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Introduction and Relevance

Sony Corporation - Restructuring Continues

Japan-based electronics and communications company, Sony Corporation, was subjected to a spate of restructuring exercises since 1994 to improve the financial performance and competitiveness of the company.

Sony formed two business groups - The Networked Products & Services Group and The New Consumer Products Group. The case details the restructuring exercise and outlines the pros and cons of these efforts. It also discusses in detail the main reasons for Sony’s problems including culture, competition and macro-environment issues.
OECD Guidance – TP Aspects of Business restructurings

- Discussion draft – Released on 19 September 2008 with 4 issue notes
- Final Report – Released on 22 July 2010 (Ch.IX of TP Guidelines with 4 Parts)

Guidance

- Special considerations for risks
- Arm’s length compensation for restructuring itself
- Remuneration of post – restructuring controlled transactions
- Recognition of the actual transactions undertaken
Business restructurings – Case studies
Conversion of full-risk manufacturer into Contract Manufacturer

Pre restructuring

Company A
Entrepreneur manufacturer
- Owns IP

Export sales to Distribution Co. X
Export sales to Distribution Co. Y

India

Outside

Distribution Co. X
Distribution Co. Y

Entrepreneur manufacturer - Owns IP
...Conversion of full-risk manufacturer into Contract Manufacturer

Restructuring carried out to achieve centralized management & control in a regional headquarter
Part I: Allocation of Risks

• Steps

  Contract → Conduct → Comparables → Hypothesise

   Control

   Financial Capacity

• Economic significance of Risks

Post restructuring

Company A
Contract manufacturer

Company Z
Entrepreneur Owns IP

Transfer of IP and Functions

Contract Manufacturing

India

Outside

Export sales

Distribution Co. X

Distribution Co. Y

Export sales
Part II: Compensation for restructuring

- Profit Potential
  - Compensation required when transfer of rights and / or assets
  - No compensation for mere reduction in profit
- To determine compensation
  - Review of FAR before and after restructuring
  - Evaluate Business reasons
  - Consider options realistically available
Part III: Post restructuring

- Apply normal TP principles to avoid competitive distortion
- Identify relationship between:
  - Compensation for restructuring and
  - Compensation for post-restructuring
Part IV: Recognition

Transfer of functions/IP to a shell company

Pre restructuring

Company A
Entrepreneur Mfg

Arm’s length C.M fee

Company B
Contract manufacturer

Physical flow of goods

Company C
Distributors

Arm’s length distribution margin
Transfer of functions/IP to a shell company

Post restructuring

Transfer of Brand name, Technology AND `KEY EMPLOYEES`
The Good and Worrisome
The Good and Worrisome

• Impact of OECD’s Guidance
  – Tax authority to respect commercially rational restructuring transactions that have economic substance
  – Restructuring may be disregarded in exceptional situation
  – Non-arm’s length behaviour to be addressed through price adjustment
  – Restructuring to be evaluated not from group’s perspective but each entity’s perspective
The Good and Worrisome

• Impact of OECD’s Guidance (contd.)

– Post restructuring to be addressed under normal TP rules

– Tax authorities may want to look at entirety of arrangements

– Presence of Tax motive is not sufficient for non-recognition

– Documentation requirements are stringent
Best Practices
• Commercial necessity vis-à-vis tax restructuring

• Management and Tax function – one unified team

• Holistic approach to documentation
  – Document the journey from pre-restructuring to post-restructuring

• Consider and manage the issues before, during and after any restructuring

• Advance Pricing Agreements

“Planning is very much Possible”
Thank You