THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

December 2025

MODULE 3.03 – TRANSFER PRICING OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Part 1

- Royalty payments (2% of gross sales) by each of the wholly owned subsidiaries within the Crackle Group to Crackle Inc.
- Royalty payments (3% of gross sales) by each of the wholly owned subsidiaries within the Crackle Group to Aerial.
- Payment (2.5% of gross sales) by each of the wholly owned subsidiaries within the Crackle Group to Twinkle.
- Payment by each of the wholly owned subsidiaries of the Crackle group performing distribution functions to Crackle Inc, for the purchase of products utilizing a price list for the various products.
- Payment by each of the wholly owned subsidiaries of the Crackle group performing distribution functions to Skyrocket, for the purchase of products utilizing a price list for the various products.
- Financing agreement between Comet and Crackle Inc (Comet extended Crackle Inc a long-term loan) with an interest rate of 13%.
- Financing agreement between Comet and Crackle Inc (Comet extended Crackle Inc a line of credit) with an interest rate of 8.5%.

Part 2

In transactions between two independent enterprises, compensation usually will reflect the functions that each enterprise performs (taking into account assets used and risks assumed). A functional analysis seeks to identify the economically significant activities and responsibilities undertaken, assets used or contributed, and risks assumed by the parties to the transactions (OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2022), Chapter 1, D.1.2).

Candidates should apply the facts of the scenario to perform a functional analysis for the Crackle Group, noting the changes that have occurred with certain entities. Some points that could be raised as part of this could include:

Crackle Inc – pre change (Country A)

Functions:

- Manufacturing
- Research and development
- Procurement of raw materials
- Quality control

Assets:

- Manufacturing facility (property, plant and equipment)
- Research and development facility (lab etc)
- Warehouses
- Staff
- Offices

Risks:

- Market risk
- Research and development risk
- Inventory risk
- Product liability risk
- Environmental risk

Characterisation:

- Fully fledged manufacturer
- Research and development (economic development)

Crackle Inc – post change (Country A)

Functions:

- Research and development
- Procurement of materials

Assets:

- Research and development facility (lab etc)
- Staff
- Offices

Risks:

- Intellectual property (DEMPE) risk – investigation required in terms of economic versus legal ownership

Characterisation:

- Research and development (economic development)

Skyrocket (Country B)

Functions:

- Manufacturing
- Procurement of raw materials
- Quality control

Assets:

- Manufacturing facility (property, plant and equipment)
- Warehouses
- Staff
- Offices

Risks:

- Market risk
- Inventory risk
- Product liability risk
- Environmental risk

Characterisation:

- Fully fledged manufacturer

Aerial (Country C)

Functions:

- Intellectual property legal ownership

Assets:

- Intellectual property

Risks:

- Intellectual property (DEMPE) risk – investigation required in terms of economic versus legal ownership

Characterisation:

- Intellectual property hub (legal ownership)

Twinkle (Country D)

Functions:

- Procurement
- Sales and marketing

Assets:

- Offices
- Staff

Risks:

- Market risk
- Procurement risk

Characterisation:

- Sales, marketing and procurement hub

Comet (Country E)

Functions:

- Financing

Assets:

- Offices

Risks:

- Credit risk

Characterisation:

- Financing/funding entity/vehicle

Wholly owned subsidiaries

Functions:

- Distribution

Assets:

- Staff
- Offices
- Warehouses

Risks:

- Market risk

Characterisation:

- Low risk distributors (assuming no sales function)

Part 3

The closure of the manufacturing facility operated in Country A by Crackle Inc would need to be considered from a transfer pricing perspective having regard to business restructuring. This may include the commercial rationale for the change and any compensation payments.

Intellectual property within the group from a DEMPE perspective would need to be considered. Aerial is the legal owner of the intellectual property, however, the research and development contributing towards the improvement and potential increase in value attached to the intellectual property may be attributed to Crackle Ltd. This flows into the compensation received by Aerial by the way of royalty payments. The actual method of calculating the royalty payments would also need to be analysed.

The arm's length nature of the payments made to Crackle Ltd and subsequently, Skyrocket for the finished goods then distributed by the associated enterprises would be examined.

The compensation received by Twinkle for functions performed would be a potential transfer pricing risk in terms of the method selected and applied. For example, a cost plus method may be more appropriate rather than a return on gross sales.

The financing arrangements between Comet and Crackle Inc are another transfer pricing risk that could be highlighted. The commerciality/purpose of the loans, interest rates, terms and conditions, issues with group affiliation, etc would need to be examined.

The differences in corporate tax rates creates potential arbitrage and profit shifting from a transfer pricing perspective.

Part 4

Reference is made to Chapter 1 of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (2022). Section D provides guidance for applying the arm's length principle.

Candidates may apply the following areas in relation to the Crackle Group:

- Identification of the commercial or financial relations.
- Comparability factors.
- Contractual terms of the transactions.
- Functional analysis (having regard to Part 2).
- Analysis of risk in relation to commercial or financial relations.

Candidates may extend on the functional analysis, particularly in relation to the transactions delineated in Part 1. This may include discussion around the form of the arrangements relative to economic substance, MNE group synergies, commercial purposes of arrangements and transactions with regard to economically relevant characteristics.

Question 2

Part 1

Reference is made to the OECD Transfer Pricing Guidelines (2022), Chapter II: Transfer Pricing Methods.

Part II of Chapter II of the OECD Transfer Pricing Guidelines (2022) lists the traditional transaction methods.

The Comparable Uncontrolled Price (CUP) method compares the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances. It is the most direct and reliable way to apply the arm's length principle. It requires the same or very similar functionality products.

A CUP method may be applied to the following transactions for the Crackle Group:

The sale of finished goods by Crackle Inc and Skyrocket to the wholly owned subsidiaries (associated enterprises) and to independent enterprises (potential internal and external CUPs).

The royalties paid by the wholly owned subsidiaries (associated enterprises) to Crackle Inc and Aerial. Potential to compare the royalty paid to each of these entities as well as benchmark them against external royalty agreements.

The financing arrangements between Comet and Cracket Inc could be benchmarked against external loan arrangements. The totality of the arrangement would need to be considered as well as the purpose of the loan and all terms and conditions having regard to the commercial and financial relations.

The resale price method begins with the price at which a product that has been purchased from an associated enterprise is resold to an independent enterprise. This price (the resale price) is then reduced by an appropriate gross margin on this price (the resale price margin) representing the amount out of which the reseller would seek to cover its selling and other operating expenses and, in the light of the functions performed (taking into account assets used and risks assumed), make an appropriate profit. What is left after subtracting the gross margin can be regarded, after adjustment for other costs associated with the purchase of the product, as an arm's length price for the original transfer of property between independent enterprises.

The resale price method may be applied to the purchase of finished goods by the wholly owned subsidiaries (associated enterprises) from Crackle and subsequently Skyrocket, whom then resell/distribute them to independent enterprises.

The cost plus method may be considered in relation to the sales, marketing and procurement functions performed by Twinkle. The cost base may be established with an appropriate allocation key with an arm's length margin applied.

Part III of the OECD Transfer Pricing Guidelines (2022) lists the transactional profit methods.

Transactional net margin method (TNMM) examines the net profit relative to an appropriate base (e.g. costs, sales, assets) that a taxpayer realises from a controlled transaction.

A TNMM may be applied to the profitability of the distribution entities within the Crackle Group. An appropriate net profit indicator could include an EBIT/Sales margin and the functions, assets and risks of these entities would need to be analysed.

Candidates may suggest that a profit split method may not be appropriate given unless contribution is made to the development of the intellectual property which appears to be economically performed by Crackle Inc via research and development. A discussion around this point could be raised for potential application or otherwise.

Part 2

The comparability factors would need to considered in the potential application of this method. Reference is made to Section D of Chapter 1 of the OECD Transfer Pricing Guidelines (2022).

Para 1.36 of the OECD Transfer Pricing Guidelines (2022) outlines the comparability factors as:

1) Contractual terms. The contractual terms of all agreements between associated enterprises in the Crackle Group should be reviewed and considered. This includes the loans, research and development, manufacturing/distribution and royalties.

2) Functions, assets and risks. A functional analysis of the Crackle Group would be conducted (with reference to Question 1(b) with comparability analysis would give consideration to the functions, assets and risks of the tested party and comparables.

3) Characteristics of property or services. The characteristics of property or services would include the products purchased and distributed as well as any services provided within the Crackle group.

4) Economic circumstances. Economic circumstances in the different markets that the associated enterprises of the Crackle Group are operating in would need to be considered.

5) Business strategies. The business strategies of the entities and comparables would be considered. For example, a subsidiary may be relatively new to the market and targeting a market penetration strategy to gain market share.

All of the comparability factors must be considered when selecting and applying transfer pricing methods.

PART B

Question 3

The question asks candidates to provide transfer pricing advice in relation to the proposed rationalisation for Collie Corporation.

It is apparent from the facts that a business restructure is proposed which would result in the following key changes:

- Intellectual property (IP) which is owned by several associates of Collie Corporation will be transferred to a central associate within the group (which has the lowest corporate tax rate of all associates)
- Payment of royalty by associates to Company E (no details are provided whether a royalty is currently paid)
- Company B to undertake research and development (R&D) on behalf of Company E, and
- One staff member will relocate from Parent to Company E.

Candidates should refer to Chapter IX of the OECD TPG which address business restructures. Having regard to the TPG, this would involve:

- An accurate delineation of the transactions before and after the restructure (identifying the commercial or financial relations)
- The business reasons for and expected benefits from the restructure, including any synergies expected to be realises, and
- The other options realistically available to the associates in the Group.

A functional analysis would identify the economically significant activities and responsibilities assumed by the parties to the transaction in the business structure. This is required to establish the global value chain and economic substance of associated entities pre and post restructure. As limited facts are provided, it will not be possible to undertake a full functional analysis.

The facts provide that the Group currently have a focus on rationalisation (also presumed to be broader than taxation), which could be assumed to result in simplification and cost savings across the Group.

As the focus on the business restructure predominantly relates to intangible property (IP), Part I, E.2 of the OECD TPG would be relevant, specifically:

- Analysis of the contractual relations with evidence of the actual conduct of the parties
- The legal form of the transaction/s relative to the economic reality of the transaction
- Has there been legal and economic transfer of the IP?
- Consideration of Chapter D.4 of Chapter VI covering hard to value intangibles may be relevant
- Which associates are involved in the development, enhancement, maintenance and exploitation (DEMPE) functions and has there been any change economically (refer to Part B of Chapter VI)?
- Has there been (or will there be) arm's length compensation for the transfer of IP and associated risk?
- What are the contractual terms between the associates both pre and post restructure
- What is the arm's length nature of the royalty (including appropriate transfer pricing method and comparability analysis to benchmark), and
- Consideration of operating profit allocation to the associates within Collie Group to the economic activities generating them.

Based on the facts provided, candidates may raise the following potential issues regarding the proposed restructure:

- There may not be capacity for Company E to undertake DEMPE functions
- Royalty payment of 5% would need to be benchmarked to ensure arm's length compensation
- Compensation has not been determined for the transfer of IP from associates to Company E
- Would need to be arm's length compensation for Company B in undertaking R&D, and
- Whether Company E should compensate Parent for the transfer of the employee who will oversee the group's IP in Jurisdiction E.

Question 4

The question asks candidates to advise on the transactions between the jurisdictions of Zelthus and Hembria. In summary, based on the facts available, most of the business of Grand Group is undertaken in the jurisdiction of Zelthus, where it has its central management and control. However, Grand Group has recently leased a warehouse from an unrelated party in Hembria where it stores its finished goods or inventory prior to selling to the independent distributor. Further, the group does not have any employees permanently based in Hembria, with employees being present for minimal periods to negotiate the contract for the warehouse and supervise the set-up of the warehouse. Candidates are expected to refer to the OECD Model Tax Convention (MTC) on Income and Capital (2017) or United Nations Double Taxation Convention to support their response. The facts provide that the jurisdictions of Zelthus and Hembria have entered into a double tax agreement, with references being to the MTC.

Based on the facts provided, candidates should consider whether a permanent establishment arises in the jurisdiction of Hembria. The concept of a permanent establishment is to determine the right of a Contracting State to tax the profits of an enterprise of the other Contracting State. As Grand Group hasn't established an entity or subsidiary in the jurisdiction of Hembria, Article 7 (Associated Enterprises) would not have application. Under Article 7, a Contracting State cannot tax the profits of an enterprise of the other Contracting State unless it carries on its business through a permanent establishment situated therein.

Paragraph 1 of Article 5 defines the term “permanent establishment” as a fixed place of business, through which the business of an enterprise is wholly or partly carried on. This definition contains the following conditions:

- The existence of a “place of business”, i.e. a facility such as premises or, in certain instances, machinery or equipment
- This place of business must be “fixed”, i.e. it must be established at a distinct place with a certain degree of permanence, and
- The carrying on of the business of the enterprise through this fixed place of business. This means usually that persons who, in one way or another, are dependent on the enterprise (personnel) to conduct the business of the enterprise in the State in which the fixed place is situated.

Paragraph 10 to the MTC Commentary to Article 5 provides that the term “place of business” covers any premises, facilities or installations used for carrying on the business of the enterprise. It is immaterial whether the premises, facilities or installations are owned or rented by or are otherwise at the disposal of the enterprise. The place of business may be situated within the business facilities of another enterprise.

Paragraph 2 of Article 5 provides that permanent establishments include:

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

However, paragraph 3 of Article 5 lists several business activities which are treated as exceptions to the general definition in paragraph 1 and which, when carried on through fixed places of business, are not sufficient for these places to constitute permanent establishments:

a) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise,
b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery,
c) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise,
d) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information, for the enterprise,
e) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity,
f) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) to e),

provided that such activity or, in the case of subparagraph f), the overall activity of the fixed place of business, is of a preparatory or auxiliary character.

The above exceptions which are merely preparatory or auxiliary and should not be treated as permanent establishments. It is recognised that although such a place of business may well contribute to the productivity of the enterprise, the services it performs are so remote from the actual realisation of profits that it is difficult to allocate any profit to the fixed place of business in question.

Paragraph 59 of the Commentary provides that “it is often difficult to distinguish between activities which have a preparatory or auxiliary character and those which have not. The decisive criterion is whether or not the activity of the fixed place of business in itself forms an essential and significant part of the activity of the enterprise as a whole. Each individual case will have to be examined on its own merits. In any case, a fixed place of business whose general purpose is one which is identical to the general purpose of the whole enterprise does not exercise a preparatory or auxiliary activity.” Whether the activity carried on at such a place of business has a preparatory or auxiliary character will have to be determined in the light of factors that include the overall business activity of the enterprise.

Paragraph 62 of the Commentary clarifies that subparagraph a) relates to a fixed place of business constituted by facilities used by an enterprise for storing, displaying or delivering its own goods or merchandise.

Paragraph 66 of the Commentary confirms that in relation to subparagraphs a) and b), it does not matter whether the storage or delivery takes place before or after the goods or merchandise have been sold, provided that the goods or merchandise belong to the enterprise whilst they are at the relevant location (e.g. the subparagraphs could apply regardless of the fact that some of the goods that are stored at a location have already been sold as long as the property title to these goods only passes to the customer upon or after delivery). Subparagraphs a) and b) also cover situations where a facility is used, or a stock of goods or merchandise is maintained, for any combination of storage, display and delivery since facilities used for the delivery of goods will almost always be also used for the storage of these goods, at least for a short period. For the purposes of subparagraphs a) to d), the words “goods” and “merchandise” refer to tangible property.

Therefore, based on the facts available, it is likely that Grant Group will satisfy paragraph (3) b) of Article 5, which would be treated as an exemption to a permanent establishment, despite the Group renting a warehouse to store goods prior to sale to an independent distributor.

Based on the facts available, the following paragraphs of Article 5 are unlikely to be satisfied:

- Paragraph 5 regarding habitually concluding contracts; and
- Paragraph 6 regarding independent agent

As Grand Group doesn’t operate through an Associated Enterprise (Article 9) or Permanent Establishment (Article 5), all of the $3,750,000 profit from $25 million sales to the independent distributor in Hembria should be attributed to Zelthus. On this basis, there is no need to allocate any profits under the arm’s length principle.

PART C

Question 5

Part 1

The OECD TPG address transfer pricing documentation in Chapter V.

Chapter 5.5 cover the objectives of transfer pricing documentation, which are broadly:

- For taxpayers to apply the arm's length principle;
- To provide tax administrations with the necessary information to undertake a transfer pricing assessment; and
- To assist tax administrations in conducting an audit.

There are several reasons why transfer pricing documentation should be prepared:

- Legal requirements for the taxpayer to meet. The extent of documentation is likely to vary between jurisdictions – some may require this to lodge with the tax administration, whilst others require it to be retained and made available if required;
- Assists in ensuring good governance and establishing an arm's length price;
- Can assist in minimising risk of further compliance activity such as review or audit;
- May reduce intensity of checks or timeframe to undertake a risk review by the tax administration;
- May reduce the provision of further information to tax administrations; and
- Reduces exposure to penalties which a tax administration may apply

Some candidates may reference the requirement to lodge Country by Country documentation, which includes master file, local file and CbC report. Taxpayers are required include transfer pricing documentation in satisfying these requirements.

Part 2

Paragraph 4.102 of the OECD TPG confirms that a safe harbour in a transfer pricing regime is a provision that applies to a defined category of taxpayers or transactions and that relieves eligible taxpayers from certain obligations otherwise imposed by a jurisdiction's general transfer pricing rules.

Transfer pricing safe harbour benefits arise for tax administrations and multinational taxpayers alike. Candidates may identify several benefits, further to those set out below.

Chapter IV (paragraph E.3) of OECD TPG addresses benefits of safe harbours.

Taxpayer:

- Reduces compliance costs of having to prepare transfer pricing documentation (saves on resources and financial costs);
- Reduces risk of a tax administration undertaking compliance activity i.e. audit, review or examination; and
- Provides certainty regarding how a tax administration may treat transactions covered by the safe harbour.

Tax administrations:

- Reduces the need to allocate resources to transfer pricing arrangements covered by the safe harbour (thus allowing to allocate resources to higher risk issues);
- No need to enter into an Advance Pricing Arrangement with taxpayers to provide tax certainty; and
- Provide assurance over transactions without the need to allocate significant resources (other than to potentially test eligibility for safe harbour).

Question 6

Part 1

Arbitration is relevant in relation to transfer pricing predominantly in relation to Mutual Agreement Procedures (MAP). Part G of Chapter IV of the OECD TPG addresses arbitration.

With the increase in international trade and investment, there continues to be ongoing disputes between taxpayers and tax administrations and also amongst tax administrations in the context of MAP. Tax treaties or double tax agreements provide a mechanism for tax administrations (competent authorities) to reach agreement, although this does not always result in the full relief of double taxation or the resolution of issues between tax administrations.

Some tax treaties have an article (refer to paragraph 5 of Article 25) where there may be the option of arbitration to provide a resolution if competent authorities are unable to seek a resolution. Generally, where competent authorities are unable to reach agreement within two years in relation to a case which a taxpayer has applied for MAP, unresolved issues can at the request of the taxpayer be solved through an arbitration process.

If two jurisdictions have an arbitration clause in their double tax agreement, this encourages the competent authorities of the tax administrations to reach a resolution to prevent any issues progressing to arbitration. Further, this also places a timeframe on competent authorities to reach an agreement, or the taxpayer can elect for the unresolved matter to be arbitrated. The existence of arbitration should encourage the use of MAP by taxpayers (rather than purely exercising domestic rights such as appeal/objection or litigation) and create an incentive for competent authorities to conduct the MAP efficiently to seek to avoid the case progressing to arbitration.

Part 2

An Advance Pricing Arrangement (APA) is defined in the OECD TPG as “An arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. method, comparables and appropriate adjustments thereto, critical assumptions as to future events) for the termination of the transfer pricing of those transactions over a fixed period of time. An APA may be unilateral involving one tax administration or multilateral involving the agreement of two or more tax administrations.”

Candidates may reference Part F of Chapter IV of the OECD TPG which addresses APAs.

Generally multinational groups may enter into an APA to reduce their risk of a future transfer pricing audit and to provide certainty in respect of future periods. Reasons or benefits of entering into an APA may include (candidates may refer to OECD TPG at F.3):

- Material transactions with an associate;
- Complexity with transactions, including uncertainty regarding most appropriate transfer pricing methodology;
- Multinational may wish to improve governance and to reduce risk, including of future transfer pricing adjustments by a tax administration;
- Recommendation by advisor to enter into APA;
- Opportunity to develop favourable relationships with tax administration/s by consulting in relation to APA; and
- Fewer resources required in the future once APA has been agreed (with possibility of rolling over APA).

The type of APA entered into i.e. unilateral, bilateral or multilateral may be dictated by which tax administrations have an APA program and whether the jurisdictions have a tax treaty or double tax agreement.

Question 7

Part 1

Candidates are expected to respond to this question in relation to the work undertaken by the OECD regarding Pillar One, Amount B.

Candidates may provide a range of responses, depending on their justification. For example, some candidates may advocate that the OECD has simplified transfer pricing for multinationals and tax administrations. However, other candidates may suggest that the OECD has not been successful as a broad range of jurisdictions have not currently adopted Amount B.

The OECD/G20 Inclusive Framework on BEPS published a report in February 2024, which was updated and finalised in June 2024, providing an optional approach (commonly referred to as Pillar One, Amount B) which jurisdictions can choose to implement to establish arm's-length prices for in-scope marketing and distribution transactions for resident distributors. The original focus of Amount B was on low-capacity jurisdictions.

The OECD report has been incorporated into the OECD TPG as an Annex to Chapter IV: Administrative approaches to avoiding and resolving transfer pricing disputes. It provides an optional simplification that jurisdictions can choose to apply to in-scope distributors, sales agents or commissionaires operating in their jurisdiction.

Jurisdictions have the option to apply the Amount B simplified and streamlined approach from January 2025, either as a taxpayer safe harbour or as a mandatory rule.

The Amount B pricing approach "approximates an arm's length outcome." Hence, whilst it applies in jurisdictions that choose to adopt it, there is no general requirement that a jurisdiction in which a counterparty is resident that does not adopt Amount B respect of its application. The report goes further and states that "taxpayers should not rely on [the Amount B pricing approach] to justify that a result should be treated as an arm's length outcome when filing their tax returns in jurisdictions that do not apply [Amount B]." Amount B may not be respected by tax administrations and therefore cannot be relied upon in counterparty jurisdictions that choose not to adopt Amount B, which potentially could lead to the outcome that instead of simplifying transfer pricing, it makes it more complex.

Further, the Amount B framework is intended to limit transfer pricing disputes relating to the pricing of baseline marketing and distribution arrangements only. The framework will not help to address disputes about the accurate delineation of a marketing and distribution arrangement, e.g., whether the activities performed by a distributor go beyond a baseline or routine contribution.

Amount B has a broad scope and is potentially applicable to a wide variety of such distribution transactions. Therefore, Amount B is likely to meaningfully impact the application of the arm's-length standard wherever amount B is in fact adopted by jurisdictions. However, Amount B has not currently been widely adopted by many jurisdictions. In summary, the impact of amount B will be dependent on its adoption by jurisdictions: the greater the number of jurisdictions, the more significant the impact. It may provide some improvement to tax certainty worldwide and to reduce the requirement of taxpayers to produce resource intensive transfer pricing documentation, including comparability analysis. However, practically it will likely only be effective for taxpayers if they are in scope of Amount B and all jurisdictions in which they have a presence adopt it. To date there has been very limited adoption of Amount B. The United States has adopted as an elective safe harbour for taxpayers.

Part 2

Candidates are expected to provide a brief explanation of what a cost contribution arrangement (CCA) is.

CCAs are addressed in Chapter VIII of the OECD TPG.

A CCA (paragraph 8.3) is a contractual arrangement among business enterprises to share the contributions and risks involved in the joint development, production or the obtaining of intangibles, tangible assets or services with the understanding that such intangibles, tangible assets or services are expected to create benefits for the individual businesses of each of the participants.

In relation to exiting or withdrawing from a CCA, this may arise when for example the agreement comes to an end or alternatively, an associate may not expect to utilise the CCA outcome or the benefits.

As set out in paragraph 8.44, an exit from a CCA will normally trigger a reassessment of the proportionate shares of participants' contributions and expected benefits. 8.45. The amount of a buy-in payment should be determined based upon the value (i.e. the arm's length price) of the interest in the intangibles and/or tangible assets the new entrant obtains, taking into account the new entrant’s proportionate share of the overall expected benefits to be received under the CCA.

In effect, an exit of the CCA may be akin to a sale to a new or existing participant (an associated enterprise) of a CCA as interest in the results of the CCA up to that time are likely to be disposed of. This may result in a transfer of the respective interest in the results of the prior CCA activity to the new or existing participants. For example, under the arm’s length principle, any such transfer of intangibles or tangible assets must be compensated based on an arm’s length value for the transferred interest. Paragraph 8.47 of the OECD TPG refers to any such compensation as a “buy-out payment. Chapters I-III and Chapter VI apply in determining the arm’s length amount of any buy-out payment. Depending on the complexity and on what was created from the CCA, this may require a valuation.

Question 8

Part 1

Reference is made to Chapter X – Transfer pricing aspects of financial transactions of the OECD Transfer Pricing Guidelines (2022).

Some points that candidates may raise and discuss may include:

- The characterisation / nature of the loan including whether it should be regarded as a loan;
- Identification of the commercial or financial relations;
- The economically relevant characteristics of actual financial transactions;
- The lender's and borrower's perspectives;
- Use of credit ratings including the credit rating of an MNE or MNE group;
- Effective group membership;
- Covenants;
- Guarantees;
- Loan fees and charges;
- Cost of funds;
- Economic modelling; and
- Bank opinions.

The transfer pricing method would be considered including the potential use of a CUP and associated comparability issues. In addition, the lower headline corporate tax rate for the borrower within the group would potentially draw attention from that jurisdiction in terms of the interest deductions created for that entity.

Part 2

Thin capitalisation refers to the situation in which a company is financed through a high level of debt compared to equity. Thinly capitalised companies can be considered to be highly leveraged or highly geared.

The amount of interest that a company pays is determined by two factors: a) The rate of interest (or similar condition) applied to its loans. b) The amount of those loans. Transfer pricing rules apply to the rate of interest (or similar condition) applied to its loans. The rate of interest is the price that is paid on a loan, and transfer pricing requires that such a price aligns with the arm's length principle.

Consideration could be given to the arm's length debt test of an entity being a notional amount applied to a hypothetical business that would satisfy both of the following two tests:

- The notional debt capital the entity "would reasonably be expected to have throughout the income year" (the borrower's test); and
- Arrangements that unrelated commercial lending institutions would "reasonably be expected to have entered into" (the lender's test).

The following issues may be considered:

- Terms and conditions;
- Credit rating/worthiness;
- Covenants;
- Consideration of the relevant factors;
- Quantitative factors;
- Return on equity capital;
- Gearing;
- Commercial rationale for related party debt; and
- Documentation and analysis to support the ALDT.

Question 9

Part 1

Transfer pricing documentation is critical in identifying and managing transfer pricing risk and also for defence in a risk review or audit by a tax administration to demonstrate compliance with the arm's length principle. In this respect, it would be prudent to advise the client of the importance of preparing and maintaining contemporaneous transfer pricing documentation.

An advance pricing agreement (APA) may be considered to be entered into with one or numerous tax authorities to provide certainty from a transfer pricing perspective. Candidates may elaborate on the advantages of APAs and types of APAs.

Some considerations that the client may be advised of that as part of their due diligence processes in relation to assessing and managing transfer pricing risks may include:

- Conduct a functional analysis;
- Delineate the transactions with associated enterprises;
- Consider the materiality of dealings between associated enterprises;
- For any previous or future business restructuring, ensure the transfer pricing analysis with arm's length outcomes are embedded in the operational aspects of the business;
- More complex analysis in relation to intangible assets utilised by group companies;
- Examine any cost sharing arrangements with respect to the arm's length principle;
- Be able to explain declines in profitability and losses, particularly sustained losses over a number of years from a commercial perspective; and
- Ensure formal agreements are in place for all intercompany transactions and how the substance of the arrangements align with the arm's length principle.

Part 2

Reference is made to Chapter VII of the OECD Transfer Pricing Guidelines – Special considerations for intra-group services.

Safe harbours would potentially be of benefit for low value adding intra-group services – e.g. back office administrative services compared to higher value adding services such as highly technical engineering services.

Considerations that tax authorities may apply in relation to safe harbours for intra-group services may include the materiality of the turnover and transactions, absence of no or low tax jurisdictions, absence of intellectual property and absence of losses (particularly recurring losses).

Candidates may highlight some benefits of safe harbours that may include:

- Transactions can be filed with greater certainty;
- A lower cost of compliance given a lower risk of review or audit by tax administrations;
- Contribute towards a robust tax risk management framework;
- Developing a more collaborative relationship with tax administrations;
- Reduce the tax risk profile of the group;
- Provides a more optimal use of resources; and
- Reduce administrative burdens.

Candidates may also discuss more broadly in relation to intra-group services.

The first key consideration in relation to intra-group services is whether they have been provided before moving onto an analysis of the arm's length nature of them. Examples of intra-group services include administrative, accounting, human resources, marketing and sales, research and development.

Some of the main issues candidates may raise include:

- Benefits test – has a benefit been received and would an independent party have been willing to pay for the services.
- Shareholder activities – not considered to be an intra-group service and therefore not chargeable given at the shareholder level (e.g. costs of compliance for the parent company, shareholding costs, listing, meetings, costs ancillary to the governance of the MNE).
- Duplication – performing for itself and another member.

- Incidental benefits – e.g. economic benefits for members in a group not directly involved in a decision and a shareholding or co-ordination centre.
- Centralised services – activities such as administrative, accounting that a central entity performs for other members of the group and are remunerated for.
- Form of remuneration – e.g. service fee, commission.
- Determining an arm's length charge:

  - Identification of actual arrangements for charging intra-group services
  - Direct charge methods – charge for specific intra-group services.
  - Indirect charge methods – cost allocation and apportionment methods such as allocation keys of staff hours, turnover, orders processed.

- Calculation of an arm's length remuneration is based on the value of the intra-group service and how much a comparable independent enterprise would be willing to pay for the service.