



Strategies and opportunities in the changing ASPAC transfer pricing environment

20 November, 2008

TAX

Agenda

Session One

- Overview of the Asian Markets and implications as to sourcing/procurement strategies
 - Case study on sourcing/procurement business models
- Strategies related to intellectual property ownership and valuation
 - Case study on a high-tech, top-market brand

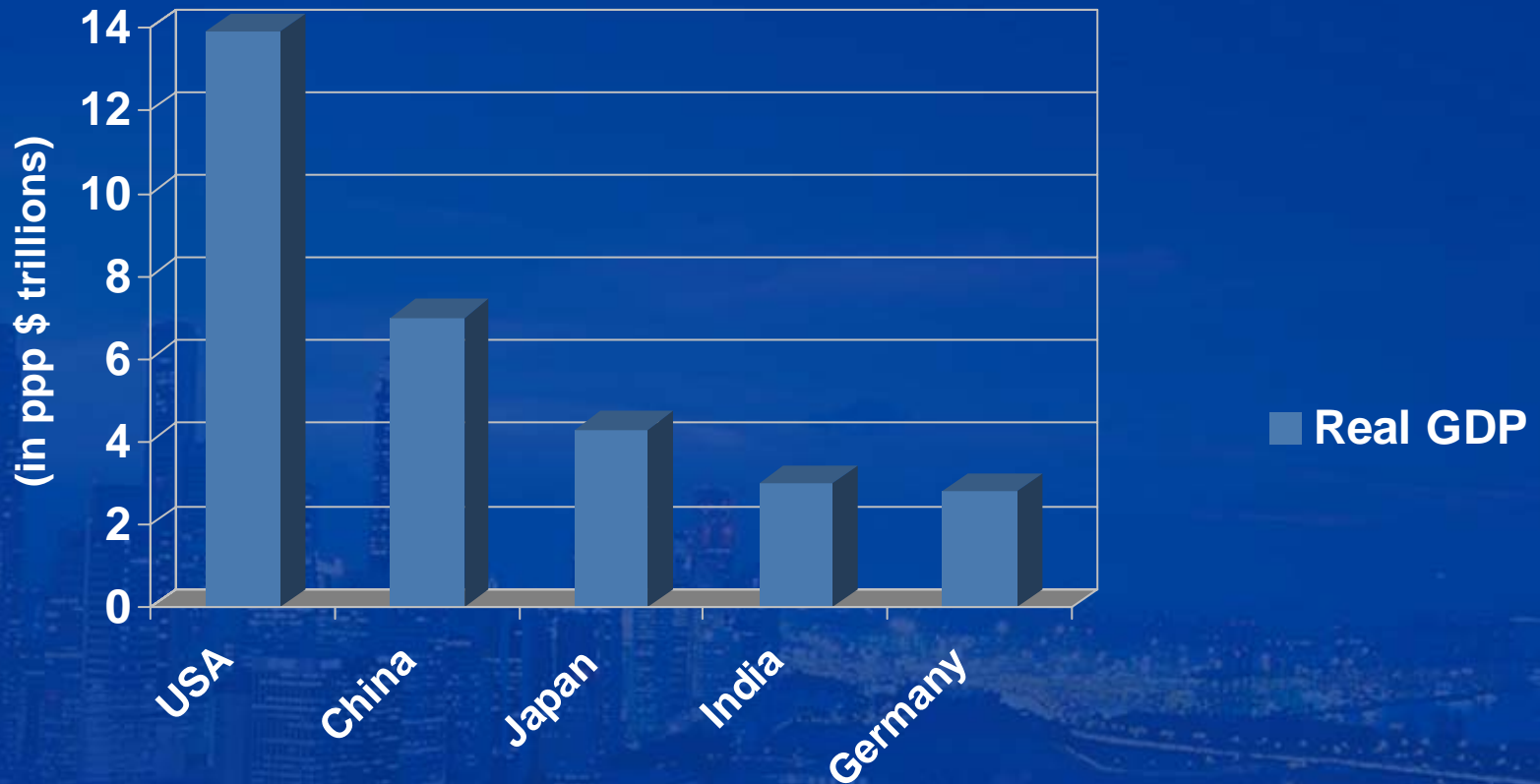
Session Two

- Evolving transfer pricing environment in Asia
 - Key trends
- Business restructures
- Strategies for dealing with tax authorities' requests in Asia



Overview of Asian markets and implications as to sourcing/ procurement strategies

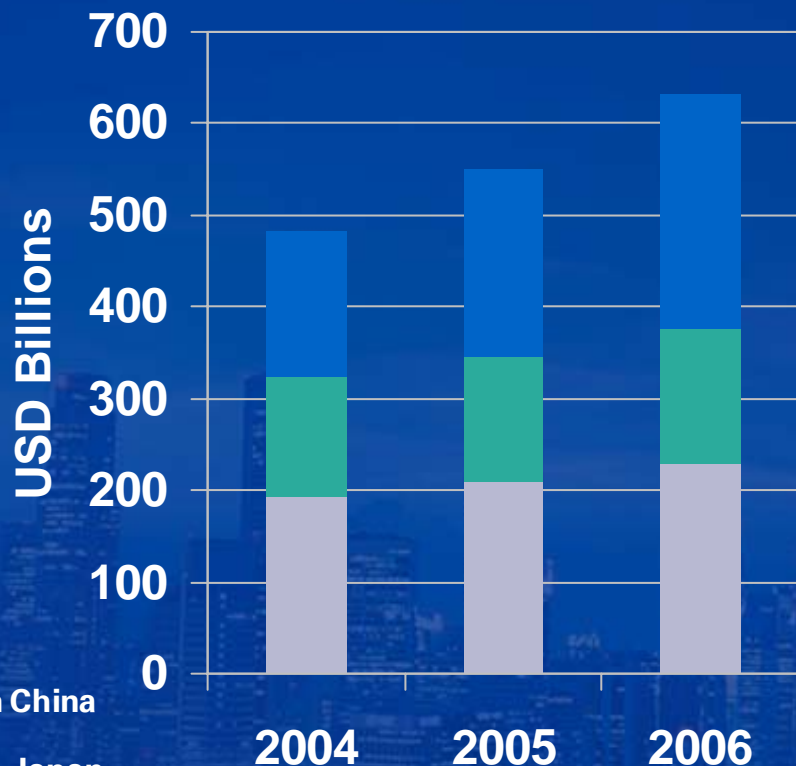
Three of the world's five largest economies are in Asia



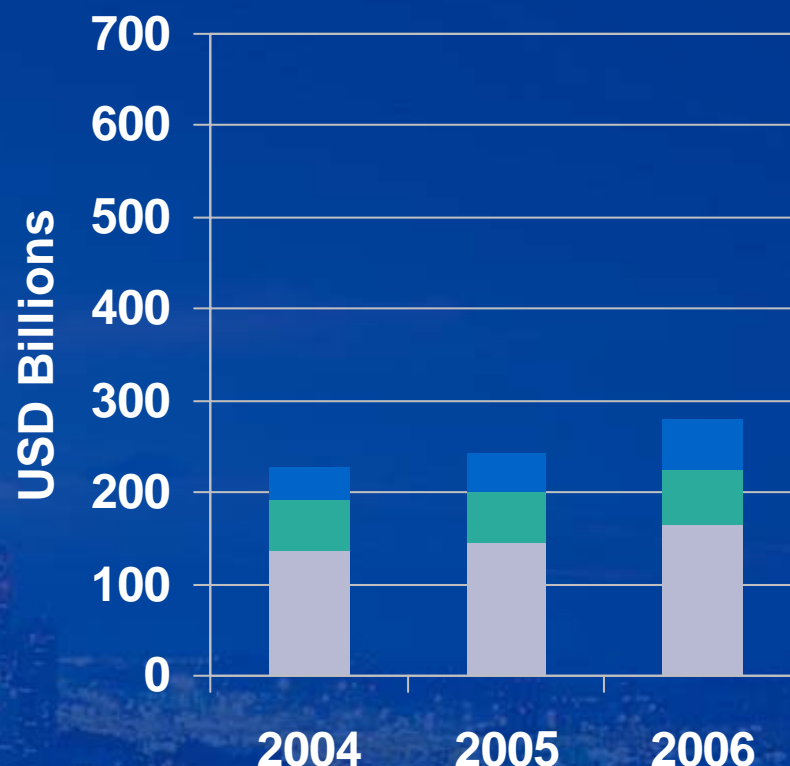
Source: CIA World Factbook

Intertwined economies further highlight importance of Supply Chain Planning

U.S. Imports from Asia



U.S. Exports to Asia



- To/from China
- To/from Japan
- Other Asia (including India)

Source: WTO, International Trade Statistics, 2007

China overview – sourcing



Source: CEIC



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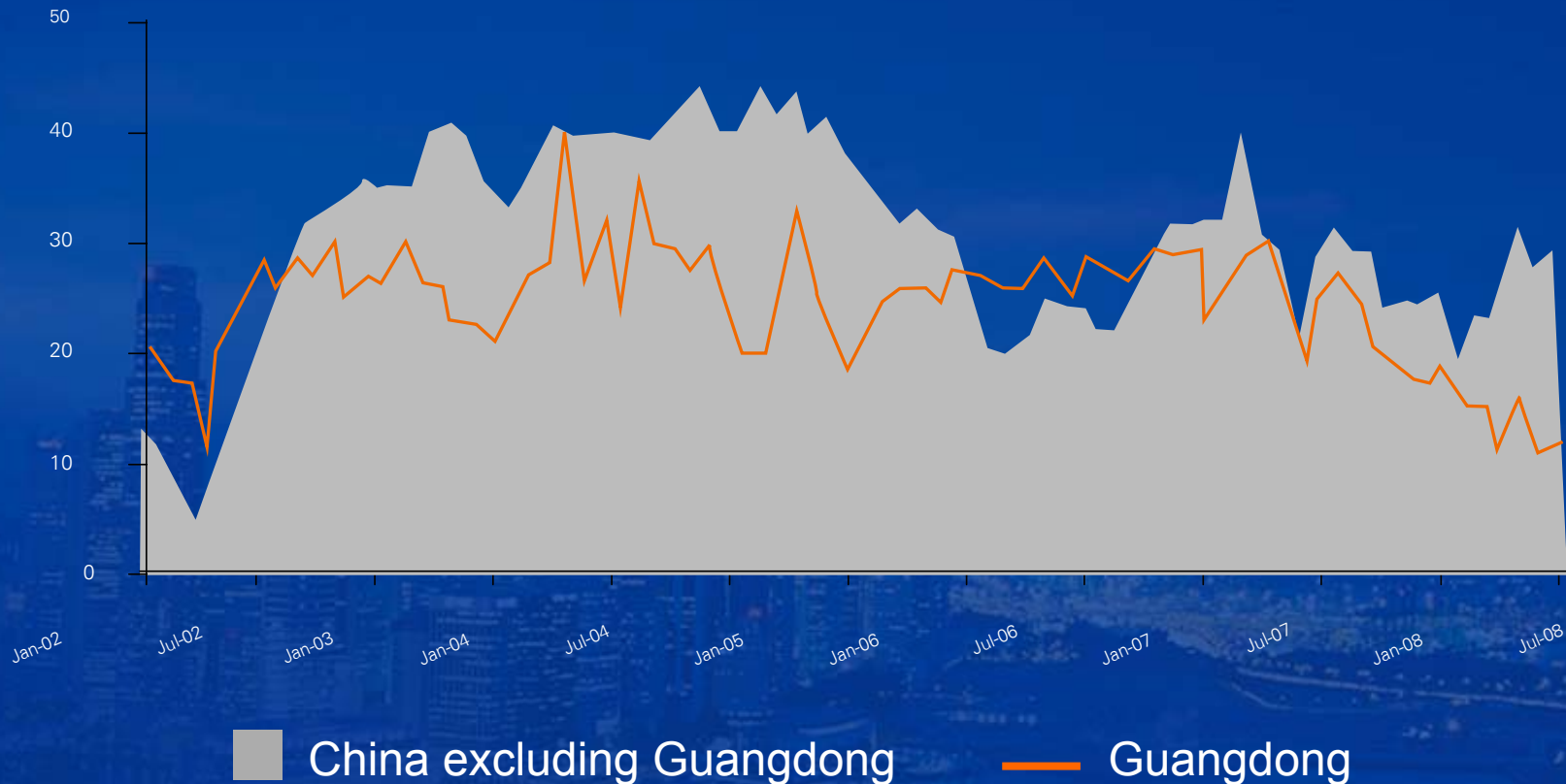
China overview – sourcing (continued)

Rising costs on China's coastal areas may shift manufacturing bases to the country's inland areas

- Main manufacturing bases are located at the coast line
- Due to increasing costs and (tax) incentives the large, coastal manufacturing bases are likely to see shifts as companies move inland to second-tier cities
- Lower costs on labour might be offset with additional transportation and logistics costs
- Also, a dependency on a local supply chain can restricts shifts inland

China overview – sourcing (continued)

Guangdong and rest of China export growth (2002 - 2008)



Source: CEIC

China overview – sourcing (continued)

- Central Governmental incentives are mainly offered through tax incentives, land subsidies and favourable financing:
 - The “Go West” campaign consists of an enterprise income tax rate of 15% ⁽¹⁾
 - “Northeast China Revitalisation”, issued in 2004, aims VAT refunds and shortened fixed assets depreciation years ⁽²⁾
 - “Rise of Central China“, the latest regional campaign, follows the former two by offering tax refunds
- Local governments are offering less tax incentives and more preferential land prices, preferential loans, cheaper utility fees and financial subsidies, especially in the economic development zones

Source: (1) Sichuan Provincial Department of Commerce

(2) “Northeast China Revitalisation” official website

Indian subcontinent overview – sourcing

Relevant factors

- Preferred sourcing destination for low-cost services due to mature vendors and large labour pool with deep technical and language skills
- High growth-rates have resulted in wage inflation, but this has been offset by increase in skill supply and quality improvements
- Increasing labour and real-estate costs have resulted in Tier-2 and 3 cities becoming preferred destinations for setup of new operations
- In addition to Services, Textiles¹ and Auto-components² are two other sourcing high-growth areas
- Supportive Government and Fiscal policies – notably SEZ regime

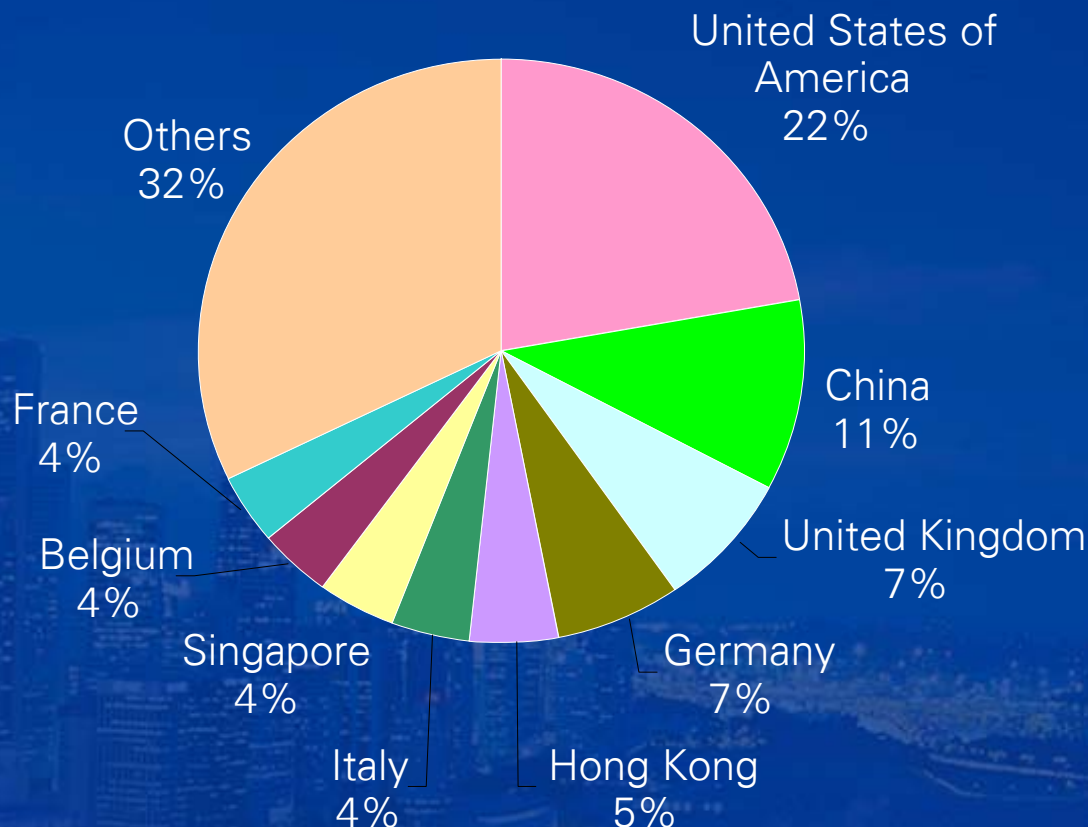
Source: (1) India Brand Equity Foundation (IBEF) website (www.ibef.org)
(2) Auto – Focus Asia (2008) (www.autofocusasia.com)

Indian subcontinent overview – sourcing – SEZ Regime

Tax Benefits	Developer	Unit	OBU	IFSC
<ul style="list-style-type: none"> ▪100% income-tax holiday of profits from developing, operating and maintaining SEZ for 10 consecutive years 	✓			
<ul style="list-style-type: none"> ▪Phased income-tax holiday of export profits for 15 years <ul style="list-style-type: none"> - 100% for first 5 years - 50% for next 5 years (unconditional) - 50% (max) for next 5 years (conditional) ▪Phased income-tax holiday for profits of OBU / ISFC for 10 years <ul style="list-style-type: none"> - 100% for first 5 years - 50% for next 5 years (unconditional) 		✓	✓	✓
<ul style="list-style-type: none"> ▪DDT Exemption 	✓			
<ul style="list-style-type: none"> ▪MAT exemption ▪Exemption from Central indirect levies (Customs, Excise, Service tax, Sales tax, R & D Cess) ▪Exemption from State indirect levies – (Sales tax, stamp duty etc.). This however is subject to each state's policies 	✓			

Indian subcontinent overview – sourcing (continued)

Indian subcontinent's major export partners by value, 2007



Source: ITC calculations based on COMTRADE statistics

Southeast Asia overview – sourcing

Some relevant factors relating to sourcing from countries in Southeast Asia (SEA)

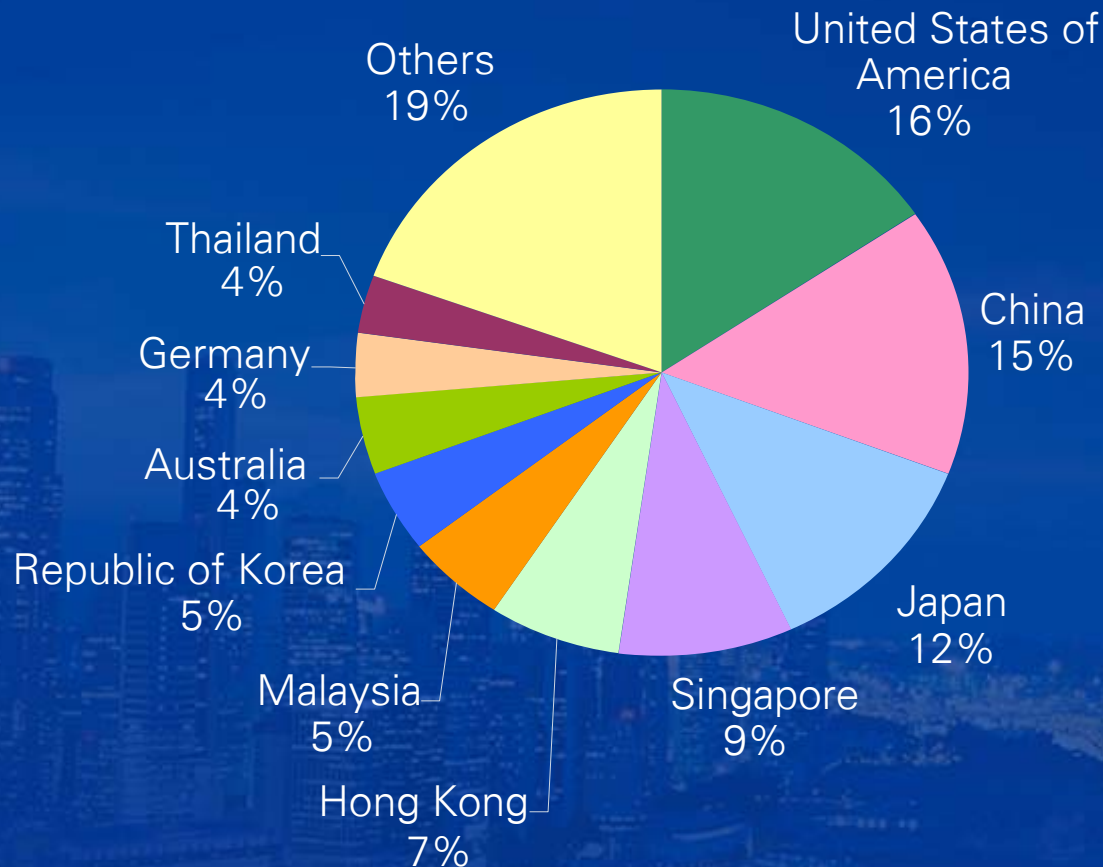
- Different social, economic and political characteristics
- Labour cost advantages compared to China
- In certain industries, SEA countries enjoy a critical mass of investment, which now serves as a magnet for further activity ⁽¹⁾
 - examples include car parts in Thailand and electronics in Malaysia
- Political instability ⁽²⁾
- In addition to ASEAN, there are a number of Free Trade Agreements (FTA) in place ⁽¹⁾

Source: (1) *Aid for Trade – South & Southeast Asia, 2007, International Trade Centre*

(2) *Asia Pacific Executive Brief, September 2008, IMA Asia*

Southeast Asia overview – sourcing (continued)

Southeast Asia's major export partners by value, 2007



Source: ITC calculations based on COMTRADE statistics



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Key supply chain risks for Asia

Risks	Comments
Product/Supplier Quality	<ul style="list-style-type: none">● Lack of supplier quality controls● Communication barriers
Regulatory Concerns	<ul style="list-style-type: none">● Lack of process standards and established practices● IP Protection
Transportation Costs / Barriers	<ul style="list-style-type: none">● Increasing prices● Poor infrastructure
Ease of Doing Business	<ul style="list-style-type: none">● Cost of start-up and closure procedures, trading costs● Complex licensing agreements

Outlook

As trading partners with Asia, other regions will continue to source goods and services based on economics and risk:

- Product sourcing locations will shift based on production economics and capacity
- Services can include pushing value added activities to the supplier and/or off-shoring back office activities to gain operational economics

Changing economics and risks require a flexible supply chain plan that can adapt quickly to changing conditions

Case Study: Sourcing/procurement business models

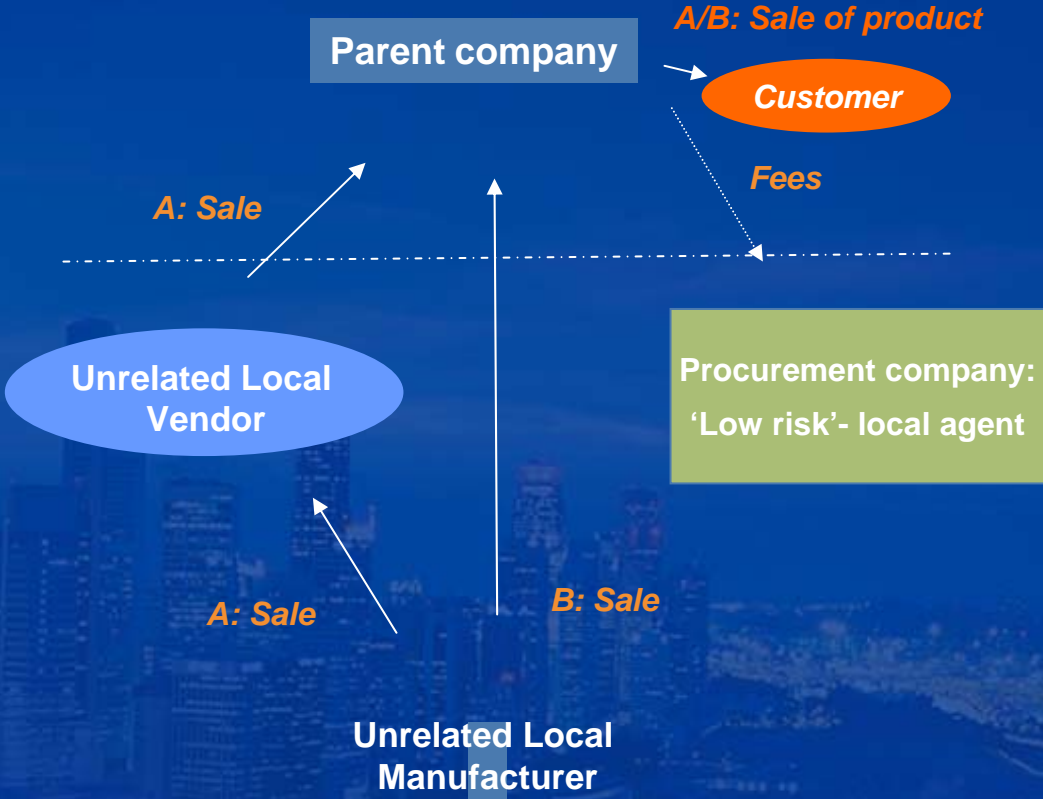
Case study:

Sourcing/procurement business models

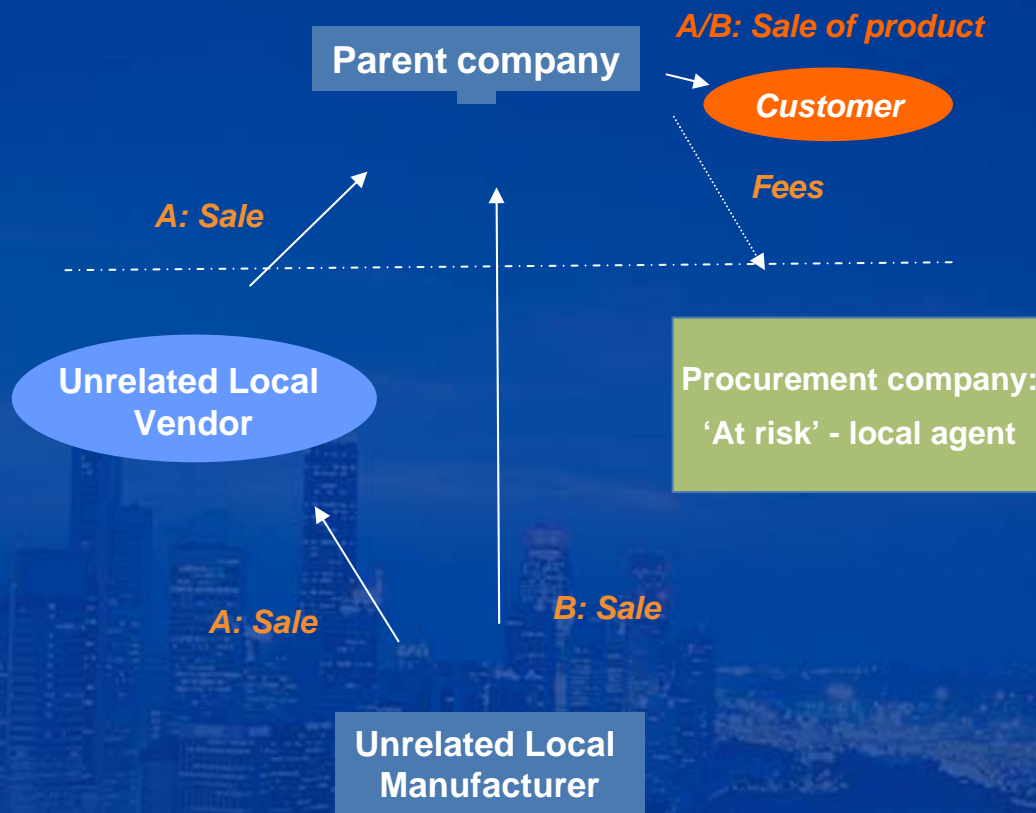
Types of procurement models:

1. Procurement – Low risk negotiation agent
2. Procurement – ‘At risk’ commission agent
3. Buy/sell - centralized procurement
4. Principal company

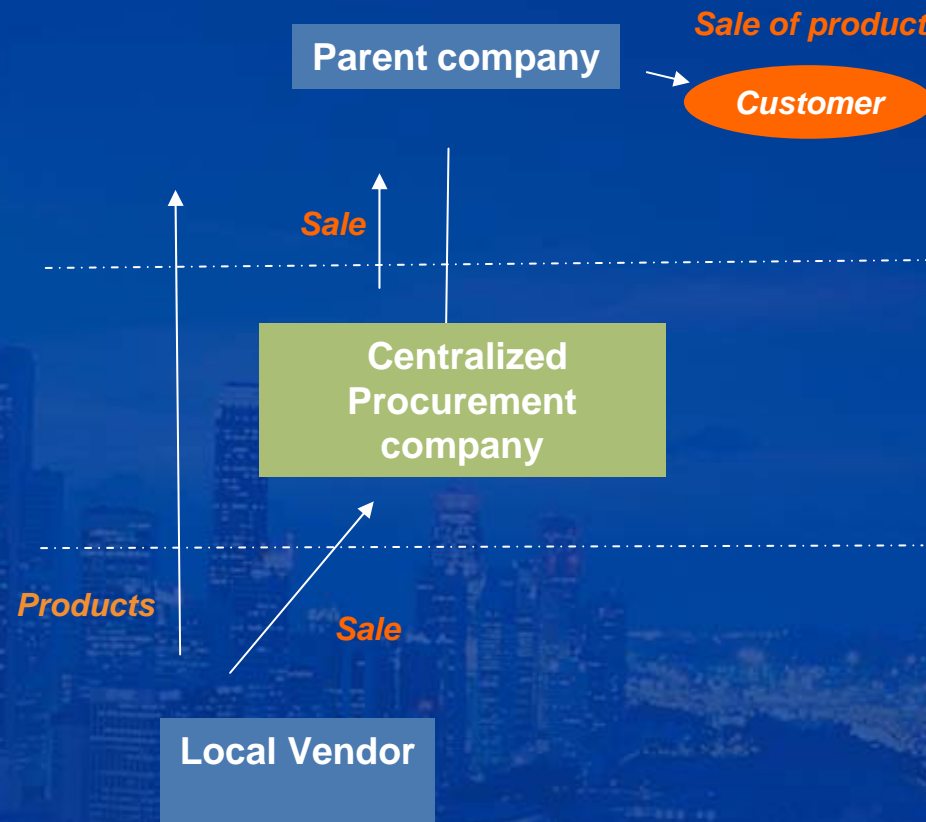
Case study: Procurement – Low risk negotiation agent



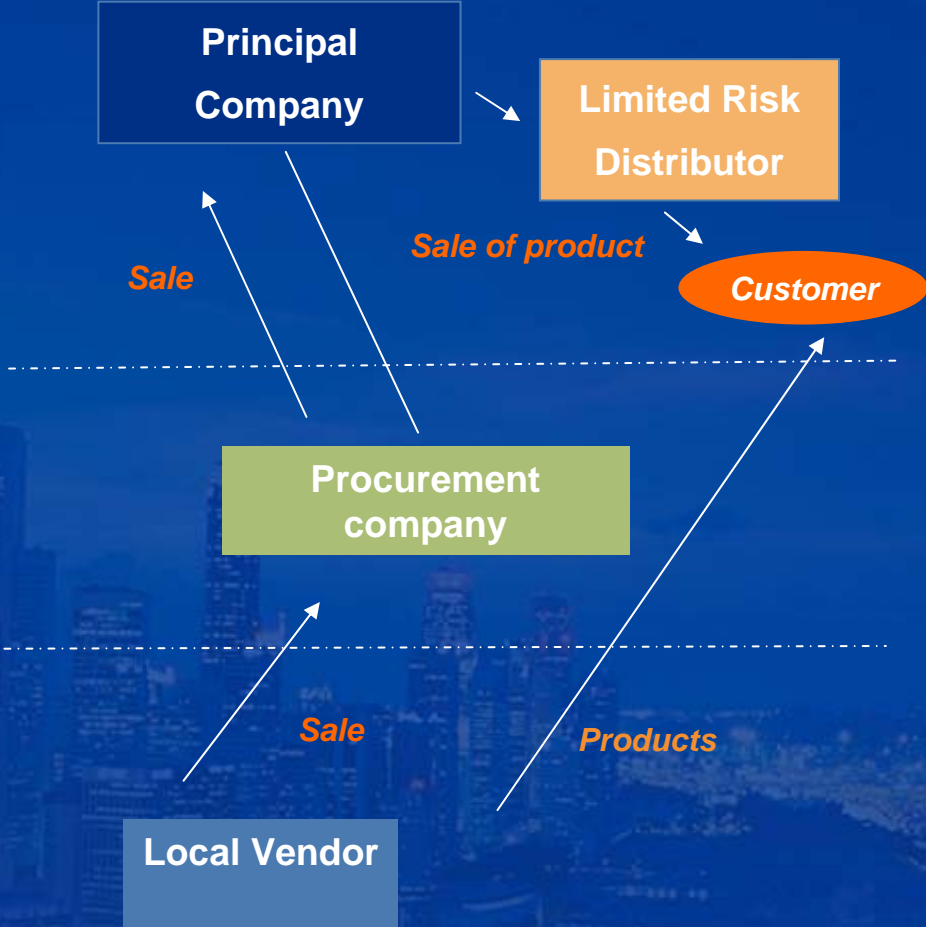
Case study: Procurement – ‘At risk’ commission agent



Case study: Procurement – Buy/sell – centralized procurement



Case study: Principal company



Case study:

Sourcing/procurement business models

- Considerations for making use of a sourcing/procurement business models are:
 - From a commercial perspective:
 - Maximising buying power and negotiating lower prices with suppliers
 - Efficient tax structuring
 - Control over spend and new innovation of products etc.
 - From a tax and transfer pricing perspective
 - Direct tax: lower ETR achievable subject to application of CFC regulations
 - Transfer pricing: alignment of pricing through centralized procurement
 - Indirect tax: reduction of VAT costs
 - C&T: first sales scenario's and making use of FTA's etc.

Intellectual property ownership and valuation

What is IP: From identification to pricing

(continued)

How to
determine
IP?

- Determine method of delivery for IP
- Evidence contractual obligation

What is IP: From identification to pricing

(continued)

How to price IP?

	Potential methods to use	Other considerations
Provision of property rights		
- Ownership interest	Value ownership interest transferred	Future enhancements to IP?
- Rights to use → Royalty	Value royalty/licence fee	What would independent party pay?
Provision of services	Cost-based vs. value-based	Determining value provided?
Provision of contractual rights (other than property rights or services)	Value contractual rights	Future enhancements to IP? What would independent party pay?

Organisational IP: From identification to pricing

What

- Potential sources of intellectual property / know-how / ownership
 - Legal IP e.g.
 - Registered brands and trademarks
 - Patented manufacturing processes
 - Competitive IP e.g.
 - Undocumented management processes
 - Intangible know-how
 - Super profit indicators

How

- Determine method of delivery for IP
- Evidence contractual obligation

Pricing

	Potential methods to use	Other considerations
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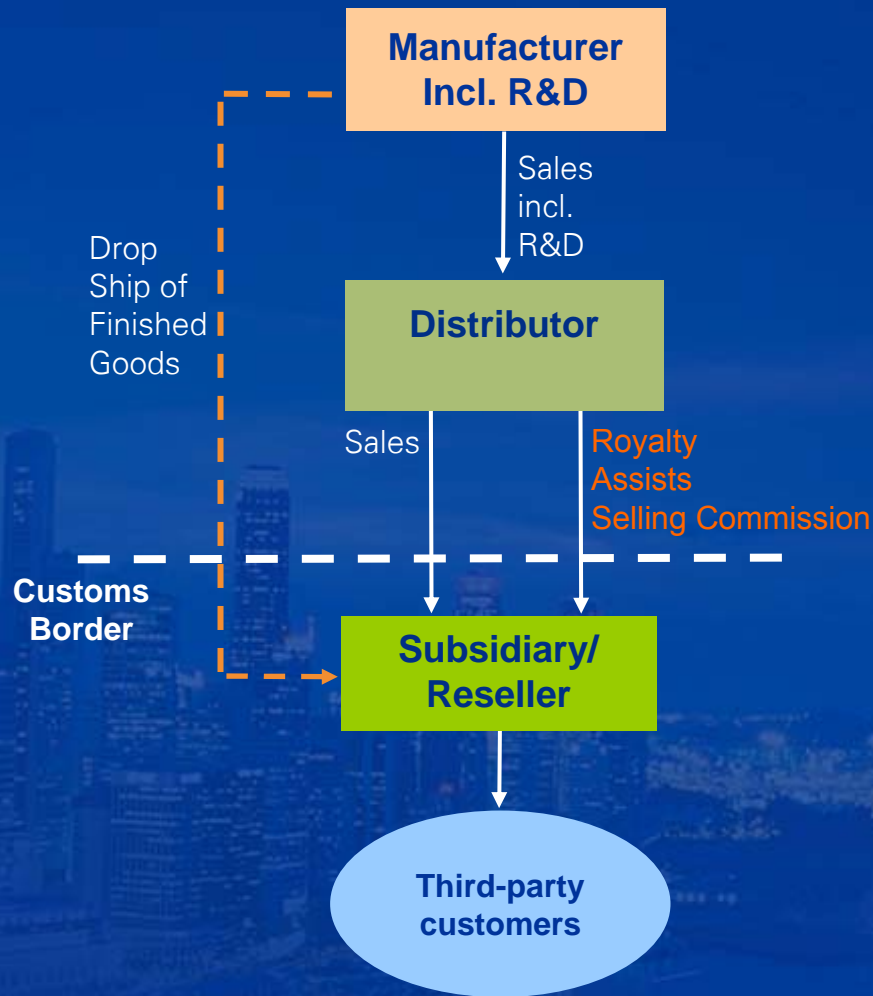
**Offsets and modifications?
Universal risk based pricing and indemnity?**

Case Study: A High-Tech, Top-Market Brand

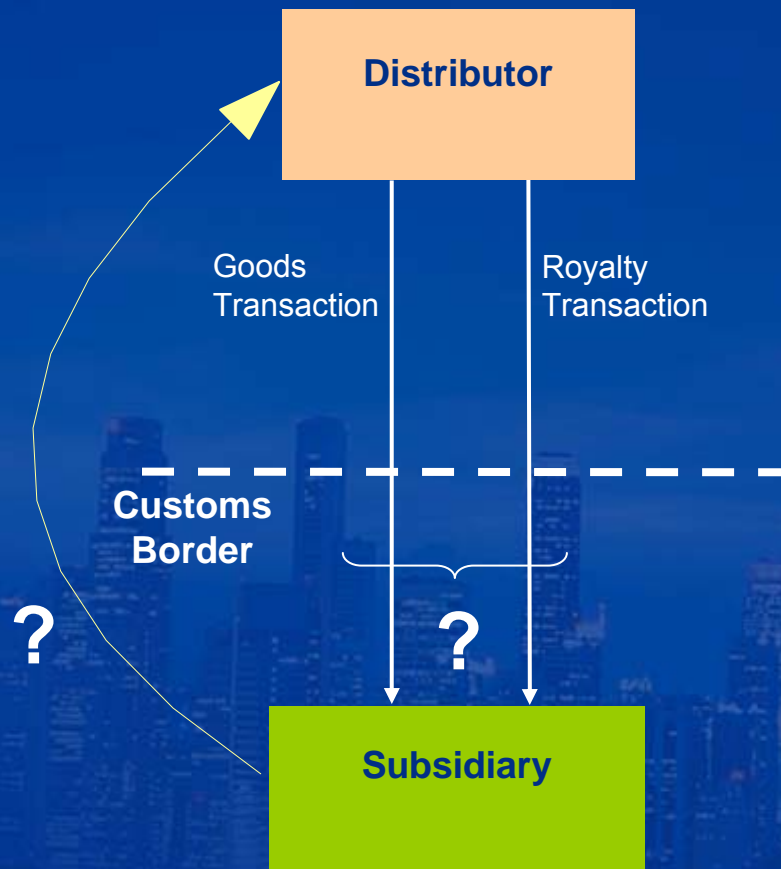
Intellectual property ownership and valuation

- Potential business models to be considered
 - Buy-sell
 - Principal/contract manufacturing
 - Principal/consignment manufacturing
 - Cost sharing

A High-Tech, Top-Market Brand Buy-Sell



Transfer pricing and customs duty considerations



Customs Consideration:

1. Customs valuation
2. Duty/VAT

TP Consideration:

- Changes to customs value from year-end transfer pricing balance adjustment and payments

Transfer pricing and customs duty considerations

Scenario

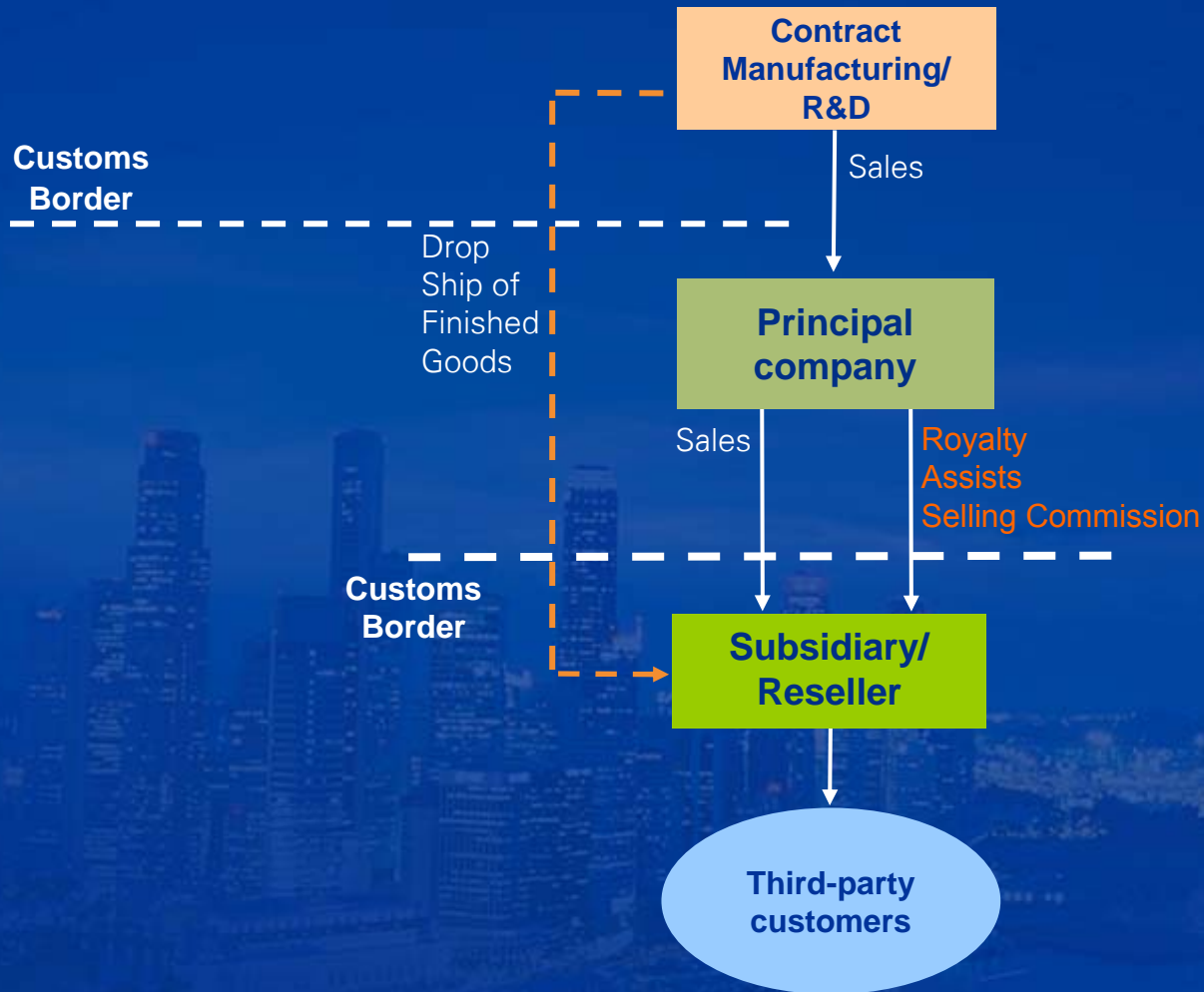
Fact Pattern



Result: False declarations on original customs entries if not reconciled with Customs

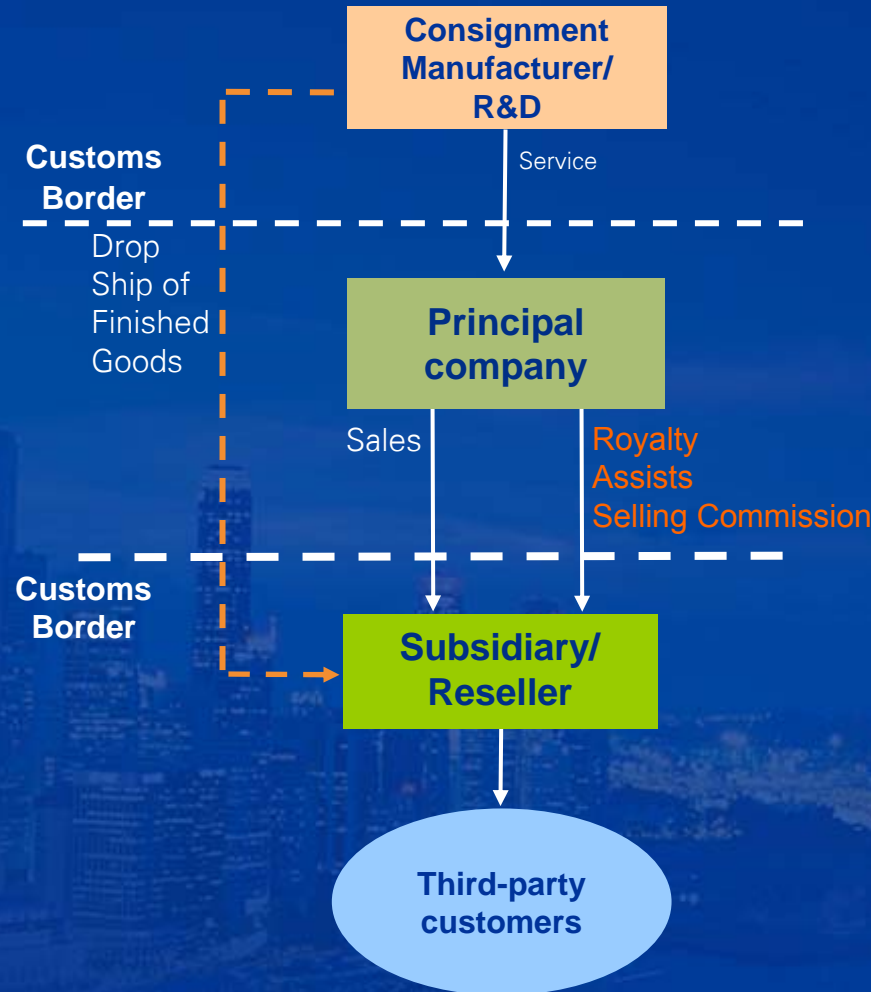
- Intent is for distributor to earn an arm's length return
- Transfer price set in January '08 based on *forecasted* assumptions
- Year-end adjustment made based on actual transactions
- Debit note or credit note issued from the seller to the buyer

A High-Tech, Top-Market Brand Principal/Contract Manufacturing



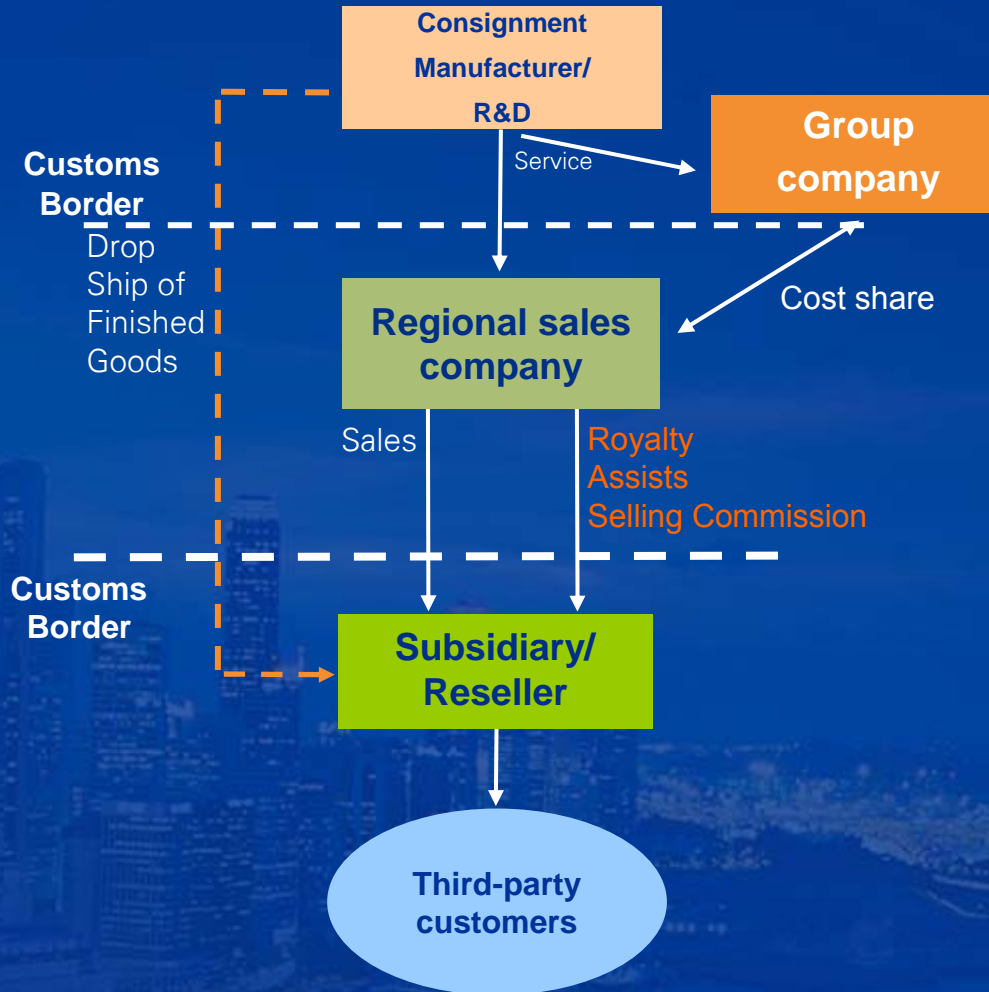
A High-Tech, Top-Market Brand

Principal/Consignment Manufacturing



A High-Tech, Top-Market Brand

Cost sharing



Coffee Break

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