Answer-to-Question-_1_

Part 1

Below are the controlled transaction between the associated Machine Group enterprises:

Country Alpha (Parent company)

1. Grant the right to utilise of key intangibles property (patents, trademarks, trade names and brand name), manufacturing know-how to its subsidiary in Country Gamma.
2. Provide loan to its subsidiaries in Country Beta, Gamma and Delta.
3. Provision of management, administration, support, information technology services, accounting, marketing assistance and demand forecasting services to its subsidiaries in Country Beta, Gamma and Delta.
4. Grant its subsidiary in Country Gamma to contract manufacture products
5. Provide marketing material and traning to its subsidiaries in Country Beta, Gamma and Delta.
6. Sale of finished products to its subsidiaries in Country Beta, Gamma and Delta.
7. Provide website maintenance (manage and update website) to its subsidiary in Country Delta

Country Beta (Subsidiary)

1. Receive loan from its parent company in Country Alpha.
2. Receive management, administration, support, information technology services, accounting, marketing assistance and demand forecasting services from its Parent company in Country Alpha.
3. Purchase of finished products from its Parent company in Country Alpha.

Country Gamma (Subsidiary)

1. Receive loan from its parent company in Country Alpha.
2. Receive management, administration, support, information

technology services, accounting, marketing assistance and demand forecasting services from its Parent company in Country Alpha.
3. Perform contract manufacturing for Parent company in Country Alpha.
1. Receive the right to utilise of key intangibles property (patents, trademarks, trade names and brand name), manufacturing know-how from its Parent company in Country Alpha.

Country Delta (Subsidiary)
1. Receive loan from its parent company in Country Alpha.
2. Receive management, administration, support, information technology services, accounting, marketing assistance and demand forecasting services from its Parent company in Country Alpha.
3. Purchase of finished products from its Parent company in Country Alpha.
4. Receive website maintenance (manage and update website) service from its Parent company in Country Alpha.

Part 2

According to OECD Transfer Pricing Guideline - Chapter II Transfer Pricing Methods, there are five methods which can be categorised as traditional transaction methods (i.e. Comparable Uncontrolled Price Method, Resale Price Method and Cost Plus Method) and Transactional profit methods (i.e. Transactional Net Margin Method, Profit Split Method). Generally, traditional method is more preferred than transactional profit method as it is more direct and relible.

Comparable Uncontrolled Price (CUP) Method
CUP Method compares the price charged for property or services in a controlled transaction to the price charged for property or services in a comparable uncontrolled transaction.

CUP method can be applied in the following controlled transactions:
1. Parent Company grants the right to utilise of key intangibles

property (patents, trademarks, trade names and brand name), manufacturing know-how to its subsidiary in Country Gamma. CUP can apply in this transaction by comparing the royalty charged to its subsidiary in Country Gamma against the royalty charged by an independent enterprise in a similar circumstance.

2. Price charged by Parent Company for sale of finished products to its subsidiaries in Country Beta, Gamma and Delta. Internal CUP can apply in this case if the Parent Company did also sell finished products to independent customers. Appropriate adjustment need to be made to in term of different in volume, delivery term and etc.

3. Parent company provide loan to its subsidiaries in Country Beta, Gamma and Delta. Arm's length interest can be determine by compare the interest rate that charged by financial institution.

Resale Price (RP) Method

RP method would apply when product that has been purchase from an associated enterprise is resold to an independent enterprise. Resale price is then reduced by an appropriate gross margin and make an appropriate profit. RP method apply when the reseller does not add substantially and do not processed the goods into a different product.

RP method can be applied in the following controlled transactions:

1. Purchase finished products by Parent Company, subsidiary in Country Beta and subsidiary in Country Delta from subsidiary in Country Beta. Parent Company, subsidiary in Country Beta and subsidiary in Country Delta will subsequently resell the finished products to their customers.

Cost Plus (CP) Method

CP method begins with the cost incurred by the supplier of property or services in a controlled transaction for property transferred or services provided to an associated purchaser.

CP method can be applied in the following controlled transactions:

1. Provision of management, administration, support, information technology services, accounting, marketing assistance and demand forecasting services by Parent Company to its subsidiaries in Country Beta, Gamma and Delta.
2. Parent Company grant its subsidiary in Country Gamma to contract manufacture products
3. Parent Company provide marketing materials and traning to its subsidiaries in Country Beta, Gamma and Delta.

An appropriate markup is to be addded on top of cost incurred by the subsidiary in Country Gamma on manufacturing to arrive at arm's length markup.

For management, administration, support, information technology services, accounting, marketing assistance and demand forecasting services, an appropriate markup is to be addded on top of cost incurred by Parent company in providing those services to arrive at arm's length markup.

Profit Split Method

Profit Split Method is not appropriate to apply on the controlled transaction of Machine Group.

Transactional Net Margin Method (TNMM)

TNMM examines the net profit relative to an appropriate base (eg. cost, sales and assets) that a taxpayer realises from a controlled transaction.

TNMM can be applied in the following controlled transactions:

1. Parent company sale of finished products to its subsidiaries in Country Beta, Gamma and Delta.

Profit level indicator (net profit over cost which directly relate to the controlled transaction) of Parent company will be used to compare with independent enterprise which carry out the same function and in the same industry.

Part 3

Concern with tax administration:

1. Net operating profit margin of Parent company is only 2% compare to its subsidiaries which their net operating profit margin is higher. In view of Parent company owned the key intangibles property, manufacturing know-how and trade secret, along with assuming higher risk, operating profit should be recorded at a higher rate.
2. Parent company is proving interest free loan to its subsidiaries. An independent enterprise would not provide interest free loan to a company.
3. Parent Company might not compensated by its subsidiary in Country Gamma for granting the right in utilise of key intangibles property (patents, trademarks, trade names and brand name), manufacturing know-how.
4. Parent Company might not compensated appropriately for provision of management, administration, support, information technology services, accounting, marketing assistance and demand forecasting services to its subsidiaries in Country Beta, Gamma and Delta.
5. Subsidiary in Country Delta acquires finished goods at cost price from Gamma. The purchase price is definitely not comply with arm's length principle as an independent enterprise will not enter into this transaction where no profit can be obtained.

Answer-to-Question-_2__

Part 1

Country by Country Report (CbCR) consists of aggregate tax jurisdiction wide information relating to global allocation of the income, taxes paid and location of economic activities. Aggregate information to be included are amount of revenue, profit or loss before income tax, income tax paid, income tax accrued, stated capital, accumulated earnings, number of employees, and tangible assets.

Part 2

Country Alpha (Parent company)

Function:

1.Strategic management

2.Intellectual property management

3.Sales

4.Research and development

5.Distribution

6.Funding

7.Administrative services (management, administration, support, information technology services, accounting, marketing assistance and demand forecasting services)

Assets:

1.Human capital (employees)

2.Intellectual property (patents, trademarks, trade names and brand name, manufacturing know-how and trade secrets)

3.Head office building

4.Office furniture

5.Computer equipment

6.Motor vehicles

Risk:
1.Market risk
2.Inventory risk
3.Warranty risk
4.Financing risk
5.Foreign exchange risk
6.Credit risk

Country Beta (Subsidiary)
Function:
1.Sales and marketing

Assets:
1.Human capital (employees)
2.Motor vehicles
3.Computer equipment
4.Office furniture

Risk:
1.Market risk
2.Inventory risk
5.Foreign exchange risk

Country Gamma (Subsidiary)
Function:
1.Contract manufacturing
2.Procurement
3.Logistics (transport finished goods)

Assets:
1.Human capital (employees)
2.Plant and equipment for manufacture
3.Building

Risk:
1.Market risk

2.Inventory risk

Country Delta (Subsidiary)
Function:
1.Sales

Assets:
1.Human capital (employees)
2.IT and office equipment

Risk:
1.Market risk
2.Inventory risk
5.Foreign exchange risk

Part 3

Country Alpha (Parent company)
It is characterised as entrepreneur, intellectual property owner and service provider. It assume most of the risk and perform extensive function.

Country Beta (Subsidiary)
It only perform sales and marketing function. Therefore, it is characterised as limited risk distributor.

Country Gamma (Subsidiary)
It is characterised as contract manufacturer and limited risk distributor. Intellectual property and manufacturing know how are from Parent company, hence it is characterised as contract manufacturer instead of full fledged manufacturer.

Country Delta (Subsidiary)
It only perform sales and marketing function. Therefore, it is characterised as limited risk distributor.

Answer-to-Question-_3__

Pre restructure

Surfco Ltd (group head company)

Function:

1.Sale

2.Design

3.Manufacture

4.intangible asset management

5.Strategic management

6.Marketing, procurement and services

7.Distribution

Asset:

1.Human capital (employees)

2.equipments for manufacturing

3.Intangible assets

4.Inventory

5.Brand name

Risk:

1.Market risk

2.Inventoty risk

Characterisation:

Surfco Ltd is characterised as full fledged manufacturer as it owned the intangibles assets, procure raw materials and perform manufacturing activities.

Surfco Sub 1

Function:

1.Sale

2.Inventory management

3.Marketing

Asset:
1.Human capital (employees)

Risk:
1.Market risk
2.Inventory risk
3.Foreign exchange risk

Characterisation:
Surfco Sub 1 is characterised as limited risk distributor as it only perform sales and marketing function.

Surfco Sub 2
Not exist before restructuring

Post restructuring
Surfco Ltd (group head company)
Function:
1.Strategic management
2.Marketing, procurement and services
3.Funding (financing to Surfco Sub1)

Asset:
1.Human capital (employees)
2.Inventory

Risk:
1.Market risk
2.Inventoty risk

Characterisation:
Surfco Ltd is characterised as limited risk distributor as all intellectual property has been transferred to Surfco Sub 1. Also, Surfco Ltd is no longer carry out manufacturing function as it is already being transferred to Surfco Sub2

Surfco Sub 1

Function:

1.Sale

2.Inventory management

3.Marketing

4.Intellectual property management

Asset:

1.Human capital (employees)

2.Intellectual property

Risk:

1.Market risk

2.Inventory risk

3.Foreign exchange risk

Characterisation:

Surfco Sub 1 is characterised as owner of intellectual property after Surfco Ltd transferred the intellectual property.

Surfco Sub 2

Function:

1.Manufacturing

2.Sales

3.Distribution

Assets:

1.Human capital (employees)

2.equipments for manufacturing

Risk:

1.Market risk

2.Inventory risk

Characterisation:

Surfco Sub 2 is characterised as contract manufacturer assume that purchase of raw materials is handled by Surfco Ltd.

Below are the key risks after business restructuring:

1.Surfco Ltd might not be appropriate compensated for transfer of intellectual property to Surfco Sub1.

2.The compensation for transfer of intellectual property by Surfco Ltd is through interest free loan made by Surfco Ltd to Surfco Sub1. An independent enterprise would not provide interest free loan to a company. An arm's length interest should be charged on loan provided to Surfco Sub1.

3.Surfco Ltd which has ceased its manufacturing operations is not being remunerated accordingly by Surfco Sub2.

4.Royalty 8% of sales charged by Surfco Sub1 to Surfco Ltd and independent Co might not comply with arm's length principle. Surfco Sub1 might be overcharged royalty. CUP method should be applied in arriving at arm's length price.

5.

Answer-to-Question-__5_

CCA is a contractual arrangement among business enterprises to share the contributions and risk involved in the joint developement, production or the obtaining of intangibles, tangible assets or services with understanding that such intangibles, tangible assets or services are expected to crete benefits for the individual business of each of the participants.

Participants is eligible to share their contributions. At the time of entering into CCA, the proportion of contribution by each of the participants must be consistent to the proportion of benefit to be received.

There are two types of CCA which are development CCA and service CCA. Development CCA will create future benefits. In contrast, service CCA will create current benefit only.

The advantage of CCA is that it does not required the participants to combine their operations in order to obtain the benefit from CCA.

The disadvantage is the participant is required to share the downside consequences of risk associated with achieving the anticipated CCA outcome.

CCA is implemented by value the each participant's contribution to the arrangement in order to comply with the arm's length principle.

Answer-to-Question-_9__

Part 1

Mutual Agreement Procedure provide the tax administrations consult to resolve dispute regarding the application of double tax convention.

The three subsidiaries can apply to tax administrqation of their country to request for relief under tax convention.

Under Article 25 of OECD Model Tax Convention, the case must be presented within three years from the first notification of the action resulting in taxation. If the tax authority is unable to reach an agreement within two years from the presentation of the case, the case will be submitted to arbitration as per taxpayer request.

Part 2

In order to minimise the risk of tax administration undertaking TP audit and adjustment. The group should ensure that they have reach an agreement with tax administration to eliminate double taxation.Taxpayer should ensure that there is no misunderstanding by the tax administration on the fact and argument.