Tax & Legal Weekly Alert

12 – 16 October 2015

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Data protection alert: The European Court of Justice declares invalid the legal framework governing the transfer of personal data from EU to US, based on Safe Harbour principles. Implications for Romania

ON 6 October 2015, the European Court of Justice (the „**Court**") has ruled by decision pronounced in case C-362/14 that the EU – US Safe Harbour framework for transferring personal data from the EU to US, when the recipient in US holds a valid certificate Safe Harbor is invalid. Also, the Court has ruled, in interpretation of the provisions of Directive 95/46/CE on the protection of individuals with regard to the processing of personal data and on the free movement of such data (the „**Directive**"), that the existence of a decision of the European Commission (the "**Commission**") pursuant to which it is recognized an adequate level of protection with respect to the transferred personal data does not prevent the supervisory authority of a Member State from examining the claim of a person regarding the transfer of personal data to a third country when the person considers that the law and practices in force in the third country do not ensure an adequate level of protection.

OECD Releases Final BEPS Reports

The Organization for Economic Cooperation and Development (OECD) released, on October 5, the final reports under the base erosion and profit shifting (BEPS) project it started two years ago to address perceived gaps in international tax rules. The final reports – one for each of the 15 items in the "Action Plan" released in 2013, except for the three transfer pricing actions, for which one report was issued – will be submitted to the G-20 finance ministers at their meeting in Lima, Peru, on October 8.

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Short presentation of the case

Maximillian Schrems, an Austrian Facebook user since 2008, has lodged a complaint to the Irish Data Protection Authority (the "**Authority**") following the statements made by Snowden with respect to the activities of intelligence services of US (in particular the National Security Agency). The Authority has rejected the complaint, on the grounds that under the Safe Harbour scheme, the transfer to US has been declared by the Commission as ensuring an adequate level of protection (i.e. protection equal to EU standards).

The High Court of Ireland, to which the case was then brought, requested the Court to rule with respect to the reasons invoked by the Authority, i.e. whether the existence of a decision issued by the Commission establishing that a third country ensures an adequate level of protection can eliminate or reduce the powers available to a national data protection authority.

The decision of the Court

Following the decision pronounced on 6 October 2015, the Court established the followings:

- The existence of a decision issued by the Commission through which it is established that a third country ensuring an adequate level of protection to the data transferred cannot annul nor reduce the competencies of the national data protection authorities
- A regulation allowing public authorities generalized access to the content of electronic communications violates the fundamental right of privacy
- The Commission did not have the competence to restrain the attributions of the national data protection authorities
- The Commission Decision 520/2000 establishing an adequate level of protection to transfer of personal data from EU to US, when the data controller has adhered to the Safe Harbour principles is invalid

Also, the decision of the Court **does not** provide any grace period or transitory period.

Consequences: revising the strategy of personal data transfer to US, based on Safe Harbor principles

The direct consequence of the Court's decision is that the Authority will have to examine the complaint of Mr. Maximilian Schrems, following to decide whether, pursuant to the Directive, the transfer of the data of Facebook's European subscribers to US should be suspended on the ground that the country does not afford an adequate level of protection of personal data.

A much wider consequence of the Court's decision is that the legal frameworks for transfers of personal data between the EU and the US, when the recipient holds a valid Safe Harbour certificate, have been declared invalid. Practically, for such situations, the personal data transfers will need to observe the applicable rules in case of any transfer to a data importer situated in a state which does not ensure an adequate level of protection, respectively based on a contract with standard clauses concluded between the data exporter and the data importer or based on the binding corporate rules.

Implications regarding Romania

In Romania, the supervisory authority in the data protection field is the Data Protection Authority (the "**DPA**").

In the context of the Court's decision, we consider that the DPA should reanalyse the transfers of personal data to assess whether the level of data protection is an adequate one, even in the absence of the Safe Harbour certification. Should the DPA assess that the protection level provided by the country of destination is not satisfactory, it can impose the prohibition of the data transfer. Also, in such case, the Romanian data controller can identify alternative options for authorizing the transfer, respectively:

- Presenting sufficient guarantees with respect to the protection of fundamental rights of the data subjects, by a contract concluded with the data importer. In such case, depending on the quality of the data importer (data controller/data processor), the standard contractual clauses of the Commission decision shall be observed, i.e. standard contractual clauses regulated the data transfer from a data controller in Romania to another data controller established in a state where the legislation does not provide an adequate level of protection at least equal with the one provided by Romanian law or, as the case may be, the standard contractual clauses regulating the transfer of data from a Romanian data controller to a data processor established in a state where the legislation does not provide an adequate level of protection at least equal with the one provided by Romanian law.
- Authorizing the transfer based on the binding corporate rules.

- Obtaining the express consent of the data subjects. The Consent should explicit and provided in such manner to be considered valid. Also, it is recommendable that the data controllers and their representatives keep proof of the consent collected from the data subjects for any possible claims or investigations from the DPA.

For further questions regarding the aspects mentioned in this alert, please contact us.

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OECD Releases Final BEPS Reports

Key Transfer Pricing Concepts in Final Reports

The final transfer pricing reports provide guidance on a multitude of transfer pricing topics. Some of the salient features include the following:

Global transfer pricing documentation and country-by-country reporting

As expected, the OECD did not introduce any new guidance in the global documentation and CbC final report, which is simply a compilation of previously released deliverables.

Role of contracts

The contractual arrangements between the parties is the starting place for the proper understanding of a transaction. However, written contracts are unlikely to provide all the information necessary to perform a transfer pricing analysis. Therefore, the parties' actual conduct should be used to clarify or supplement the terms of the contract, or replace the contract if the contract is not supported by the conduct of the parties.

Risk

To contractually assume risk, a party must exercise control over the risk and have the financial capacity to assume the risk.

Although there is no bright line test to determine control over risk, the factors considered include: (1) performance of the decision to take risks; (2) the performance of responding to risks associated with the business opportunity; and (3) performance of risk mitigation activities.

The guidance permits day-to-day risk mitigation activity to be outsourced as long as the party outsourcing the risk mitigation activity exercises control over the party doing the day-to-day risk mitigating activity.

The guidance provides a six-step process to determine the entity incurring risk.

Intangibles

The final report retains the 2014 guidance on categories of intangibles, transfer pricing methods, and important functions related to the development, enhancement, maintenance, protection, and exploitation of intangibles (the DEMPE functions).

To be entitled to intangible returns associated with the DEMPE functions, the final report incorporates the control and funding requirements from the deliverable on risk, discussed above. The guidance states that the entity entitled to the profit or loss between projected and actual outcomes will be the entity exercising the control functions over the risks that caused the difference.

Funding and cash boxes

An entity that does not control the financial risks associated with its funding will be entitled only to a risk-free return. An entity that does control the financial risks associated with the DEMPE functions will be entitled to a risk-adjusted return.

Recharacterization

If a transaction lacks the commercial rationality of an arrangement that would have been agreed between unrelated parties, the guidance permits the non-recognition of the transaction. The fact that a transaction is not observed between unrelated parties is not sufficient grounds for not recognizing the transaction.

Hard-to-value intangibles

If the taxpayer cannot demonstrate that its pricing is based on a thorough analysis, the ex post outcome will be used as a presumptive evidence of the appropriateness of ex ante pricing arrangements.

The OECD includes several exemptions to this rule based on unforeseeable events and adopts a five-year look-back rule with a 20 percent tolerance. They also allow taxpayers to bypass the provisions of this section by disclosing the underlying ex ante and ex post data and explaining why the variance was not anticipated.

Cost contribution arrangements

The final report updates the CCA guidance to conform to the changes on contracts, risk, and intangibles discussed above. The guidance retains the requirement that ongoing contributions be valued at value rather cost unless the parties value the opportunity cost of the upfront commitment to contribute resources to the CCA.

Low-value-adding intragroup services

To qualify for the safe harbor on low-value-adding intragroup services, taxpayers must document the cost pool and choose appropriate allocation keys.

If the level of low-value-adding intragroup service fees exceeds a threshold determined by an individual country, tax administrations are able to require a full functional analysis and comparability analysis including the application of the benefits test to specific service charges.

Dispute resolution

Twenty nations—Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, the U.K. and the U.S.—have committed to provide for mandatory binding MAP arbitration in their bilateral tax treaties as a mechanism to guarantee that treaty-related disputes will be resolved within a specified time frame. Other countries have agreed to minimum standards and a peer review monitoring system.

Profit splits

Final guidance on profit splits has been postponed until 2016 and 2017.

For further questions regarding the aspects mentioned in this alert, please contact us.

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