PhD. Candidate: Mirna S. Screpante, LL.M.
Supervisors: Prof. Dr. Alexander Rust & Prof. Dr. Pasquale Pistone
External Supervisor: Scott Wilkie

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?

Value creation as a driver for shifting with “substance”

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

Allocation of profits without “substance”

Economic reality approach (actual conduct over contractual arrangements)

“Formulaic” allocation of profits with “substance”

Profit shifting (low-tax jurisdictions)

Value creation as a driver for shifting with “substance”

Transition where value is created (Action 8 of BEPS)

Profit (i.e. DEMPE FUNCTIONS) shifting to low-tax jurisdictions

New standard of LEGAL tax avoidance? “Acceptable” and “Non-acceptable” tax planning?

ALP vis-à-vis functional-formula standard

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 those people really doing?
  - Are they really necessary for that function?
  - Could that activity be performed somewhere else?

- 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”...?