THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

December 2025

MODULE 3.03 – TRANSFER PRICING OPTION

ADVANCED INTERNATIONAL TAXATION (THEMATIC)

TIME ALLOWED – 3¼ HOURS

This exam paper has **three** parts: **Part A**, **Part B** and **Part C**.

You need to answer **five** questions in total. You will **not** receive marks for any additional answers.

You must answer:

- **Both** questions in **Part A** (25 marks each)
- **One** question from **Part B** (20 marks)
- **Two** questions from **Part C** (15 marks each)

Further instructions

- You must use the appropriate currency, unless otherwise stated. Any monetary calculations should be made to the nearest whole unit of currency. Any necessary time apportionments in your calculations should be made to the nearest whole month.
- You must provide appropriate line breaks between each question, and clearly indicate the start of each new question using the formatting tools available.
- Marks may be allocated for clarity of presentation of your answers.
- The time you spend answering questions should correspond broadly to the number of marks available for that question. You should therefore aim to spend approximately half of your time answering Part A, and the other half answering questions in Parts B and C.
- There is no separate reading time, so you can start typing your answers as soon as the exam begins. However, we recommend that you set aside some time to thoroughly read each question and plan each of your answers.
- **Although references and short quotes from the OECD Transfer Pricing Guidelines and/or the UN Practical Manual on Transfer Pricing can be included in your answer, you will not receive any marks for copying directly from either the OECD Transfer Pricing Guidelines or the UN Practical Manual on Transfer Pricing.**

PART A

You are required to answer BOTH questions from this Part.

The following facts apply to both Questions 1 and 2.

The Crackle Group is a multinational group of companies, and a global leader in the pyrotechnics industry in terms of reputation and market share. The group has an extensive global workforce that conducts product development from prototype to full scale manufacturing and distribution.

Crackle Inc., the ultimate parent entity (UPE) of the group, is tax resident in Country A with a headline corporate tax rate of 30%. Crackle Inc. had a large manufacturing facility that was recently closed as a result of Crackle Inc.'s historical loss-making position, exacerbated by damage caused to the manufacturing facility from an explosion.

Crackle Inc. funds and conducts research and development in pyrotechnic knowledge, to improve existing products and create new products. Wholly owned subsidiaries within the Crackle Group perform distribution functions in each of their respective jurisdictions, paying a royalty of 2% to Crackle Inc. under their respective distribution agreements. These royalty payments are paid regardless of each subsidiary's financial position.

Skyrocket Pty Ltd (Skyrocket) is a wholly owned subsidiary of Crackle Inc., tax resident in Country B with a headline corporate tax rate of 30%. Skyrocket was recently established to take over the manufacturing activities previously undertaken by Crackle Inc., while Crackle Inc. continues to fund and perform research and development functions.

Aerial Pty Ltd (Aerial) is a wholly owned subsidiary of Crackle Inc., tax resident in Country C with a headline corporate tax rate of 15%. Aerial is the legal owner of all intellectual property within the Crackle Group and conducts no other functions for the group.

Each wholly owned group subsidiary that performs distribution functions is now to pay a royalty of 3% to Aerial under a new set of distribution agreements, replacing the existing arrangement and royalty payments to Crackle Inc. The new royalty payments will be paid regardless of each subsidiary's financial position.

Twinkle Pty Ltd (Twinkle) is a wholly owned subsidiary of Crackle Inc., tax resident in Country D with a headline corporate tax rate of 20%. Twinkle operates as a global sales, marketing and procurement hub for the group. All wholly owned group subsidiaries that perform distribution functions compensate Twinkle for performing these functions, applying a return on each subsidiary's gross sales of 2.5%.

Crackle Inc. had wholly owned subsidiaries in various regions and jurisdictions around the world, that distribute products manufactured by the group, each compensating Crackle Inc. utilising a price list for the range of products purchased from Crackle Inc. Following the closure of the Crackle Inc.'s manufacturing facility, Skyrocket will now receive compensation for products that it sells to the distributing subsidiaries.

Crackle Inc. also had arrangements with independent distributors in various global regions, which compensate Crackle Inc. based on individual distribution agreements following commercial negotiations. Following the closure of Crackle Inc.'s manufacturing facility, Skyrocket will now receive compensation for products that it sells to these independent distributors.

Comet Pty Ltd (Comet) is a wholly owned subsidiary of Crackle Inc., tax resident in Country E with a headline corporate tax rate of 17%. A financing agreement is in place between Comet and Crackle Inc., under which Comet has extended a long-term loan to Crackle Inc. with an interest rate of 13% for the purpose of constructing the manufacturing facility. Comet has also extended a line of credit to Crackle Inc. for working capital purposes with an interest rate of 8.5%. Comet received a long-term loan from an external financial institution in Country E, guaranteed by Crackle Inc. The financing arrangement between Comet and Crackle Inc. remains in place, following the shift in manufacturing functions from Crackle Inc. to Skyrocket.

1. **You are required to:**

   1) **Accurately delineate the transactions between the Crackle Group's associated enterprises.** (5)

   2) **Perform a functional analysis of the Crackle Group, including any changes.** (10)

   3) **Identify any transfer pricing issues and risks that may be present for the Crackle Group.** (5)

   4) **Explain how you would apply the arm's length principle in relation to the Crackle Group.** (5)

Total (25)

2. **You are required to:**

1) Explain which transfer pricing methods you would consider and apply, in relation to the transactions between the Crackle Group's associated enterprises. (15)

2) Identify any potential comparability issues relating to the transfer pricing methods applied to the transactions between the Crackle Group's associated enterprises. (10)

Total (25)

PART B

You are required to answer ONE question from this Part.

3. Collie Corporation is a multinational group which operates through associated enterprises in five jurisdictions. The group's sales have grown considerably since the Covid-19 period, and its current business strategy has a focus on rationalisation. The group's chief financial officer (CFO) has proposed the following changes to the group's operations:

   - All of the group's intellectual property (IP), which is legally owned by several group entities, will be transferred to the associated enterprise (Company E) in Jurisdiction E, which has the lowest corporate tax rate of 15%. Company E currently employs eight staff, and its primary activities are currently limited to the distribution of finished products to independent parties in Jurisdiction E.

   - The parent company will relocate one staff member to Jurisdiction E to oversee the group's IP.

   - Company B, based in Jurisdiction B, will undertake research and development on behalf of Company E on a contract basis.

   - Company E will apply a royalty to associated enterprises, based on 5% of sales.

   You have been recruited to Collie Corporation as its tax director.

   In applying the arm's length principle in relation to the CFO's proposal, you are required to provide key advice on any considerations from a transfer pricing perspective. You should provide appropriate references in support of your response. (20)

4. Grand Group has its central management and control functions, and undertakes the majority of its business operations, in the jurisdiction of Zelthus. The group plans to grow its business in a neighbouring jurisdiction, Hembria, to meet high demand, with many Hembrian residents crossing the border to purchase its products.

   During the year ending 31 December 2025:

   - Grand Group leased a warehouse from an unrelated, independent party in Hembria, for which it paid a commercial amount of rent.

   - No Grand Group employees have permanently resided in Hembria.

   - Five Grand Group employees travelled to Hembria for periods of fewer than five days, on no more than ten occasions per employee. The main purpose of the travel was to source and negotiate a contract for the warehousing of goods in Hembria; the employees also supervised the initial setup of the warehouse.

   - Grand Group entered into a distribution arrangement with an unrelated party to sell its finished goods to customers in Hembria. When fulfilling orders for the distributor, goods were loaded by an unrelated company's employees onto trucks owned by the independent distributor.

   - Grand Group recorded sales of £75 million to customers in Zelthus, with a net profit margin of 12%.

   - Grand Group operated as a manufacturer, marketer and distributor in Zelthus by selling directly to end consumers in the jurisdiction.

   - Grand Group recorded sales of $25 million to distributor in Hembria, with a net profit margin of 15%.

   - Grand Group has not established a subsidiary, entity or corporation in Hembria.

   The governments of Zelthus and Hembria signed a double tax agreement in 2015.

   You are required to advise on how the transactions between the jurisdictions of Zelthus and Hembria should be treated for transfer pricing purposes, in relation to the fiscal year ending 31 December 2025 for Grand Group. (20)

PART C

You are required to answer TWO questions from this Part.

5. You have recently been employed as head of international tax for a multinational group. The group does not currently prepare any transfer pricing documentation.

   You are required to provide the following advice to your chief financial officer:

   1) **Why transfer pricing documentation should be prepared, and why its submission to tax administrations is required. You should detail the type of information, the purpose of the information, and how often this should be provided to a tax administration.** (10)

   2) **The benefits of being eligible for a transfer pricing safe harbour.** (5)

   You should provide support, including references to relevant law, in your advice.

   Total (15)

6. **You are required to:**

   1) **Explain the relevance of arbitration in the context of transfer pricing.** (8)

   2) **Explain why a multinational group may wish to enter into an Advance Pricing Arrangement.** (7)

   (Total 15)

7. **You are required to:**

   1) **Advise whether you consider the OECD to have been successful in its recent BEPS solution to simplify transfer pricing. Your response should be supported by references to relevant law.** (10)

   2) **Explain how the arm's length principle applies in relation to an associated enterprise exiting from a cost contribution arrangement.** (5)

   (Total 15)

8. You are a transfer pricing adviser. A multinational group has sought your advice, from a transfer pricing perspective, in relation to the intra-group financing implications of the pending acquisition of an independent enterprise. Under the plans, the independent enterprise will subsequently form part of the group as an associated enterprise. If the deal is successful, the group will seek to provide finance to the new associated enterprise, which is tax resident in a jurisdiction with a headline corporate tax rate of 15%.

   You are required to:

   1) **Discuss the transfer pricing aspects of intra-group financing that the group may consider before entering into intra-group financing arrangements.** (10)

   2) **Raise any implications for thin capitalisation and transfer pricing in relation to the potential intra-group financing.** (5)

   (Total 15)

9. You are a transfer pricing tax specialist at a global international tax consultancy firm, and your Partner has asked you to assist a client.

   You are required to explain the considerations that would need to be given to:

   1) **Risk assessment and risk management of transfer pricing; and** (10)

   2) **Transfer pricing in relation to intra-group services.** (5)

   (Total 15)