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Transfer Pricing in the fashion sector. Analysis of the BEPS action plans 1 – 8/10 and the Gucci Case

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INTRODUCTION - A BRIEFLY GUIDELINE TO THE TP

The Transfer Pricing phenomenon emerges in a context where each multinational has different tax system, where the registered office is located. This shows the strong impact that the strategic positioning of the legal seat has, in order to reduce taxes and thus increase income of a single firm. For instance, in Europe we have a lot of different tax regimes that may lead multinationals to move abroad where this taxation is more convenient.

The Transfer Pricing playing a very central role, and it moves on the edge of the offside, it could be legal or illegal, and the goal it so move incomes (revenues) between countries. This is possible thanks to intra-group operations, that have more convenient costs than between two different firms.

According with the International Revenue Service. "Transfer Pricing", Accessed July 31 2020, this concept is summarized as follows:

"The regulations under section 482 generally provide that prices charged by one affiliate to another, in an intercompany transaction involving the transfer of goods, services, or intangibles, yields result that are consistent with the results that would

have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances."

But how does it actually work? It's an accounting-practice where one division charges another division for goods and services provided between controlled companies. This practice determines the changing cost to another, and it is applied to intellectual property as well for instance patents, interests and royalties (intangibles is the preferred assets). Royalties and interests are regulated by the Art. 26-quarter, 5 paragraph, D.P.R. n.600/1973.

By way of explanation, I would propose a practical example.

Let's consider a plane manufacturer has two division: D-A which studies algorithms, and D-B manufactures plane parts. In a real situation D-A sell algorithms to plane makers (intra-group operation), then D-B pay for algorithms as the D-A is an external firm at market price, based on the arm-length principle. But this is not the case, indeed division A charges a lower price to division B. Because of this, D-A has lower revenues and D-B costs of goods sold are lower and this permit to the firm to increase division profits. The difference between division in terms of revenues and costs is the same amount, and this means that that is no financial impact on overall company, so it is balanced.

For what regards the taxation regime, division A is located in a higher tax regime country than division B, and for this reason D-A is less profitable, and consequently division B is taxed at lower rate.

By summing up, the overall company by charging price of each division is able to evade taxes, but they have to pay attention to the tax authorities that have a consistent tool to defeat and limit this illegal approach made by multinationals.

What we will analyze in this thesis is first a general briefing about all flows in the fashion sector. The first chapter would analyze both the flows for this particular sector that generates billion of euros around the world, and the overview on what price should be set in the intragroup exchanges based on the Action 8-10 of the BEPS project, in other words, what method led multinational companies to select and apply the right price method in relation to the external environment, and the so called comparables, that are the results of the benchmark analysis. The second chapter is an extension of the first one because the main topic is the same, but it highlights the critical situations that these methods may encounter in their application.

The third one is the recent case of Kering Group, focusing on Gucci S.p.a. situation among different countries and subsidiaries, and I'll try to explain how they saved millions of euros with just the creation of a branches of Gucci (LGI) based in Swiss

for the profit allocation. All the chapter revolves around this theme and it is my personal reconstruction of the facts, this because there was no definitive sentence against Gucci, therefore they reached an agreement regarding the sum to be paid to the Italian tax authorities. Moreover, I focused to another aspect, the residency of the two former Gucci's CEOs. Thanks to their home in Switzerland, they were able to save several million at the expense of the Italian social security system, with much higher deductions that the Swiss one.

Finally, the last chapter would be an introduction to a very sensitive and actual issue, the digital economy explained by the Action 1 of the BEPS project, which is (in my opinion) the biggest challenge in years, and it will be very crucial after (during) the Covid-19 pandemic period. It is important to understand the difference between physical stores that use the e-commerce platforms and MNE that use intangibles in order to create value without being present in a given jurisdiction.

ABSTRACT

La presente tesi prende spunto dal comparto moda, e nel primo capitolo si illustrano quanto articolata possa essere la struttura di una grande azienda che crea oggetti di culto come nel settore fashion. Successivamente, dato il problema del Transfer Pricing, si prova a ricostruire come e perché determinati scambi infragruppo assumano un valore ed un prezzo di scambio rispetto ad un altro, facendo così chiarezza sulle metodologie di applicazione di tali prezzi e dei suoi eventuali rischi nella determinazione dei comparabili attraverso la benchmark analisi.

Ci sarà poi, nel capitolo 3, un caso studio riferito al più grande caso di evasione fiscale in Italia, il caso Gucci, che nel 2019 ha visto pagare il gruppo Kering la somma di 1.2 miliardi di euro al fisco italiano. Tutto ciò è stato possibile grazie ad una controllata sita in Svizzera dal nome LGI, la quale è stata assoggettata come "stabile organizzazione occulta". Infine, nell'ultimo capitolo si evidenzia come entrino in contatto vari aspetti del BEPS Action plans, in particolare l'Action 1, che tratta il tema della digitalizzazione, e l'Action 8-10, lo stesso che mette in risalto nel primo capitolo le problematiche relative alla creazione del valore. Un tema cruciale quello della digitalizzazione, dovuto anche all'attuale storia mondiale. Infatti, il Covid-19 ha spinto tante piccole imprese a sfruttare l'e-commerce, ma sostanzialmente differenti dalle multinazionali che sfruttano la loro volatilità nella creazione del valore per generare immensi profitti senza fare i conti con la tassazione internazionale.

1. TRANSFER PRICING IN THE FASHION SECTOR. OVERVIEW ON THE ACTION PLANS 8-10 OF THE BEPS

It's known that multinationals use transfer pricing system in order to erode the tax base for saving money. It's also known that all the biggest fashion multinationals try to do this as in the Kering group case (we will see it in the following chapters), and how Gucci reached the goal to save billions of euros. We will start this section with the explanation of how values and prices among intragroup exchanges are chosen, that is the main tool used by multinational to allocate costs and profits around the world according to the *BEPS action plans 8-10*.

Moreover, it is also hard to asses value to the intangibles, and in the era of the high e-commerce transactions it's also important to give a right residence principle to the company that create value for the parent, and the digitalization[1] is still the biggest challenge in the digital economy.

In this chapter, by the help of the flows in the fashion sector, we will see the biggest problem in transfer pricing for this sector and I would show in detail on which principles the *value creation* is based, with the help of the Gucci study case.

[1] see Chapter 4, BEPS project

1.1 MAIN FLOWS IN THE FASHION SECTOR.

In the fashion sector exists some typical transaction referring to the multinational sectors[2].

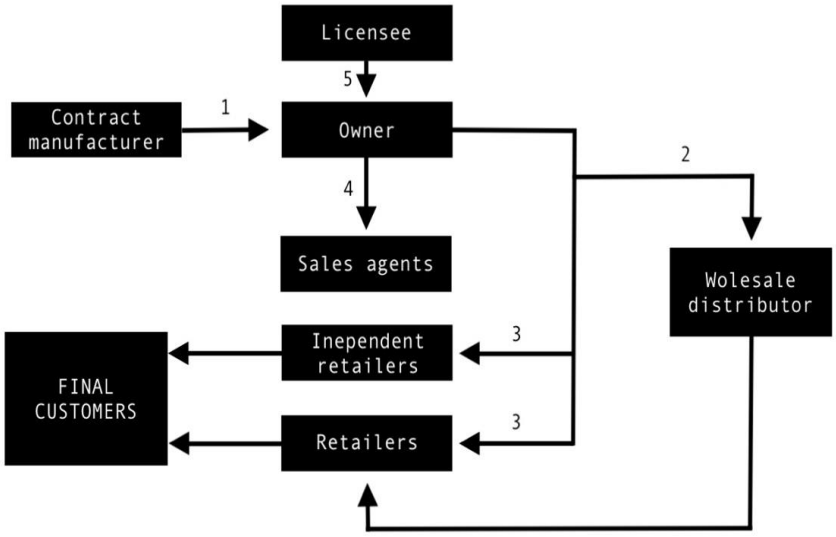

Figure 1 - In this graph taken by KPMG is shown some internal transactions in a hypothetical fashion firm

The numbers represent above mentioned transaction:

1 Outsourcing the production of goods

2 Sale final goods to wholesale distribution, in relation to their market

3 Sale final goods for the retailer distribution, in relation to their market

4 Services provided from sales agents to the owner

5 Royalties (brand licensing)

[2] KPMG – "*Transfer Pricing in the fashion sector*". Online article, 21/06/2018

Or in a more complex view we have an example as the figure 2[3] of the potential cross-border transaction in the fashion groups:

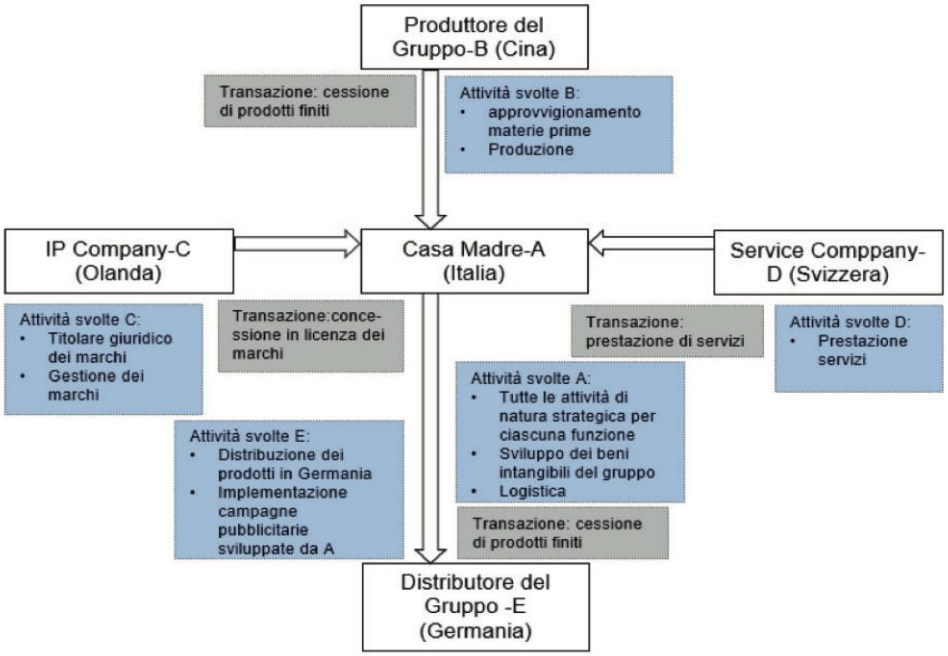

Figure 2 – A more complex view of intragroup exchanges (cross border transactions) in the fashion sector

The architecture of the value chain in the fashion sector is nowadays very complex, from the battle for row materials to the customer experience. The nature of this market, led multinationals to create sub-holding, branches, subsidiaries all around

[3] Marco Orlandi – *"L'impatto del progetto BEPS nei gruppi della moda. Un caso pratico"*. Online article. 02/2019

the world to bring from those countries as much incentives as possible, and consequently them generate a lot of intragroup exchanges.

Obviously, it is just an example because this architecture is very simple, but it is able to highlights how many intragroup transactions they are able to build just in the fashion sector. It is also noted that each branch or subsidiary has a specific task to carry out such as production and design, supplying and so on. For the tax planning is fundamental to take under control subsidiaries based in states where the taxation is nil, and thanks to the intragroup' exchange they make profits.

Before the Base Erosion and Profit Shifting project (BEPS; Chapter 4), the disputes have been resolved with the *foreign-investment principle*, but it was not so effective. In the pre-BEPS era, fiscal authorities tried to rebuild the architectural structure of the subsidiaries, and their profit in relation to the state where they may have been taxed. This is the highlighted case in the chapter 3, in the Gucci (Kering) case we can see how the foreign-investment principle take place. The principal headquarter was in Milan but the logistic center in Swiss had generated a huge profit for all Kering group, just with the license for selling the Gucci brand worldwide, it is the so called *wholly artificial arrangements.*

Nevertheless, it is very unlikely that the subsidiary is completely dissociated from the holding company. It is not real the following description of this extreme situation, where subsidiaries can independently: set prices or make discounts, offer independent after sale services or create advertising and promotion just by themselves.

It is evident that the above situation does not represent the true situation among multinationals, and because of all these reasons, the BEPS project take place and follow that the Art. 4 of the OECD model, paragraph 3 deletes the *tie-breaker rule*[4]. This means that now it is not important to assess if the residence is in a foreign country or not, but if the subsidiary respect the *arm's length principle*, under the *free competition market principle*.

Therefore, we can also add some critical aspects for multinationals during the transfer pricing in the fashion and/or luxury sector, such as:

- Interaction between Transfer Pricing and BEPS
- Transfer Pricing adjustment (budget data vs actual data)
- Routine activities vs non-routine activities
- Existence of marketing intangibles

[4] See paragraph 48, Action 6, BEPS project

- IP Company: analysis of the juridical vs economical jurisdiction
- Interaction of Transfer Pricing between other legislation (e.g., patent box)
- Internet sales
- Possible CUP and interaction between third parties
- Income loss for retailer companies
- High costs for flagship stores

1.2 PHASES FOR OUTLINING THE FREE COMPETITION PRINCIPLE AND THE VALUE CREATION PRICES

The OECD model highlights several phases in order to outline and apply the *free competition principle*:

1 – identify economic and financial transaction

2 – recognize the above-mentioned transaction

3 – select the most appropriate TP method (traditional or transactional)

4 – apply the selected method

The first point consists of the examination of the most relevant economic characteristics among transactions under examination: contractual terms; assets

risks, functions; characteristics of goods or services; economic conditions; business strategies.

The second point is the evaluation of the rationality and the conformity of those transactions, and if do not exists any rational behavior, they need a more accurate examination in relation to their economic nature.
The third and fourth point is used for the individuation of the best transfer price determination.

This brief summary needs a deep and careful economic and financial analysis, and they must follow the principle delighted in the OECD model, paragraph 1.34 which explains as follows:
"The typical process of identifying the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations requires a broad-based understanding of the industry sector in which the MNE group operates (...). The understanding is derived from an overview of particular MNE group responds to the factors affecting performance in the sector, including its business strategies, markets, products, its supply chain and the key function performed, material assets used, and important risk assumed. This information is likely to be included as part of the master file (...) in support of taxpayer's analysis of its transfer pricing, and provides useful context

in which the commercial or financial relations between members of the MNE group can be considered."

1.2.1 Overview on prices applied and main methodologies used for TP

I would first focus on the main methodologies used by multinationals for price determination, how and when they arrange this system (all fundamental indications are enacted in the OECD model):

1 - Traditional methods

- "Comparable Uncontrolled Price" (CUP)
- "Resale Price Minus" (RPM)
- "Cost Plus" (CPLM)

2 - Transactional methods, the so-called income methods

- "Profit Split Method" (PSM)
- "Transactional Net Margin Method" (TNMM)

CUP – One multinational should sell goods at the market price (as in Gucci case, chapter 3). This means that in intragroup exchange, authorities look to the external environment in order to understand the true value of the product sold within the

same group. It's evident how difficult is to evaluate intangible goods, for instance software and patents.

Even with the problem of the intangible assets, it's the most used by authorities and it's the most reliable, but at the same time it's very difficult evaluate this application because it's very hard to find in the real world an identical situation.

It is applicable just when in the intercompany transactions there are maximum and minimum market prices and companies must buy the same amount of goods; so, the price should correspond to the market average price.

Conversely, if the amount is not the same, it's not possible to apply he CUP method.

RPM – Authorities consider as "nominal value" just the production cost plus a mark-on which is based on all the process such as raw materials, labor and risks.

This is most used by manufacturing companies if they do not use significant intangible goods. The first step is to identify the final price for goods and services on the market. This allow to evaluate the expected gross margin, which play an active role because if it is compared to the sale proceeds, it is possible to determine the transfer price for goods and services for the connected party. It is allowed to use external or internal comparables in order to determine the gross profit margin.

TNMM – It's an evolution of the CPLM and RPM. It analyzes the net profit of the past year, in comparison to the independent firms. It's used to understand if there

are inconsistencies between the cost classification, in particular about cost of sales and operating expenses. During this analysis it's important to calculate financial index, evaluate comparable transactions, choose a sub-company which has no unique intangibles goods. Generally speaking, this method can be used when: is not possible to resell goods similar to the ones object of the analysis; one company do operational routine activities such as production and distribution; transactions must be identifiable and similar in terms of products and services.

PSM – This method determines if the transaction between intracompany is in line with the arm-length principle or in a fair market price. It is most used when two companies want to share the risk, and it is also a good method for handling situation where two companies share synergy and contribution to achieve one goal and this synergy cannot be easily isolated. Moreover, it's important to say that this method requires a significant amount of information, and the analysis as well is very complicated. It is a very expensive method, the main risk to apply it is to waste time and money.

How and when apply those methods?

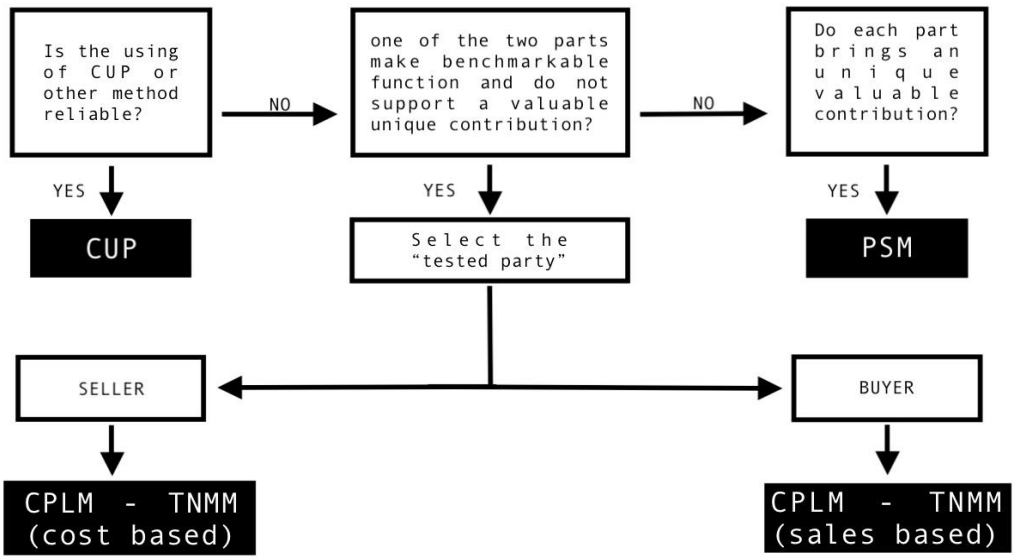

Figure 3 – Shows when CUP method is preferable to the PSM one in relation to the benchmark analysis. KPMG, Transfer pricing in the fashion sector. 21/06/18

1.3 BENCHMARK ANALYSIS

With the use of the TNMM methodology, it is often used a benchmark analysis in comparison to the external environment, and in particular this analysis shows the market profitability in comparison with the company which is analyzed.

The benchmark analysis is a tool that is useful for identifying a set which represent a sample, that must correspond to a comparable company, similar to the ones that

we want analyze. The objective is to evaluate intercompany operations in a real competitive environment, for instance Gucci and Prada in the Italian's market.

The *Guideline OECD* underline when two operations are comparable:

- none of the differences compared to each other can objectively affect the examined condition from the point of view of the used method
- economic corrections can be applied to eliminate the consequences of these differences

1.3.1 Comparability Criteria of the Benchmark Analysis

First, according to Piergiorgio Valente[5] step is to take into account for the analysis one company in terms of operative structure, market where it operates, by analyzing economic, competitive and regulatory factors which in turn influences the tax payer.

Secondly, the analysis put the attention on the intercompany transaction, the subject of the analysis, and all the interaction with third parties and them will be evaluate by the so called "5 factors of comparability":

[5] page 450 and over - P. Valente, A. Della Rovere, P. Schipani. *"ANALISI DI COMPARABILITA' NEL TRANSFER PRICING. METODOLOGIE APPLICATIVE"*. Ipsoa Editore, 2013, I EDIZIONE

1) Characteristics of goods and services

The final value for goods and services is influenced by specific characteristics which distinguish one to another and set the final price. If we are referring to an intangible goods, what is analyzed is the type of the transaction (the contract type such as leasing or selling), type of intangible goods (patent, license or brand name) and all staff referred to the contract; in the case of services, it's important to analyze the nature, type of service and the deadline; in the case of tangible goods, they are concerned about quality, raw materials, availability on the market and sales volume.

2) Functional analysis

It analyzes the functions of each intercompany operations and the tangible and intangible assets utilized by the overall company.

It is evident that in this stage the analysis is about the structure and the organization of the company, and the role of the tested party (the firm analyzed and often is the ones with the easiest organization and structure), in relation to the holding one and its affiliate companies.

3) Contractual terms below

Here is the analysis of the intragroup operations, in particular the contractual condition of the controlled company or in those exchange, this is useful because it

determines the responsibility, benefits and risks of each company, generally speaking is about the compliance with contractual conditions.

4) Business strategies

It is about strategy on price's goods, innovation and development of products and the approach to defend its strategy and quotes on the market. The verification here is about the congruity with respect to the free market, and the strategy of the sub-holding company. The controlled company must be in line with the independent company on the market under free competition circumstances.

5) economic conditions

The economic situation represents the most important situation to analyze: ceteris paribus, prices on free market varies in relation to the market type. Market type changes in the geographical ubication, breadth of the market, competitors, supply and demand, administrative condition for each state, travel costs, productions factors and the deadline of each transaction.

A careful analysis of the "five factors comparability" it is fundamental to choose the right transfer pricing plan, and it is able to determine the application of it by following the OECD model, in comparison to the external and internal environment.

1.3.2 Benchmark analysis: operational profiles and comparables

The goal of benchmark analysis is to compare the tested party (company under analysis) with the external environment by two different approaches.

In the OECD Model, Chapter 3, paragraph 3.41 and 3.42 is reported as follow:

- Additive approach, 3.41

  "*The first one (...) consists in the taxpayer drawing up a list of third parties that he believes carry out potential comparable transactions. The taxpayer then collects as much information as possible, on transaction conducted by these third parties to confirm whether they are in effect acceptable comparables (...). This approach arguably gives well-focused results – all the transactions retained in the analysis are carried out by well-known players in the taxpayer's market (...)".*

- Deductive approach, 3.42

  "(...) deductive approach starts with a wide set of companies that operate in the same sector of activity, perform similar broad functions and not present economic characteristics that are obviously different. The list is then refined using selection criteria and publicly available information (e.g., from database, Internet sites, information on known competitors of the

taxpayer). In practice the "deductive" approach typically starts with a search on a database (...)".

We can use both, there are no preferences but it must be transparent and testable, and them can be used jointly as reported in the OECD model[6]:

- *"It would not be appropriate to give systematic preference to one approach over the other because, depending on the circumstances of the case, there could be value in either "additive" or the "deductive" approach, or in combination of both. The "additive" and "deductive" approaches are often not used exclusively. In a typical "deductive" approach, in addition to searching public database it is common to include third parties, for instance known competitors (...), which may otherwise not be found following. purely deductive approach (...). In such cases, the "additive" approach operates as a tool to refine a search that is based on a deductive approach.".*

In order to compare the tested party, I would show a simple scheme where is depicted the *first step* of the so called *comparables:*

- stage 1: identify ages of the company analysis
- stage 2: board-based analysis (general analysis)

[6] see paragraph 3.45, Chapter 3, OECD model

- stage 3: find the most appropriate TP method to the circumstances of the above general case, and the financial indicators useful for compare the tested party
- stage 4: Revision and identification of the internal and external comparables
- stage 5: Choose you TP method
- stage 6/7: identify the potential comparables in relation to the characteristics of the single transaction in the 3rd step and the "5 factors comparability" (mentioned in the previous section). Then make some adjustment.
- stage 8: interpretate data according to the arm length principle.

The *second step* it is a qualitative analysis according to the data obtained in the first step, and where will be eliminated all companies that not correspond the comparability of the tested party. The procedure to eliminate these companies is the following:

- analyze commercial description of each company and eliminate companies that differ from the tested party in type of goods and services, carries out a wide range of activities, makes some intercompany operations.
- analyze websites of each company, because it allows to find more specific details on goods and services and intercompany operations.

- analyze the financial statement, for a deeper analysis, and the final outcome is a list of all comparables, in a list called *rejection matrix.*

Third and last *step* is a quantitative and financial analysis of the rejection matrix and as defined in the *OECD model*[7], could be useful to analyze more than one financial year.

This step takes into account all profit level indicators (e.g., cost plus margin, operating margin, berry ratio).

Then all financial data will be used for creating an average of the profit level indicator, then the benchmark analysis take place with the interquartile. The interquartile indicator is used for verifying the intergroup transfer price in relation to the external environment, on other hand it verifies if the result for the tested party is in line with the comparables.

There are, in some cases, certain comparables that are not in line with the scope, and they generate critical situation during the tested party analysis.

As defined in the OECD model, exist a phenomenon called Cherry Picking:

[7] See paragraph 3.76, Chapter 3 of the OECD model

"(...) a situation where a tax authority tries to impose a TP adjustment on a taxpayer based on a few of cherry-picked related party transactions of other comparable companies with an intention to maximize its adjustment".

This means that during the identification of the comparables, documents must be transparent and testable (replicable) as shown in this paragraph.

1.3.3 Issues generated by the benchmark analysis

The OECD model in the 2012 has published a document called "*Draft on timing issues relating to Transfer Pricing"*[8] which focus on different approaches generated by the arm-length principle in relation to the benchmark analysis:

- ex-ante basis: the nominal value is referred to the information obtained from the last economic transaction available.
- ex- post basis: tax payers and/or tax authorities can test the arm-length principle after above mentioned transaction.

These principles generate issues in the TP application, because tax authorities could apply the *ex-post basis* after that companies, in a certain moment, have applied the

[8] http://www.oecd.org/ctp/transfer-pricing/Timing_Issues_Comments.pdf

first one with less information than authorities' ones, and the OECD model in 2012 published a document, asked from the private sector, for the draft on timing issues. In this document is evident that tax authorities in the "after business analysis" must take into account the possession of information for the taxpayers when the document was redacted, without any recent news.

The second issue is about loss-making companies in relation to the comparables. The OECD model in fact establish in the Chapter 3, section 3.64 and 3.65, that any loss-making company could be tested as comparables, if this loss is not about the normal business condition, on other word it is just an overall industry recession period.

2. THE CIRCUMSTANCES OF APPLICATION OF THE CUP METHOD

The connection between TP methods and comparables contains several issues in its application. The analysis must take care about facts and circumstances in order to follow the arm-length principle. Is not always possible rely on contractual terms for setting comparables, because these are hidden information; for instance, it is noted that the contract between buy-sell distributors leave more risk on the comparables and it is very difficult to observe this phenomenon not on public domain. This means that TP methods are not always suitable and applicable in every possible situation because its applicability depends on fact and circumstances.
Furthermore, if CUP method is equally satisfactory to another, the application of the CUP is the preferred one.

Notwithstanding, in some circumstances the transactional profit methods are preferable from the traditional methods. I would propose some examples:

- The analysis on the net profit margin is more precise than an analysis on gross margin, this in a situation where we would consider the functional analysis of the controlled transaction between tested party and comparables uncontrolled transactions, because exist functional differences between the

tested party and uncontrolled transactions, which is focused on operating expenses under the level of the gross margin).

- When the parties contribute to a significant unique intangible in highly integrated activities is more appropriate to make a transactional profit than a traditional method (one-side method).
- When exist a limitation among information collected on third parties' gross margin, traditional methods could be not easily applicated.

However, the application of transactional methods is not always possible because is difficult to obtain data, however the CUP method could not be a possible solution when, in relation to the third parties, exist differences in: high operating costs of the retail store, different levels of "must-buy", different breadth and depth of the collection.

2.1 WHEN THE PROFIT SPLIT METHOD IS PREFERABLE

In addition to the above paragraph, there are several reasons to the applicability of the transactional model, in particular the profit split method (PSM).

Exist seven conditions for the application of the PSM:

- It should be coherent with the functional analysis of the controlled party, and it should reflect the allocation of the risks between both.

- It should be coherent with the determination of the profit, which is split between parties, that it was previously independently agreed.
- It should be coherent with the approach of the profit split.
- It should be calculated in the right way (reliable).
- If the controlled transaction is measured with transactional split method (e.g., ex ante), it is reasonable that those criteria are chosen before the transaction.
- Whom follow this method, must be able to explicit the method used for the profit split allocation.
- The profit split allocation should be in line with the agreement over year.

It is stated that without any external and reliable data (comparables), the analysis is based on the relative value of each associated parties. Multinationals have a more sophisticated approaches to split the relative contribution of each enterprise by using the relative investment or cost. The cost-based allocation key is used mostly when the function of people is central in the generation profit, which is combined.

However, it is a normal procedure to split revenues between third parties in relation to the external, as in this case, or internal data. Some examples below:

- join-venture arrangements between third parties (in the fashion sector is common the co-marketing or co-promotion)

- franchise agreements, both the franchisor and the franchisee could split the franchisee's profit.
- uncontrolled license (for example agreements on the royalty rates, which varies as the profit varies.

2.2 CRITICAL SITUATION: INCOME LOSS FOR RETAILER COMPANIES. FLAGSHIP STORES

Before the Covid-19, multinationals used to open flagship stores[9] around countries. The flagship store is a strategic marketing strategy that allow brands to transmit their style, values and brand story by opening a lot of unique branded shops with aggressive design and highly qualified personnel.

Nowadays, during the Covid crisis those shops tend to have huge costs like prime location, full knowledge, furniture and so on. Because of all those reasons, the parent company of the flagship store may decide close them, or not. On average, it is difficult to observe long term investment on flagship stores made by independent distributors.

[9] *"A flagship store is the lead store in a retail chain acting as showcase for the brand or retailer. Its job is to draw customers into brand over (…)"*. via www.shopworks.co.uk

The strategy is just about the image of the brand and the emotion that the store transmits to the final customer, and if the parent company decide not to close them, it may evaluate to give a contribution to the shop.

The Italian doctrine and Agenzia Delle Entrare in the 2013 had replied during "Telefisco" to one question about those flagship stores. Authorities said that from the moment that those particular shops are based in a very high strategic position and the goal is to give to the brand a high visibility and strong awareness about the service and goods quality, is justified in the case of TP, that goods prices are not in line with single retailed with no brand advertising.

Agenzia delle Entrate explained that the extra costs arising from flagship stores must be considered as a risk, and a discount on goods is allowed (it's like an extra cost reimbursement), it is in line with the functional analysis of the OECD model, because it is not just a simple retailer. Moreover, the flagship store must be intended as a common risk between IP owner and distributor, and it is not clear who should have the control over this particular investment, but it is established that their interest it is aligned by increasing visibility and sales and they agree for sharing the initial loss of the flagship stores. For calculating this special event, the *transactional profit split* is the right way to follow, as reported by the "Comments on Public

Discussion Draft – BEPS Action 8/10 - Revisited guidance on Profit Split Part I", September 8, 2016.

By summing up, this is the particular case where the IP owner is not able to exercise the full control over the flagship store and its management, but he knows well that the risk will be shared with the distributor and the store may increase the visibility and the customer experience of the brand, in order to create a huge amount of profit in the future.

2.3 CRITICAL SITUATION: PSM IN RELATION TO THIRD PARTIES' SALES

Generally, when we speak about physical store, we can refer to the Directly Operated Store (DOS) or independent shop (e.g., multi-brand store, franchising).

It is not easy to follow the right way to separate and quantify the contribution from different parties, especially for companies that have highly sophisticated business approach to determine the right amount of value coming from the company business process.

During the JTPF meeting, 24 October 2018, was determined the right inventory of profit splitting factors in a win-win situation for both parties, tax administration and companies. They have set five different categories:

1 People-based factors

2 Sales/volume-based factors

3 Asset-based factors

4 Cost-based factors

5 Others

The analysis of the management or financial accounting derives these splitting factors. Obviously, the main issue is understanding why some indicators are accumulated in one way or other over time, and in some cases these indicators are very complex in order to accumulate valuation, which does not correspond to the true value of the intangible asset.

1 – Either number and/or factor of employee remuneration are used when key people carry out key factors for a specific company. However, exist a judgment regarding which employee's contribution or numbers can be included in this factor. In addition, one view is concerned about employee's compensation, because it sustains that it already reflects the importance of the contribution for each single employee. In addition, this way can be problematic regarding the

employee's inclusion, because their activity cannot be related to the PSM method, because such activities drive the application for the company.

2 – Sales/volume splitting factors are mostly used in addition to other splitting factors. They reflect the effort during different stages: sales, distribution, marketing, R&D, quality and so on. All of these factors depend on the type of business and the group strategy.

3 – The asset value used for the splitting must be measured with the arm-length principle, and these factors are used when the contribution is about intangible asset. There are several views to understand this issue, but some consider this aspect crucial. So, is used when the asset-based splitting factor and tangible property should be taken into account, because the legal ownership of the intangible assets is not part of the evaluation. Intangible assets are difficult to evaluate and should arise issues from locational perspective. Under this hypothesis, objective factors can better calculate the relative value of intangible assets (people, tangible assets, costs and so on).

4 – Cost-based factors are used jointly for presenting the value creation of the activities. The value creating activity now can reflects costs of that activity.

5 – The residual factors category includes contributions which derives from functional analysis, external benchmark analysis and so on.

2.4 CRITICAL SITUATION: TP ADJUSTMENTS AND VAT IMPLICATIONS

At the end of the year, it is possible that companies need a transfer pricing adjustment. For this reason, according to the Internationaltaxreview.com website, the Central Revenue on 2 November 2018 has clarified the issue regarding the VAT application in context of intragroup exchanges for MNE.

Let's suppose that a company want to implement a new product chain for the development and marketing of a A-branded goods. The A economic and legal ownership plus its relative know-how is in possession of a non-EU related company (B1). Because of its operativity, we assume that this company is the principal, and it assumes all production and distribution risks of the goods and it is able to concede the utilization for free of the brand and the know-how for subsidiaries which produce and commercialize the A-branded goods.

The Italian entity presents the ruling to the Central revenue (A1) signed an agreement with non-EU related company (B1), where the first entity must act as

contract assembler for the second. Then, A1 will help B2 with its equipment that produce for the group as manufacturer. After that, goods are sold all over the world by B1, or it can split the commercialization, for instance B1 for the America and call another company C3 in Africa and Asia.

The A-branded goods that produce B2, have been bought by A1 at a market prices, and prices from A1 to B1 and C3 (who commercialize goods) should be in line with the company policy and the average market price. The group's TP policy outlines that when the A1 profit margin for a given fiscal year goes beyond the interquartile year, company must make some TP adjustment.

Then, in agreement with the intercompany policy, B1 must pay a higher contribution to A1 if the latter suffers operational losses, and these losses could be identified in equipment's cost (substantial costs) useful in the manufacturing cycle.

The above situation arises some questions to the Italian tax authorities for the TP adjustments in relation to the VAT purpose. The European commission working paper N. 932 of 28 February 2017 and Agenzia delle Entrate explained the VAT issue and explained under what circumstances the VAT has an adjustment impact:

- if it is agreed among third parties
- if the intragroup transactions for services and goods are easily identifiable

- if exist a direct link among consideration and transactions

Moreover, according with the above European working paper, the TP adjustment and VAT interconnection can have VAT involvement when: the TP adjustment can be seen as a correction for a taxable supply of goods and services carried out in this year, and this led to a change in the taxable tax base. In this specific case, the VAT may change up or down for these operations. In addition, the same document highlights that *"(...) For there to be any VAT implications, the rules as regards the existence of supply for consideration pursuant to Article 2(!) of the VAT Directive, there must be a supply made in exchange for consideration, and a direct link has to be established between them. This would have to be assessed on a case-by-case basis."*

Finally, in the above explanation, I did not individuate any correlation between TP adjustment and goods and services supplier by the Central Revenue. Besides, they cannot assert for sure that TP adjustments have created a change in the VAT taxable basis in relation to the above transactions. Rather, for what concerning the intragroup exchange, the Central Revenue has declared that the payment from B1 to A1 does not represent a case of service or good remuneration (exempt for VAT purposes) because they cannot identify any direct link among consideration and transaction.

3. STUDY CASE – KERING GROUP AND GUCCI

Gucci is an Italian fashion house, it manufactures clothing, perfumes, accessories and textiles and so on. Gucci was founded by Guccio Gucci in Florence in 1921.

After a brief introduction of the overall structure of Kering S.A., and then I would focus on the latter company and his Swiss subsidiary, Luxury Goods International (LGI), the "pawn" for saving money with transfer price procedure, and then why Gucci had made the strategic choice to set his main subsidiary in Canton Ticino, Switzerland (residence principle and the right allocation for the "Place of Effective Management", POEM).

This case is famous for being the biggest tax settlement ever agreed by a company with Italian tax authorities and in this thesis, I would rebuild the entire path of Kering group, Gucci S.p.a. and LGI company.

After this, I would focus on the CEO's situation, derived from the Italian investigation which unmasks the real *tax residence* and what they have to pay in Italy for their own income.

3.1STRUCTURE OF KERING

Today Kering S.A. is one of the biggest holding in the fashion sector, which have bought several premium brands such as Bottega Veneta, Alexander McQueen, Yves Saint Lourent, Balenciaga and so on. The company have more than 40.000 employee and in the 2019 earned over 15.9 billion euro.

The Kering groups has two different division (shell companies), one localized in Holland named Kering Holand, and the second one in Luxemburg called Kering Luxemburg, where the taxation regime is favorable for paying taxes. Then Kering Luxemburg owns in turn a lot of companies, included Gucci S.P.A. which is connected to a very large warehouse company, called Luxury Goods International (LGI) in Ticino, Switzerland but authorities noted something strange in this correlation.

This scheme started in 1997 and after two years, LGI became a Gucci's exclusive logistic center, this because all clothes and accessories passed into LGI warehouse (Cadempino) which in turn delivers all the merchandising worldwide.

The graphic below would try to depict this scheme:

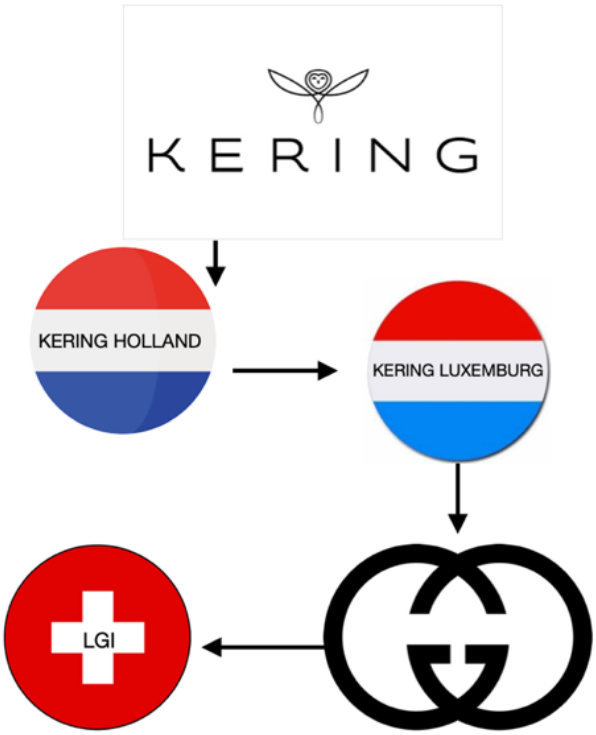

Figure 4 – personal representation of Kering structure

This company architecture started to lose pieces in 2017 when the court of Milan decided to start investigating the contacts of overall Gucci company, in particular with LGI company for tax evasion, money laundering and document forgery against unknown persons, focusing on managers of Gucci as well in particular regarding Castera S.a.r.l. The request for documents is also made at the Office of the Attorney General of Switzerland (OAG).

It is supposed that Gucci saved over €2.5 billion taxes over seven years with this architecture, thanks to the low *corporate tax rate* in Ticino (Swiss) which is 8%. At the end of the legal battle, Kering agreed to pay €1.25 billion over the LGI company, a controlled division.

Kering tried to defend itself with an official communication regarding the case: *"The group pays its due taxes in Switzerland, in compliance with the law and the fiscal status of the company. This business operating model in known by French and other competent tax authorities";* but as you can imagine, this was totally false.

3.2 GUCCI STRATEGY BASED IN SWISS

Why Gucci decided to place its subsidiary in Swiss? There are several reasons in order to understand well the comparison between Italy and Swiss.

- Strategic position

As Italian we know how far is Swiss from Milan. We take at maximum 2 hours to reach the Ticino by truck or by car. LGI was very near from the headquarter of Gucci (90 minutes), and this had permitted to managers as well to enjoy the income tax rate applied to the Swiss workers, indeed during years both CEOs lived in Swiss but they worked in Milan, and this was the first sentry for Italian authorities.

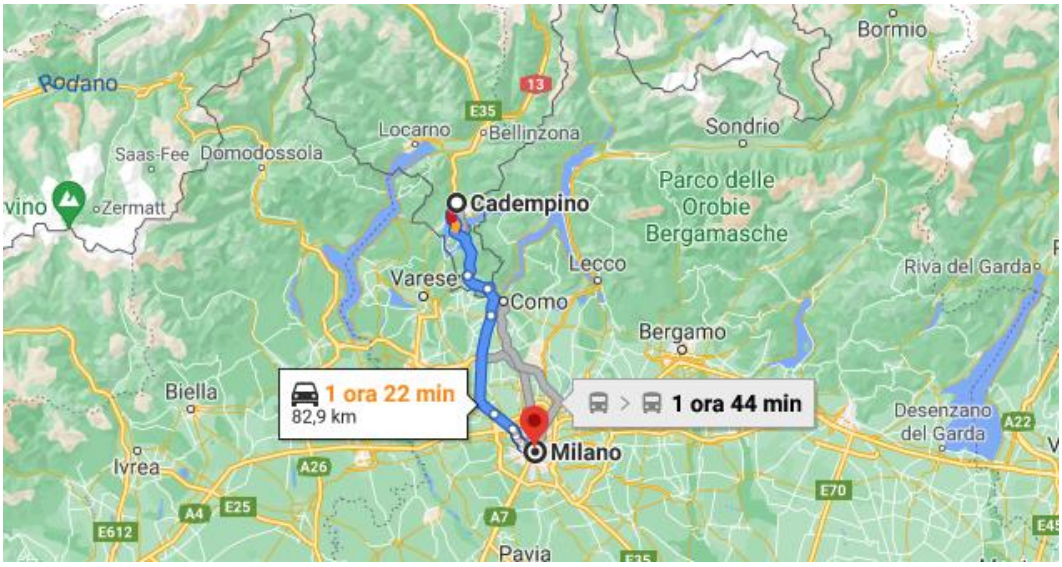

Figure 5 – Distance between Milan and Cadempino via car. Google maps screenshot

- Corporate tax rate: 8% in Swiss versus 31% in Italy (tax ruling)

First, the advance tax ruling is a tool that use multinationals to set and clarify an individual tax agreement with a single state, and it helps to remove uncertainty within a particular taxation law. This is a tool that permit to a single multinational to have some tax advantage but it should be transparent for both countries.

But this is not the case, in fact according to the authorities, Gucci reached a deal just with Ticino region, and this permit to pay a corporate tax rate of 8% instead to pay 31% in Italy.

Indeed, if you don't report the agreement, you could be accused of tax avoidance, and the definition given by Wikipedia is the following: "*The conduct put into*

practice by the taxpayers who puts in place a legal transaction or a chain of legal acts that are in themselves lawful, for the only purpose of reducing the tax obligation".

This convention between these two states for avoidance of double taxation and the regulation of certain other tax, income, and capital questions, is settled by the law 23 December 1978, n.943 and it has been modified by the law 4th May 2016, n. 69. In the art. 27 is written that this is a secret agreement between companies and states, and it should be communicated only to the authorities, when requested. That information could not be reveled and it can be used just in case of public juridical procedure or juridical decision.

For this reason, I could not find any official document about this agreement, but there are some articles of Mediapart and L'Espresso that explain this dispute. Some articles show how LGI was used for not pay the Italian taxes, because the major revenues came from the commercialization of the Gucci's goods worldwide.
Some other information came from Canton Ticino, which admitted that the "fashion valley" represent the highest source of income for this region; other companies use this system in order to save money such as Armani, Hugo Boss, Versace, The North Face and so on.

- Income tax rate: 2% (special agreement) versus 43% in Italy

Not just goods, but income of the two former Gucci CEOs De Marco and Bizzarri as well, are under indictment for fiscal evasion. The vicinity from Milan and Canton Ticino permitted to reach their ghost houses in Swiss, where their residency was based and this allow them to enjoy a particular tax regime, dedicated just for 5300 rich foreign people could enjoy. The indiscretion reported from Mediapart journal, said that they reached an agreement on their private income with Swiss equal to 2%, instead the ones applied in Italy for income over 75.000€ which is the 43%.

This special treatment is based on the article 15 (1) and 18 of the *Convention between the Swiss Confederation and Italian Republic for the avoidance of double taxation and the regulation of certain other questions relating to taxes on income and capital*.

Let's analyze these articles:

- Art. 15 (1) says that salaries, wages and other derivates gained by the resident of a contracting state, related to other dependent activities are carried out only in such state, unless the above-mentioned activity is done in the contracting state. If the activity is carried out in such state, the remuneration is taxed in the other state.

- Art. 18 could explain how and why the two CEOs of Gucci received those salaries and they are taxable in Swiss, but there are further reasons of why italian authorities believed that De Marco and Bizzarri were guilty of evasion.

3.3 THE RELATION BETWEEN GUCCI AND LGI

Luxury Goods International (LGI) was founded in Canton Ticino as a warehouse by Gucci. After years, when Kering Group had bought Gucci, it decided to make LGI its exclusive logistic center. But what does it mean? The LGI now has the monopoly of the overall distribution, and just LGI was able to deliver worldwide all goods of the company, and this operation permit to the LGI to get a massive revenue in Swiss, and this is the major source of revenues for it.

In 1999 Gucci S.p.a. gave to LGI the exclusive use of its brand, and this operation permitted to give a volatile value of intangible asset such as a brand name of a multinational. We can say that this operation opened doors to a massive transfer pricing operation between Gucci and LGI, both with the same parent, Kering Group.

The scheme is not complicated, LGI purchase product made in Italy by Gucci at the cost price, and thanks to the vicinity of Milan to Ticino, LGI stores all goods in its warehouse and then it is able to sell Gucci's products worldwide, and they generate revenues taxable only in Swiss, because apparently who is really selling goods is LGI, and Gucci just shifted revenues from Italy to Swiss, and the low taxation is permitted just thanks to the above-mentioned tax ruling.

3.4 WHAT WENT WRONG?

First, it's necessary to say that any official document is secret because the international law tend to protect all customers and firms.

What is evident from this case is that LGI has the monopoly of Gucci's distribution, and officially Gucci sold goods to LGI to evade the Italian tax regime.
This is possible because who sells product in Swiss at cost price, the revenues in Italy are something like zero in comparison to the LGI one, where the true revenues are taxed with a more favorable tax regime as shown before. Obviously, the price charged by LGI during its distribution is the real price.

This mechanism shows how hard is to establish how should be the cost price on the reselling market, with just one buyer. The above graph emerged thanks to tvsvizzera.it[10] which shows in details the net income made by LGI:

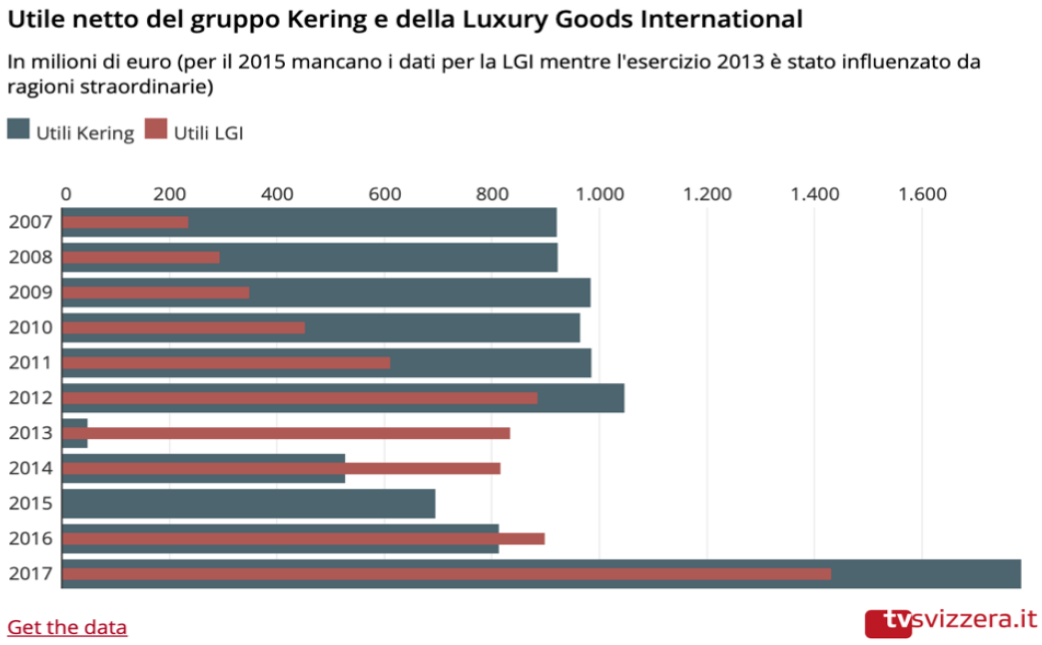

Figure 6 – The difference in net income generated by overall Kering group (grey) and LGI alone (red)

As we can see, the red line is the net income of LGI related to the Kering as a group in grey. LGI started make profits in 2007 (390 million swiss francs) which represent the 43% of the total group net income, to 2017 when LGI reached 1.4 billion francs

[10] https://www.tvsvizzera.it/tvs/kering-gucci_le-dubbie-pratiche-fiscali-di-un-gigante-della-moda/44722480

of net income, which represent more than 80% of the total net income of the Kering group and generated over 10 billion francs in revenues:

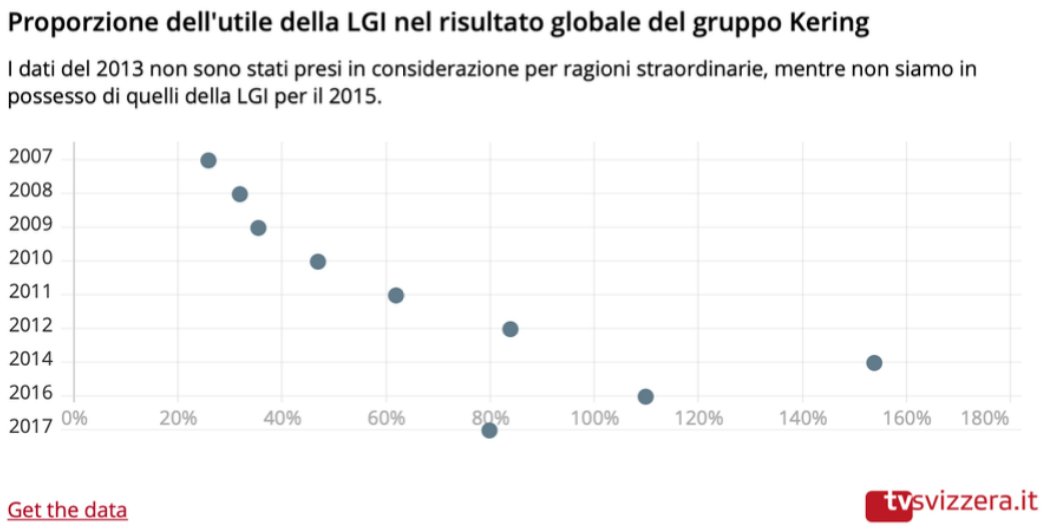

Figure 7 – Proportion of LGI's profit in the overall result of the Kering group

What the authorities were looking for is not just money, but employees as well, if we consider that the overall group has 10.000 employee worldwide and they generate less than 20% of the entire sales volume, in comparison to the 600 employees of LGI.

But there is another mistake made by the managers of Gucci. The vicinity between the headquarter of Gucci and LGI is not a causality. The place of effective management (POEM) for LGI is not in Swiss, and LGI became automatically a

dependent industry of Gucci, and the former CEO of Gucci has the residency in Swiss just for the favorable taxation on income.

In conclusion, I can say that LGI is a branch of Gucci, and after years they decided to separate these two environments with their respectively management and the profits of LGI are in reality profits made by Gucci, and they should be taxed in Italy, even if they try to hide this information under monopoly situation, but it's more difficult hide tangible assets like the cost of labor and row materials.

In 2017 Kering tried to justify the past situation by creating a huge "valley" called Prometheus. The goal was to "redefine the engineering" of taxation of LGI and create a huge production firm to make it looks like a real subsidiary, but this does not work and finally Kering paid to the Italian tax authorities the biggest amount ever in the Italian context, bargaining the sum of 1.25 billion euros.

Instead, after this legally turbulent period, Kering decided to dismantle the cantonal golden goose, and in 2019 announced the imminent closure of the logistics center, and it will thus return to the Italian territory (jurisdiction). This movements may generate a loss of Swiss tax revenue of 80 million francs, and over 300 employees will lose their jobs.

3.5 EVIDENCE FROM CASTERA S.A.R.L. IN RELATION TO THE INCOME TAX RATE FOR DE MARCO AND BIZZARRI (FORMER CEOs)

As said in the previous paragraph, two former CEOs De Marco and Bizzarri enjoyed the favorable income tax rate of 2% because of their residency in Switzerland.

First, who opened the way of the income tax rate at 2% is De Marco, after the first investigation on Gucci S.p.a., the Mediapart journal had found some documents[11] related to the Castera S.a.r.l. which is created by the Kering Luxemburg as a shell company until 2010 and it had no revenues and no costs.

[11] Consultable on: https://meloniclaudio.wordpress.com/2019/01/27/kering-evasione-fiscale-per-lex-ceo-de-marco/

Registre de Commerce et des Sociétés
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RCSL Nr. : B78377	Matricule : 2000 2415 322
	eCDF entry date : 13/07/2018

BALANCE SHEET

Financial year from 01 01/01/2017 **to** 02 31/12/2017 *(in* 03 EUR *)*

CASTERA S.à r.l.
124, Boulevard de la Pétrusse
L-2330 Luxembourg

ASSETS

	Reference(s)	Current year	Previous year
A. Subscribed capital unpaid	1101	101	102
I. Subscribed capital not called	1103	103	104
II. Subscribed capital called but unpaid	1105	105	106

Figure 8 -Balance sheet of Castera S.a.r.l. in 2017

Then, the following years, Castera increased personnel and wages's costs as well, and the European Investigative Collaboration (EIC), thanks to the Mediapart collaboration, had discovered that this shall company was used just for paying wages to the CEOs and other managers.

Year	Personnel costs / Wages and salaries	Social security costs	Income Tax (IT) / Net wealth tax (NWT)
2009	0		70 (NWT)
2010	5 227 403		44 100 (NWT)
2011	5 413 032	15 845	685 021 (IT)
2012	8 251 980	20 133	198 649 (IT)
2013	6 682 557	28 696	129 618 (IT)
2014	**12 309 996**	20 221	227 982 (IT)
2015	8 302 189	29 467	271 500 (IT)
2016	6 552 739	18 201	67 760 (IT)
2017	**12 576 317**	27 102	185 100 (IT)

Figure 9 – Personnel costs, Social security costs, Income tax of Castera S.a.r.l. from 2009 to 2017

In the late 2014, after the introduction of the new Gucci's CEO Bizzarri, the former CEO De Marco received 24 million euros for severance pay to him, but the *social security costs* were too low in comparison to the Italian one, this was possible thanks to the residence in Switzerland, but actually he was living in Milan. In addition, De Marco did not pay anything to the Italian fiscal system, and 100.000€ to the Swiss one.

6. Staff costs	1605		605	-12.603.419,00	606	-6.570.940,00
a) Wages and salaries	1607		607	-12.576.317,00	608	-6.552.739,00
b) Social security costs	1609		609	-27.102,00	610	-18.201,00
i) relating to pensions	1653		653		654	
ii) other social security costs	1655		655	-27.102,00	656	-18.201,00
c) Other staff costs	1613		613		614	

Figure 10 – Staff costs, income statement od Castera S.a.r.l.

This severance pay was divided as follow:

- €1 millions in stock sharer of Kering
- €10,7 millions for annual wage paid by Vandy International S.p.a
- €11,2 millions of severance pay Vandy International S.p.a

What is interesting is the fact that its residency is in Panama, his bank account is based in Singapore at LGT Bank registered by Vandy International.

In conclusion, for tax authorities exist the evidence that Castera S.a.r.l. by these bank accounts paid De Marco a yearly production reward and this fiscal model was built to erode the Italian fiscal system for what concerned tax on salaries. The following picture is just my own intuition regarding the architecture of this model, since there are no judgments about it.

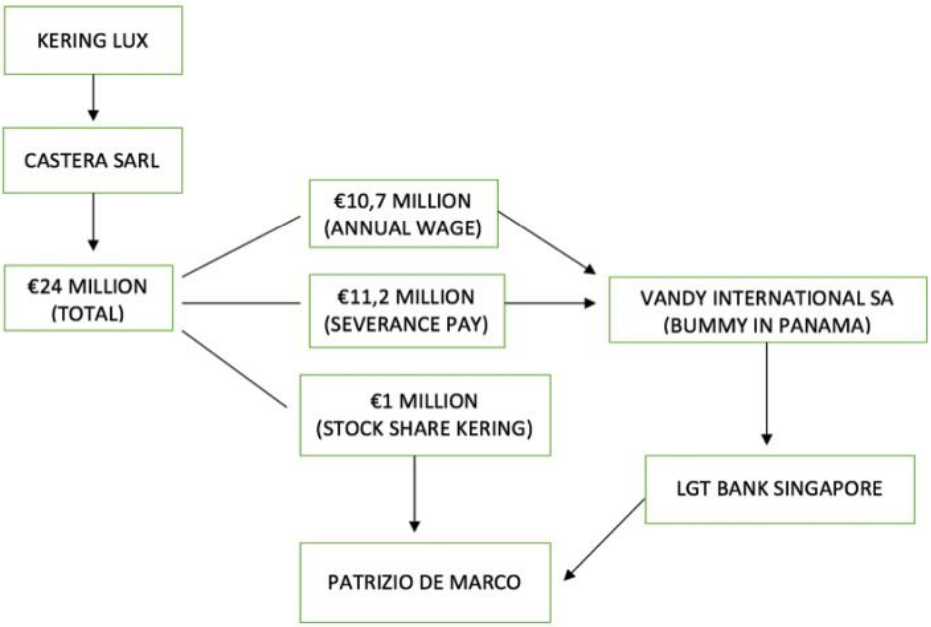

Figure 11 – Personal representation of the total salary received by De Marco

For what concerned Marco Bizzarri, was the CEO of Gucci from 2014 to 2017. As said before he enjoyed a special tax treatment as his predecessor, thanks to its residency and the architecture of Castera S.a.r.l. which paid salaries.

What differ from the previous CEO is the total amount of the net salary which was €8 million per year. During the first year he paid on these 8 million euros just the 13% of income tax and as well Kering enjoyed this scheme because of his social security contribution, 0.36% on Bizzarri's gross salary which correspond to 34.000€, and just the 0.2% paid in Italy, which correspond to 19.000€.

This particular architecture was approved by Francois-Henri Pinault, the major shareholder of Kering group, and all confidential documents are reserved and discovered by Mediapart journal.

His home in Switzerland, which is the center for saving money with his residency, was not inhabited, he enjoyed just holidays in Switzerland since there are no minimum thresholds for living there, in addition he spent 500.000 swiss francs for house services.

What did not convince the Italian tax authorities was a house in Milan bought by BV Servizi (Bottega Veneta, owned by Kering), and this company paid all bills for this apartment but the name of the tenant was the son of Bizzarri, which did not work for Kering.

Moreover, for what concern the salary, Kering paid to him €8 million, and it was divided in two different parts paid by Castera and Gucci, respectively €5.8 million and €3.6 million. The first transaction segment was under the Swiss regime, and him enjoyed a tiny tax rate super-rich foreigner, and he paid just €146.000 in taxes (0.25%); instead on the second transaction segment he paid €1.2 million which correspond to the 33% income tax rate, instead paying the 43% in Italy.

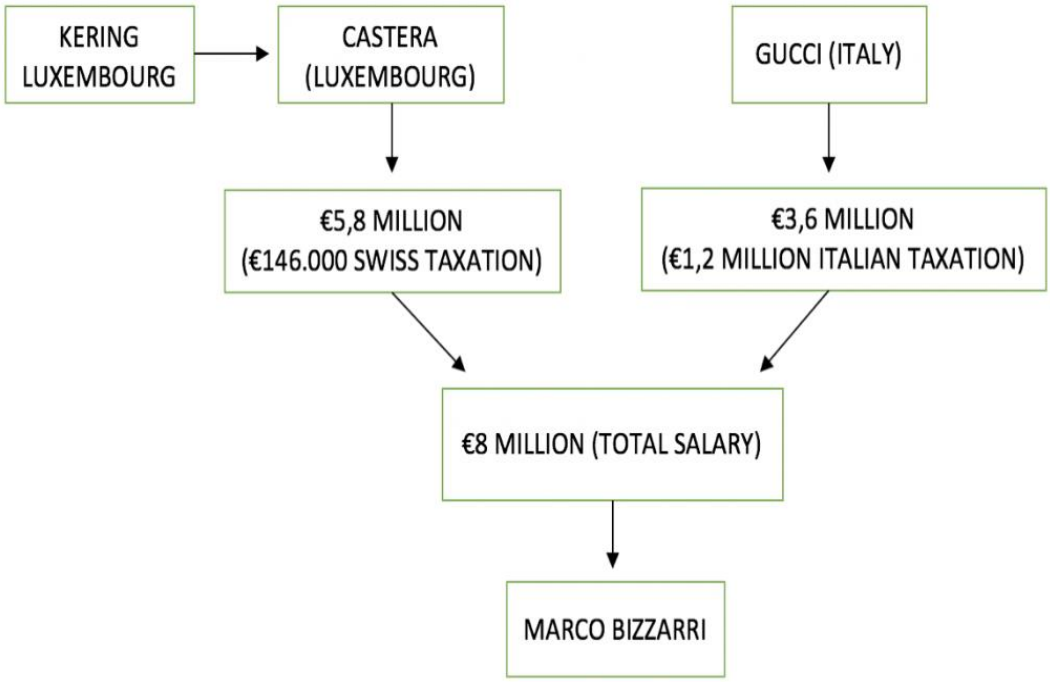

Figure 12 - Personal representation of the total salary received by Bizzarri

3.6 FUTURE DEVELOPMENTS

The media scandals that arise from the fashion valley, and obviously Gucci is not an isolated event, highlights some critical aspects in relation to the taxation for these fashion groups. In the 2018, after the involvement of Kering group in the Gucci tax scandal, some adjustment arises.

The "Fiscal project 17 and Cantonal Strategies" with which it intends to abrogate all tax concessions established between cantons and companies with special statute;

moreover, it intends to review the Swiss' administrative practice. Cantons, where the company is based with his legal seat and their preferential taxation, in order to avoid the transfer of their headquarters, they will have to mitigate the applicable (low) tax rate to taxable profit. This procedure could permit to reach a direct tax of 21.5%, from the previously 17%.

Nevertheless, some tax advisors think that the corporate tax rate and the direct federal tax rate of 8.5% applicable to profits or legal persons should be reduced, this because this tax was born as complementary tax in relation to the canton tax, but with years it becomes the principal one. With the Fiscal Project 17, cantons must take into consideration to lower this tax, for containing the transfer of the legal seat and their managers to another cantor or state. The examination carried out must take into consideration the disaggregated tax revenue of: company with special status, principals' company and the swiss finance branch. But what is also necessary is to divide the principle of the application for legal entities and legal person.

Finally, Switzerland agreed to implement BEPS minimum standards during the G20 meeting, derived from the necessity to increase awareness in TP among Cantonal tax administration and Switzerland tax commissioner. Them had signed the Multilateral Competent Authority Agreement for the Automatic Exchange of Country-by-country Reports and Multilateral Convention to implement tax treaty-

related measures to prevent BEPS, accepted on 4th December 2018. On other hand, this agreement permits to have more transparent information, and it "rock the boat" among other fashion companies, that changed their corporate structure.

After this chapter I would focus on the BEPS project in relation to the taxation of the digital economy (Action 1), which is the actual critical situation during and after the Covid-19 crisis, this because the pandemic period has forced businesses to operate online, but not all companies operate online in the same way.

4. BEPS AND DIGITAL ECONOMY

In this chapter I will explain how the OECD model managed the TP in large sense, and in relation to the Chapter 1 (Actions 8-10), how them reached to set different standards and transfer pricing method, which is based on these action plans. In addition, the Gucci case is an example of how the BEPS creates principles for profits allocation, in particular this allocation is done where the value is created (Milan for Gucci, not in Switzerland). All of these principles are applied among intragroup exchanges.

Authorities became aware of this issue many years ago, in fact the 35th president of the Unites States of America Jhon F. Kennedy, during a *special message to the Congress on Taxation*, April 20, 1961[12] examined this problem in relation to the past environment, significantly different and static from now, claimed the following:

"A strong and sound Federal Tax system is essential to America's future. Without such a system, we cannot maintain our defenses and give leadership to the free world. Without such system, we cannot render the public services necessary for enriching the lives of our people and furthering the growth of our economy. (...)

[12] All the speech is consultable on the site: www.presidency.ucsb.edu/documents/special-message-the-congress-taxation

(…) Recently more and more enterprises organized abroad by American firm have arranged their corporate structures-aided by artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights, the shifting of management fees, and similar practices which maximize the accumulation of profits in the tax haven—so as to exploit the multiplicity of foreign tax systems and international agreements in order to reduce sharply or eliminate completely their tax liabilities both at home and abroad. (…)"

It seems written just five or six ago. The President J.F.K. decided to stop this injustice for who must pay more, even if these companies are smaller than others. He had introduced the concept of *"tax deferral"*[13], and even today is one of the basements of the OECD model which want to develop the BEPS project.
What differ from the tax deferral to the BEPS project is the perspective adopted, this because in the past, without a such globalization, the president had an internal perspective, we can say state-centered perspective. Nowadays the perspective must be directed to the whole world one.

By using the words of the OECD secretary-general during the G20 meeting in Moscow, 2013:

[13] *"Tax deferral refers to instances where a taxpayer can delay paying taxes to some future period. (…)".* Via Wikipedia

"This Action Plan, which we will roll out over the coming two years, marks a turning point in the history of international tax co-operation. It will allow countries to draw up the co-ordinated, comprehensive and transparent standards they need to prevent BEPS".

The acronymous BEPS stands for:

- Base Erosion: is an artificial displacement of the profits in countries where the taxation is nil
- Profit Shifting: elusive actions to reduce the taxation base

This issue emerges from States that are losing revenues from the multinational taxation, and moreover, this tax elusion generates additional effects on the economic equilibrium because it favors aggressive fiscal policies, increase the distortion in the debt of businesses and finally reduce the financing of public infrastructures.

The Base Erosion and Profit Shifting (BEPS) is an action plan which want defeat the international shifting of profits for multinationals or against the international tax evasion. It was signed by 76 countries which includes Italy, and it was born under a politic matrix.

More specifically, BEPS strategies are the ones that permit to exploit the gaps of fiscal rules, and them can shift profits in countries where the taxation is very low, and the economic activity is not carried out in that country.

It is dangerous for the integrity of fiscal systems because this practice corrodes the tax revenue of a single state. It is estimated that the total amount of lost tax revenues in one year is around 4/10% of the global tax revenues, which corresponds to 150/250 billion euros.

4.1 INTRODUCTION TO THE BEPS ACTION PLANS

What change from the past is the definition of *permanent establishment* because with a more dynamic market is not easy to say if a warehouse may become a permanent establishment or not, as in Amazon case, where the e-commerce is the central point for creating revenues.

The action plan describes *15 actions* and from them the 2nd to the 14th is based on three different pillars: Coherence (from 2 to 5), Substance (from 6 to 10), Transparency (from 11 to 14). Let's analyze these 15 actions with the help of Deloitte's explanation[14]:

[14] See more on: www2.deloitte.com/global/en/pages/tax/articles/beps-actions.html

Action 1: Tax Challenge, in the context of *digital economy.*

This action would address the challenge born with the *digitalization*, in relation to the international tax rules. This action is still evolving, even more after the Covid-19 which changes the MNE and SME e-commerce behavior. This action is divided in two pillars: reallocation of profit, global anti-base erosion mechanism. The first one determines where taxes must be paid and on what basis, in particular is referred to the allocation of the portion profit for a single state. The second one is about the profit shifting, in the context of highly digitalization for MNE. It is also explained that these rules are applied even in case of non-highly digitalize firms

Action 2: Hybrid Mismatch Arrangements

This action would defeat the hybrid mismatch arrangements effect and also give some recommendations for preventing, in some circumstances, to get treaty benefits for hybrid entities.

Action 3: Controlled Foreign Company Rules

This action would invite states to implement in their jurisdiction CFC rules that stop the shifting of profits to the low-taxed foreign subsidiaries or branches of MNE. Moreover, the second pillar on the economy digitalization, may counteract the abuse of existing CFC rules.

Action 4: Interest Deductions

This action would limit the base erosion put in place interest's deduction and other costs such as investments among intragroup MNE's exchanges. The OECD model set different maximum percentage thresholds in presence of debts, which is an insurmountable limit. On other words, they try to limit some fiscal benefits that a MNE can benefits when its debt increase. This action also includes recommendation for each state's rules. That percentage is a fixed ratio rule that permit to deduct interests up to a fixed part of earning (EBITDA), another rule is for MNE with high level of external debt as mentioned before, and it allow to deducts: net interests equal to the group's net interest-to-EBITDA ratio.

Action 5: Harmful Tax Practices

The BEPS regarding the harmful tax practices, orders its removal in favor of principles of transparency, and moreover would highlight the economic substance of operations. In addition, for the action 5 it is very important to assess if a preferential regime is harmful and they need to set a different standard, this is useful for substantial activities such as patent box or intellectual properties. Moreover, in presence of tax ruling, it establishes a new way to exchange information regarding its compulsory spontaneous exchange.

Action 6: Preventing Tax Treaty Abuse

Action 6 would prevent the treaty abuse by developing a method in order to avoid the granting of treaty benefits where it should not be applied. This aim is one of the standard that the BEPS want prevent, and exists two different elements: one is that states should put a preliminary statement in their tax treaties, where they must declare that the aim of these treaties is not for paying nil taxes; the second one is about a rule introduction in their respective jurisdiction which prevent treaty abuse and treaty shopping, on other words if exists a tax treaty between states, the company will try to obtain the same advantages even if it is not resident, for example with the help of a conduit companies.

Action 7: Avoidance of Permanent Established Status

As said before, what changes is the definition of permanent establishment (PE) for companies and legal person. In this situation a non-resident company can sell with the help of a commissionaire in a jurisdiction. Another example is when a dependent agent does not finish the contract in such jurisdiction. Another point is about the exploitation of different activities, like warehouses in the Gucci case.

Action 8/9/10: TP aspects of intangibles / TP risk and capital / TP high risk Transaction

What is really relevant in our case is the 8-10 block, which explain the mentioned chapter one and two, and them are grouped together. Them would redefine the rules for TP, in this way the taxation on profits is in line with the true economic activity. Action 8 is able to respond to the TP issues for what concerning intangibles and the contribution arrangements, the final scope in fact, is to erode the tax base by the shifting intangible assets intragroup exchange. Because of their nature, intangible assets are difficult to evaluate and the OECD model put under light this issue.

The action 9 is referring to the contractual and capital allocation among companies. It explains how who hold the risk, can take decisions for its company and if effectively it benefits revenues.

Finally, action 10 analyze carefully high-risk transactions in terms of erosion. This action would defeat the price manipulation, the cost swelling and so on, and it is related to the profit split issue.

Action 11: Methodologies and data analysis

This action takes under examination existing information on BEPS or the elaboration of new data by suitable indicators, and they will be collected. The final purpose is to create economic analysis used for the monitoring the evolution over time. Moreover, the OECD established a guide which it may be used by

governments to evaluate fiscal effects of BEPS and then by using this guide they can react within each country.

Action 12: Disclosure rules

This action would increase the transparency and the cooperation between fiscal authorities, and this action permits to better understood which is adopting an aggressive tax planning for taxpayers, and is mandatory for who want to adapt it. This action is able to prevent these aggressive planning.

Finally, the UE has adopted a directive on administrative cooperation 2018/822 (DAC6) which is used among UE's countries to dialogue with taxpayer, they must report cross-border transactions and CRS avoidance to their respective tax authorities.

Action 13: TP documentation

The OECD reviews the documentation rules for TP including compliance costs for businesses, to build a strong transparency between tax authorities and tax payers; this permit to tax authorities to assess BEPS risks and the correct TP. It is composed by 3 levels:

- Master file: it contains standard information used by MNE
- Local file: it contains information for transfer pricing

- Country-by-country report (CbC): it is mandatory for MNE and is a document that authorities annually need, and it is about profits, tax paid, and other indictors.

Action 14: Dispute resolution

The OECD model gives a precise mechanism resolution to the disputes by eliminating all interpretative uncertainties for the mutual agreement procedures (MAPs) that arise from the BEPS project. Moreover, it is established a deadline of 24 moth for resolving disputes between states.

Action 15: Multilateral instrument to modify Bilateral tax treaties

This action would limit the signing of bilateral treaties by using multilateral instruments for modifying treaties; this is useful for speed up the process that implements measures which react to the tax elusion. On other words, jurisdictions now can rapidly adjust bilateral tax treaties, in line with the BEPS's recommendations.

It is important to say that that action 1 and 15 are the basis on which the other actions (pillars) rest.

4.1.2 Future perspective for the BEPS project

Some questions arise in the post-BEPS era. These questions are about the possibility for MNEs to move some assets where the taxation is low, and this shift may generate a loss of tax revenue and jobs where the taxation is higher. Exists other incentives that may lead to shift for instance the production, such as the labor cost, but it alone is unable to determine this shifting.

The risk of delocalization is higher if the holding has spun off a specific function (e.g., marketing, after sale service) and it is based in these countries where the taxation is low (Switzerland in the Gucci case), and on these subsidiaries the value of intangible assets or profits is not in line with the principle of free market competition. It is possible in this case that the subsidiary may be reabsorbed by the holding, because will be nil the past benefits generated by the foreign country's jurisdiction. In this case however, the reabsorption it's not always in the lower tax regime.

Finally, the principles of the BEPS project are applicable to the so called "brick and mortar economy" (real economy, is characterized from the presence of physical stores, production and people). Some issues emerges if during the analysis of intragroup transaction in the context of the *digital economy,* because this particular situation, activities are carried out online without the physical presence of the

people, and the consumption of the goods or services is done in a foreign country. On other hand, what is not clear is the *place of effective management* (POEM), this particular "staying at a place" where the fiscal residence of the company is based and where the company is managed, is not still reliable as in the pre-digitalization era, because of the nature of the internet and digital tools.

4.2 INTRODUCTION TO THE DIGITAL ECONOMY BY THE ACTION 1, PILLAR ONE

It is not a coincidence if the BEPS project starts with the introduction of the *digital economy* in the action 1, because this is the biggest challenge for tax authorities, it is like a "dog chasing its own tail" as we say in Italy. On other words, the digital evolution is faster that the fiscal evolution in the field of digitalization (*Malherbe, 2015).* Another issue is that actual rules designed for tax evasion are not designed for the digital economy, and the rush to adapt the rules does not lead to their resolution (*Brauner, 2014).*

For many, the central problem is still the concept and the definition of "headquarters" and "permanent establishment" in the OECD model, this because is possible to manage an entire company just with the use of a personal computer and

other high-tech tools such as *servers* around world. It's evident that that notion must be wider, and the OECD must be aware of where a specific company has large market shares, in order to tax incomes in that specific market share.

The OECD tried to avoid this issue by reinforce the *residency principle*, but even in this case, in the context of digital economy, companies pay a residual share of profits for the e-commerce sector. This issue arises because the state's jurisdiction is subsidiary to that of the principle of residence *(Franzoni, 2015).* In fact, it seems that the OECD model pay attention just to incomes generated in the resident state, but the focal point should be where income is generated, not in relation to their residence.

4.3 ISSUES OF PILLAR ONE OF THE BEPS ACTION PLAN

Exists a lot of issues generated by the Action 1 of the BEPS as illustrated by Bloomberg, however before starting, it is right to say that Action Plans would establish among jurisdictions a common ground and highlights potential risks and ideas while members try to achieve a consensus-based solution.

The pressure derived from the challenge of the economy in the 21st century led to a strong pressure between states that want to base this concept on different principles which are the bases for the next rule generation. In fact, significant changes have modified the BEPS project and OECD guidelines, this because as said in this chapter, the digitalization run faster than international tax system, considering the fact that these companies are increasing their market share among world, but not so quickly as to impose wicked and hasty rules on the overall economy.

However, exists a .com list called "Fortune 500"[15] which includes some pre-.com companies which have anticipated this era and now more and more big companies are following the same path as their predecessor by the digitalization of their business model, and them will be more and more affected by the pillar one, as long as will exists a form of agreement between fiscal authorities and companies. Such companies are: Apple #11, Amazon #13, Microsoft #60, Facebook #184; and who is following these big companies are: Airbnb, Booking, eBay, Netflix, Uber and so on.

[15] To consult the updated list for 2020 see more on: www.fortune.com/fortune500/

4.3.1 Unified approach of the Pillar One

During the end of 2019 it was released by the OECD a consulting documentation which describe the "unified approach" scheme, which brings together three proposals called "without prejudice" about the experts of digital economies.

Such proposals are:

1- "User participation proposal", managed by some European countries.

2- "Marketing intangibles" proposal, managed by the U.S.A.

3- "Significant economic presence" proposal, managed by G24 and India.

Despite the name "unified approach" of all these proposals, it's evident that the name is not properly correct, this because the final goal of these proposals would try to solve the same issue.

Nevertheless, these three proposals have some common points, their perspective on digital economy and the way to solve fiscal issues are very different between them. In fact, the first one is about digital companies born during the past 10/20 years; instead other two proposals are different in terms of type of companies and business model, we can think about two different type of business model, the ones like Facebook and Amazon that have their major interests online and they don't need to operate in a defined physical location; another type of business model is a traditional companies (most of the Italian companies) which are strongly linked to

the territory in which they operate, and even through a digital business model, they will not easy give up their presence in the community.
Moreover, these approaches about marketing and intangibles it seems to obtain or modify the profit allocation within the free market principles, instead for the others it seems that it is not essential.

Finally, despite the good intentions of the OECD, this approach does not seem to be a fully cohesive framework. For Bloomberg, and even in my opinion, it is not fully clear if the "unified approach" is theoretically valid for facing the new global challenges that emerges by the digitalization era.

4.3.2 The meaning of Digital Economy from 2015 to 2018 and over

In the BEPS action 1 published in the 2015 was announced the issue of *"digital economy",* while in the publication of 2018 the nomenclature of this issue was changed in "*highly digitalized businesses".*

Despite the presence in 2018 of some advises concerning the characteristics of these highly digitalized businesses, for instance reliance on intangibles, user participation and so on, does not exist a clear definition of what is really mean this topic. It seems, according to Bloomberg, that the OECD would propose a dynamic definition of it,

by taking under consideration the evolution of such digital companies in relation to companies that are not digitalized such as who produce semifinished goods, pharmaceutical businesses, airlines, shipping businesses and so on.
However, this absence of definition of the problem does not permit to follow the dynamicity of the global digital market because they chase chance, they do not anticipate it.

The center of the discussion is the so-called *intangibles* and *data/user participation,* because exist the risk that many companies can be considered as highly digitalized businesses, even if they are not as said before. This issue arises because during years, businesses such as appliances industries build increasingly technological and interactive smart goods, or the engineering industry which uses virtual reality and other tool to provide smart services.
Practically, by chasseing Google, Netflix, Facebook and so on, the risk of high digital taxation could fall on other companies which differ substantially from these, such as Whirpool, Italferr, Manens Tifs, Loccioni and so on, and finally the *consumer-facing businesses concept* can solve this issue.

So, the final question that arise from this assumption is about to develop new financial tax regime just for internet giants, or is to achieve some standards for business sectors which use digital technologies and intangibles?

Any business sector clustering it is very difficult to set and apply, and this assumption constrict the OECD to adjust continuously this clustering and groups. Instead, if rules are clear and concise, they do not need to run after the remodeling of rules per cluster, in order to set up a long-term aim.

4.4 MEANING OF VALUE CREATION AFTER THE 2000s AND THE "VALUE CRYSTALLIZATION" CONCEPT

We have analyzed the meaning of the value creation in the context of actions 8-10 BEPS and in the chapter one, and it is strictly related to the transfer pricing outcomes. It is strange that in the last OECD TP publishing, 2017, there is no definition about TP for MNEs and fiscal authorities regarding the meaning of "value creation", but it just arises several questions, issues and news about this concept. Moreover, the BEPS project is accused of negligence from some, because it is not useful for designing tax policies.

However, the OECD BEPS action plan gives a definition in the Actions 8-10 as follow:

"It is important to understand how value is generated by the group as a whole, the interdependencies of the functions performed by the associated enterprises with the

rest of the group, and the contribution the associated enterprises make to value creation". In addition, it is proved that intangibles can represent a value contribution for MNE.

In the 20th Century the value creation was always taxed in the jurisdiction to which it belongs, for instance the petrol sector was taxed where they extracted it. But, in the 21th Century the petrol extraction is not yet the biggest source of income around the world.

Nowadays information, the so-called *big data,* are the biggest source of income and this income does not exploit underground resources, but they "extract and exploit" digital data. The absence of underground generate volatility in the taxation of data, because they do not belong to any specific state, but the value creation is related just in the mere number of network participant in the most of the case.

This assumption is useful for understanding the issues which information generates, and the value creation principle falls. In fact, many states denounced the problem of the value creation because MNEs are able to evade taxes in the state where the service is provided or where the data is collected.

According to Bloomberg, authorities should introduce the concept of "value crystallization", which is useful to help bridge the gap between tangible and intangible resources (data). Moreover, this new concept should be related to another concept, "market jurisdiction", already elaborated by OECD. The central point is that governments do not grant rights for data procurements because it can be done remotely, instead in the petrol market they must ask for extracting raw materials.

Another important point is the *privacy,* and the discussion of this matter is still evolving day by day, and even if the information remains under user's property, some MNEs used to collect data violating the regulations, under the assumption of information clustering (Cambridge Analytica case, 2018). Authorities are thinking to introduce information and data storage as intangible resource owned by governments, and MNEs who want collect data, must collect information by a legal entity on the soil of governments. This theory may permit governments to implement the taxation on intangibles, this because information is the center for creating this new type of value.

The "value crystallization" concept could be useful for businesses which provide remote services and the data streaming (e.g., Netflix, Amazon, Booking.com, Sky etc.). It is known that MNE with high value of digitalization cannot create value without real customers and users behind screens.

In conclusion, many noted how the OECD Action 1 (pillar one) is evaluated in contrast with the consensus between member states regarding the BEPS plan Action 8-10. The Action 8-10 regards the substance, and it allocates profits to people functions. On other hand, the first pillar allocates profits (amount A) where exist few personal function or control management risks.

Thus, the next logical step should be to rebalance this gap by introducing in the pillar one another variable in the amount A, and this amount A should be calculated as remuneration for intangibles goods in relation to the market jurisdiction. However, the amount A does not rebalance all assets in comparison to the relative returns or even assess of intangible MNE's assets.

4.5 THE INTANGIBLES

As said in this chapter, the Action BEPS starts with the biggest challenge, digital economy, and deeper the *intangibles.*

The OECD guideline in 2017 has declared that intangibles are *"(...) not physical or financial asset, which is capable of being owned or controlled for use in commercial activities, and whose or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances (...)".*

Nowadays, intangibles are the most valuable assets among MNEs and as reported by “The Global Intangible Finance Tracker (GIFT)”, the 52% of the absolute value of publicly traded companies is attributable to intangible assets, and this value amounts to US$57,3 trillion. Moreover, in some sector such as software, streaming media, cosmetics, intangible assets are the 80/90% of the overall company’s value.

Exists two macro area of intangibles: marketing and trade intangibles; the first one represents the biggest value and some examples of this group are: brands, customer data, patents, customer relationship and so on.

It is interesting highlight that the definition of intangibles given by the OECD guidelines in the section 6.6, that does not take into consideration the “consumer data” definition. This particular asset represents the daily online interactions between users on the world wide web, platforms, apps, and technologies in general. The customer data asset is used by digitalized MNEs for creating value by these daily interactions. To be more precise, we do not know if actually customer data are or are not a marketing intangible, but this asset might be allocated in that category, as explained in the OECD guidelines.

But how these customer data should be evaluated?

According to Bloomberg, one possible way to evaluate the value of customer data under the assumption of free market competition and the arm-length principle, is to

examine companies that manage loyalty programs that is not specific for a given sector, more in particular its profits. For them it seems reasonable that a portion of a given profit is related to this market jurisdiction. In other words, the loyalty programs can use their range of operating margins and returns to attribute an operating margin or return on locally derived revenues from companies that are highly digitalized, that may reflect their contribution in relation to the customer data.

However, a clarification is necessary, the residual profit in some MNEs and new companies that are based on digital technologies, can born as natural monopoly (e.g., Facebook, Airbnb and so on). This clarification arises an issue concerning the taxation under the monopolistic assumption, because this permit to generate high volume profits. This challenge would face up to the circumstances where this problem does not arise, and the true challenge is when does not exists any consistent residual profits for compensating all jurisdictions, and the matter becomes more complicated if we want analyze the intertemporal effects (loses or investments), because this loses/investments should be made by the principal.

Nevertheless, this issue is still not analyzed by the OECD model and I would not like to go too far into this complicated matter.

The final point for the digital post-BEPS era is referring to the following issue: the activity location, that arise several questions: if I buy online a brand-new laptop via smartphone while I'm on vacation in Europe and the delivery is for the next day, but its billing and its debiting takes place at my residence, does the market jurisdiction refer to mine or that of the host countries? What happen if I delivery the laptop to my residency if the location of the server identifies it as Europe?

Even if the it is not a relevant issue for many, in Europe thanks to the Treaty of Maastricht (1993) permit the free movement for people and goods among different market jurisdictions, can became an issue and the OECD model may take into consideration even this point.

By summing up, I would like to close with a provocation under the question form: "Where is my value?".

CONCLUSIONS AND FUTURE PERSPECTIVE

Obviously, the narration of this topic does not take into consideration all the variables of the matter, and moreover the phenomenon of the transfer pricing is not limited to the fashion sector.

The Covid-19 is pushing some MNEs to the future, or to say better, in the fashion sector Gucci has gone beyond the unthinkable. A news from a few months ago explained where this company sees the horizon: virtual fashion clothes.
This because some experts noted that the virtual world is creating its own "virtual" economy that works like the real economy, prices are set by the market demand and its scarcity. This thesis would take into consideration how to evaluate, compare and setting prices among intragroup exchange in comparison to the external environment, but what if the new model clothes are just virtual? Where and how the value is created? Is the BEPS Action plan ready to counter this phenomenon?

We do not know what kind of strategy the OECD will adopt, but for the moment we can limit ourselves to understanding where these companies will point their strategy and new products.

The new reference models are obviously the high-tech giants such as electronics and social media, with reference to their volatile structures and the value creation, much more volatile and maneuverable than a material garment.

Indeed, Gucci thanks to its stylist Alessandro Michele, and in collaboration with Wanna[16], them drawn up agreements with few virtual games like Pokémon Go and Fortnite, which use augmented reality or just avatar and together started to "sew to measure" some clothes for their characters, and they designed "fake shoes" for social media like Snapchat and Instagram, in the form of "filter".
The "Gucci Virtual 25" shoes are available online just for 10$, and the price is a thousand times below the original price, but the Z generation seems to appreciate this new type of shoes, without considering the fact that are the first virtual shoes that can be purchased with real money. So, here is the new trendy fashion among young people, for who want create a social identity, which is common among the youngest.

Therefore, how can we chase these new trends, and how can we compare the value creation in this near future? Is it the time to consider the digitalization as a key issue?

[16] https://wanna.fashion/main

International tax authorities began to recognize this challenge as the principal one. The BEPS action plan and the OECD's future tax policies address in addition to the digitalization, the fact that the value creation is fundamental to assess how and where tax the biggest MNEs that operative in a volatile way.

As seen in this thesis, we are still a long way from completely abolishing the procedures that damage the taxable bases for MNEs, and is still a long way to solve the gap between MNEs and SMEs. However, there are some inputs and politics pressure that are working on fairer taxation and trying to solve past issues. The value creation concept must be aligned with the current market environment and the high digitalized tools that permit to reach different worldwide jurisdiction just with a click.

In addition, as said in the previous chapter, the Covid-19 crisis push all type of businesses to go online, but the market is not equal for all, let's just think about to the SMEs in relation to the MNEs that erode the tax base thanks to their subsidiaries and so on.

Then, the OECD during the fist-wave of Covid, February 2020, proposed a reform for taxing the digital business and the digital commerce, the so-called e-commerce.

The OECD finally seemed ready to apply the Action 1 of the BEPS, which would have changed the situation for the worldwide taxation, but it would have left some aftermath for what concerns the rights of the taxing allocation in terms of jurisdictions, and the allocation profits as well (Action 8-10, BEPS).

According to Oliver Treidler, CEO and founder of TP&C based in Berlin, he wrote that stakeholders, and even for him, it's getting frustrating that some basic concepts are disappearing (for instance the value creation, as explained in the previous chapter), in favor of a quick change of course towards the political pressure that want to be recognized the "digital state taxes" for each country.
However, the OECD commission has several issues opened on the table, but after this crisis, the main attention is about the Covid-19 and its developments because all economic activities and even people were in stand-by.

Furthermore, on LinkedIn exist several professional articles about the impact of the virus on the transfer pricing. Experts focused on the change in the risk allocation among related-parties and the TP adjustment in relation to the effects of extraordinaries economic circumstances (interests, VAT, target margins, etc.).
However, is right to say that each company has different needs and situations, and the assessment of it its necessary to be done by experts. All TP adjustment must be

done in relation to the arm length principle, this permit to the MNEs to justify all adjustments if some authorities will ask some clarifications.

Anyway, the biggest challenge now is about upcoming negotiations and the future scenarios must be done quickly, without second thoughts and concisely. Experts have identified three possible scenarios.

First scenario (past scenario, before the end of 2020; short term scenario). It is possible that the economic situation calls for a sense of responsibility for each single state. Central governments made large cash loans, and this may lead to a strong pressure for each single state, this because following the financing, they might raise taxes to repay it during and after the emergency. While debt ceiling is now lifted (for instance the Italian government increase its debt several times to cope the emergency), exist a limit and these loans and debt must be reabsorbed. Exist a fine line of how much this taxation should be, because a high tax rate may slow down the economic recovery, and here each single state plays a very central role with their monetary policies.

In this possible scenario, the digital taxation and the taxation of MNEs play a marginal role, this because they are not impacted by the decisions of single states,

however these states see the digital taxation like a “like preserver at sea”, because the context of e-commerce has grown.

However, in this scenario we could have one possible solution, by introducing national digital taxes or by reorientating the first BEPS pillar towards each single market states, without putting additional tax burden on local companies (by extending the domestic tax base), but this situation generates international disputes because other states may lose tax revenue. In fact, the main problem is thought to be that tax policies could be nationalized, and consequently this may impact the national budget in relation to each single financial situation.

In conclusion, despite the above situation it is alluring to individual states and for the tax revenues, it was also difficult to think about an efficient solution in the short term, because exist several unresolved issues. In other words, affecting this reform will not help anyone.

The second scenario (by adopting the pillar one by the end of 2021/22; medium term scenario) it a more possible solution, this because OECD might be not conditionate by the crisis only, with a more concise solution. By extending the timeline for negotiations, authorities might reach a sustainable solution for the first pillar and for the overall economies, in contrast to the first scenario. Even in this

scenario, politics play a very central role, by convincing their voters that the solution must be found in the international context.

For all, TP experts, countries and even for the OECD, a medium\long term orientation is the best solution, so as not to leave issues that are already particularly controversial and unsolved to chance. In fact, TP experts asked loudly to maintain principles of the fist pillar, and solve all existing disputes. While there are no evidences that the evolution of the first pillar generates debates among states, this could, however, provoke a change during the alignment of it (digitalization) with the international taxation and the profit allocation (arm's length principle) and the OECD must take into consideration several national proposals.

The third scenario (long-term orientation) would like to rewrite the rules of the game. To be honest, the OECD did not have any second plan for the first pillar, despite the economic crisis started few years ago. Many bear that the OECD is trying to change this plan following the protests of the states, that are asking a new model because the market is changing faster than ever, and the digitalization of the markets may lead to a reduction in the tax base; even the transfer pricing regulations must be redefined and the concept of the value creation, the central point for MNEs and the biggest challenge for the 21th Century. So, the OECD has a lot of political pressure to change these now obsolete concepts for everyone.

One problem encountered by experts is that the OCED has trayed too far from the arm's length principle in the context of digitalization. The possible solution of this problem is maybe the change in the value creation concept, and this should be based on people and not on intangibles. As remarked before, without people behind the screens, MNEs are not able to produce any value. Nevertheless, no new value creation concepts are still created or analyzed by the OECD.

In other words, the OECD should take into consideration to discuss with each single state for what does the value creation means for them, and then is possible to establish a common consensus on this new concept. So, the OECD should englobe the arm's length principle with the political element concepts such as fairness and sustainability.

Although is reasonable to think that this change may take time, it is necessary to reach a temporary compromise on this topic, because it has already been too long. According to Oliver Treidler, an expert in TP, this temporary compromise should be to allocate a tax portion of tax paid by MNEs highly digitalized, to different market jurisdiction, on a proportional calculation for digital revenues in these jurisdictions. According to Treidler, may exists several positive feedbacks from the application of this concept.

Firstly, taxes paid by MNEs remain equal in their amount, and negotiations between states would be isolated to a single item, namely the share of taxes that should be redistributed. Moreover, the tax allocation will be politics-based and arbitrary, which is in contrast to the pillar one and outside the regulatory framework, but it would permit to intercept a compromise among countries, that means cooperation instead of nationalization. This would increase attention to the national reforms.
This compromise for TP experts, can outline the change of the 21th Century, and it would mark the obligation to respect the promise made, a new redefinition of the value creation, defined among states by a good faith negotiation.

Finally, according to Open[17], the June 5th during G7 meeting a new step has been set among MNEs and Countries in relation to the digital taxation for the high-tech giants, and Facebook and Google appear to be in favor of this apparently fair taxation. The goal of this proposal reform is to tax high-tech MNEs in countries where their services are provided and where they generate high income; another point is to stop the shifting of the income in the major tax haven, which permit to pay low taxes thanks to the local tax regime. The agreement was reached by USA, Japan, UK, Germany, France, Canada and Italy.

[17] https://www.open.online/

The agreement is based on two different pillars:

1- MNEs have to pay more taxes on profits obtained from where the services are provided or where the goods are sold
2- Setting a minimum tax rate (15%)

The next step is to try to apply these concepts, and the discussion will continue on the 9th July 2021 during the next G20 in Venice (IT).

In conclusion, will the states be able to assert their rights towards multinationals? Is the value creation still playing a central role in profit creation? Will the BEPS be able to defeat the new aggressive policies of MNEs in the context of the digital economy?

Big news on transfer pricing and international taxation are coming, we have just to wait few months from now.

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Work hard, stay humble, be kind

Sometimes you win, sometimes you learn