GT Société d'Avocats
Avocats à la Cour

Practical application of the profit split method ('PSM') in the EU

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Summary

1- Selection of the PSM

2- Practical considerations

- Determination of the combined (residual) profit
- How to split the profit
- Administration of the PSM

Selection of the PSM

- PSM currently get strong support from different stakeholders; but
- Is it for the right reasons? i.e. lack of "perfect" comparables? alternative to the ALP?
- Discussion draft Chapter I TPG confirms that the most appropriate method standard remains; but
- Many concerns expressed in public consultation on the BEPS discussion draft on the use of PSM in the context of global value chains (PSM DD)…

Selection of the PSM

- Especially as the PSM DD might make use of profit splits more widespread, through:
  - Concepts such as "integration" or "global value chain";
  - Providing scenarios where some situations would be appropriately addressed by one-sided analyses; or
  - Recommending a wide use of PSM as a corroborative method.

Selection of the PSM

- Impact of recognition of "new" IPs (assembled work force, local market characteristics…), of characterization …

Selection of the PSM

- In certain circumstances (unique or/and valuable contributions, highly integrated business models…), PSM are relevant in achieving an arm's length alignment of profit allocation to **HIGH / MATERIAL** value creation;

- Value creation should implies responsibility i.e. risks and related potential losses…

- When PSM are appropriate, practical and implementation issues are to be addressed from both perspectives, Tax administrations and MNEs.

Practical Considerations

- PSM raise major practical / implementation issues…
- …that may be better and jointly addressed at the EU level (compared to OECD/UN) because of:
  - Fewer countries
  - Macro economic "integration"
  - Common or comparable "neighbouring" regulations: competition regs, copyright/patent, commercial / corporation laws…

Impact of certain concepts

- "Global Value chain" and "integration": the mere fact of being integrated to a group and to be part of the value chain should not automatically lead to PS "eligibility";
- Need to clearly define and put emphasis on "high/material" value creation factors;
- If not what would be the border with global formulary apportionments;
- Ex-Ante approach: guidance on what supporting elements should be taken into account and recognized (business plans, forecasts …); "commensurate with outcomes" thresholds?
- This is critical to limit subjectivity and related uncertainties for both, tax administrations and MNEs.

Determination of the combined (residual) profit

- Determination of the operating profit
  - Which accounting data(Consolidated or sub-consolidated accounts data or local statutory accounts? Is reconciliation necessary?);
  - Different accounting gaaps;
  - In case of complex situations (conglomerate, multi lines of business), how to delineate the profit to the tested transactions, will indirect allocation of costs be accepted?;
  - Multiple Regional HQ / "Entrepreneurs"…
  - Extraordinary or financial components should be considered?

How to split the profit

- Do commonly referred allocation keys …i.e.
  - Cost-based keys (e.g. headcount, sales)
    - simple but subjective
    - Assessment of the correlation test can be challenging in the EU (e.g. often complex transactions in the single market
  - Asset-based keys, (e.g. based on relative contribution to economic valuation)
    - difficult to implement
    - Better fit to EU market and companies?
- Really reflect high / material contributions to value creation?
- Help from economic theory/valuation?

Administration of the PSM

- How to ensure that transactions surrounding and potentially impacting the profit to be split are treated congruently by tax administrations? Can the possibilities provided by the EU Directive on Administrative Cooperation be used?
- Are the APA programs in EU Member States and the EU JTPF APA Guidelines up to date for dealing with (multilateral)PSM situations?
- How to ensure effective and efficient application of the PSM for the tax administration/companies without creating too much compliance costs?