Kindly note that for the purpose of this examination, following terminology is used consistently:

e.g. 1.16 of TPG means Chapter 1 paragraph 16 of OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, 2022 .

Answer-to-Question-_1_

With the combined reading of 1.6 and 1.36 of TPG, comparability analysis is at the heart of the application of the arms lenght principle and it is important to identify the commercial or financial relations between the associated enterprises in order to accurately delineate the actual controlled transactions.

1) Accuraterly delineate the transactions between the Crackle Group associated enterprises

Controlled Transaction 1:
Aerial being the legal owner of the intellectual property ('IP') it licenses the IP to Twinkle and Comet(assuming it undertakes the distribution activies)and in return as a compensation Aerial receives 3% on sales of each distribution company

Controlled Transaction 2:
Crackle Inc, who is still undertaking funding and performing research and development functions in Pyrotechnic knowledge (Intangible asssets)

Controlled Transaction 3:
Skyrocket undertaking the manufacturing function will now supply the finished products to the

a) Twinkle
b) Comet
and in return receive the compensation for the products that it sells to Twinkle and comet based on utilising a price list for the range of products purchased.

Controlled Transaction 4:
Twinkle, serving as global sales, marketing and procurement hub, will

give these intra-group services to
a) Skyrocket
b) Comet
and in return recieve fees based on 2% of their sales

Controlled Transaction 5:
Comet is receiving a long-term intragroup loan from Crackle Inc (i.e. funding) for the purpose of construction of manufacturing facility and in return pays to Crackle Inc interest rate @ 13%

Controlled Transaction 6:
Comet is receiving Line of credit financial service from Crackle Inc and in return Comet will pay interet rate @8.5%

Controlled Transaction 7:
Comet has received Financial guarantee from Crackle Inc with respect to a long term loan received from an external financial institution

2) Functional analysis of the Crackle Group

Per 1.51 of TPG, In delineating the controlled transaction and determining the comparability between controlled and uncontrolled transactions or entities, a functional analysis is necessary and This functional analysis seeks to identify the economically significant activities and responsibilities undertaken, assets used or contributed and risks assumed by the parties.

Crackle Inc:

Functions Performed:
i) Funds and conducts the research and development of Intangible assets (Basically Pyrotechnic knowledge)
ii) It lends loans to its wholly owned subsidiary - Comet
iii) Provides Line of credit and Financial guarantee to Comet
iv) Peoples function since it has extensive global workforce that conducts product development

Assets Used:
i) Intangible assets such as Pyrotechnic knowledge

ii) Capital since it is extending loan to Comet
iii) Research and Development personnel

Risks assumed:
i) Finance risk (because of lending loans)
ii) Development risk (with respect to Intangibles)
iii) Infringement risk

Skyrocket Pty Ltd:

Functions performed:
i) Manufacturing activities
ii) Peoples function
iii) distribution function

Assets used:
i) Manufacturing facilities (tangible assets)
ii) Global workforce related to full scale manufacturing

Risks assumed:
i) Finished Products Inventory risk
ii) credit risk
iii) product obsolence risk
iv) Hazard risk with respect to the manufacuturing unit like any accidents
v) Infrastructure of operational risk

Twinkle Pty Ltd

Functions performed:
i) Procurement function/Supply chain function
ii) Marketing and sales function
iii) Distribution function
iv) People function

Assets used:
i) Expetised personnel with respect to Procurement, marketing and

distribution functions
ii) Customer Networking related assets like database

Risks assumed:
i) Transactional risks (with respect to procurement)
ii) Marketplace risk (with respect to procurement)

Aerial Pty Ltd:

Functions Performed:
i) Legal owner of all Intellectual property

Assets used:
i) Intellectual property

Risks assumed:
i) credit risk (in terms of royalty to be received from other Associated enterprises)
ii) Infringement risk

Comet Pty Ltd:

Since, its manufacturing facitliy is still under construction

Functions Performed:
i) None
ii) People function

Assets used:
i) Working capital
ii) Trained personnel

Risks assumed:
i) Hazard risk (with respect to manufacturing facility)
ii) Payment risk

3) Identiyfing any transfer pricing issues and risks that may be present for the Crackle Group

i) For the manufacturing activities conducted by Skyrocket, there is no markup/additional compensation levied by Skyrocket to the other Associated enterprises (its just utilising pricing list for the range of products purchased)

ii) Unsure whether Aerial is conducting any DEMPE (Development, Extension, Maintenance, Protection and Exploitation) functions with respect to Intellectual property and it has been termed as legal owner.

iii) Whether Crackle Inc is receiving any compensation for its functions of funding and conducting R&D with respect to Pyrotechnic knowledge.

4) Applying Arms lenght principle:

Per 1.6 of TPG - Comparability analyis is at the heart of the aplication of Arms lenght principle and and to conduct the comparability analysis we have to accurately delineate the actual transaction and can be done as follows:
1) Contractual terms of the transaction
ii) Functions performed, risks assumed and assets used by each of the party to the transaction
iii) characteristics of the property transferred or services provided
iv) Economic circumstances of the parties and of the market in which the parties operate
v) Business stratergies pursued by the parties.

Therefore, by conduting the comparability analysis or by analysing the economically relevant characteristscs we start our Arms length principle application.

Answer-to-Question-2_

1) Per 2.1 of TPG, Transfer pricing methods are used to establish

whether the conditions imposed in the commercial or financial relations between the associated enterprises are consistent with the arm's lenght principle.

In selecting the most appropriate method, the following are to be considered while analyzing:

i) Respective strengths and weaknesses of the methods
ii) appropriateness of the method considered
iii) availability of the reliable information
iv) degree of comparability between controlled and uncontrolled transactions, including the reliability of comparability adjustments.

Applciation of Transfer pricing methods:

Comparable Unctrolled Price method ('CUP'):
It is 2 sided method where both the parties are tested. The CUP method compares the price charged for property or services transferred in a controlled transaction tot he price charged for the property transferred in a comparable uncontrolled transactions under comparable circumstances. CUP would be generally appropriate fortransactions involving transfer of commodities.

And it depends on high product characteristics resemblence.

In our case, In case of Controlled transaction 3,i.e. Skyrocket supplying the manufactured goods to Twinkle and comet, CUP would be more appropriate since Crackle Inc has individual distribution agreements with independent distributors are available, which is now owned by Skyrocket.

We have an internal CUP available which is considered to be highly reliable. Hence, CUP may be used for Controlled Transaction 3.

Further, in case of Controlled Transaction 5 and 6 i.e. Crackle Inc lending longterm loan and Line of credit to Comet Pty Ltd, Per 10.90 of TPG, since the widespread availability of information and analysis of loan market it will be easier to apply the CUP method to financial transactions.

Hence, CUP may be the most appropriate method for intragroup loans and line of credit.

Resale Price Method ('RPM'):

It is single sided method where the tested party with less functions carried out will be selected as testor.

Resale price method begins with the price at which the product that has been purchased from an associated enterprise is resold to an independent enterprises.

In our case, with respect to distribution associated entities like Twinkle, Comet they sell the finsihed product to the independent parties. RPM would be an appropriate method.

Cost Plus method ('CPM'):

The cost plus method is also a single sided method and it begins with the costs incurred by the supplier of service in a controlled transaction for the services performed to an associate purchaser. An appropriate cost plus markup is then added to this cost, to make an appropriate profit in light of the functions performed and the market conditions.

In our case, with respect to Controlled transaction 4, i.e. Twinkle providing Procurement, marketing and sales functions to the group, the most appropriate method would be CPM.

Transactional Net Margin method ('TNMM'):

The transactional net margin method is also a single sided method and it examines the net profit relative to an appropriate base that a tax payer realises from the controlled transaction. and it is used in similar lines to RPM or CPM however, if the controlled transaction do not fall under those two methods.

In our case, Controlled transaction 1, i.e. Aerial licensing Intangible assets to its associated enterpises, assuming the comparables under uncontrolled environment is not fully available or its leading to adjustments, we can consider applying TNMM for the Controlled Transaction 1.

At the same time, we can use TNMM for Controlled Transaction 7 , i.e Financia Guarantee provided by Crackel Inc to Comet.

Transactional Profit Split Method (TPSM):

TPSM is a two-sided method and it is most appropriate to use when the following conditions are noted:
i) Transations involving unique and valuable intangibles
ii) Highly intergrated business operations
iii) Shared assumption of economically significant risks, separate assumption of closely related risks

In our case, Controlled Transaction 1, Crackle Inc funds and conducts R&D in prototype knowledge may involve unique intangible creation and it has high intergration with other AEs knowledge.

we may consider, TPSM for Controlled transaction 1.

2) Comparability issues:

May arise in our case with respect to pricing the transactions:

i)undertaken by the Twinkle to its Associated enterprises @ 2.5% of gross sales. considering the intra-group support services having a such a high revenue being at te tax jurisdiction bearing tax rate of 20%. It may lead to uncertainity and high risk of scrutiny from the tax administrations.

ii) Remuneration/compensation received by the Skyrocket being in the highest tax rate jurisdiction @ 30% and just receiving the compensation based on the price list for the range of products used for manufacturing is also a potential issue since there are more activities undertaken by the skyrocket which is not getting compensated to the extent of resources and risk assumed.

Answer-to-Question-_4__

As per Article 5.1 of OECD Model Tax Convention on Income and on Capital, 2017 ,the term permanent establishment means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

Per Article 5.2 of OECD Model Tax convention on Income and on Capital, 2017 Permanent establishment includes especially:

a) place of management
b) a branch
c) an office
d) a factory
e) a workshop
f) a mine, an oil or gas well, a quary or any other place of extraction of natural resources.

Per 5.4 of OECD Model tax convention, the following activities which are of auxiliary or preparatory characters do not deemed to be a Permanent establishment:

i) the use of facility solely for the purpose of storage, display or delivery of goods or merchandise beloning to the enterprise
ii) the maintenance of stock of goods or merchandize beloning to the enterprise solely for the puropose of :

a) storage, display or delivery
b) processing by another enterprise

iii) maintenance of fixed place of business
solely for the purpose of carrying on, any other activity, of an enterprise.

iv) any combination of activities mentioned above.

However, per Article 5.4.1 of OECD model tax convention, 2017, if the following activities are carried on in the fixed place of business, it is not considered to be of preparatory or auxiliary characters:

1) that place consititutes PE for the enterprise under provisions of this article; (OR)
2) Overall activity resulting from the combination of the activities carried on by the two associated enterprises or closely related enterprises at the two places, is not of preparatory or auxiliary character

and these functions are part of COHESIVE BUSINESS OPERATIONS.

In our case, Grand Group activities are noted as below:

i) In Jurisdiction Zelthus:

a) Place of central management and control functions are carried out
b) It operates as manufacture, marketer and distributor and by selling directly to end consumers

ii) In Jurisdiction Hembria:

a) THERE IS A FIXED PLACE OF BUSINESS i.e. WAREHOUSE (leased and assuming the effective utilization and control of the warehouse is fully vested with Grand Group)

b) It entered into an agreement with the unrealted distributor, to sell the goods ultimately to the end customers in Hembria jurisdition

c) Grand group has no subsidiary or entity incorporated in the Hembria jurisdiction.

By applying the Article 5.4.1 of OECD Model TAx convention, 2017 and by analyzing the facts and circumstances of the case, the activities undertaken by Grand Group in Jurisdiction Hembria does not fall under the category of Auxiliary or preparatory in nature.

By invoking Article 5.4.1 of OECD Model tax convention, the fixed place of business being wearhouse in Hembria will consititute as PERMANENT ESTABLISHMENT per Article 5.1.

Further, As per Article 7.1 and 7.2 of OECD Model Tax Convention on Income and on Capital, 2017 Profits of an enterprise of a contracting state shall be taxable only in that state unless the enterprise carries on business in the other Contracting State through a Permanent Establishment situated therin. If the enterprise carries on business as aforeasid, the profits attributable to the Permanent establishment in accordance with the provisions of Paragraph 2 may be taxed in that other State. Per Paragraph 2, the profits attributable in each contracting state to the PE referred to in Para 1 are the profits it might be expected to make, if it were a separate and independent enterprise engaged in the same or similar activities under the same or similar conditions, taking into account, functions performed, assets used and risks assumed by the enterprise throught the PE.

Therefore, Article 7.2 of OECD MTC again referes to the FAR (Functions, Assets and Risks) analysis as stated in 1.51 of TPG which inturn leads to accurate delinealation of controlled transaction which ultimately leads to application of Arms Lenght Principle.

Conclusion:
1. Therefore, the revenue earned by Grand Group:

a) In Jurisdiction Zelthus - 75 million pounds will be taxed in Zelthus.

b) In Jurisdiction Hembria - treating it to be a seperate, independent party - $25 million may be taxed by Hembria.

Answer-to-Question-_9__
1) Per 1.61 of OECD TPG, Risk managment is used to refer to the function

of assessing and responding to the risks associated with the commercial activity.

Risk Management comprises of 3 elements:

1 element: the capability to make decisions to decisions to take on, lay off, or decline a risk bearing opportunity, together with the actual performance of that decision making.

2 element : the capability to make decisions on whether and how to respond to the risks associated with the opportunity , together with the actual performance

3 element: the capability to mitigate risk, that is the capability to take measures that affect the risk outcome, together with actual performane of such risk mitigation.

Element 1 and 2 above is control over risk,
Element 3 is risk mitigation, which can be outsourced.

Let me take an example to explain risk assessment and risk management:

Eg. A bank has 2 potential customers:

Customer 1 : Is a Blue chip company and with high rate of profits and comparatively the risk is lower

Customer 2: Is a debt-equity balanced company with external debts raising and with moderate rate of profits and risk being comparatively higher.

Risk assessment funtion takes into account what are all the risk the bank would assume while giving loans to Customer 1 and customer 2 and at the the same time derive the benefits which it could get out it and to decided whether it is ready to take and has the financial capabilities to take up both the upward and downward reward.

In our case, if bank decides to give loan to customer 2, it should be ready to take both the benefit (i,e Customer 2 repaying loan interest and principal on time) and at the same time take a loss i.e. downward reward (non-payment by customer 2)

Risk management:

In our example, Bank should be independent enought to evaluate its potential customers and ultimately decide to take up the decision to accept of deny or modify the potential customer.

and it should have financial capability to undertake the control mitigation function to take up steps to minimize the downward reward.

2)Transfer pricing in relation to intra-group services:

There are 2 main issue sin the analysis of transfer pricing for intra group services:
1) whether the intragoup services here in fact has been provided
2) Whether the intra-group charge for such services for tax purposes are in accordance with the arms lenght principle.

To address 1st issue: we seek to undertake BENEFITS TEST- to determine whether the activity performed for one or more group members by another group member with economic or commerical value to enhance or maintain the business position and whether the independent enterprise in similar comparable circumstances would have been willing to pay for the activity if performed for it by an independent enterprise.

To address 2nd issue: We should identify what arrangements, if any have actually been put in place between the associated enterprises to facilitate charges being made for the provision of servcies between them and by applying Transfer pricing methods to arrive at the most appropriate method to price such controlled transaction.

Per 7.31 of TPG, the most appropriate method for pricing intra-group services would be Comparable Uncontrolled Price or cost-based method (cost plus method or cost based Transactional Net Margin method).

Answer-to-Question-_8__

1) Per 10.51 of TPG, It is always important to take into account the perspective of the lender and borrower, in analysing the economically relevant characterists of the transaction.

Further, Per 1.33 of TPG, identifying the commercial or financial relations and conducting the comparability analysis forms major part in accurately delineating the transaction and ultimately leading to effective application the Arms Lenght Principle.

From the Lenders Perspective, it is important to consider the following:

i) whether the lender has financial capacity to bear the risks if the transaction is undertaken and whether it has independent right to accept, deny or modify the transaction and it assumes the risks associated

ii) Considering the risks to be assumed by the lender:
a) Repayment of the amount transferrred by the borrower
b) comepensation expected for the use of the amount overtime i.e interest or similar payments
c) compensation for any other associated risk factors (e.g. if the lender has inturn borrowed from another lender so the lender might have interest to pay to external lender)
d) terms of the loan, how much amount to lend, and evaluation of credit worthiness/credit rating of the borrower should be considered since independent parties conduct thorough credit assessment of the potential borrower to enable them on the identification and evaluation of risks. (i.e lower credit rating is higher risk and higher credit rating is lower risk)

iii) Economic conditions of loans should also be viewed in the context of the regulations that may affect the position of the parties. (eg.

Insolvency law in the borrower country is not strong)

iv) Covenants: Covenants provide a degree of protection to the lender and so limits its risk. That protection can be in the form of incurrence covenants means require or prohibit certains actions by the borrower without the consent of the lender or maintenance covenants means typically to meet some agreedd financial indicators.

Therefore, it is important to clearly state the loan amount, loan period, interest rate and its payment and principal repayment period and other covenants as deem fit.

The above Transfer pricing aspects are to be considered before entering into intra-group financing agreement.

2) Thin capitalization rules are jurisdiction specific rules and it is one of the BEPS 15 Actions points , 2015 to identify and eliminate the intra-group loans which are in disguise being equity pumping rather than the actual loans. Wherein the loans agreements having no fixed repayments structure.

Since, interest expenses is considered to be allowable expenses under majority jurisdictions income tax laws, to eliminate such disguised equity transactions Thin cap rules are introducted.