Answer-to-Question-_1_

Part 1

Accurate delineation of the transaction between associated enterprises is the starting point of the transfer pricing analysis. Accurate delineation means determination of the facts and circumstances of the controlled transactions between the MNE Group members. In Stolhurst Group the following controlled transactions are identified within the Group:

1. Stolhurst ParentCo located in Country G sells finished goods and replacement parts to Stolhurst Sub 1 in Country H

2. Stolhurst ParentCo located in Country G sells finished goods and replacement parts to Stolhurst Sub 2 in Country I

3. Stolhurst ParentCo located in Country G licenses intellectual property (brand name) to Stolhurst Sub 1 located in Country H and receives royalties at the rate of 8% of sales in Country H

4. Stolhurst ParentCo located in Country G licenses intellectual property (brand name) to to Stolhurst Sub 2 located in Country I and receives royalties at the rate of 10% of sales in Country I

5. Stolhurst ParentCo located in Country G receives intra-group loan from Stolhurst Sub 3 in Country J and pays interest on the loan

6. Stolhurst ParentCo located in Country G has entered into a Cash pooling arrangement with Stolhurst Sub 3 located in Country J

7. Stolhurst ParentCo located in Country G receives administrative support and marketing services from Stolhurst Sub 4 in Country K and pays management fee to Stolhurst Sub 4 at the

rate cost plus 25%

8. Stolhurst Sub 1 receives administrative support and marketing services from Stolhurst Sub 4 in Country K and pays management fee at cost plus 25%

9. Stolhurst Sub 2 receives administrative support and marketing services from Stolhurst Sub 4 in Country K and pays management fee cost plus 25%

10. Stolhurst Sub 3 provides investment management services to other group members

Part 2

In accordance with the OECD TP Guildelines Functional analysis is a key task in TP analysis and means the identification of the economically significant characterizations of the transactions, identification of functions performed, assets used and risks assumed by each of the parties to a controlled transaction and analysis of actual conduct of the parties to determine if it is in line with the contractual provisions on functions to be performed and aallocation of risks.

In Stolhurst Group the members have the following functions risks and assets:

Stolhurst ParentCo:

Functions:

1. Legal ownership of intellectual property
2. Significant research and development
3. Manufacturing

Assets:

No information is provided in the question, however, with the functions given it could be assumed that Stolhurst ParentCo owns production facilities, warehouses to maintain stock of goods, facilities used for R&D, human capital. Anyway the factual establishment of all of the above is subject to broader analysis of actual conduct of the parties, to determine if the entity in fact posesses all these assets to be able to perform the functions described above.

Risks:

Manufacturing risk
Credit risk
Inventory risk (as sales are to independent enterprises as well)
R&D risk (key R&D functions)
Warranty risk (if sales replacement parts, assumed that warranty is present)
Market risk
Foreign exchange risk
Financial risk

Characterization: Manufacturer, IP owner carrying R&D and determining the strategic management of the group (board meetings where key decisions are taken)

Stolhurst Sub 1

Functions:

Distribution, retail sales

Assets:

1. Retail stores in Country H
2. Personnel (assumed - subject to actual conduct analysis)

Risks:

No sufficient information, but assumed

Market risk
Inventory risk
Foreign exchange risk

Characterization: Subsidiary, Distributor for particular country (not possible to identify from the question if it is limited risk or not, how the volume of stock of goods delivered by the parent is regulated)

Stolhurst Sub 2

Functions:

Distribution, retail sales

Assets:

1. Retail stores in Country I
2. Personnel (assumed - subject to actual conduct analysis)

Risks:

No sufficient information, but assumed

Market risk
Inventory risk
Foreign exchange risk

Characterization: Subsidiary, Distributor for particular country (not possible to identify from the question if it is limited risk or not, how the volume of stock of goods delivered by the parent is regulated)

Stolhurst Sub 3

Functions:

Investment management

Assets:

No information is provided in the question, however, with the functions given it could be assumed that Stolhurst Sub 3 possesses financial resourses. It is subject to thorough analysis.

Risks:

Financial risks (subject to thorough analysis if able to assume the risk and has financial capacity)

Characterization: Subsidiary, Financial services provider but subject to deeper analysis may be a conduit

Stolhurst Sub 1

Functions:

Distribution, retail sales

Assets:

1. Administrative support and marketing

Risks:

No substantial risks identified

Characterization: Subsidiary, Administrative services hub

--------------ANSWER-1-ABOVE---------------

--------------ANSWER-2-BELOW---------------

Answer-to-Question-_2_

Part 1

OECD TP Guidelines determine 5 methods to be used for establishment of arm's length prices in controlled transactions. Selection of the most appropriate method should be based on strengths and weaknesses of the methods and teir appropriateness depending on the nature of the transaction and availability of comparables. There are 5 methods deteremined in OECD TP Guidelines: Three traditional transaction based and two transactional profit based methods. Traditional methods are the most preferred as they are most direct.

Traditional transaction based methods:

1. Comparable Uncontrolled Price (CUP) method

CUP method consists of direct comparision of a price of goods or fees for services charged in a controlled transaction with price charged in comparable uncontrolled transactions which include internal (same transaction with independent party as with associated) and external (between two independent parties) comparables. This is the most preferred methods as allows the direct comparison between two prices. In the case at hand can be applied to sales from Stolhurst Parentco to Stolhurst Sub 1 and Stolhurst Sub 2 as there are available internal comparables (sales to Independent Co 1 and Independent Co 2). It can also be applied to determine the arm's length interst rate in intragroup loan with reference to comparable loans based on credit rating of the borrower and comparable loans that would be provided between independent enterprises in comparable circumstances.

2. Resale price method

Resale price methods looks at the price charged at the on-sale of goods by goods purchased by one associated enterprise from the other one to independent parties. Price is then reduced by the appropriate resale price margin to come to the original arm's length purchase price. It is based on gross profit indicators. Problems could arise because of lack of comparables as fnding of gross profit information on uncontrolled transactions could be problematic.
In the case at hand there could be potential comparables as Stolhurst Parentco sells goods to independent parties as well and if they also act as distributors, subject to availability of information on their resale price margins, RPM may be applied.

3. Cost plus method

Cost plus method starts with the identification of costs incurred by a manufacturer or service provider and determination of the mark up on those costs applied at sales of the manufactured goods or provision of services. This method is also based on gross profit indicators where it is problematic to find comparables. However, it could be applicable to sale of goods manufactured by Stolhurst parentco and soldd to subsidiaries (if economic characteristics of comparable transactions with independent entities are reliable) and to intragroup services (management and marketing) provided by Stolhurst Sub 4 to other group entities.

Transactional methods

4. Transactional Net Margin Method (TNMM)

TNMM compares the net profit indicator in controlled transaction calculated as ratio of net profit to assets, sales or costs with the same indicator in a comparable uncontrolled transaction. In this method the main indicator is the net profit. Strength of the method is that net profit is not affected so much by functional differences as the gross profit margins. In the case at hand TNMM can be applied to transactions between the Stolhurst Parentco and its Subs 1 and 2 if the information is available on reliable comparables.

5. Transactional profit split method.

This method consists of allocation of profits between associated enterprises based on appropriate allocation key where the unique intangibles are used or there is a high level of integration between the enterprises parties to the transaction. In the case at hand this method does not seem to be appropriate for any of the identified transactions.

An important comparability issue may be with cash pooling as it is not something usual between independent parties and there could not be comparables. OECD TP Guidelines recognise that associated enterprises may enter into transactions that could not or rarely be observed between independent parties.

Part 2

Tax authorities may rise a number of questions with regard to the controlled transactions. The most important ones are:

1. Interst rate for inercompany loan

2. Cash pooling arrangement between Parent and Subsidiary, its logic and benefits, interrelation with the intercompany loan and interest rate. Location of Stolhurst Sub 3 in a low-tax jurisdiction (5%) is an additional factor.

3. Differences between royalty rates paid by Sub 1 and Sub

2. The company should be prepared to demonstrate and support the considerations that affect the rate.

4. Cost plus mark up of 25% is too high for intra-group services which can be regarded as low value adding services and the used method is direct charge. The tax rate in Country K is also low (10%) and it could be regarded as profit shifting through high price of intra-group services. Also, the benefit test should be applied: whether an independent entity would be willing to pay for such services.

5. Stolhurst Sub 2 was in lost position but in the most recent year but we do not have sufficient information on years before. If the loss continued for a number of years it can also trigger a deeper scrutiny.

--------------ANSWER-2-ABOVE---------------

--------------ANSWER-3-BELOW---------------

Answer-to-Question-_4_

Part 1

Permanent establishment is a fixed place of business through which a business of a resident of one state is carried on the other state. There should be: 1) fixed place 2) business conducted 3) degree of permanency. The place should be at the disposal of the non-resident.

Building of an airport runway should be regarded as a construction project under OECD Model. For construction projects OECD Model TAx Convention Article 5 establishes an extended threshold of 12 months. The temporary buildings on the site location if exist for more than 12 months may trigger a PE risk for Megalop.

However, the commentaries recognize that this threshold gives rise to abuses. Therefore anti-fragmentation rules have been introduced providing that the length of activities of connected subcontracrors may be added to the days of main contractor activities in calculation of the threshold.

Existense of a Double TAx Treaty following the OECD Model between Megalot and Gigalot may ensure that only the profits attributable to the PE in Gigalot can be taxed in Gigalot.

Part 2

Profits attributable to the PE in Gigalot shoould be determined under the rules of OECD on attribution of profits to PE.

OECD approach is that any PE should be regarded as a separate entity acting independently from its head office and the profits that should be attributed to it must be determined as the profits it would make if it was an independent entity.

TP analysis should be applied to determine the functions performed, assets used and risks assumed by the PE during its activities and then appropriate renumeration should be calculated based on the facts and circumstances.

--------------ANSWER-3-ABOVE---------------

--------------ANSWER-4-BELOW---------------

Answer-to-Question-_6_

Part 1

Implications for Borderline plc of acting in a country which has not entered iinto a DTA with its residency country may give rise to serious problems. If the domestic law of its residency country does not have unilateral provisions on exemption of foreign sourced income or credit of foreign income tax, the risk of double taxation is very high. Also, in the absence of DTA there is no legal basis for Mutual Agreement Procedures (unless borth countries are members of some other bilateral or multilateral document) if the company faces double taxation or discriminative taxation.

Part 2

Country by country reporting is a multilateral measure introduced as a result of OECD BEPS project. Under the CbCR countries shoudl exchange the country by country reports on controlled transactions of the MNE Group members in their jurisdictions. These reports should facilitate the TP audits and information queries by tax authorities. However, setting up an entity in a country that follows a policy not to enter into tax treaties has high risks that 1) no multilateral instrument on CbCR also entered 2) the reports produced, methodologies follwed in the residency country will not be recognized in the other state 3) additional reporting requirements may be imposed in the other country.

--------------ANSWER-4-ABOVE---------------

--------------ANSWER-5-BELOW---------------

Answer-to-Question-_5_

Part 1

Safe harbours are determined to provide simplified rules for the companies who qualify for these rules for easier TP analysis and documentation which could significantly ease the burden on the enterprise. However, adhering to a unilateral safe harbour introduced by one country may lead to double taxation as the other countries's tax authorities where other MNE group members are located may not agree with the pricing of the transaction between the company joined the safe harbour program in the other country and the company resident in their countries. While the safe harbours can be useful and help to ease the administrative burden in one country, it is recommended to adhere if there are bilateral or multilateral ones or if there are available double tax traties containing Mutual Agreement Procedure Article, preferably with Mandatory Arbitration clause.

Part 2

Having a contemporaneous TP documentation may facilitate the process for future tax audits. It is usually a positive signal to the tax authorities that the taxpayer has paid due attention to the arm's length pricing of its transactions. Yearly review of the methodology and comparables used may help the company to avoid unexpected challenges. On the other hand, it can be costly for a company. However, if the key factors, circumstances and characteristics of the transactions do not change for multiple years only high-level revie and adjustments to changing market circumstances may be appropriate.

Part 3

Arms length principle is the principle agreed on by OECD members and widely accepted principle that leads to the most reliable approximation the prices in controlled transactions to those in transactions between independent parties that would produce most reliable results. Currently there is no reliable alternative to this principle as all the alternatives have significant weaknesses including the Global Formulary Apportionment.