Cross-border Outsourcing
Issues, Strategies & Solutions

Natalie Reypens, partner Loyens & Loeff

Content
1. Introduction
2. Domestic law provisions
3. PE in source country as a result of outsourcing
4. Attribution of profits to a PE arising from outsourced activities
5. Transfer pricing
6. Withholding tax
7. Impact of anti-deferral regimes on outsourced structures
8. Discussion and Suggestions
1. Introduction

• Emerging markets
• Technological change in communication and logistics
• Financial crisis

Internationalization of the value chain: outsourcing

• Belgium one of the most globalized countries (political, economic and social integration)

Inbound outsourcing: R&D

Outbound outsourcing
  - Production and assembly operations
  - Services

- Administrative (35%)
- IT and software services (33%)
- Technology services (21%)
- Call-centers (11%)
1. Introduction

• 5 strategic drivers:
  - Labor cost savings
  - Increase of organizational flexibility
  - Access to qualified personnel offshore
  - Growth strategy
  - Other cost savings

• Outsourcing destinations

- USA
- Other European countries
- Belgium
- Other Asian countries
- Africa
- North America
- China
- Latin America
1. Introduction

- Outsourcing models

![Pie charts showing outsourcing models in Belgium, Other European countries, and USA.](chart)

- Outcome of outsourcing
  - Increase of competitiveness
  - Increase of productivity and efficiency
  - Better focus on core competencies
  - Improved organizational flexibility
  - Better access to qualified personnel
Content

1. Introduction
2. Domestic law provisions
3. PE in source country as a result of outsourcing
4. Attribution of profits to a PE arising from outsourced activities
5. Transfer pricing
6. Withholding tax
7. Impact of anti-deferral regimes on outsourced structures
8. Discussion and Suggestions

2. Domestic law provisions

1. Tax deductibility of service fee payments
2. Withholding tax (section 6)
3. Transfer pricing rules (section 5)
4. Outsourcing to subsidiary: participation exemption
5. Outsourcing to branch (section 4)
6. R&D incentives
2. Domestic law provisions

Tax deductibility of service fee payments

1. Art. 49 ITC
2. Art. 54 and 198.10° & 307 ITC
   - Payments to tax havens
     - Reversal of burden of proof:
       ▪ Actual and true transaction
       ▪ Arm’s length nature of payment
       ▪ Not a mere artificial construction

R&D incentives

- Increased R&D investment deduction/tax credit
  - One-time 14.5% of investment cost
  - Spread 21.5% on depreciation amount
  - Or tax credit : = 33.99% x 14.5/21.5%
- Payroll wage tax reduction of 80%
- Expat status for foreign executives
- Foreign tax credit on royalty income (15/85)
- others
2. Domestic law provisions

R&D incentives

• Patent Income Deduction
  - Deduction of 80 % of income (ETR 6.8 %)
  - Income from licensing or part of the sales price
  - Patents or supplementary protection certificates
  - Self-developed in R&D center in Belgium or abroad
  - or acquired and further improved
  - Outsourcing is allowed but sufficient substance in Belgium (coordination function)
3. PE in source state

Service Recipient

BE/ offshore

Outsourcing
payment of fee

offshore /BE

Service Provider

PE

3. PE in source state

Permanent establishment
Art. 5 OECD MC

Belgian establishment
Art. 229 ITC


• Fixed place PE/BE
• Agency PE/BE
• Service PE/BE
3. PE in source state

1. Fixed place PE
   (i) Place of business at disposal
       • Factual or economic right to use
       • E.g. through presence of its own employees
       • E.g. premises of service provider
   (ii) Fixed
       • More than temporary presence of employees
   (iii) Used to carry on business of service recipient (Agency PE)
       • Intervention of service recipient
       • Under supervision of the service recipient
       • NOT preparatory and auxiliary, NOT supervision and coordination

Example: Ruling dd. 19 June 2012:
- Services performed with own personnel and own equipment of service provider
- No employees of service recipient in Belgium
  → No PE
3. PE in source state

- No PE (Art. 5 §4 a) & b) MC)
- But Belgian establishment (Art. 229 §1, section 2, 9° and 10° ITC)

Service Recipient

Warehouse with goods of Service Recipient

Outsourcing of warehousing

· No PE (Art. 5 §4, c) MC)
· Except if SR intervenes in the processing of the goods.

Service Provider
3. PE in source state

- Procurement → no PE (Ghent 30.11.2004)
- Direct customer contact or involvement in commercial sales process → PE (Brussels 2.5.2001 and Brussels 19.01.2011)

3. PE in source state

2. Agency PE
   (i) Dependent agent (or independent beyond ordinary course of business)
   (ii) Acting on behalf of service recipient
   (iii) Authority to conclude contracts in the name of
   (iv) Habitually exercise authority
3. PE in source state

- Entitlement to conclude contracts
- Negotiate all elements of contract without signing (Com.DTT 5/402; ruling 28.2.2012)
- Bind principal re its core business
- Direct representation
- NOT commissionaire (acts in its own name)

Dependent

- Legally or economically (↔ Com.DTT)
- Related or unrelated
- Legally dependent:
  - subject to significant control
  - bound by detailed instructions on performance
  - no discretionary power re local organization of activities
- Economically dependent:
  - No own business risk (remuneration ?)
  - Only one principal ?
3. PE in source state

Independent beyond ordinary course of business
• E.g. commissionaire, broker
• In terms of activity and obligations of sector
• Full cycle theory (Com.DTT)
  - Purchase, production and sales

3. Service PE

3. Service PE

• Only few DTTs
• Belgian establishment (Art. 229§2/1 ITC).

“When a foreign enterprise performs services in Belgium for the same or connected projects through one or more individuals who are present in Belgium and perform services during a period or periods exceeding 30 days within a period of 12 months, the activities carried on in Belgium in performing these services form a Belgian establishment.”
3. PE in source state

• Case study 1: contract manufacturing

- Outsourcing of assembly
- Cost plus remuneration

3. PE in source state

• Case study 2: call center services

- Negotiate with customers within parameters
Content

1. Introduction
2. Domestic law provisions
3. PE in source country as a result of outsourcing
4. Attribution of profits to a PE arising from outsourced activities
5. Transfer pricing
6. Withholding tax
7. Impact of anti-deferral regimes on outsourced structures
8. Discussion and Suggestions

4. Attribution of profits to PE

Belgium as source state
- Art. 228 §2, 3° ITC : profits realized with intervention of PE
- Net amount
  - Expenses that weigh on BE taxable income
  - Incurred by BE or made by HQ for account of BE
  - Proportional part of HQ (if allowed by DTT)
- Arm’s length principle
4. Attribution of profits to PE

- Art. 7 §2 OECD MC
  “profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently”.
- OECD Report on PE allocation (22 July 2010)
- 2010 update of OECD Commentary
4. Attribution of profits to PE

- Authorized OECD Approach applied to current DTTs (2005 MC)
- No official comment of BTA
- Ambulatory vs static interpretation
- Ruling Commission and TP Unit

Does existence of PE have any impact in case of Agency PE?

Principal

Agent

\[ \frac{+ \text{AL profit}}{- \text{AL profit}} \]

0
4. Attribution of profits to PE

- Additional profit to be attributed to PE?
- Dual taxpayer approach of OECD PE Report
- Certain risks and economic ownership of assets legally belong to principal
- Two possible situations:
  - Agent assumes only limited risk but has more full-fledge distributor’s profile
  - Risks that are not manageable

4. Attribution of profits to PE

- TP adjustment (Art.9) vs PE allocation (Art.7)
- Art. 9 : contractual and legal allocation of risks
- Art. 7 : economic reality and significant people functions.
4. Attribution of profits to PE

Belgium as home state
• PE exemption on the basis of the DTT
• Deduction on the basis of Art. 199 ITC
• Net profit calculated on basis of Belgian rules
• If no DTT: taxation, no credit

Content

1. Introduction
2. Domestic law provisions
3. PE in source country as a result of outsourcing
4. Attribution of profits to a PE arising from outsourced activities
5. Transfer pricing
6. Withholding tax
7. Impact of anti-deferral regimes on outsourced structures
8. Discussion and Suggestions
5. Transfer Pricing

- Art. 26 ITC
- Art. 79 and 207 ITC
- Art. 185 §2 ITC
- OECD TP Guidelines
- How to align between jurisdictions?
  - TP Guidelines
  - Pan EU databases and inter-quartile range of
  - APA and MAP

Service Recipient

BE

fee

Service Provider

offshore

Fee > ALP ⇔ Art 49, 26
Fee < ALP ⇔ Art 207
5. Transfer Pricing

- Business restructuring in view of outsourcing
- Transfer of something of value?
- Allocation of anticipated savings
5. Transfer Pricing

- Case study 3: contract manufacturing and location savings

- Design, produce & sell brand name clothes

- Outsource manufacturing

- Location savings

- Co. A

- Co. B

- High cost jurisdiction

- Low cost jurisdiction

- High competitiveness

- No significant risk

- Routine function
5. Transfer Pricing

- Case study 4: Sub-contracting services and location savings

![Diagram showing relationship between Co. X and Co. Y.]

- Co. X, based in BE, specializes in highly specialized engineering services.
- Co. Y, based in a low cost jurisdiction, sub-contracts engineering work.
- High demand and developed valuable IP.
- Share location savings and profit split.

Content

1. Introduction
2. Domestic law provisions
3. PE in source country as a result of outsourcing
4. Attribution of profits to a PE arising from outsourced activities
5. Transfer pricing
6. Withholding tax
7. Impact of anti-deferral regimes on outsourced structures
8. Discussion and Suggestions
6. Withholding tax

- Art. 228 §3 ITC

<table>
<thead>
<tr>
<th>BE Service Recipient</th>
<th>Service Provider</th>
</tr>
</thead>
<tbody>
<tr>
<td>fee for technical assistance or services</td>
<td>e.g.</td>
</tr>
<tr>
<td>• India</td>
<td></td>
</tr>
<tr>
<td>• Argentina</td>
<td></td>
</tr>
<tr>
<td>• Brazil</td>
<td></td>
</tr>
<tr>
<td>• Morocco</td>
<td></td>
</tr>
<tr>
<td>• Tunizia</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>BE Service Recipient</th>
<th>Service Provider</th>
</tr>
</thead>
<tbody>
<tr>
<td>Services in or outside Belgium</td>
<td>No DTT &amp; no taxation</td>
</tr>
</tbody>
</table>

- 33% on gross income – 50% 
- Treaty reduction

Content

1. Introduction
2. Domestic law provisions
3. PE in source country as a result of outsourcing
4. Attribution of profits to a PE arising from outsourced activities
5. Transfer pricing
6. Withholding tax
7. Impact of anti-deferral regimes on outsourced structures
8. Discussion and Suggestions
7. Impact of anti-deferral regimes

• No CFC rules
• Some indirect rules (Art. 54, 198.10°, 203, 344 §2 ITC)
8. Discussion and suggestions

• No litigation or substantial discussions
• Agency PE discussion
• Intangibles Report
• Discussions on location savings

Thank you!