<u>From catwalk to customer – How to market fashion</u>

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AIJA Half-Year Conference 23-26.11.2016, Verona

I. What does the distribution structure of MNE's look like and what disadvantages could arise from it?

1) Let me start with a short introduction of my topic. As you already know, I have been asked along to talk about some tax aspects of the supply chain management. Indeed, it is true that for multinationals taxation plays a very important role in drawing up their business and distribution model. My goal is to give you a basic introduction of how supply chain model management is used concretely by companies to save taxes.

Ok, coming back to the question about the traditional distribution structure from a tax point of view, allow me to break my answer down in three parts. First, I 'll start by giving you information about the classic "buy-sell"- model. Then, I 'll make this concrete to you by giving you an example. Finally, I 'll talk about the clearly disadvantages of this model.

2) So, to start with, wat is a "buy-sell" model? A "buy-sell" model is the traditional supply chain model used by most of the multinationals until the nineties of the last century. Within a company group each entity operated very independently. The producing entity bought the raw materials, and after manufacturing, sold the finished product to the local distributor. The local distributor was a full-fledged distributor, almost comparable to a completely independent company, which bore the full risks.

From a tax point of view, each transaction in this „Buy-Sell"-chain had to take place at „arms length". In concrete terms, this meant that each single entity in the chain had to be compensated in accordance with the risks it was bearing. Due to the fact that the risk of the distributor in the buy-chain model is high, a large part of the global profit must be attributed to him.

3) This brings me to the following example. In particular, high-quality products (such as fashion items) are mostly sold in to countries where there exists a high tax level. Therefore, the profits made by the seller in those countries are heavily taxed.

As you can see on the present slide, this multinational wants to sell a jeans to the customer. The jeans is manufactured in country A (Italy for instance) and is sold for 100 euro to a distributor in country B (Germany for instance). In Italy, where the manufacturing process takes place, the producing company makes an economic profit of 50 euro and pays around 20 euro taxes. In Germany the jeans is sold to the customer for 300 euro. The distributor makes an economic profit of 150 euro, on which he pays 70 euro taxes. The global tax rate is 90 euro. The profit before tax is 200 euro and the profit after tax is 110 euro.

This example clearly shows the disadvantage of the "buy-sell" model. The high risk bore by the distributer, leads to a situation where a large part of the profit is allocated to him. The fact that the distributers are mostly located in high tax jurisdictions, leads to a high total tax rate. So, it's evident that from a fiscal point of view this is not an interesting supply chain model.

II. What are possible tax solutions for this problem?

4) Ok, now of course we are coming to the interesting part of my presentation. I remember that for me it was an almost unique experience when I learned what a small change in the distribution model, can mean for the global tax rate of a company. Of course, I' m a tax-lawyer, but nevertheless, I'm sure it will be of particular interest to you too.

This small change is the transformation of the "buy-sell" model in to the entrepreneurial model. Here again, there are three main points that I 'd like to cover about this entrepreneurial model. First I start by giving you the explanation of the model with reference to an example, I'll then show you where the fiscal optimization lies, and finally I 'll briefly explain the possible disadvantages of this system.

5) An "Entrepreneurial model" means, that a management entity is set up on top of the supply chain. This management entity not only makes all decisions for the group, but also concludes all the treaties and contracts. In fact, both legally as economically, all the risks are now allocated in to the management entity. The other entities of the supply chain have become so called "salary workers" for the central entrepreneur. They work for a fixed fee, without having to bear any buy / sell risks.

So, what exactly is the tax benefit of this model? The entity that carries the most risks, makes also the most money. Consequently, the "entrepreneurial model" allows that most of the profit can be allocated to the management entity. It's clear that you have to make sure that this management entity is located in a "low tax jurisdiction". Now, the total profits are taxed at a lower tax rate, and as a result there is a lot more money left over after taxes.

6) Allow me to repeat the jeans example, mentioned before. Using the entrepreneurial model, our jeans is still manufactured in Italy, and eventually sold to a costumer in Germany. The difference is now that all risks are born by the management company, located in Switzerland. In this way, not only the risks, but also the profit of about 180 euro is thus centralized in Switzerland. The manufacturer in Italy and the distributer in Germany receive a fixed fee, and both keep a marginal profit of about 10 euro. The profit in Switzerland is taxed at about 10%, in Germany and Italy to around 50%. The overall profit after taxes is now 172 euro, instead of 110 euro under the “buy/sell” model. It is quite obvious that this makes a significant difference.

7) This brings me to my next point: tax efficient supply chain management, also known as the fiscal optimization of the entrepreneurial model. Around the management unit, a company can now further develop and optimize the whole structure of service providers. Each subsidiary is thereby, as the management company itself, located in the country where it is expected to get the most fiscal benefits. In the countries that tax sale transactions highly, only a distribution department remains, that carries as less risks and gains as less profits as possible.

8) In this slide you can see an example of a developed entrepreneurial model. The managing entity stands at the center of all these entities. At this level, all decisions are made for the whole group and all contracts are concluded as well. The other entities work only in the payroll service. This implies that all the risks and profits come together at the management entity. As said, from a tax perspective the company of course has to make sure, that the central entrepreneur is located in a „Low Tax Country“. In Europe countries that often act as hosts of central entrepreneurial are mostly low tax countries like Switzerland or Ireland. At a global level we can think about places like Singapore or Dubai.

At present, countries are battling to welcome the management entities. That's why so many countries are now planning to sink their corporate tax. We can think specifically at the United Kingdom, which after the Brexit has announced to reduce its taxes to the lowest level of all European countries.

9) Finally, I ‘d like to remind you that this entrepreneurial system has also some disadvantages.

First of all, it is absolutely important that the structure is not a “paper structure”. This means that the effective management decisions need to be taken at the level of the central entrepreneur. The board must actually come together and control the group from the country in which the management entity is established. The major drawback now is that if this is not the case, or there is any doubt in this regard, the risk exist that tax authorities disallow the system. This can lead to double taxation or financial penalties for the company.

Secondly, one has to keep in mind that this system only works as long as the company makes profit. After all, it is so that the central entrepreneur is contractually obliged to pay a certain fixed sum over a longer period of time to its connected entities. This leads to a situation wherein the group is suffering a loss, while the connected entities continue to make profit, and have to pay taxes on this profits. In this case, the group makes losses, and still has to pay taxes on it.

To summarize, the entrepreneurial model clearly has significant tax advantages compared to the “buy/sell” model and is therefore today used by many multinationals to save taxes. The entrepreneurial model allows this companies to allocate the gains in a low tax jurisdiction, what indeed leads to a significant lower global fiscal pressure. Care needs to be taken that this model is no paper construction. Also noted is that this model only works as long as actual profit is available.

Ok, that’s everything I wanted to say about the entrepreneurial model. I ‘d be very happy to answer any questions you may have.

III. Internet sales – what are the possible results from a taxation point of view?

10) Ok, this question brings us to the magical world of VAT. My goal is here to give a you a basic introduction of the European VAT rules concerning distances selling contracts.

There are three main points I’d like to cover. First, I ‘ll start with the crucial question in which country the VAT apply. I ‘ll then go on covering the influence of transportation on this topic, and finally I ‘ll talk about the possibility for the seller to opting-in the VAT-rules of the country of the costumer.

11) So, let me first put it straight that from income tax point of view, internet sales don’t have a significant impact on the existing regulations. If there is no permanent establishment in a third country, the seller only pays directly taxes in the country, from where he organizes his internet sales. For that reason, there is no big problem with income tax. However, there is especially a problem with the value-added-tax (VAT).

The question is, which value added tax is applied on the purchase – either VAT from the country of the seller or the VAT of the country of the

consumer. On the slide you can see an example of a seller with seat in Luxembourg, who sells fashion online to a customer in Belgium. Should the Internet seller charge Luxembourg VAT at 15% or
Belgian VAT at 21%?

12) This VAT question is entirely dominated by the question of who organizes the transport.
In principle, the VAT of the country of the consumer applies when the internet seller organizes the transportation and sells annually for more than € 35.000 in to the country of the consumer. This means that the seller has to be registered in the country of the consumer. The seller is also obligated to submit VAT returns in the country of the costumer and of course pay the VAT to the local administration

13) As mentioned, there is this threshold of € 35.000. What happens if the seller, organizer of the transport, on year basis remains below this amount? In this case the seller has the choice of whether to charge its own VAT or the VAT of the country of the seller. In some cases, consumers could ask their own VAT, whichever is cheaper for them. This obviously requires a proper VAT-registration of the seller in the country of the costumer.

14) This brings me back to the transportation question. Most of the time the transportation is organized by the seller. But in some cases it happens that the customer collects the goods directly in the country of the seller. In case of collection by the customer the VAT rate of the seller's country are always applicable. state, but only if the collection is completely „self-organized" by the customer.

Ok, that is in a nutshell what I wanted to say about the VAT rules by internet selling. It is of great importance for the seller to know which VAT he has to charge. So, is the seller organizing the transport, and on an annual basis he delivers for more than € 35.000 in to the country of the consumer, he has to charge the VAT from the country of the consumer.

If there are questions about this topic, I ‘d be very happy to answer them.

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