TAX Institute for Austrian and International Tax Law Vienna

WU Wirtschaftsuniversität Wien Vienna University of Economics and Business

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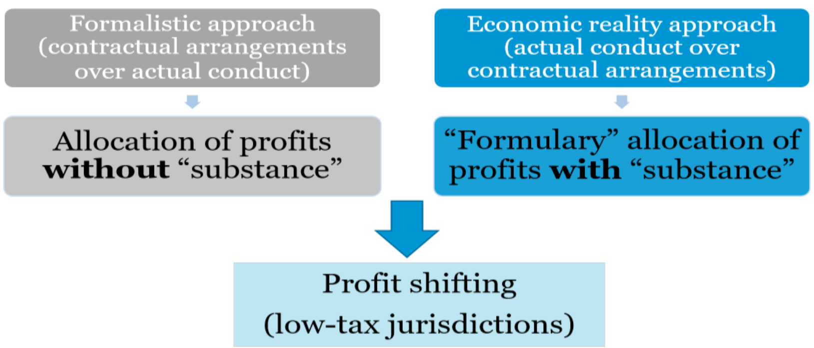
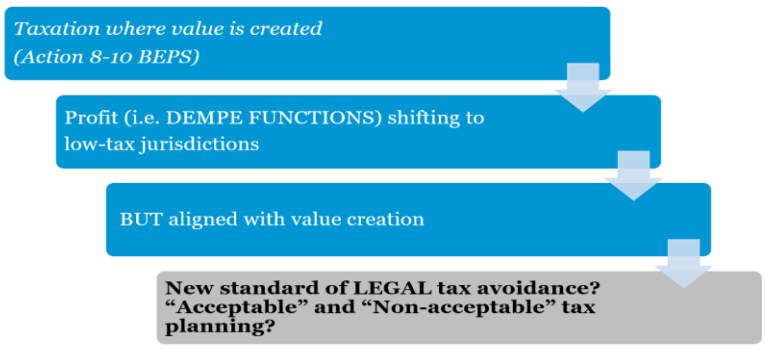
Rethinking the Arm´s Length Principle in the Era of Value Creation. *An Analysis of Intangibles Profit-Shifting Tax Planning Structures*

1° Research question: *Do changes to Chapter VI of the 2017 OECD Guidelines on intangibles, provides a substantive modification to the guidelines to the extent that the interpretation of the arm´s length principle vis-à-vis value creation, i.e. alignment of taxing right where activities are performed, would prevent the profit of shifting to low-tax jurisdictions as expected by the OECD?*

Where was (ex-ante BEPS), where is (ex-post BEPS) *still* the same problem?

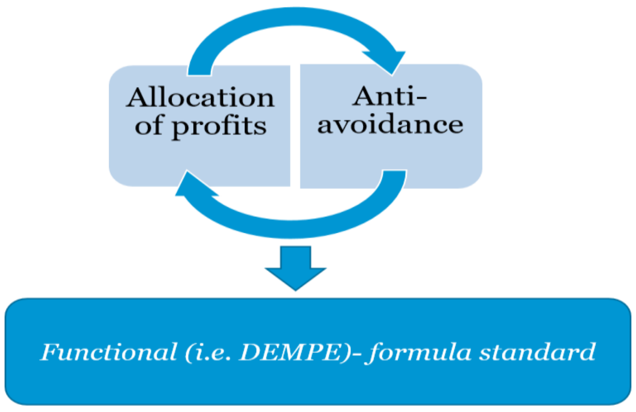


Value creation as a driver for shifting with "substance"



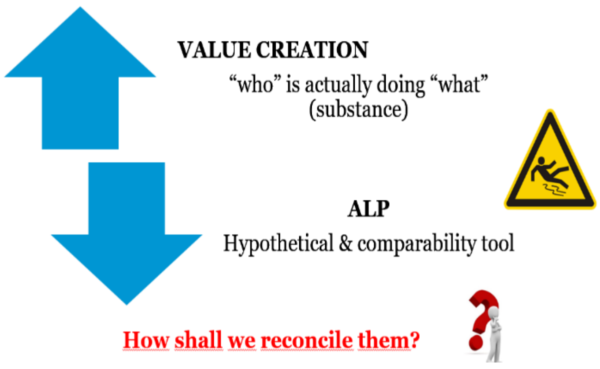
2° Research question: *Should value creation be interpreted exclusively as a standard to allocate profits based on the fact that serves as a "new" functional (i.e. DEMPE)-formula-based standard? If so, how should the value creation standard be interpreted within the arm´s length principle provided that its nature goes beyond comparability and hypothetical nature?*

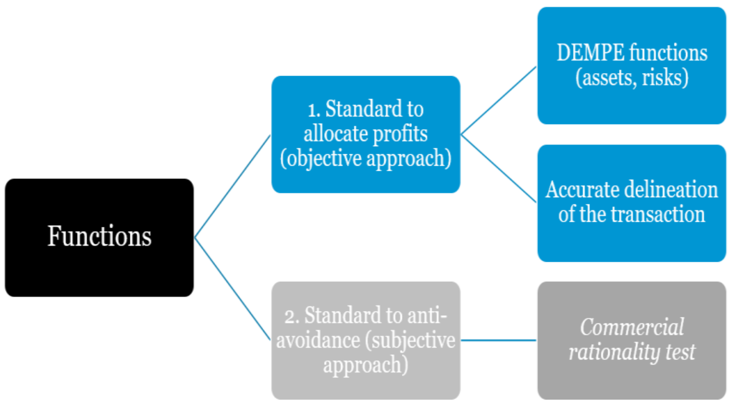
Value creation vis-à-vis "reality": two sides, same coin



ALP vis-à-vis functional-formula standard

The beginning of fall of the ALP?





VALUE CREATION goes beyond source, but where is it going?

- Seeks to determine where certain **income arises** but **beyond a legal concept** ("origin principle"? But what is "origin"?);
- **Economic attributes** attract value creation (functions, people who perform functions and control/capacity to bear risks)
- A **functional concept** based in "reality" ("assignment of an economically right to tax")

3° Research question: *Could / should value creation based on this functional (i.e. DEMPE) -formula-based standard serve as an anti-avoidance function to target tax avoidance disguised in apparently genuine structures (where there is alignment of allocation of profits with value-generating activities-with substance-) that in terms of how income is earned might not be commercially rational?*

Value creation as subjective standard (commercial rationality standard):

- ✓ There is legal substance BUT it is not commercially "right" based on the location and manner of performance of business functions. Are DEMPE functions and factors (i.e. people) located in a "commercially rational" manner?
  - Business sustainable with the people located in that jurisdiction?
  - What are these people really doing?
  - Are they really necessary for that function?
  - Could that activity be performed somewhere else?

- ❑ By ***what standard***?
- ❑ ***From whose perspective*** and according to ***what underlying experience*** and judgment is "commercial reality" to be determined?

- How should commercial rationality be reconciled between value creation and the nature of the ALP considering it is a **requirement to recognize** the transaction?
- (i) as to whether commercial rationality should be interpreted within the framework as if the ***transaction would have been agreed*** in a way that unrelated parties under comparable circumstances would have done? (NOT in line with value creation?)
- (ii) whether the ***transaction itself*** should be commercially rational irrespective of comparable economic circumstances? (in line with value creation?)

Formulaic (or formulary?!) apportionment wearing "value creation clothes"…?