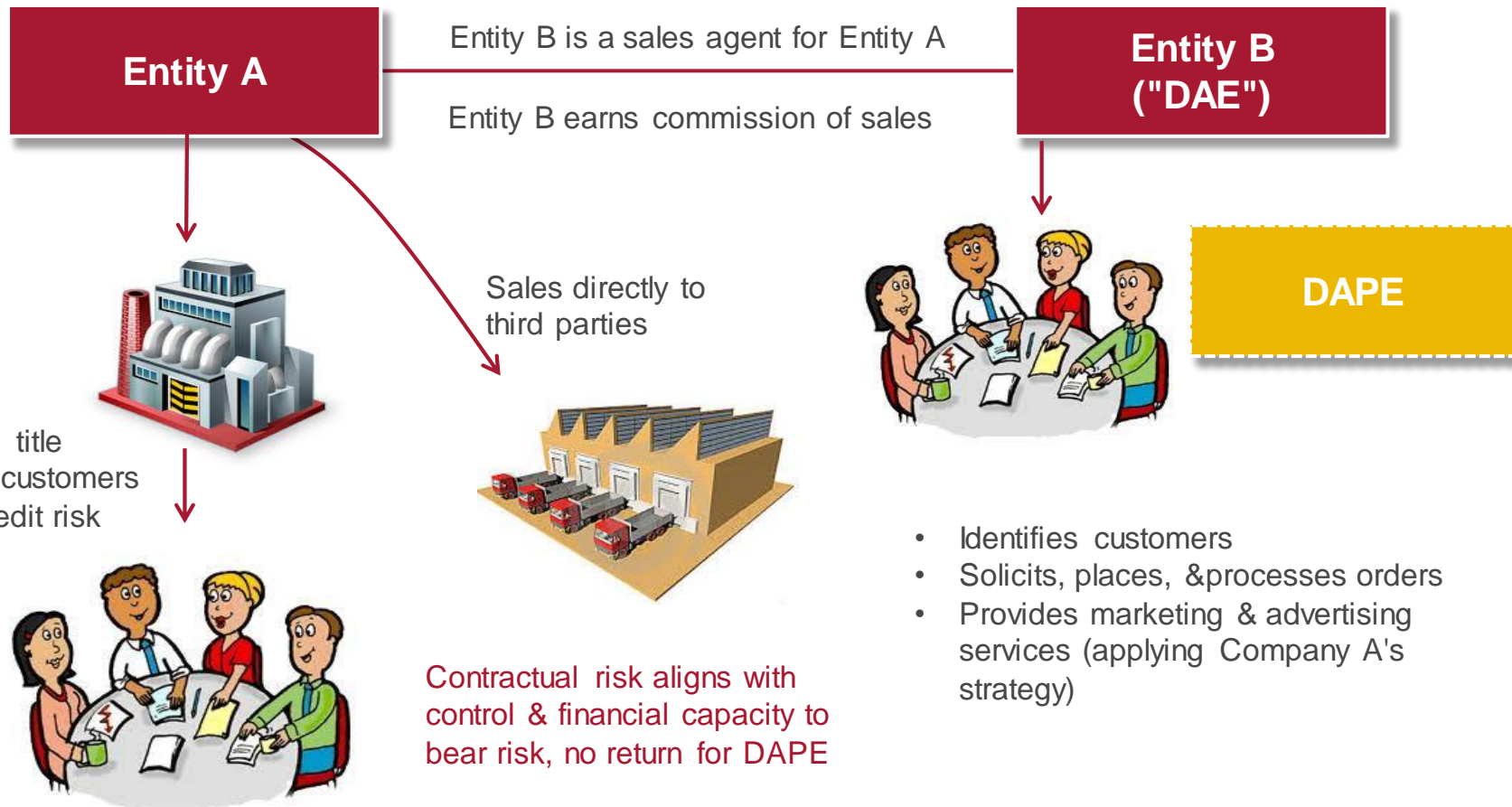
BEPS Guidance – Functional & Contractual Alignment

- Appropriate delineation of the transaction including:
 - Contractual terms;
 - Functions, assets, and risks;
 - Characteristics of property/services;
 - Economic circumstances; and
 - Business strategies
- Contractual terms only as a starting point where the combined view will "provide evidence of the actual conduct of the associated enterprises" (1.43)

Risk & Control over risk

- Control and financial capacity to assume risk is emphasized (1.60, 1.64, 1.65)
- Identify risk
- How is the risk contractually assumed?
- Functional analysis
- Contractual assumption risk aligned with conduct and other facts?
- Control over risk and financial capacity to bear the risk?

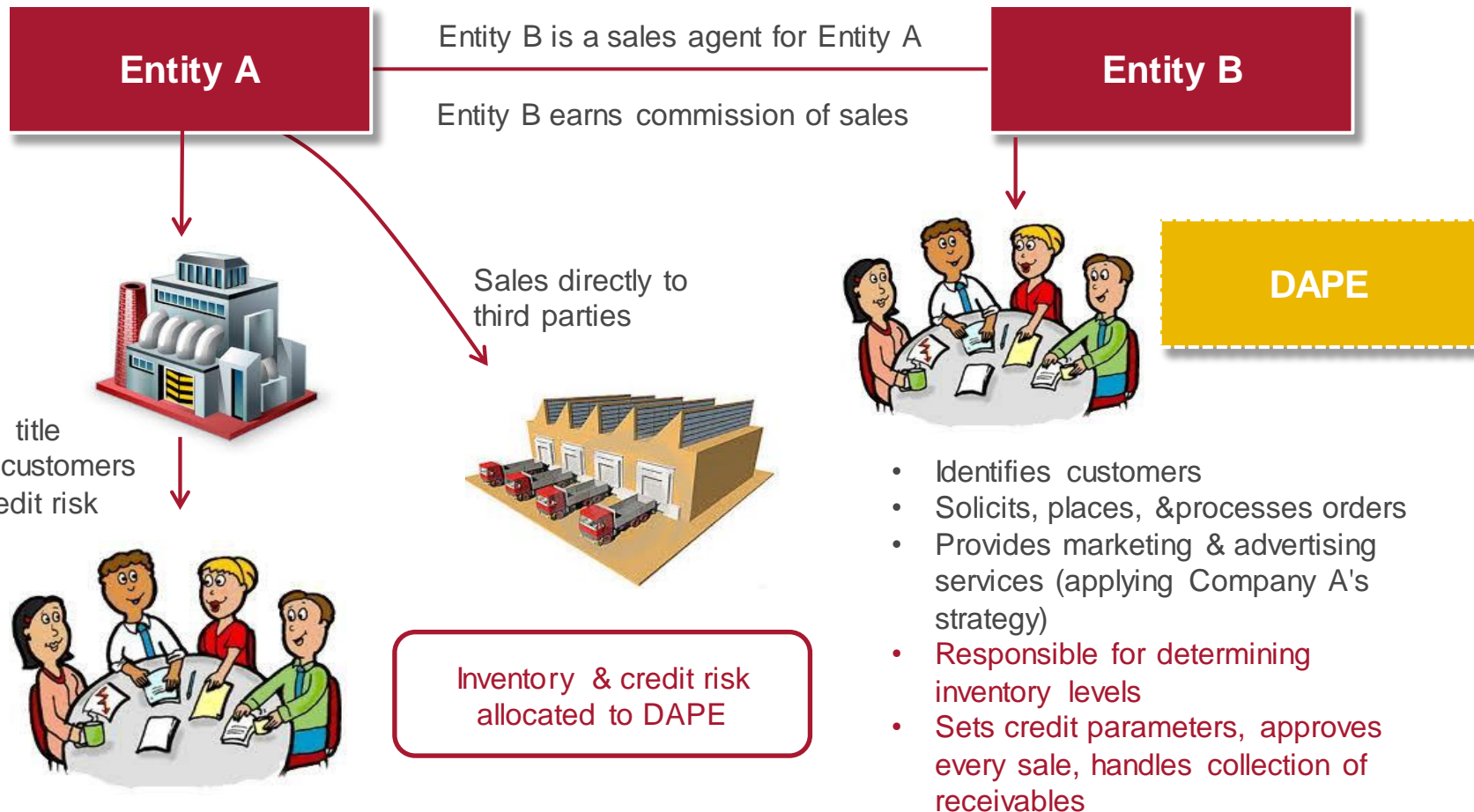
Guidance Examples – DAPE (Ex: 1)



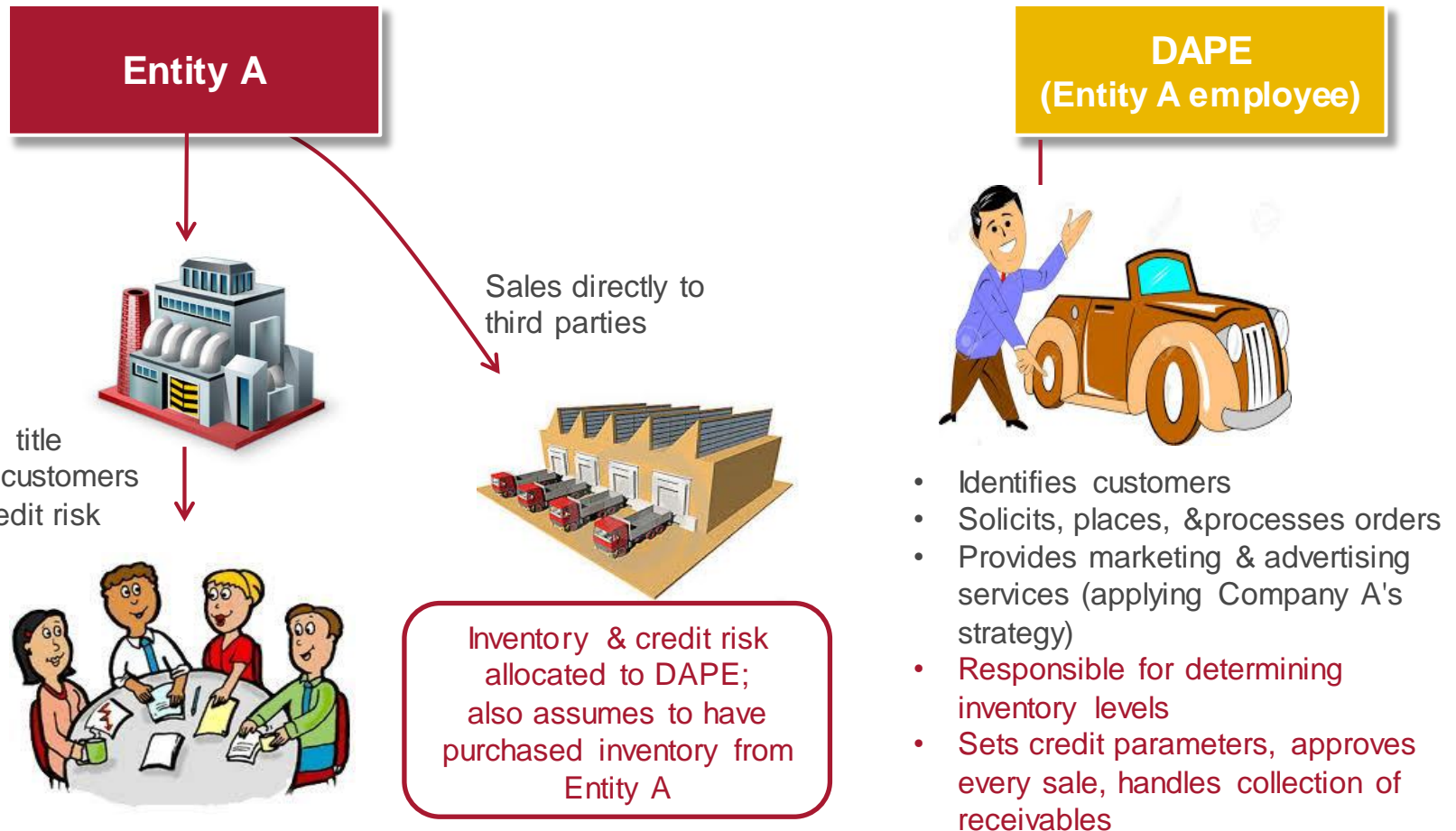
Guidance Examples – DAPE (Ex: 1)

| Entity A | Entity B |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none">• Sets sales strategy• Selects agent, monitors performance• Sets pricing policy• Decides budget, marketing strategy and content• Legally protects marketing IP• Retains title to inventory• Responsible for warehousing, determining inventory levels• Bears credit risk, sets credit parameters, approves every sale. handles collections | <ul style="list-style-type: none">• Identifies customers, solicits, places and processes orders• implements Entity A's marketing strategy (gets fully reimbursed)• Generates no local marketing IP (sales channels are generic and not specialized) |

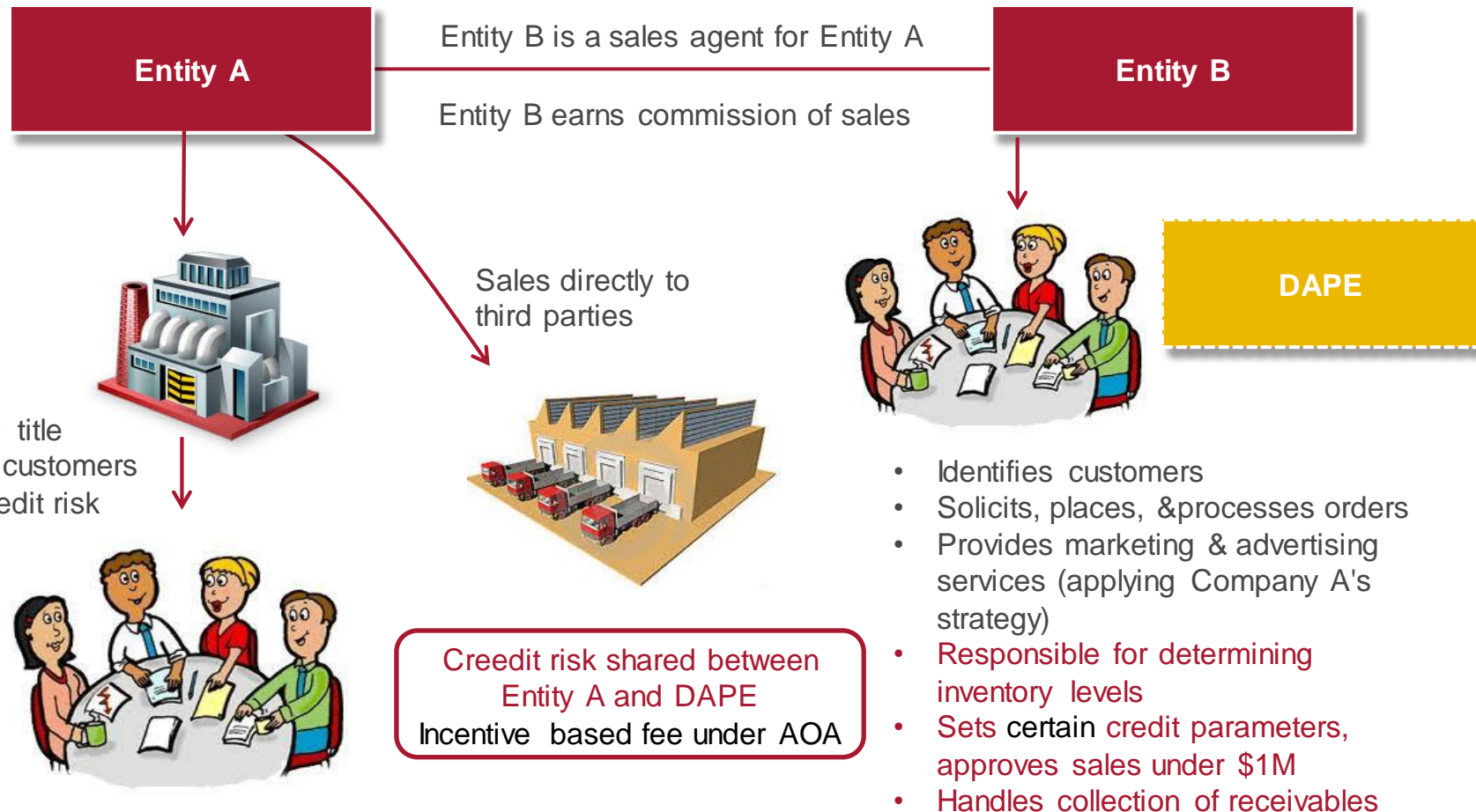
Guidance Examples – DAPE (Ex: 2)



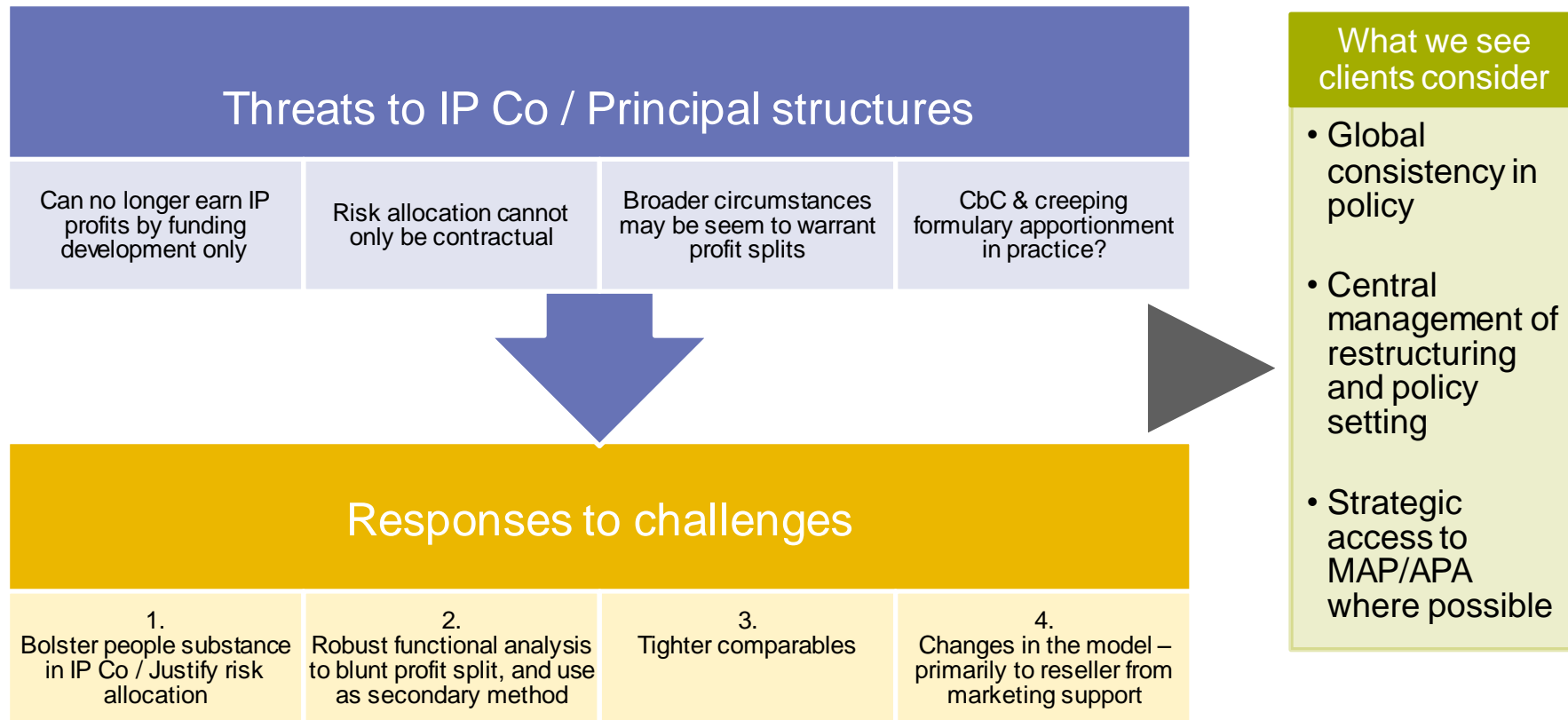
Guidance Examples – DAPE (Ex: 3)



Guidance Examples – DAPE (Ex: 4)



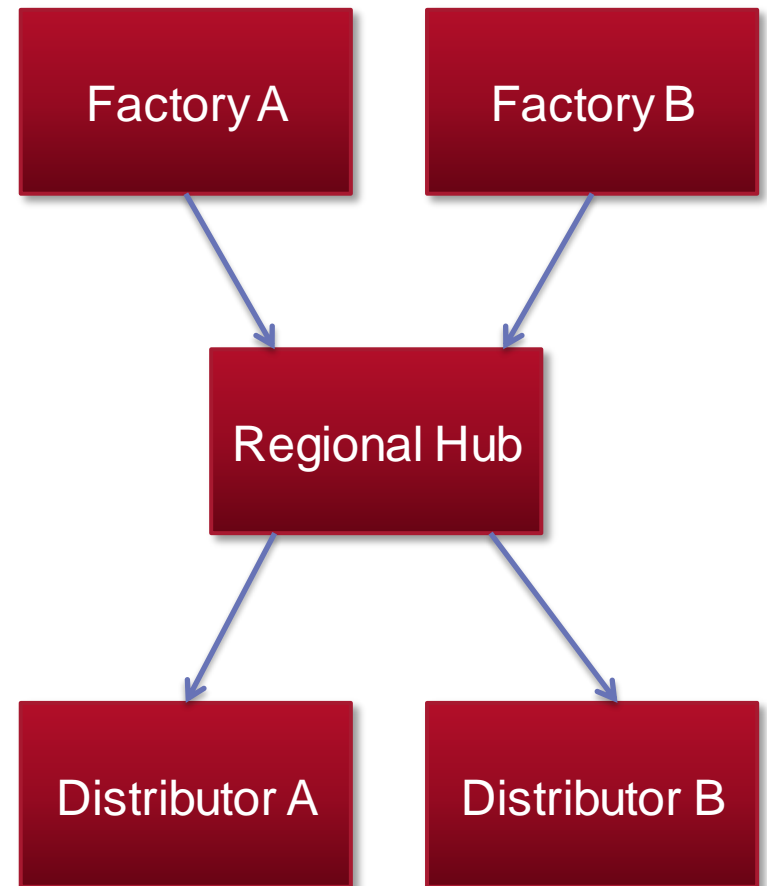
What we see happening



Hub structures

Hub structures

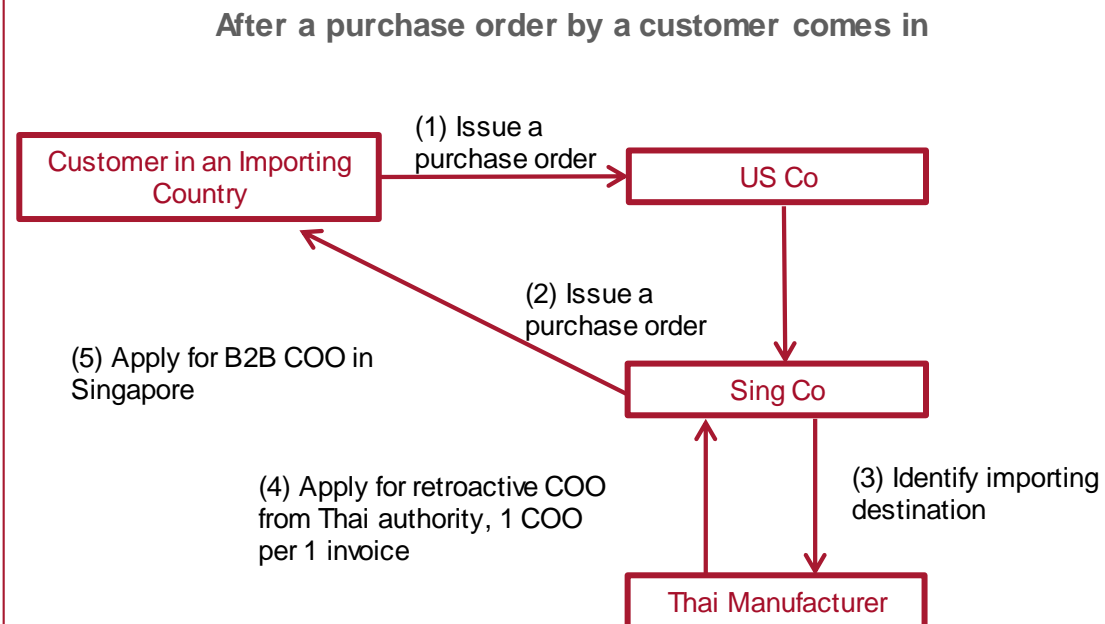
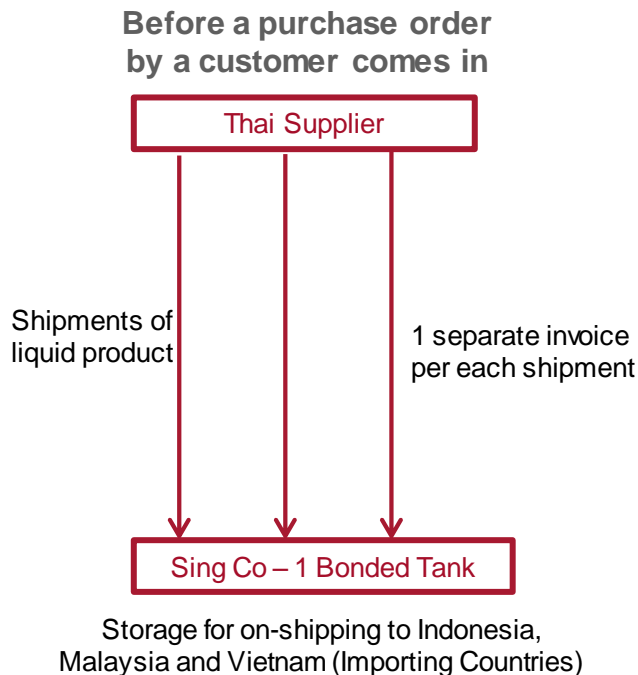
- Consider lower PE thresholds (see next slide)
- Implications for duty preferences
 - FTAs network – spaghetti bowl effect
 - Back to back COO
 - Self certification v. certification by authority



Hub Structure - Expanded PE definition

- Fact patterns that need consideration
 - Distributors - DAPes, in particular under the form of commissionaire & similar arrangements
 - Storage Hub - PEs under Article 5(1) to which exemptions in Article 5(4) do not apply (e.g. Warehouses as fixed place of business PE)
 - Who owns the goods in the hub?
 - Who owns the warehouse?
 - Mere storage or are there employees and if so, whose employees?

Implications for duty preferences – B2B COO



Issues

- Which Singapore issued B2B COO is equivalent to which Thai issued COO?
- Will Importing Country's Customs reject the Singapore issues B2B COO?

INCOTERMS

INCOTERMS Implications

Purpose and function

- Seller and buyer's responsibilities
- Point of delivery: Legal delivery v. physical delivery
- Point of risks transfer
- *INCOTERMS do not determine point of title transfer – check sale contract!*

Revenue recognition

- Point of title transfer
- Retention of title considerations

Indirect tax considerations

- Taxable supply of goods?
- Title transferred before or after the goods are cleared from customs in the importing country?

FTA implications

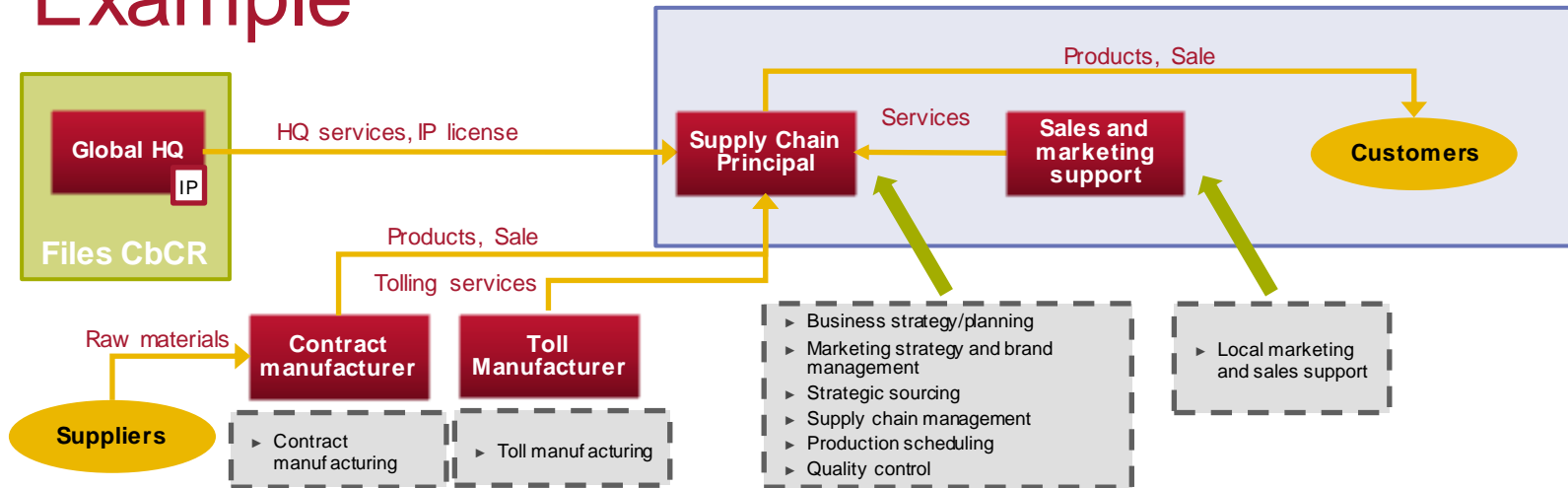
- Which sale is an export sale?
- In a third party invoicing arrangement, which FOB value is used for RVC determination?

INCOTERMS 2010

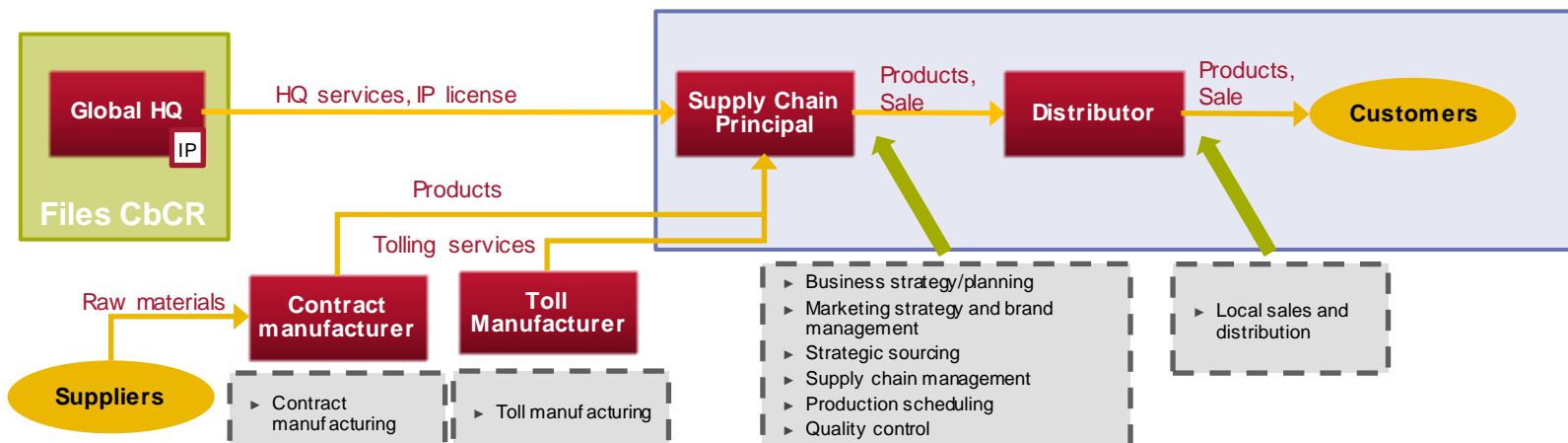
| | Any Transport Mode | | Sea/Inland Waterway Transport | | | | Any Transport Mode | | | | |
|------------------------------|--------------------|--------------|-------------------------------|---------------|----------------|--------------------------|--------------------|----------------------------|-----------------------|--------------------|---------------------|
| | EXW | FCA | FAS | FOB | CFR | CIF | CPT | CIP | DAT | DAP | DDP |
| Responsibilities | Ex Works | Free Carrier | Free Alongside Ship | Free On Board | Cost & Freight | Cost Insurance & Freight | Carriage Paid To | Carriage Insurance Paid To | Delivered at Terminal | Delivered at Place | Delivered Duty Paid |
| Loading Charges | Buyer | Seller* | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller |
| Delivery to Port/Place | Buyer | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller |
| Export Duty & Taxes | Buyer | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller |
| Origin Terminal Charges | Buyer | Buyer | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller |
| Loading on Carriage | Buyer | Buyer | Buyer | Seller | Seller | Seller | Seller | Seller | Seller | Seller | Seller |
| Carriage Charges | Buyer | Buyer | Buyer | Buyer | Seller | Seller | Seller | Seller | Seller | Seller | Seller |
| Insurance | | | | | | Seller | | Seller | | | |
| Destination Terminal Charges | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Seller | Seller | Seller | Seller | Seller |
| Delivery to Destination | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Seller | Seller |
| Import Duty & Taxes | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Buyer | Seller |

Impact on transformations

Example



Before



After

Audit environment

Tax audit trends for the future?

- Be prepared for more frequent and aggressive PE audits
- Consider also what kind of picture and message CbC Reporting gives to a particular tax authority
- Treaty scrutiny on IP holding companies?

What tax authorities may look for - TP

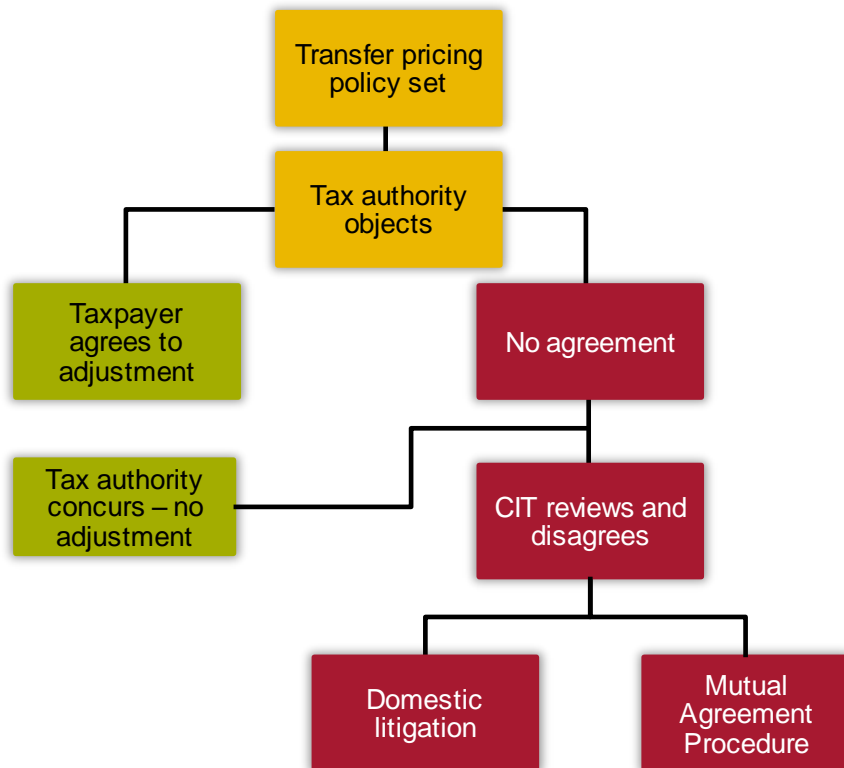
- (Subjective) Evidence of profit shifting
- High-profit, low-tax entities
- Low profits per employee
- Common structures which may be at risk in post-BEPS environment
- Differential returns for similar-function entities in other locations
- Value generated in market country vs. tax paid in market country
- Allocation of capital to entities with limited employees, in conjunction with a view on their functions

"Tough questions"

- Information exchange outside of CbCR based on relevance
 - Will taxpayers be told?
- CbCR used as a blunt instrument, creeping formulary apportionment?
- Disclosure of value chain information not related to transactions with the entity
- Effect on APA/MAP negotiations?
- Others?

Dispute resolution avenues

What are your options when an audit occurs?



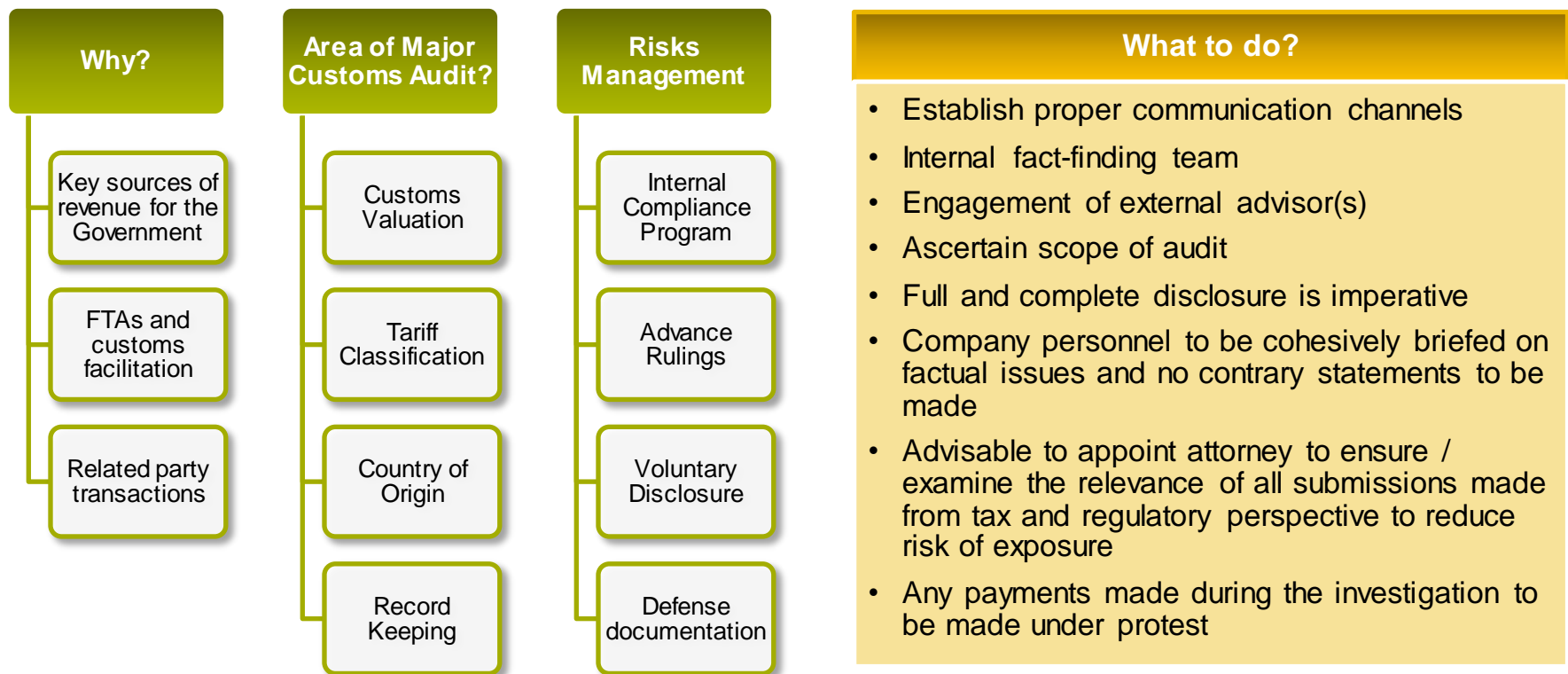
| | Appeal | MAP |
|-----------------------------------------|------------------------------------------------|---------------------------------------------------------|
| Resources | High commitment throughout | High commitment upfront, medium commitment thereafter |
| Representation & involvement | Full representation and involvement throughout | No involvement in communication between tax authorities |
| Result | Resolves domestic issues only | Can resolve issues in two or more countries |
| TP Audits | Can trigger other audits | Can trigger other audits |
| Binding | Binding result locally | Not always mandatory |

Risk review process

- Know your risks and choose where to fight
- If policy realignment required, do early and doc.



Customs Audits



Trends of Future Supply Chain

- Future of manufacturing?
 - 3D printing
 - Freight forwarder cum toll manufacturer?
 - Crowd sourcing of design ideas from customers
 - IP ownership?
- Future of delivery?
 - Use of unmanned aerial vehicles?
 - Mobile phone and Internet application

Thank you

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