

GUCCI
GUCCI GROUP



**BOMBAY MANAGEMENT ASSOCIATION
11TH ANNUAL INTERNATIONAL TAXATION
CONFERENCE**

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2005**

**THE DEFINITION OF ASSOCIATED
ENTERPRISES UNDER THE OECD MODEL
TREATY AND THE RELATIONSHIP
BETWEEN TRANSFER PRICING AND ANTI-
AVOIDANCE**

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THE ISSUES AT STAKE, IN PRACTICE

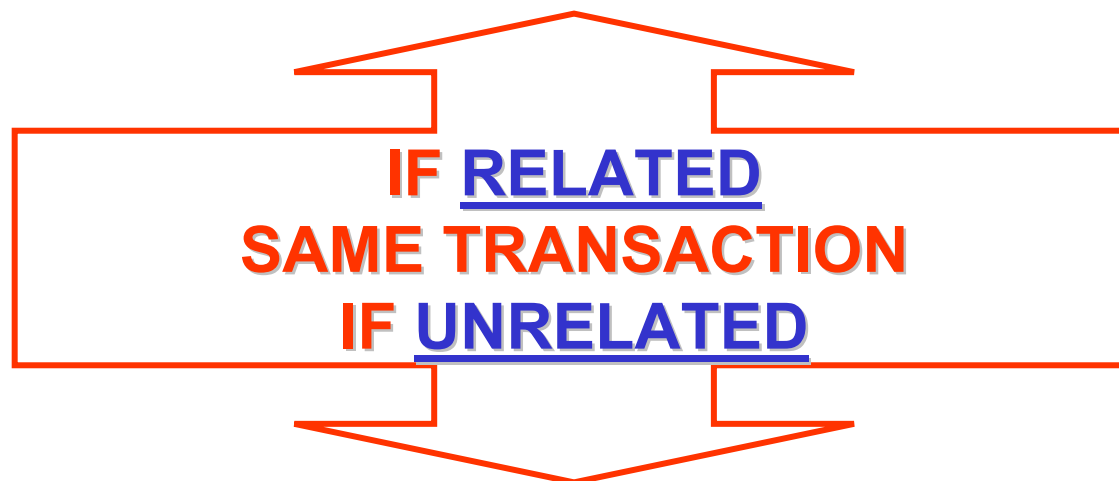
ASSOCIATION = KEY REQUIREMENT FOR APPLICATION OF TP REGIME(S) AND SPECIFIC OBLIGATIONS AND RIGHTS

- ✓ Arm's Length Standard
- ✓ Selection and Application of Most Appropriate TP Method
- ✓ Requirement of TP Documentation
- ✓ Application of TP Specific Audit Rules and, possibly, Penalties
- ✓ Application of TP Specific Dispute Resolution Mechanisms
- ✓ Obligation of Corresponding Adjustment under Art. 9(2) OECD

MC

THE ISSUES AT STAKE, IN PRACTICE

CHALLENGEABLE AGAINST AN ARM'S LENGTH BENCHMARK



CAPABLE OF BECOMING THE BENCHMARK AND OF AFFECTING DEDUCTIBILITY OF COMPARABLE TRANSACTIONS/DEALINGS UNDERTAKEN BY THE ENTERPRISE

STRUCTURE OF THE PRESENTATION

~~-THE TRIANGLE-~~

CONFLICTING
DOMESTIC NOTIONS

**THE ESSENTIAL
FRAMEWORK**

**ECONOMICS OF
MULTINATIONA
LBUSINESSES**



**THE PROBLEM &
A TENTATIVE
SOLUTION**

CONTEXT &
RATIONALE OF THE
OECD MODEL
CONVENTION

UNCERTAIN
WORDING &
REGIME UNDER
ART. 9 OECD MC

THE NOTION OF ASSOCIATED ENTERPRISES IN SELECTED COUNTRIES

AUSTRALIA

- ✓ Control relationship not required
- ✓ Transfer pricing rules also applicable in tax avoidance / tax evasion transactions.

BRAZIL

- ✓ No equity interest required. Also includes non-resident exclusive agent, distributor or dealer for the purchase or sale of the company's goods, services, rights.
- ✓ Dealings with counterparties resident in countries with a favourable corporate income tax rate (< 20 %)

THE NOTION OF ASSOCIATED ENTERPRISES IN SELECTED COUNTRIES

FRANCE

Two Forms of Control are relevant:

- ✓ ***De Jure*: Majority holding - Voting rights – Decision Making Power**
- ✓ ***De Facto*: Contractual or even factual relationships**

GERMANY

- ✓ **Substantial participation (holding of at least 25%)**
- ✓ **Controlling influence**
- ✓ **Interest in income of other person**

ITALY

- ✓ **Very broad notion of De Facto Control**

THE NOTION OF ASSOCIATED ENTERPRISES IN SELECTED COUNTRIES

JAPAN

- ✓ Direct or indirect ownerships of at least 50 % of the shares with or without voting power
- ✓ Special relationship enabling to substantially determine business policies of other enterprise.

**NETHERLANDS
& UK**

- ✓ Wording similar to the one contained in Art. 9(1) of the OECD MC

**UNITED
STATES**

- ✓ Parties owned or controlled directly or indirectly by same interests;
- ✓ Ability to cause parties to make arrangements differing from those made by unrelated parties.

THE NOTION OF ASSOCIATED ENTERPRISES IN SELECTED COUNTRIES

*SHAREHOLDIN
G*

DIRECTORSHIP

DE JURE CONTROL



**DOMESTIC NOTIONS OF
ASSOCIATED ENTERPRISES**

DE FACTO CONTROL

*SEVERAL TYPES OF CONTRACTUAL OR FACTUAL
RELATIONSHIP*

ART. 9(1) OECD MODEL CONVENTION

“... 1. Where

- a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or**
- b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, ...”**

PARTICIPATION IN MANAGEMENT

What does “*participation*” mean?

Does it require that the “managers” of both/all the companies involved in the scrutinized transaction/s are the same?

Can the enterprises be regarded as associated if their “managers” are linked by:

brother- family relationships (e.g. parent-children, sister, otherwise relatives);

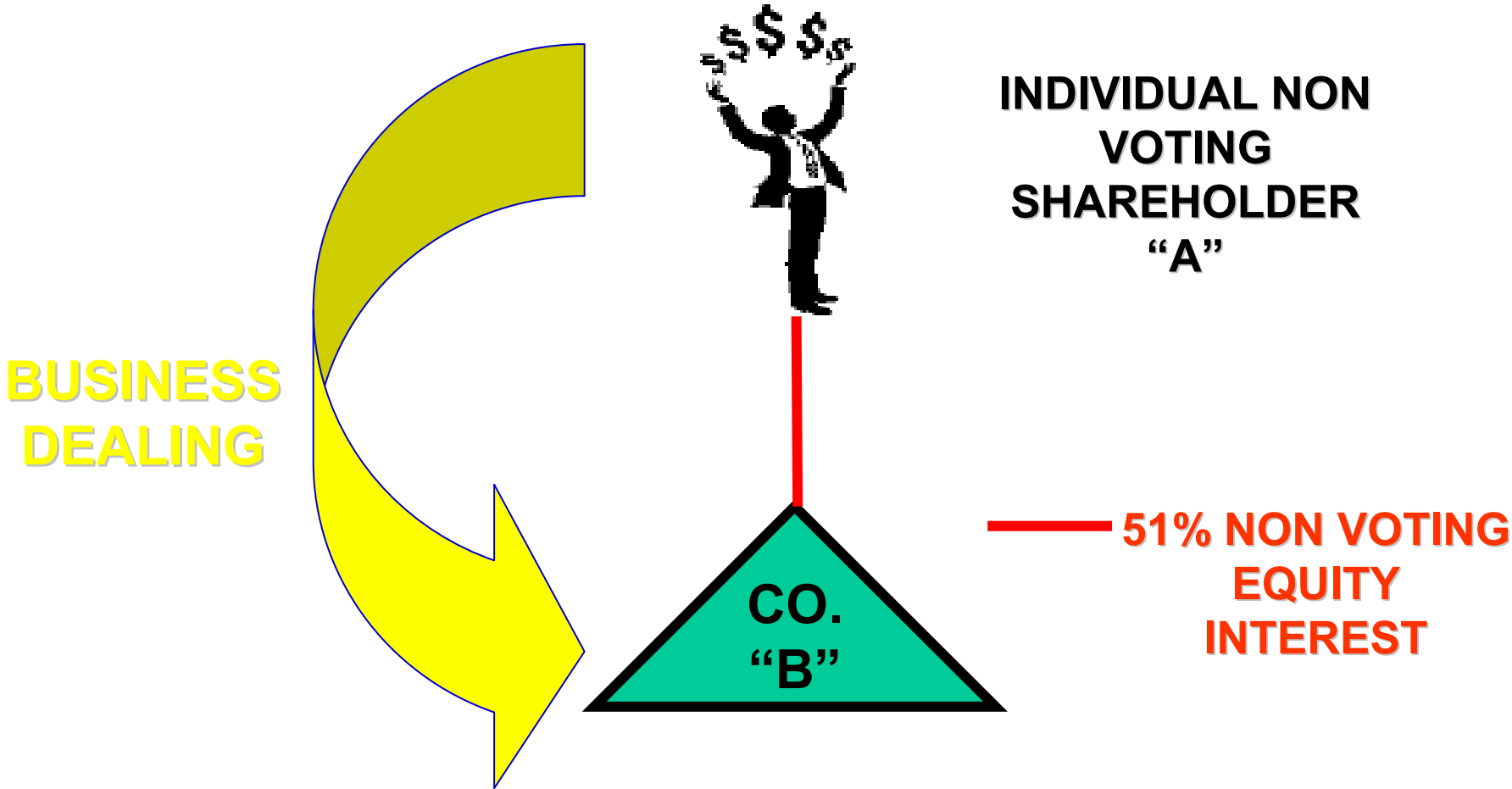
common membership of organizations, circles, groups of interests;

past common experiences or friendship?

Do the internal control/audit (Sarbanes-Oxley) procedures play a role in the present assessment?

PARTICIPATION IN CAPITAL

- NON VOTING SHARES -



**INDIVIDUAL NON
VOTING
SHAREHOLDER
"A"**

**BUSINESS
DEALING**

**51% NON VOTING
EQUITY
INTEREST**

**CO.
"B"**

PARTICIPATION IN CONTROL

- CONTRACTUAL CONTROL-

CONTROLLING PARTY	CONTROLLED PARTY
Franchisor	Franchisee
Intellectual Property Licensor	Intellectual Property Licensee
Monopolist Supplier	Purchasers/Clients
Sole Client/Purchaser	Supplier(s)
Exclusive Agent	Principal
Principal	Non-exclusive Agent

PARTICIPATION IN CONTROL

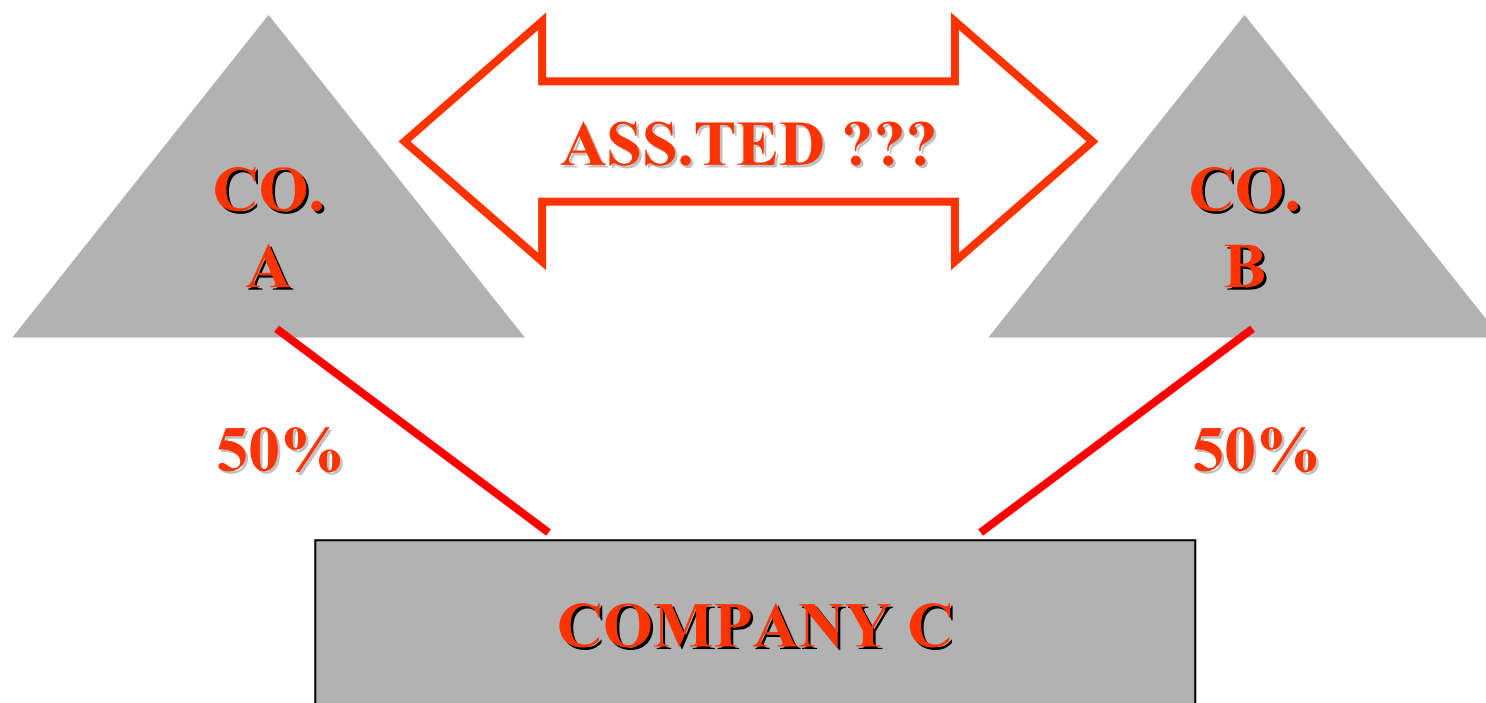
- CONTRACTUAL CONTROL-

Co. A. is financially overexposed vis à vis Co. B, which granted to Co. A an amount of credit essential for Co. A's business. Are Co. A and Co. B associated enterprises for the purposes of Art. 9(1)?

Are Co. A and Co. B associated enterprises for the purposes of Art. 9(1)?

PARTICIPATION IN CONTROL

- Participation in the capital or management of the same (third) Company -



PARTICIPATION IN CONTROL

- Participation to the same joint venture project -



**JOINT VENTURE PROJECT
(NO LEGAL ENTITY)**

“SPECIAL RELATIONSHIP” & “ASSOCIATION”

“...Where, by reason of a special relationship between the payer and the beneficial owner or between both of them and some other person, the amount of the interest (royalties), having regard to the debt-claim (use, right or information) for which it is (they are) paid, exceeds the amount which would have been agreed upon by the payer and the beneficial owner in the absence of such relationship, the provisions of this Article”

OECD MODEL CONVENTION - ART. 11(6)

OECD MODEL CONVENTION – ART. 12(4)

“SPECIAL RELATIONSHIP” & “ASSOCIATION”

“...It is clear from the text that for this clause to apply the interest (royalties) held excessive must be due to a special relationship between the payer and the beneficial owner or between both of them and some other person. There may be cited as examples cases where interest (royalty) is paid to an individual or legal person who directly or indirectly controls the payer, or who is directly or indirectly controlled by him or is subordinate to a group having common interest with him. These examples, moreover, are similar or analogous to the cases contemplated by Article 9. ...”

OECD MODEL COMMENTARY TO ART. 11 - § 33

OECD MODEL COMMENTARY TO ART. 12 - § 23

“SPECIAL RELATIONSHIP” & “ASSOCIATION”

“...the concept of special relationship also covers relationship by blood or marriage and, in general, any community of interests as distinct from the legal relationship giving rise to the payment of the interest (royalty)...”

OECD MODEL COMMENTARY TO ART. 11 - § 34

OECD MODEL COMMENTARY TO ART. 12 - § 24

THE APPLICABLE INTERPRETATION RULES

“... As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the laws of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State...”

OECD MODEL CONVENTION, ART. 3(2)

THE APPLICABLE INTERPRETATION RULES



*International Law
Commission*

Vienna Convention On The Law Of Treaties

SECTION 3. INTERPRETATION OF TREATIES

Article 31 – “*General rule of interpretation*”

Article 32 – “*Supplementary means of interpretation*”

THE APPLICABLE INTERPRETATION RULES

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.

2. The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes:

(a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty;

(b) any instrument which was made by one or more parties in connection with the conclusion of the treaty and accepted by the other parties as an instrument related to the treaty.

(...)

ARTICLE 31 – “General rule of interpretation”

THE APPLICABLE INTERPRETATION RULES

3. *There shall be taken into account, together with the context:*
 - (a) *any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;*
 - (b) *any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;*
 - (c) *any relevant rules of international law applicable in the relations between the parties.*

4. *A special meaning shall be given to a term if it is established that the parties so intended.*

ARTICLE 31 – “General rule of interpretation”

THE APPLICABLE INTERPRETATION RULES

“Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

- (a) leaves the meaning ambiguous or obscure; or***
- (b) leads to a result which is manifestly absurd or unreasonable”.***

ARTICLE 32 – “Supplementary means of interpretation”

THE APPLICABLE INTERPRETATION RULES

“... The context is determined in particular by the intention of the Contracting States when signing the Convention as well as the meaning given to the term in question in the legislation of the other Contracting State...”

OECD MODEL COMMENTARY ON ART. 3 - § 12

THE RELEVANT CONTEXT OF THE CONVENTION

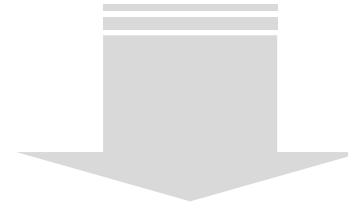
CASES OF TREATY RELIEF OF THE ECONOMIC DOUBLE TAXATION

***- TRANSFER
PRICING***

***- DIVIDEND TAX
CREDIT***

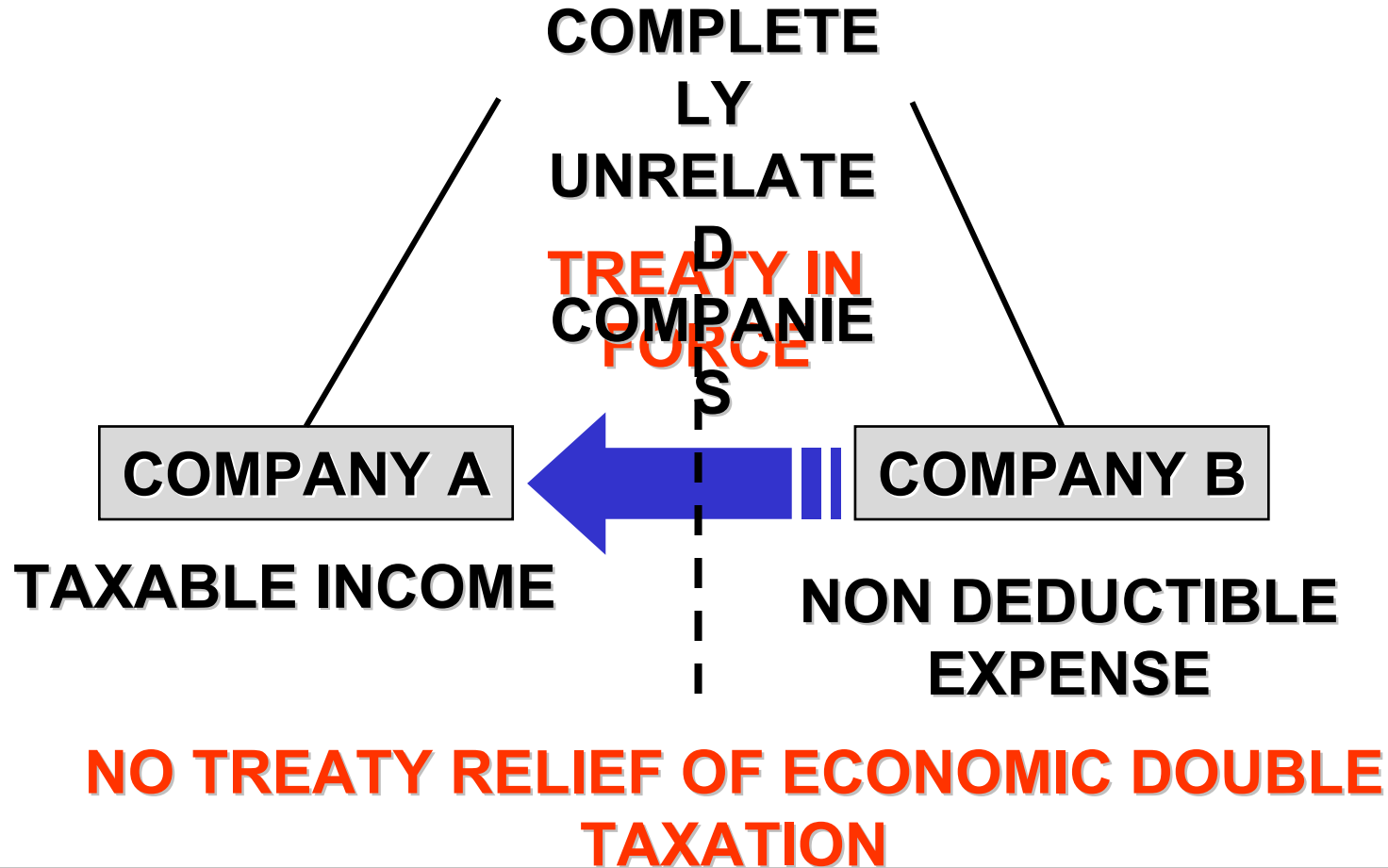


**SAME ECONOMIC
SUBJECT**



**COMMUNITY
INTEREST**

THE RELEVANT CONTEXT OF THE CONVENTION



THE RELEVANT CONTEXT OF THE CONVENTION

THE CONTEXT

**RELIEF OF ECONOMIC
DOUBLE TAXATION**

**PECULIARITY OF THE
TP**

PHENOMENON

**SAME ECONOMIC
SUBJECT**

+

**ABILITY TO
INFLUENCE**

DECISION MAKING

ASSOCIATION

OTHER INTERNATIONAL STANDARDS

IAS 27 – Consolidated financial statements and Accounting for Investments in Subsidiaries

Control (for the purpose of this Standard) is the power to govern the financial and operating policies of an enterprise so as to obtain benefits from its activities.

A subsidiary is an enterprise that is controlled by another enterprise (known as the parent).

OTHER INTERNATIONAL STANDARDS

IAS 28 – Accounting for Investments in Associates

An associate is an enterprise in which the investor has significant influence and which is neither a subsidiary nor a joint venture of the investor.

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control over those policies.

OTHER INTERNATIONAL STANDARDS

Significant Influence

If an investor holds, directly or indirectly through subsidiaries, 20% or more of the voting power of the investee, it is presumed that the investor does have significant influence, unless it can be clearly demonstrated that this is not the case.

Conversely, if the investor holds, directly or indirectly through subsidiaries, less than 20% of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated.

A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

OTHER INTERNATIONAL STANDARDS

Significant Influence

The existence of significant influence by an investor is usually evidenced in one or more of the following ways:

- (a) representation on the board of directors or equivalent governing body of the investee;
- (b) participation in policy making processes;
- (c) material transactions between the investor and the investee;
- (d) interchange of managerial personnel; or
- (e) provision of essential technical information.

OTHER INTERNATIONAL STANDARDS

EU CUSTOMS CODE

Article 143 Implementing Code

Persons shall be deemed to be related only if:

(a) they are officers or directors of one another's business;

(b) they are legally recognized partners in business;

(c) they are employer and employee;

(d) any person directly or indirectly owns, controls or holds 5% or more of the outstanding voting stock or shares of both of them;

(e) one of them directly or indirectly controls the other;

OTHER INTERNATIONAL STANDARDS

EU CUSTOMS CODE

Article 143 Implementing Code

Persons shall be deemed to be related only if:

(f) both of them are directly or indirectly controlled by a third person;

(g) together they directly or indirectly control a third person or

(h) they are members of the same family:

- husband and wife,*
- parent and child,*
- brother and sister (whether by whole or half blood),*
- grandparent and grandchild,*
- uncle or aunt and nephew or niece, etc. (...)*

OTHER INTERNATIONAL STANDARDS

EU CUSTOMS CODE

Article 143 Implementing Code

(...)

Persons who are associated in business with one another in that one is:

- the sole agent,*
- sole distributor or*
- sole concessionaire, however described, of the other shall be deemed to be related only if they fall within the above outlined criteria.*