
Transfer Pricing and the Final BEAT Regulations: What You Should Know

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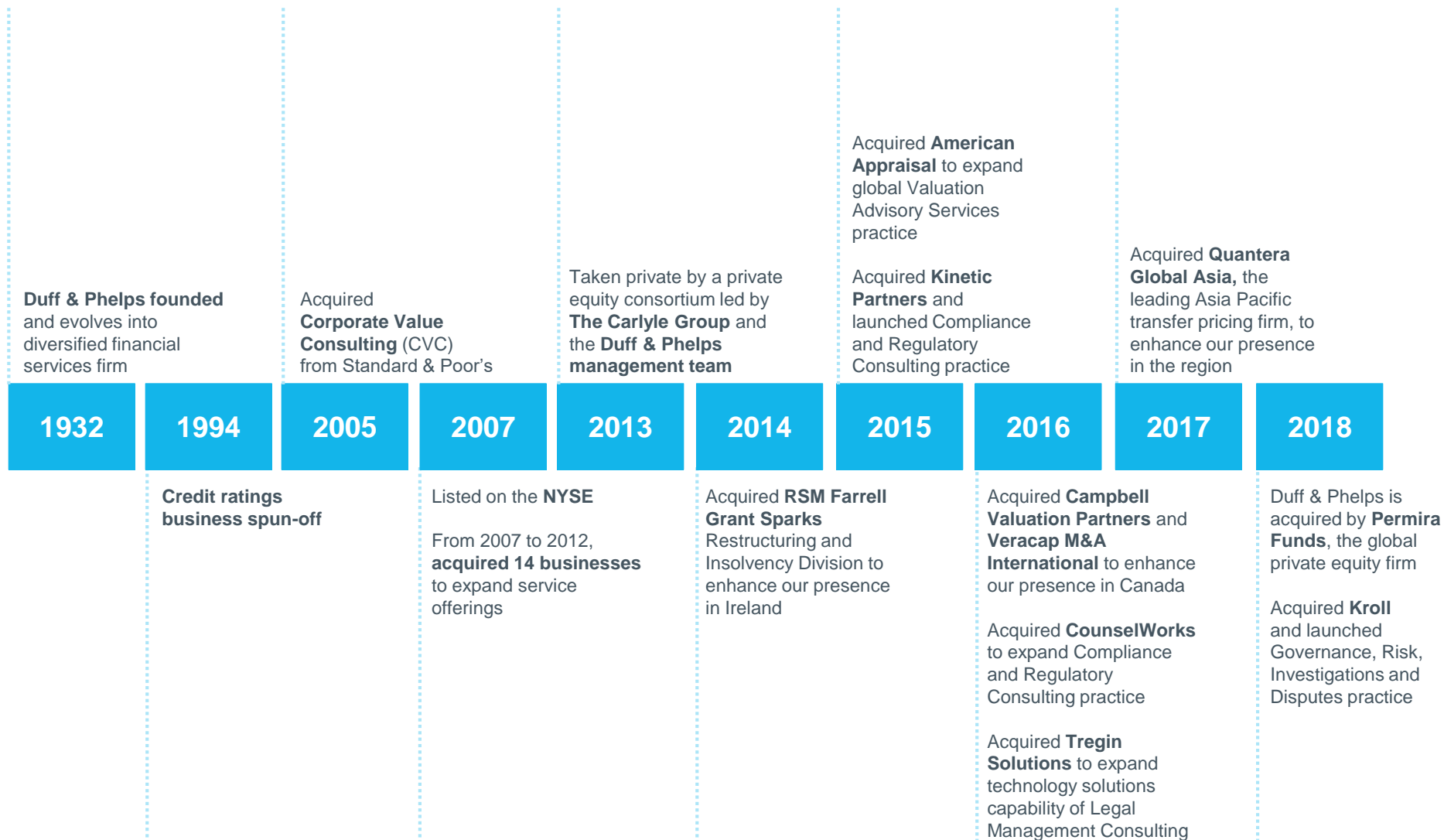
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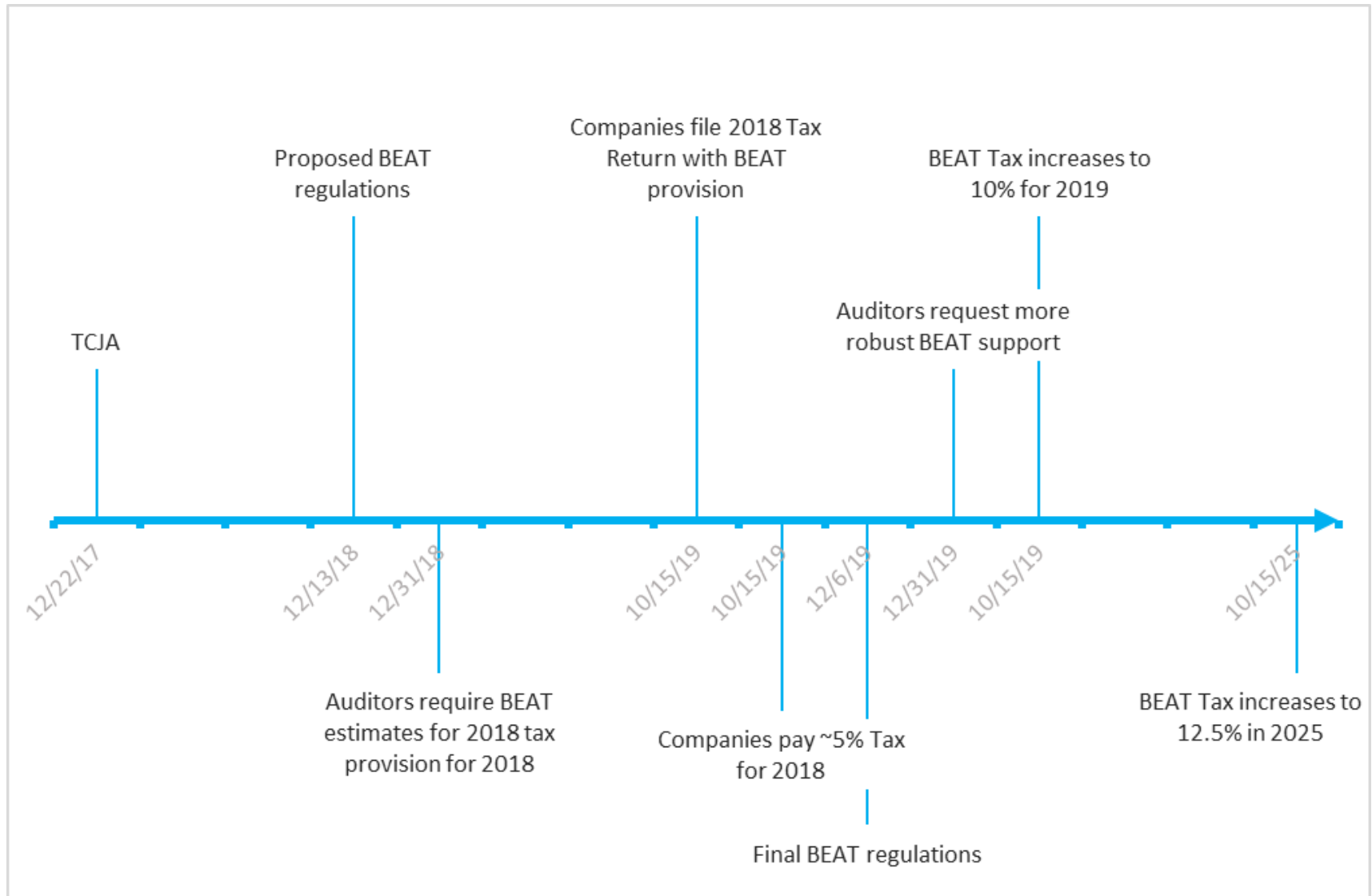
Author substantive books, periodicals and articles on transfer pricing and tax valuation matters



Agenda

1. Need-to-Know Highlights of Final BEAT Regulations:
What's most impactful to your transfer pricing policies?
2. Fact patterns causing companies to think about change
3. Specific planning considerations for
 - » Intercompany services
 - » Intangibles
 - » Related party financing and debt

BEAT Timeline for Calendar Year Company



Final Regulations

What Changes Matter for Transfer Pricing?

Bad News	Good News
No additional provisions to allow netting	BEAT relief provided for several types of non-recognition transactions (e.g., sections 332, 351, 368)
No further certainty from clarifications on Cost Sharing	SCM exception still remains and includes clarification
Certain planning structures are called out as abusive (e.g., dual domestic company)	
Middleman Concept	
Deductions calculated for permanent establishment business profit allocations are base erosion payments	
Related party hedging transactions, even for commodities, are base erosion payments	
New books and records requirements are mandatory if taxpayer wants an SCM election	

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Netting

- Significant amount of preamble dedicated to this topic given numerous comments
- **Final Regulations keep gross basis requirement**
 - No specific additional clarity provided on cost sharing
 - BEAT Netting Rule is retained (relates to mark-to-market deductions)
 - Netting is allowed to the extent otherwise permitted by the code or regulations
 - The final regulations also do not provide for a netting rule for related-party hedging transactions

“... decline to provide such specific guidance because it is beyond the scope of the final regulations; however the Treasury Department and the IRS... intend to study the effect of these provisions on the BEAT and whether changes should be made to the regulations thereunder to better take into account new considerations under the BEAT.”

Middleman Concept

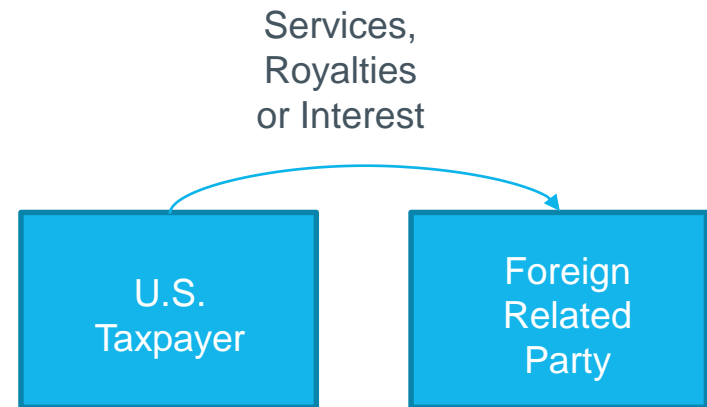
- **Comments requested additional guidance relating to:**
 - Arrangements in which a taxpayer services as a middle-man or makes a “so-called” passthrough payment
 - Revenue sharing arrangements, including those from:
 - » Dealing operations
 - » Profit splits
- **Final regulations do NOT adopt a general exception**
 - “...because the proper characterization depends on the underlying facts and the relationships between the parties.”
- **1.59A-3(b)(2)(i) added:**
 - “The determination of the amount paid or accrued, and the identity of the payor and recipient of any amount paid or accrued, is made under general U.S. federal income tax law.”

Transfer Pricing Policy Change is Expected

- Treasury and the IRS expect BEAT to impact 103,500-114,500 taxpayers
- *“The Treasury Department and the IRS recognize that in response to these final regulations, these businesses may alter the way they transact with related versus unrelated parties. They may make **changes to financial arrangements, supply chain arrangements, or the locations of business activity...**”*
 - (Page 183-184 of Final Regulations)

Fact Patterns Causing Companies to Think About Change

- Companies with significant outbound payments
 - Foreign headquartered companies with U.S. subsidiaries
 - Companies with offshore IP holding companies
 - U.S. entities with significant intercompany debt payments
- Profit Split Companies using U.S. header entity
- Companies that didn't used to care about tracking SCM-qualifying services



Intercompany Services: Qualifying for the SCM Exception

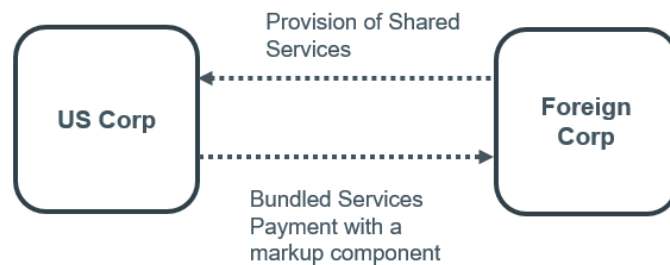
- If a service transaction can be properly defined as an eligible service under the Services Cost Method in the U.S. transfer pricing rules (1.482-9(b)(2)), it can be **excluded** from the BEAT:
 - The service is a “covered service”
 - » Specified covered services per Section 3 of Revenue Procedure 2007-13
 - » Median comparable markup on total services costs is less than or equal to 7%
 - The service is not an “excluded activity” per Treas. Reg. Section 1.482-9(b)(4)
 - No “business judgment rule” necessary for BEAT

Key Takeaway

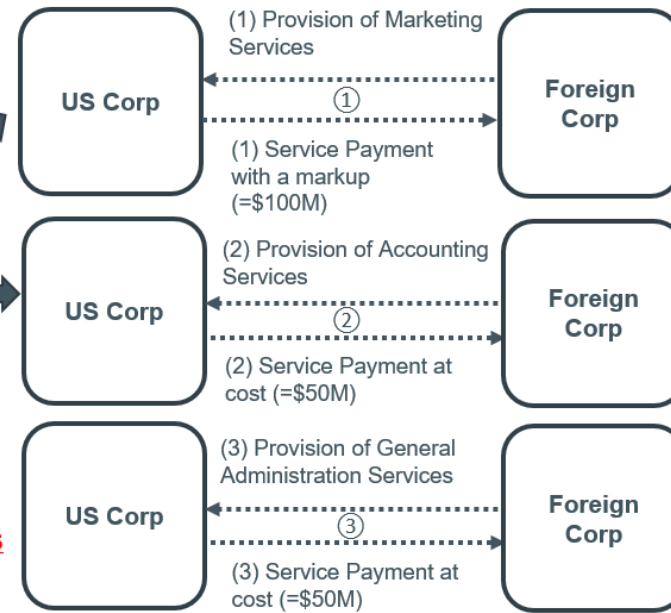
- Companies may not have previously needed to identify such eligible services in their non-U.S. affiliates, nor analyze in such detail and now the BEAT implications may make this analysis a valuable exercise

SCM Exception: Planning and Analysis

Pre-Recharacterization of Transactions



Post-Recharacterization of Transactions



UNBUNDLING TRANSACTIONS

US Corp's Income Statement	In Millions of USD
Sales	500
SG&A	200
Services Payment	200
Operating Profit	100
Subject to BEAT	200

US Corp's P&L's Income Statement	In Millions of USD
Sales	500
SG&A	200
SCM Non-Qualified Services Payment (1)	100
SCM Qualified Services Payment (2) + (3)	100
Operating Profit	100
Subject to BEAT	100

SCM Exception: Documentation and Support

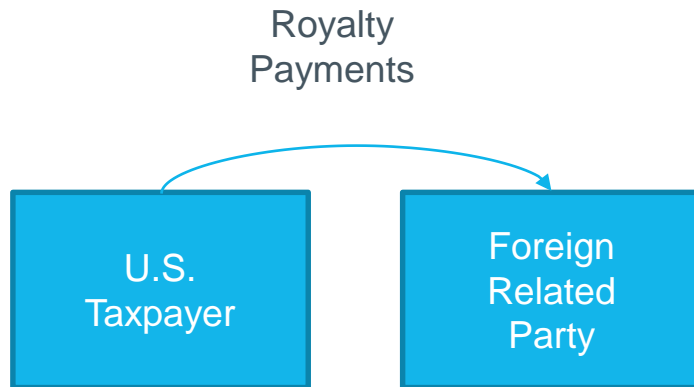
SCM Exception Documentation Requirements – § 1.59A-3(b)(3)(i)(C)

- Documentation must be adequate to:
 - Verify the amount charged for the services and the total services costs incurred by the renderer, including a description of the services in question
 - Identification of the renderer and the recipient of the services
 - Calculation of the amount of profit mark-up (if any) paid for the services
 - Sufficient documentation to allow verification of the methods used to allocate and apportion the costs to the services
- Documentation is mandatory to claim SCM exception

Key Takeaways

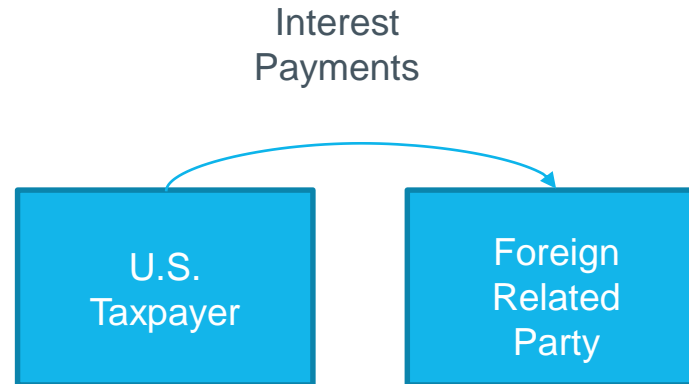
- Documentation required for SCM follow similar requirements to what is expected for ordinary course transfer pricing support. However, differences with local country rules and OECD guidelines will require a few additional steps to take advantage of the SCM exception
- A holistic and consistent approach to global shared services transactions will pay dividends for BEAT but also for day-to-day transfer pricing support for services

Intangibles: Outbound Royalty Payments



- Examine Facts of the U.S. Business and use of Foreign IP
- Reassess Target Royalty Rates
 - Use / Scope / Life
 - Arm's Length Range
- Examine Value of the IP
 - Analyze IRR of royalty income vs. cost
- Consider Industry Adjustments
 - Volume / Profit
- Re-examine Comparables
- Consider Alternative Methods
 - CUT vs. CPM/TNMM
- Re-evaluate overall IP Structure, including CSA RAB share computations if appropriate

Related Party Financing and Debt Structures

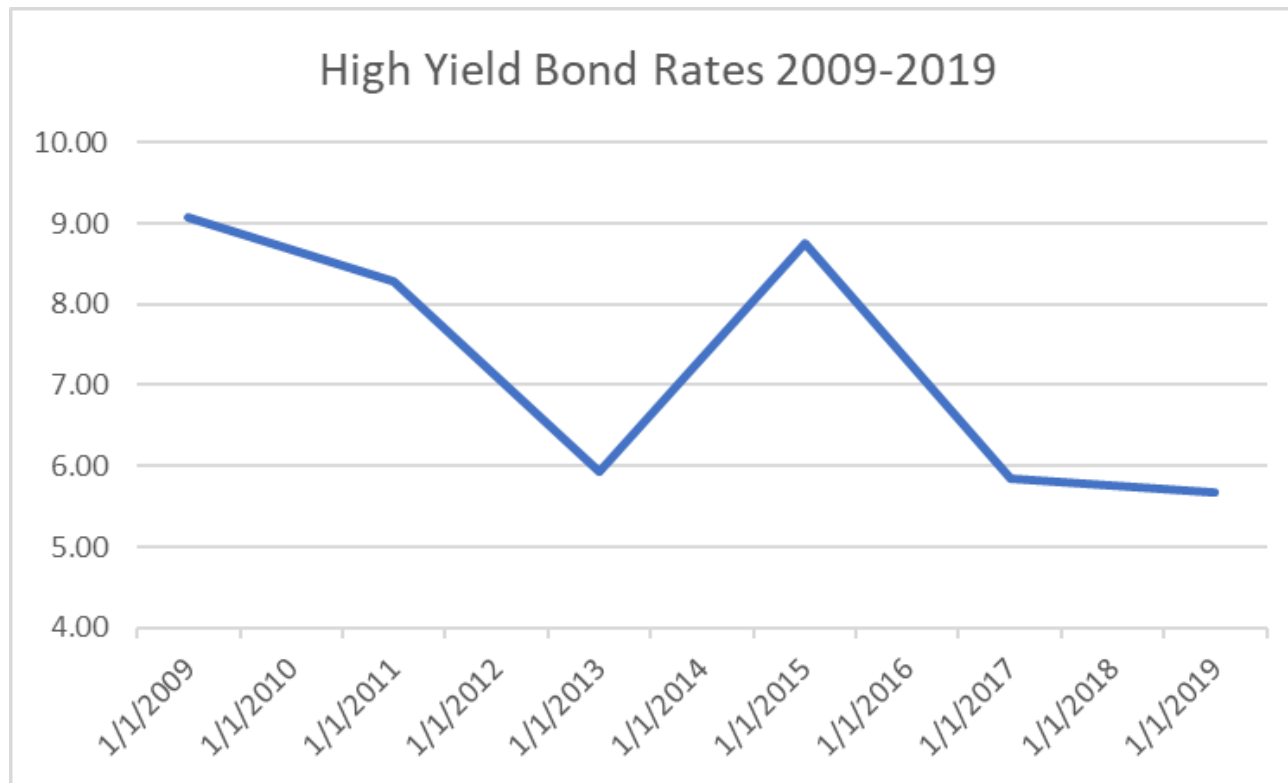


$$\text{Interest Payments} = \text{Interest Rate} \times \text{Debt Amount}$$

Two red arrows point downwards from the words "Interest Rate" and "Debt Amount" in the equation above to the corresponding terms in the equation below.

Related Party Financing and Debt Structures

- Refinance outstanding loans to take advantage of lower interest rates



Related Party Financing and Debt Structures

Apply a safe harbor

- Safe harbor rates can sometimes be lower than market rates
- Look to country of lender for appropriate safe harbor rate
- Evaluate whether safe harbor applies
- Consider U.S. perspective

Europe

- Many tax authorities subjecting loans to more scrutiny, not less
- Implicit support/use of parental group rating?

Asia

- Use of safe harbors varies significantly by country
- Loans may often need to meet certain low risk requirements for safe harbors to apply

Related Party Financing and Debt Structures

- De-Risk loans through changes to:
 - Security
 - Covenants
 - Term to Maturity
 - Payment terms
- Consider if borrower credit quality has improved since original loan issuance
 - Better forecasts
 - Healthier balance sheet

Anti-Abuse Provision

- Transactions will be recharacterized according to their substance
- Emphasis on principal purpose
- Mention of
 - Transactions involving unrelated persons, conduits or intermediaries
 - Transactions to increase amount of deductions taken into account in the denominator of the base erosion percentage
 - Transactions to avoid application of rules applicable to bans and registered securities dealers
 - Nonrecognition transactions that increase the adjusted basis of property that a taxpayer acquires in a specified nonrecognition transaction

Summary

BEAT and Transfer Pricing Considerations

- The Base Erosion and Anti Abuse Tax (“BEAT”) provision would apply to corporate taxpayers¹ with:
 - \$500 million average annual gross receipts for the three year period ending with the preceding taxable year.
 - U.S. taxpayer’s deductions for intercompany payments for services, interest, certain property / assets, and royalties must be greater than 3 percent of its total deductions allowed.
- Additional tax of 10 percent of their “modified taxable income” less regular tax liability on a worldwide basis will be assessed (5 percent for 2018; 12.5 percent after 2025).

¹ BEAT does not apply to regulated investment companies, REITs, or S Corporations.

TRANSACTIONS

Tangible Property

Services

Intangible Property

Financing

OUR CAPABILITIES

- Evaluation of Aggregation of Tangible, Services and Intangible Transactions
- Alternative Supply Chain Modeling
- Evaluation of Disaggregation of Service Transactions
- Application of Services Cost Method (SCM) – Identifying and Quantifying SCM Services
- Services Benchmarking
- Royalty Rate Benchmarking
- Scenario Analysis for Interest Rates
- Application of Safe Harbors
- Review and Optimization of Debt Structures

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Michelle Johnson has been practicing transfer pricing for over fifteen years. A managing director, Michelle has significant experience advising clients on transfer pricing and valuation matters, including global transfer pricing documentation preparation, ASC 740 (FIN 48) recognition and measurement analyses, intangible property valuation, and transfer pricing policy development. Michelle is a member of Duff & Phelps' financial services team and has significant experience assisting companies with pricing matters involving asset management, insurance, banking, and global dealing transactions. Michelle is also a frequent speaker on inter-company services transactions and has performed dozens of analyses in this area. In addition to preparing documentation, restructuring and planning assistance for companies ranging from start-ups to Fortune 100 firms, Michelle has been called upon as a transfer pricing expert in numerous audit defense matters.

Previously, Michelle led the development of Ceteris' ASC 740 (FIN 48) service line and pioneered several thought leadership publications on behalf of the firm. She is an award-winning speaker and has presented at numerous conferences and seminars regarding transfer pricing issues. She served as co-editor of the Wolters Kluwer Guide to International Transfer Pricing: Law, Compliance and Tax Planning Strategies, and co-authored the BNA Tax Management Portfolio on ASC 740-10 (FIN 48) (published 2012). Michelle also oversaw Ceteris' U.S. operations and was responsible for quality and training of the company's U.S. transfer pricing practice. Earlier in her career, Michelle was part of Ernst & Young's transfer pricing practice, having spent time in the company's Chicago, San Jose and New York offices.

Michelle obtained her Master's degree in Economics from New York University and a BS in Economics and French, with a minor in Mathematics, from the University of Illinois (magna cum laude).

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Patrick McColgan is a managing director in Duff & Phelps' Atlanta office and part of the Transfer Pricing practice. He has a strong focus on assisting growth companies with their global transfer pricing needs through the design of defensible and pragmatic solutions. Patrick has more than 11 years of transfer pricing experience and has worked across a number of industries including automotive, chemical, consumer products, medical products, pharmaceutical, software, internet, and manufacturing.

Throughout his career, Patrick has advised his clients on a broad spectrum of transfer pricing issues. Discrete areas of his experience include: strategic supply chain planning, IP restructuring, global BEPS alignment, headquarter allocation analyses, transfer pricing/customs integration, audit defense and litigation support, and transfer pricing policy design. Patrick also assists his multinational company clients and private equity clients with their transfer pricing due diligence and post-acquisition integration planning.

Prior to joining Duff & Phelps, Patrick was a director with Ceteris and a manager at Deloitte's Transfer Pricing practice prior to that.

Patrick graduated with honors from the University of St. Andrews, Scotland with a Masters in Financial Economics. He has guest-lectured on transfer pricing topics at Duke University, Seattle University and is an active member of the International Fiscal Association (IFA) and the National Association for Business Economics (NABE).

Justin Radziewicz

Director, Transfer Pricing



Justin Radziewicz joined Duff & Phelps as a director with significant experience advising clients' senior management teams on a variety of transfer pricing and valuation matters. Justin has supported and managed large litigation support projects, prepared U.S., OECD and local country transfer pricing documentation for tangible, intangible and service transactions, assisted in the design and preparation of economic planning and global transfer pricing policy projects, performed cost-sharing analyses, ASC 740 (formerly FIN 48) recognition, and analyzed complex transfer pricing issues in compliance and controversy contexts. Justin has considerable experience with the design, implementation and maintenance of large and complex intercompany services analyses for Fortune 100 companies, providing a seamless integration between service provider and his client's internal team. Justin also has considerable experience related to intangible property licensing transactions, royalty rates and agreements.

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Justin's clients include Fortune 100 and Fortune 500 companies across a broad range of industries – including e-commerce, automotive, chemicals, consumer goods, pharmaceutical, telecommunications, software and software development, retail and industrial goods. He has published several articles about transfer pricing, including an in-depth look at the U.S. Services Regulations. Previously, Justin joined Ceteris after acquiring a BA in Psychology from DePaul University.