

LEA Global

# Fundamentals of Intercompany Agreements (ICAs) for Organisational Design and Transfer Pricing Compliance

12 November 2024



Rising Star Association



INTERNATIONAL ACCOUNTING BULLETIN

# Welcome – This Webinar Will Begin Momentarily

## Housekeeping Items

- This webinar will be recorded.
- The link to the recording and PowerPoint will be posted on the Events registration page on LEA's member portal post webinar. An email will also be sent to today's attendees, post webinar, with this information.
- Please use the chat box to share comments or questions.
- This webinar is eligible for 1 Continuing Professional Education (CPE) credit.
- Four (4) polling questions – will be initiated throughout this webinar to monitor engagement as required by NASBA standards.
- Your CPE certificate will be emailed to you in a couple of weeks.
- At the end of the meeting, you will be asked to complete an evaluation of this webinar. Please take time to complete this as your input is valuable when planning for future webinars.

# Agenda

- The role of intercompany agreements (ICAs) in corporate structuring
- What do we need to achieve?
- What do we need to avoid?
- Recap of OECD transfer pricing basics relating to ICAs
- Key recent international developments concerning ICAs
- Where does this leave corporates?
- ICAs in the tax compliance lifecycle
- The challenge for tax advisory firms
- How we help
- Q&A

# Today's Presenter(s)





Based on United Nations estimates, approximately how many MNEs were there globally in 2022?

\$1,000,000

\$500,000

\$250,000

\$100,000

\$50,000

\$25,000

\$16,000

\$8,000

\$4,000

\$2,000

\$1,000

\$500

\$300

\$200

\$100

♦ A

7,000

♦ B

22,500

♦ C

53,000

♦ D

80,000

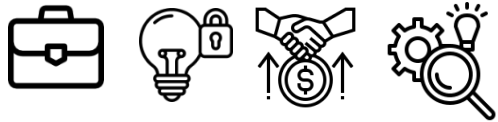
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# EXAMPLE SCENARIO: INTEGRATING IP ACQUIRED IN M&A TRANSACTIONS



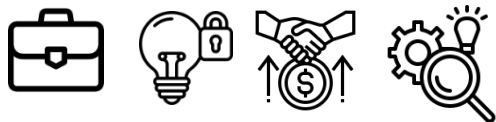
Entity A



## Scenario:

- Entity A is an established SaaS business, which sells Product A
- Entity A acquires Entity B, which holds IP rights in Product B
- The rationale for the acquisition was to integrate Product B into Entity A's platform

Entity B



= acquired  
entity

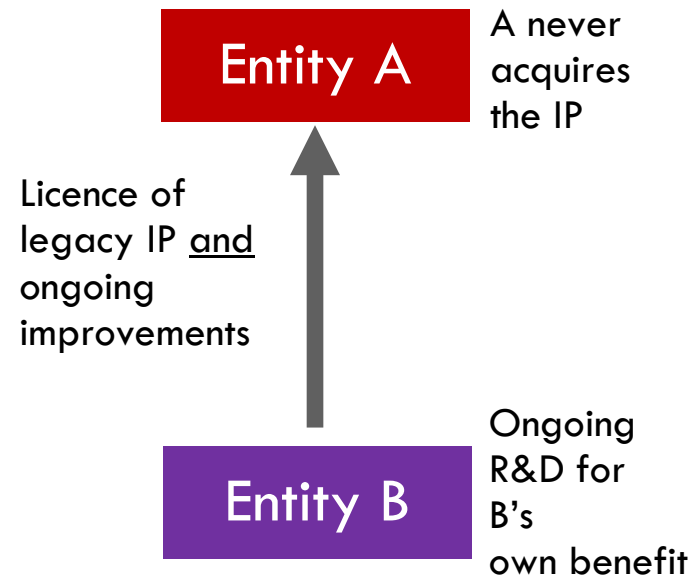
Entity A needs to decide:

- what to do with Entity B's IP
- which entity or entities should enter into contracts with customers
- how to treat the management and R&D functions performed by Entity B's staff

## THREE POSSIBLE OPTIONS (NOT EXHAUSTIVE)



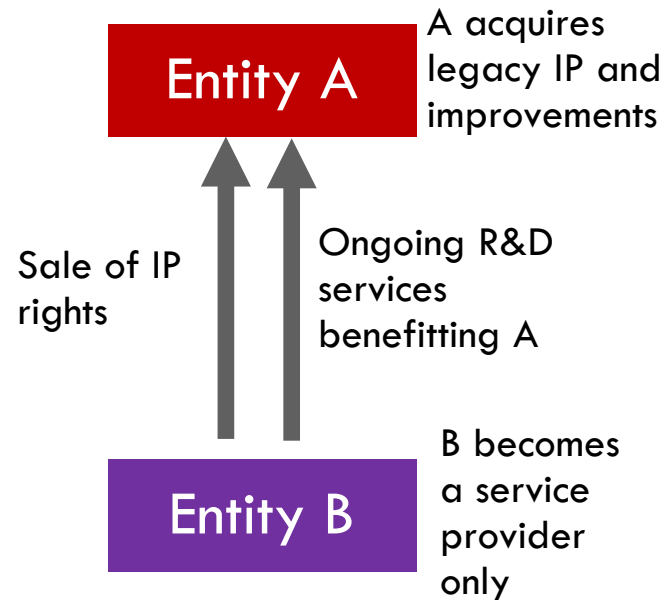
### Option 1: Legacy IP rights and improvements stay with B



#### Considerations

- Does B have substance to bear R&D costs and R&D risks?
- What IP licence terms (including royalty rates) would make sense commercially?

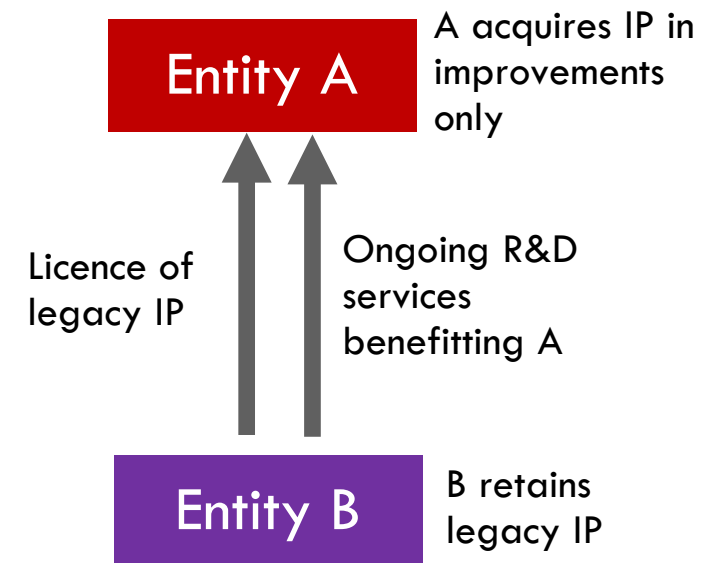
### Option 2: Move Legacy IP rights to A



#### Considerations

- Valuation of IP
- Structuring of sale and cashflows
- Tax charges on disposal / exit

### Option 3: Legacy IP rights stay with B, new IP owned by A



#### Considerations

- Structuring of licence fees e.g. fixed royalty / declining royalty / profit split
- Term of licence



Based on the US Treasury Regulations, what is the deadline for signing and dating a Cost Sharing Agreement (CSA) must be signed?

◆ A

30 days

◆ B

60 days

◆ C

90 days

◆ D

No deadline

50 / 50

?



\$1,000,000

\$500,000

\$250,000

\$100,000

\$50,000

\$25,000

\$16,000

\$8,000

\$4,000

\$2,000

\$1,000

\$500

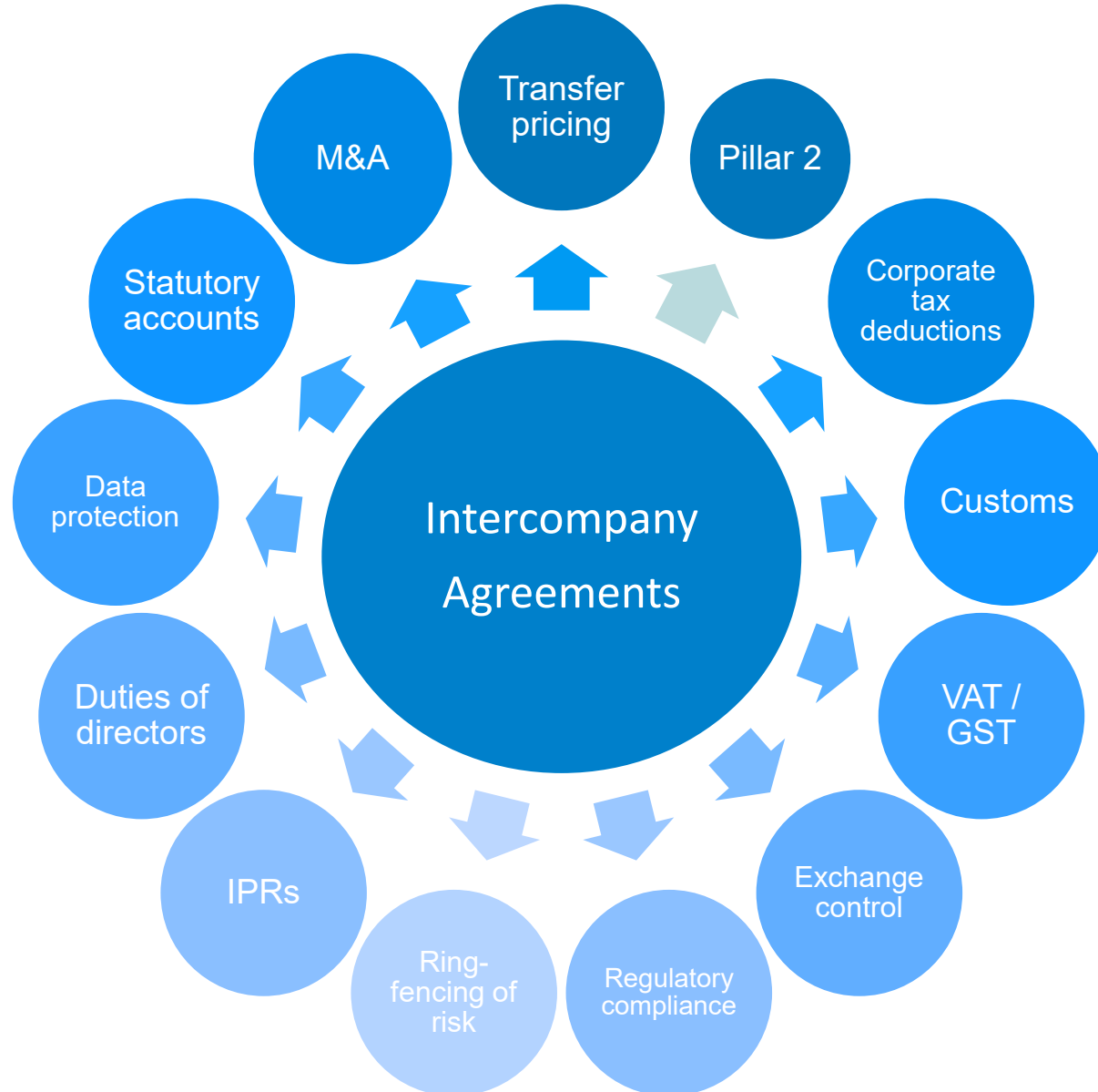
\$300

\$200

\$100



# INTERCOMPANY AGREEMENTS: WHAT DO WE NEED TO ACHIEVE?



**Key requirements** regarding the legal aspects of tax and transfer pricing compliance:

1. Ensure that intercompany agreements are **contemporaneous** and clearly implement the group's price setting policies on a forward-looking basis
2. **Verify** that the descriptions of transactions in TP documentation is consistent with the contractual terms which were actually in place during the relevant periods

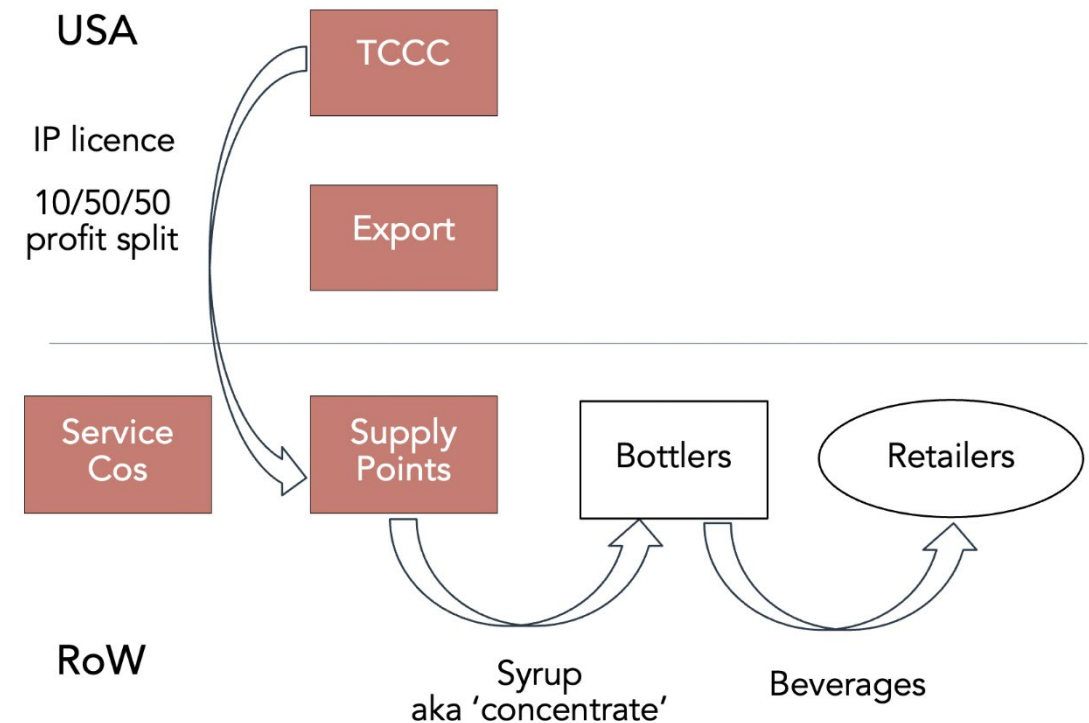
## ICAs: WHAT DO WE NEED TO AVOID?



## THE COCA-COLA COMPANY & SUBSIDIARIES V IRC (USA, 2020)



- During the period 2007-2009, Coca-Cola operated a 10-50-50 profit split arrangement between the relevant US entities and local 'supply points' in other countries.
- The supply points manufactured syrup and then sold it on to third party bottling companies.
- The profit split allowed the supply points to retain profit equal to 10% of gross sales, with the remaining profit being split 50/50 with the US entities.
- As part of the justification for this profit split, the group claimed that valuable intangible assets (including IP and goodwill) was owned by the local supply points rather than the US entities.
- The group's TP position was contradicted by the ICAs in place, which stated that all relevant IP was owned in the US. Furthermore, none of the ICAs reflected the 10-50-50 pricing structure.



### Consequences:

- The US Tax Court ruled in favor of the IRS.
- The Coca-Cola Company has estimated the incremental additional tax liability arising from the ruling to be US\$ 12 billion.



## COCA-COLA FOURTH QUARTER 2020 EARNINGS CALL

### KEY MESSAGES ON TAX DISPUTE

- We disagree with the U.S. Tax Court Opinion and will vigorously defend our position
- We have consulted with external advisors and undergone detailed analysis in arriving at our current position and determining next steps
- Thorough analysis has led us to believe we will ultimately be successful, although there is no assurance that the courts will ultimately rule in the Company's favor
- We have not made any changes to our underlying effective tax rate\*; however, in 2020, we recorded a \$438 million charge for prior tax periods by assessing the likelihood that the courts could apply different methodologies and tax treatment in these periods
- If the tax court opinion is ultimately upheld, along with an adverse ruling on pending issues:
  - We estimate ~\$12 billion of aggregate incremental tax liability for all years up to and including 2020, including interest incurred through December 31, 2020
  - Applying the IRS' proposed transfer pricing methodology would increase our underlying effective tax rate\* by ~3.5%

Refer to Exhibit 99.2 to Company's Form 8-K filed with the SEC on Feb. 10, 2021



What is the most fitting metaphor for tax advice which is not accurately implemented in legal reality?



♦ A A chocolate teapot

♦ B An ashtray on a bike

♦ C A glass hammer

♦ D A fart in a jar

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\$500,000

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\$1,000

\$500

\$300

\$200

\$100

50 / 50



# OECD TP BASICS: THE ROLE OF INTERCOMPANY AGREEMENTS



## ICAs in TP documentation:

- **Master file:** must contain “*a list of important agreements related to intangibles*”
- **Local files:** must contain “*copies of all material intercompany agreements*”

## ICAs are required for low value-adding intra-group services

*“An MNE group electing for application of this simplified methodology shall prepare the following information and documentation ...*

- *Written contracts or agreements for the provision of services and any modifications to those contracts and agreements reflecting the agreement of the various members of the group to be bound by the allocation rules of this section.”*

(OECD TPG 2022 § 7.64)

## OECD steps for

### “delineating the actual transaction”

with respect to risk:

1. Identify economically significant risks with specificity.
2. Determine how specific risks are contractually assumed by the associated enterprises.
3. Functional analysis regarding control and mitigation of risk, impact of upside or downside consequences of risk outcomes, and financial capacity to assume risk.
4. Determine whether the contractual assumption of risk is consistent with the conduct of the parties and other facts of the case.
5. Where the party assuming risk does not control the risk or does not have the financial capacity to assume the risk, apply the guidance on allocating risk.
6. Price the actual transaction, taking into account assumption and allocation of risk and appropriate compensation for risk management functions.

(Paraphrased from OECD TPG 2022 § 1.60)

## RECENT INTERNATIONAL DEVELOPMENTS REGARDING ICAs AND CORPORATE STRUCTURE DESIGN



Coca-Cola (2020), Aspro (2022), Skechers (2023), Microsoft (2023)  
AirBnB (2024)



JP Morgan (2023); BlackRock (2022 and 2024); HMRC guidance on allocation of risk (2024); HMRC guidance on TP policy design best practice (2024)



2023 Administrative Principles on TP (esp. re timing of ICAs and 'clear and unambiguous' requirement)



SingTel (2021), PCG on Intangibles (2024), WHT analysis (2024), Pepsi WHT litigation (2024)



Draft EU TP Directive (esp. the requirement that post year end adjustments be made symmetrically and before the filing of CT returns)



Amount B, Pillar 2

## WHERE DOES THIS LEAVE CORPORATES?



### **‘Yesterday’**

Tax and TP in a silo

TP documentation prepared in arrears

Superficial functional analysis

Agreements often absent or vague

Structuring of transactions often driven by tax considerations

### **‘Today’**

*Ex ante* price setting is the standard

Contemporaneous agreements required

Pillar 2 increases the pressure on TP

Multiple stakeholders need to be managed

Holistic design of corporate structures is essential



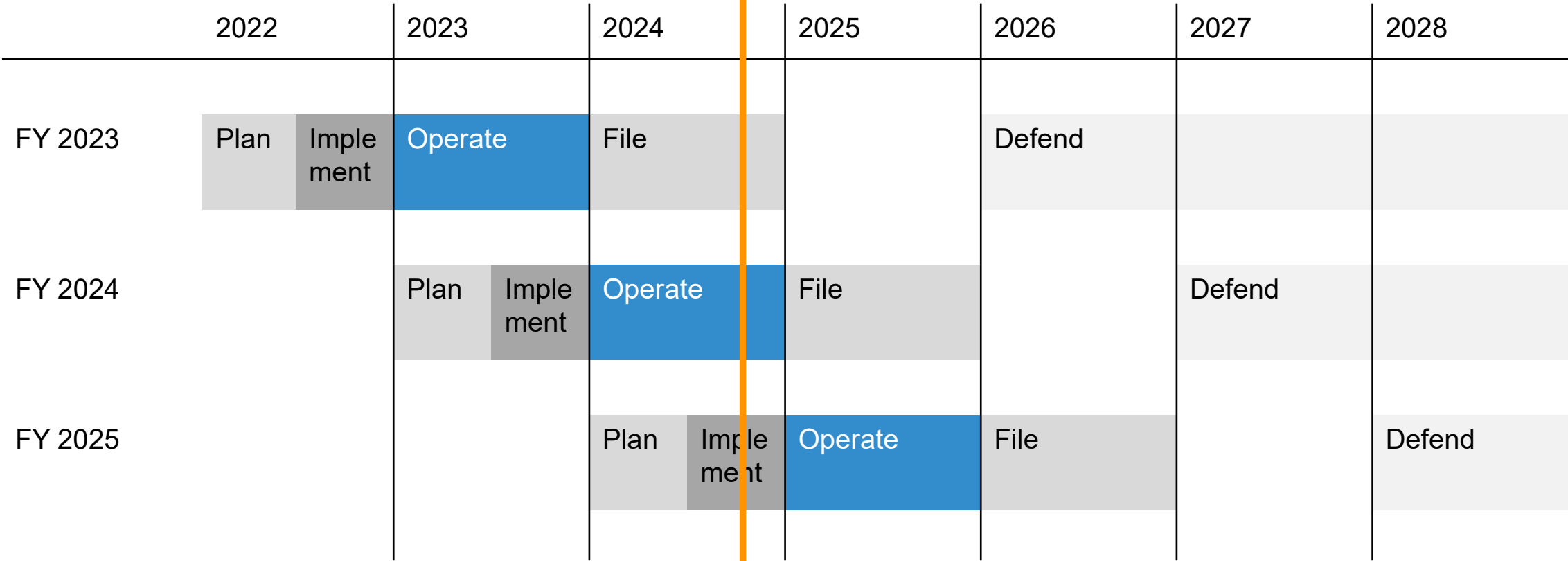
# ROLE OF ICAs IN THE TAX COMPLIANCE LIFECYCLE



You are  
here



Actions



# HOW THE CHALLENGE OF SUPPORTING MULTINATIONAL GROUPS CAN PLAY OUT FOR TAX ADVISERS



Tax firms  
(rightly)  
identify TP  
as a key  
opportunity

Clients  
want  
holistic  
support ...

... but  
firms may  
lack the  
confidence  
to provide  
it ...

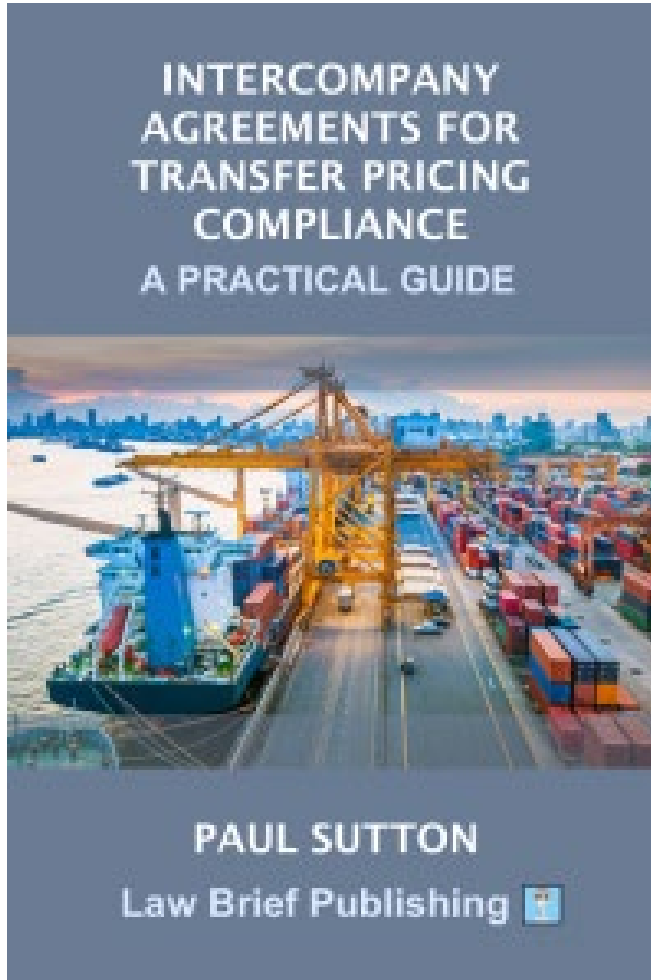
... and  
may  
struggle to  
find the  
right  
partners

Clients are  
forced to  
look  
elsewhere

Firms miss  
out on the  
opportunity  
to develop  
their track  
record

The cycle  
continues

# LCN: TAX AUDIT-READY AND TRANSACTION-READY LEGAL STRUCTURES



Trusted by multinational groups with  
combined annual revenues of over  
USD 140 billion

Described by the UK's Chartered Institute of Tax (CIOT) as “a  
*world leader in creating legal substance for Transfer Pricing  
compliance.*”

## Awards and recognition



- WINNER -  
International Team of the Year



- WINNER -  
Excellence in International Legal  
Services



- SHORTLISTED -  
Boutique Law Firm of the Year



Which of the following statements regarding pricing clauses in intercompany agreements is correct?

♦ **A** They should be as vague as possible

♦ **B** They should be set out in an annex, so they can be updated more easily

♦ **C** They should be clear and unambiguous as to the amounts payable

♦ **D** They should simply state that any payment must be 'arm's length'

50 / 50



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\$100



## Q&A REGARDING TP COMPLIANCE AND INTERCOMPANY AGREEMENTS (ICAs)

