

1st Subject
IFA Mumbai October 2014

Cross-border Outsourcing

Issues, Strategies & Solutions

Natalie Reypens, partner Loyens & Loeff

IFA Belgium – 15 October 2013

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

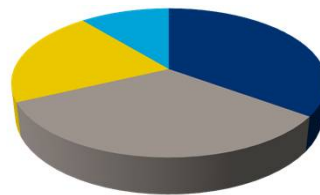
- Belgium one of the most globalized countries (political, economic and social integration)

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1. Introduction

- Inbound outsourcing : R&D
- Outbound outsourcing
 - Production and assembly operations
 - Services

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



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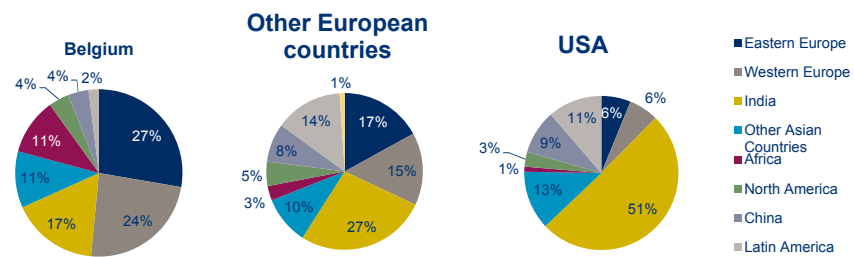
1. Introduction

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

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1. Introduction

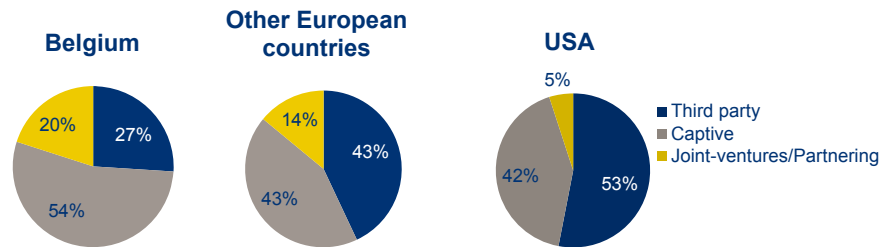
- Outsourcing destinations



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1. Introduction

- Outsourcing models



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1. Introduction

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

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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**
-

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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

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2. Domestic law provisions

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 : = $33.99 \% \times 14.5/21.5 \%$
- Payroll wage tax reduction of 80 %
- Expat status for foreign executives
- Foreign tax credit on royalty income (15/85)
- others

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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)

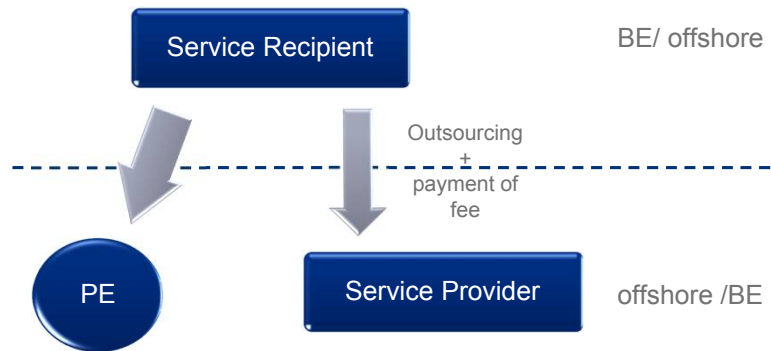
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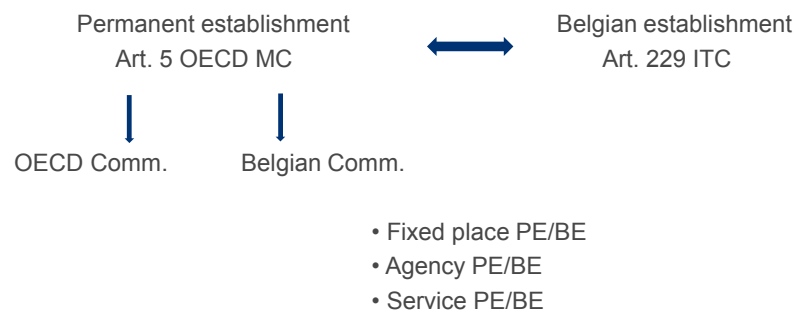
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3. PE in source state



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3. PE in source state



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3. PE in source state

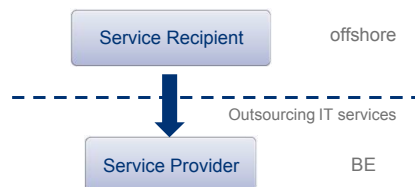
1. Fixed place PE

- (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

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3. PE in source state

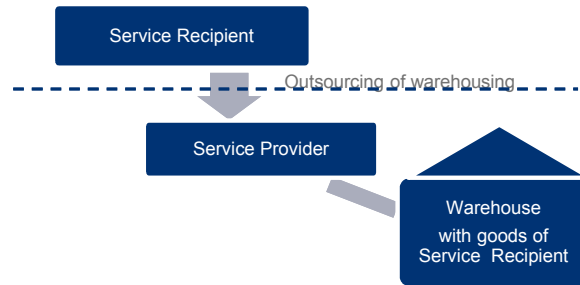
- Example : Ruling dd. 19 June 2012 :



- Services performed with own personnel and own equipment of service provider
- No employees of service recipient in Belgium
 - No PE

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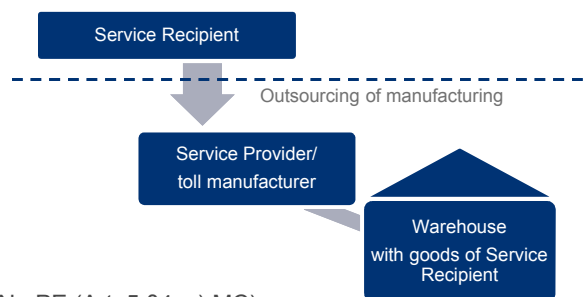
3. PE in source state



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

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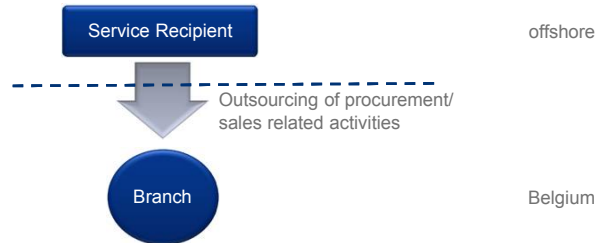
3. PE in source state



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

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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

- Dependent agent (or independent beyond ordinary course of business)
- Acting on behalf of service recipient
- Authority to conclude contracts in the name of
- 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)

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3. PE in source state

Dependent

- Legally or economically (\leftrightarrow 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 ?

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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

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3. PE in source state

3. Service PE

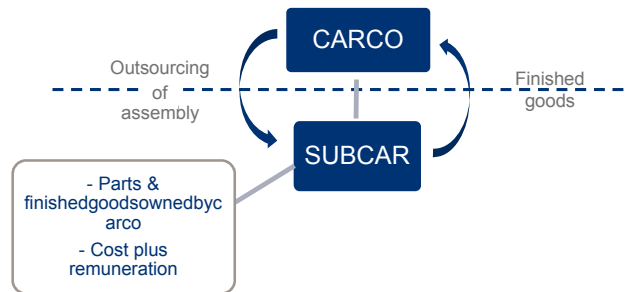
- Only few DTTs
- Belgian establishment (Art. 229§2/1 ITC).

“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.”

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3. PE in source state

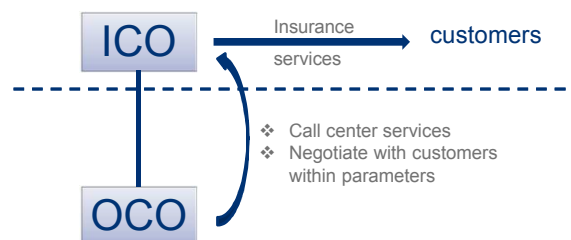
- Case study 1 : contract manufacturing



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3. PE in source state

- Case study 2 : call center services



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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

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4. Attribution of profits to PE

- Authorized OECD Approach = functionally separate entity approach
- Step 1 : functional and factual analysis
 - as if separate enterprises
 - allocation of functions, risks and assets
 - based on people functions
- Step 2 : comparability analysis

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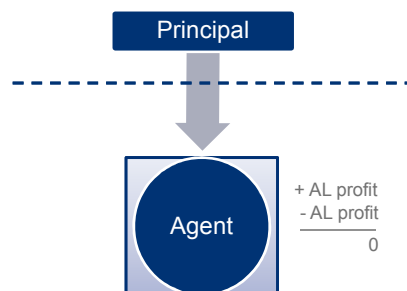
4. Attribution of profits to PE

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

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4. Attribution of profits to PE

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



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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

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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.

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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

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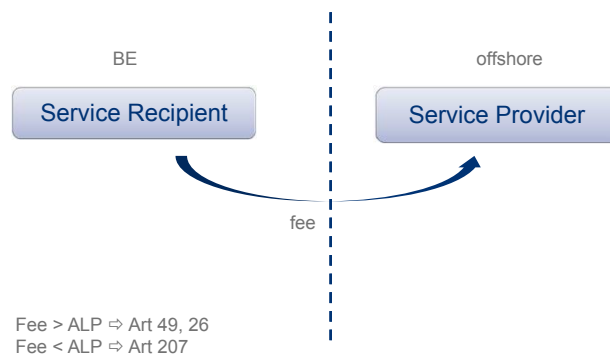
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5. Transfer Pricing

- 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

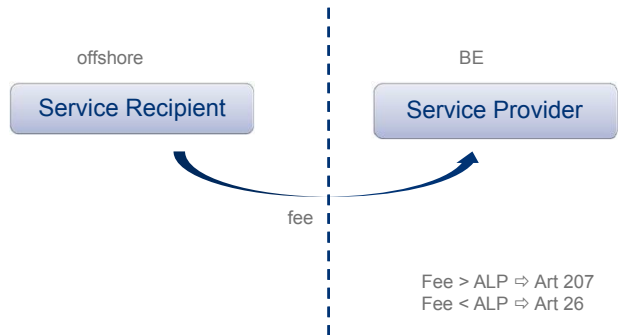
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5. Transfer Pricing



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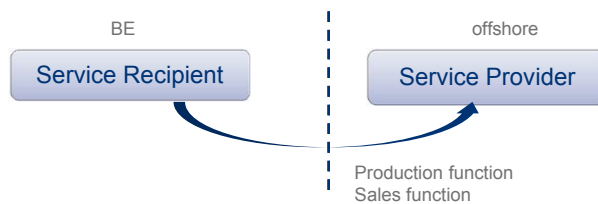
5. Transfer Pricing



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5. Transfer Pricing

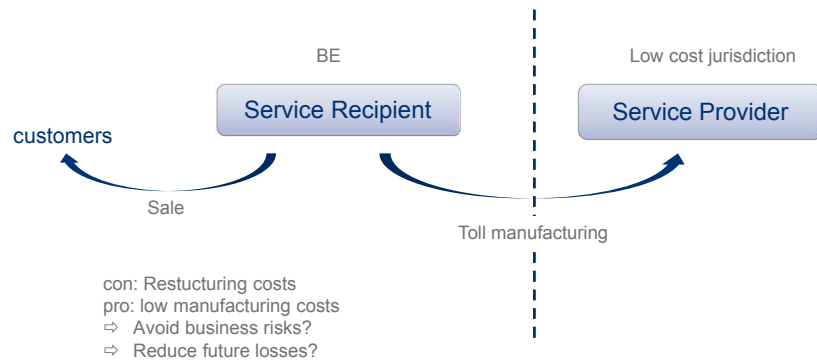
- Business restructuring in view of outsourcing



- Transfer of something of value ?
- Allocation of anticipated savings

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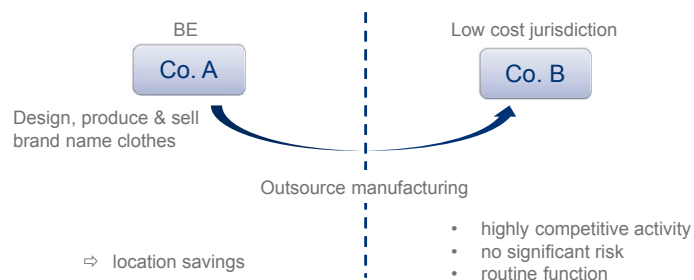
5. Transfer Pricing



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5. Transfer Pricing

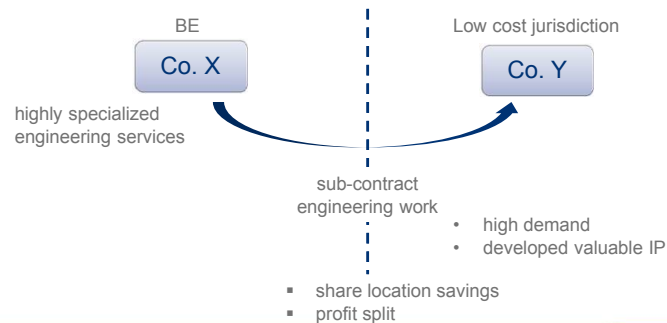
- Case study 3 : contract manufacturing and location savings



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5. Transfer Pricing

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



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6. Withholding tax

- Art. 228 §3 ITC



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

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7. Impact of anti-deferral regimes

- No CFC rules
- Some indirect rules (Art. 54, 198.10°, 203, 344 §2 ITC)

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8. **Discussion and Suggestions**

8. Discussion and suggestions

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

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Thank you !

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