

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2024

MODULE 3.03 – TRANSFER PRICING OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Part 1

In their responses, candidates should make reference to the Organisation for Economic Cooperation and Development (OECD) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022 (TPG) or alternatively the United Nations Practical Manual on Transfer Pricing.

The glossary of the TPG states that "two enterprises are associated enterprises with respect to each other if one of the enterprises meets the conditions of Article 9, sub-paragraph 1a) or 1b) of the OECD Model Tax Convention with respect to the other enterprise."

The 2017 OECD Model Tax Convention assists countries concluding bilateral tax conventions. It is one of the basis's for negotiation and application of bilateral tax treaties, and also provides a means for settling on a uniform basis for the most common issues that arise in the field of international double taxation. Article 9 addresses Associated Enterprises and states where "a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of a enterprise of the other Contracting State, or b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State."

In summary, an Associated Enterprise is generally parent and subsidiary relationships, and companies under common control. Generally, this results through shareholding and/or or common directors.

Based on the facts provided, the following transactions are undertaken between associated enterprises within the Beach Group:

<u>Entity</u>	<u>Details</u>
Beach plc	<ul style="list-style-type: none"> • Provision of intellectual property, including licences, trademarks, copyrights and manufacturing know-how to associated enterprises including Creek Pty Ltd, Canal Pte Ltd and Aqueduct Inc. * Refer to note below • Provision of services, including information technology, general administration, treasury, insurance and marketing support • Sale of Beach branded finished goods to Creek Pty Ltd and Canal Pte Ltd • Receipt of contract research and development from Canal Pte Ltd • Receipt of logistics services from Canal Pte Ltd
Creek Pty Ltd	<ul style="list-style-type: none"> • Purchase of Beach branded finished goods from Beach plc. • Receipt of intellectual property from Beach plc. *Refer to note below • Receipt of services, including information technology, general administration, treasury, insurance and marketing support from Beach plc. • Receipt of logistics services from Canal Pte Ltd.
Canal Pte Ltd	<ul style="list-style-type: none"> • Provision of contract research and development for Beach plc. • Provision of contract manufacturing for Beach plc. • Provision of logistics services for Beach plc, Creek Pty Ltd, River Ltd and Aqueduct Inc. (UPDATE) • Receipt of services, including information technology, general administration, treasury, insurance and marketing support from Beach plc. *Refer to note below. • Purchase of Beach branded finished goods from Beach plc.

	<ul style="list-style-type: none">• Provision of services, including dispatch of orders to Aqueduct Inc. in relation to Beach online platform business
River Ltd	<ul style="list-style-type: none">• Receipt of services, including information technology, general administration, treasury, insurance and marketing support from Beach plc. *Refer to note below.• Receipt of logistics services from Canal Pte Ltd
Aqueduct Inc.	<ul style="list-style-type: none">• Purchase of Beach branded finished goods from Beach plc.• Receipt of services, including information technology, general administration, treasury, insurance and marketing support from Beach plc. *Refer to note below.• Receipt of services from Canal Pte Ltd in relation to Beach online platform business.

It is noted that the information in the facts have been sourced from the Beach Group Country by Country Report (CbCR), which is predominantly used for risk assessment purposes. A tax administration undertaking compliance activity should source additional information, rather than relying solely on the CbCR. The written contractual terms and the actual dealings between the associated entities should be considered in delineating the transactions.

* Further, it is not clear based on the facts provided it is uncertainty whether each group entity receives or benefits from each category of intellectual property and various services. For example, River Ltd sources pool pumps from unrelated entities and may not make use of all services provided (or available to be provided) by associated enterprises.

It is reasonable for candidates to make assumptions regarding some additional transactions which may arise between members of the Beach Group.

Part 2

A functional analysis is defined in the glossary of the TPG as "the analysis aimed at identifying the economically significant activities and responsibilities undertaken, assets used or contributed, and risks assumed by the parties to the transactions."

In undertaking a functional analysis, candidates should refer to Chapter 1, D1.2 of the TPG.

It is acknowledged that limited information is available and candidates are able to make reasonable assumptions regarding the functions, assets and risks for the type of entity. Below is a typical functional analysis (i.e. the below is not exhaustive), and this will vary depending on further facts being sourced.

Beach plc

Functions

- Development, maintenance and protection of intellectual property
- Provision of administrative and associated services (information technology, general administration, treasury, insurance and marketing support)
- Sales and marketing activities
- Retail store operation
- Distributor of Beach products

Assets

- Intellectual property (licences, trademarks, copyrights and manufacturing know-how)
- Human capital
- Office and related equipment (computer, chairs, desk)
- Motor vehicles
- Office premises
- Highly skilled employees

Risks

- Market risk
- Foreign exchange risk
- Product liability (warranty)

- Inventory

Characterisation

- Entrepreneur, exploitation of intellectual property
- Service provider to associated enterprises
- Retail operations

Creek Pty Ltd

Functions

- Sales and marketing

Assets

- Office and related equipment
- Human capital
- Motor vehicles
- Warehouse

Risks

- Inventory
- Market

Characterisation

- Distributor

Canal Pte Ltd

Functions

- Contract manufacturing
- Contract research and development
- Procurement of manufacturing inputs
- Logistics activities
- Sales and marketing
- Distribution

Assets

- Plant and equipment for manufacturing
- Warehouse and building
- Office and related equipment
- Motor vehicles
- Human capital

Risks

- Foreign exchange
- Inventory
- Market

Characterisation

- Contract service provider
- Distributor

River Ltd

Functions

- Sales and marketing

Assets

- Human capital
- Office equipment
- Motor vehicles

Risks

- Inventory

- Market
- Product liability

Characterisation

- Distributor (independent products)

Aqueduct Inc.

Functions

- Online sales

Assets

- Human capital
- Computer equipment

Risks

- Market

Characterisation

- Online retailer

Question 2

Part 1

Chapter II of the TPG addresses transfer pricing methods. Further, Chapter VII also has relevance in relation to intra group services. Candidates should reference the appropriate paragraphs of the TPG in support of their response.

<u>Entity</u>	<u>Details</u>	<u>Transfer pricing method</u>
Beach plc.	<ul style="list-style-type: none"> • Provision of intellectual property, including licences, trademarks, copyrights and manufacturing know-how to associated enterprises including Creek Pty Ltd, Canal Pte Ltd and Aqueduct Inc. • Provision of services, including information technology, general administration, treasury, insurance and marketing support • Sale of Beach branded finished goods to Creek Pty Ltd, Canal Pte Ltd • Receipt of contract research and development from Canal Pte Ltd • Receipt of logistics services from Canal Pte Ltd 	<ul style="list-style-type: none"> • Refer to below (associated enterprise likely being the tested party) • Cost plus • Refer to below (associated enterprise likely being the tested party) • Cost plus • Cost plus
Creek Pty Ltd	<ul style="list-style-type: none"> • Purchase of Beach branded finished goods from Beach plc. • Receipt of intellectual property from Beach plc. • Receipt of services, including information technology, general administration, treasury, insurance and marketing support from Beach plc. • Receipt of logistics services from Canal Pte Ltd. 	<ul style="list-style-type: none"> • Transaction net margin method (TNMM) or Comparable uncontrolled price (CUP) • IP factored into cost plus • Cost plus • Cost plus or factored into TNMM e.g. (EBIT/Sales)
Canal Pte Ltd	<ul style="list-style-type: none"> • Provision of contract research and development for Beach plc. • Provision of contract manufacturing for Beach plc. • Provision of logistics/ services for Beach plc, Creek Pty Ltd, River Ltd and Aqueduct Inc. (UPDATE) • Receipt of services, including information technology, general administration, treasury, insurance and marketing support from Beach plc. • Purchase of Beach branded finished goods from Beach plc. • Provision of services, including dispatch of orders to Aqueduct Inc. in relation to Beach online platform business 	<ul style="list-style-type: none"> • Cost plus • Cost plus • Cost plus • Cost plus • TNMM e.g. (EBIT/Sales) • Cost plus
River Ltd	<ul style="list-style-type: none"> • Receipt of services, including information technology, general administration, treasury, insurance and marketing support from Beach plc. • Receipt of logistics services from Canal Pte Ltd 	<ul style="list-style-type: none"> • Cost plus • Cost plus
Aqueduct Inc.	<ul style="list-style-type: none"> • Purchase of Beach branded finished goods from Beach plc. • Receipt of services, including information technology, general administration, treasury, insurance and marketing 	<ul style="list-style-type: none"> • TNMM e.g EBIT/Sales • Cost plus

support from Beach plc. *Refer to note below.

- Receipt of services from Canal Pte Ltd in relation to Beach online platform business.
- Cost plus

It should be noted that as River Ltd purchases finished goods from unrelated parties which are also distributed to unrelated parties, the TNMM is unlikely to be the appropriate method. The transactions with associates are services, with a cost plus being the most appropriate method. i.e. River Ltd is the entrepreneur in relation to their distribution activities.

Part 2

A comparable analysis should be undertaken. The OECD TPG define “comparability analysis” as a comparison of a controlled transaction with an uncontrolled transaction.” Controlled and uncontrolled transactions are comparable if one of the differences between the transactions could materially affect the factor being examined in the methodology (e.g. price or margin), or if reasonably accurate adjustments can be made to eliminate the material effects of such differences.

Chapter III of the OECD TPG address comparability analysis. In undertaking a comparability analysis, paragraph 3.4 sets out the steps.

Based on the facts provided, a review of internal comparables should be undertaken prior to considering external comparables. Further analysis would have to be undertaken, based on a functional analysis and identifying significant comparability factors. However, as River Ltd purchases similar products (i.e. non-Beach branded) from unrelated parties, this may be a potential internal comparable for the distribution/sales and marketing activities of associated entities such as Creek Pty Ltd and Canal Pte Ltd. However, it is noted that the value of sales made by River Ltd (250m) to independent parties is greater than the sales made by Creek Pty Ltd (100m) and Canal Pte Ltd (40m). A comparability adjustment may need to be considered.

If it is assessed that the internal comparable is not reliable or significant comparable adjustments would be required, other sources of information would need to be considered such as public databases for potential comparable companies which undertake similar activities as the tested parties.

Part 3

Candidates may raise a number of potential valid concerns regarding the application of the arm’s length principle. Further work would have to be undertaken and the responses are preliminary and based on the information supplied in the question.

Non-exhaustive examples include:

- Despite Beach plc being the legal owner of all of the groups intellectual property and employing 2,000 employees, all other associated enterprises in the group make a higher margin. Beach plc makes a margin of 2.5% net profit to sales margin and 1.5% net profit as % of total assets. It is possible that Beach does not apply an arm’s length price in relation to transactions with associated enterprises (i.e. sales of finished goods or services).
- Despite Aqueduct Inc appearing to undertake limited economic activity, including limited functions and with only 15 employees, they return a substantial profit margin (50% net profit margin and 550% net profit to total assets). It is also apparent that Aqueduct operates in the jurisdiction with the lowest tax rate.
- Candidates may raise questions regarding Beach plc being the legal owner of intellectual property for the group, but Canal Pte Ltd undertaking services relating to the intellectual property for the Group. This raises considerations around the concept of development, enhancement, maintenance, protection and exploitation of intangibles (DEMPE).

PART B

Question 3

Candidates may reference and explain the OECD TPG, Chapter IX: Transfer Pricing Aspects of Business Restructures.

A full functional analysis would be required for all entities to establish the global value chain and economic substance of the Flipper group pre and post restructure. Identification of the economically significant activities and responsibilities undertaken, assets used or contributed, and risks assumed by the parties to the transactions. Further, each entity should be characterised following identification of the functions, assets and risks of the entities. Candidates may note the practical nature of functional interviews to be conducted with a broad range of personnel of the associated enterprises as part of a functional analysis, this includes personnel at not only the strategic but operational levels across various business divisions.

- Identify the commercial and financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations in order that the relevant circumstances attaching to those relations in order that the controlled transaction is accurately delineated; and to compare those conditions with those of comparable transactions between independent enterprises.
- Requires understanding of the relevant industry.
- Consider options realistically available.

Candidates may make certain assumptions given the list of facts provided is not exhaustive but would be expected to apply the facts to a functional analysis in terms of pre and post restructuring for the entities within the Flipper Group and also characterise them.

<u>Entity</u>	<u>Pre-restructuring</u>	<u>Post-restructuring</u>
Flipper Ltd Country A	<p>Functions: Manufacturing and production, warehousing, procurement, research and development, distribution, intellectual property holder, marketing and sales.</p> <p>Assets: Intellectual property, property, plant and equipment, inventory, staff, offices, warehouses, retail stores.</p> <p>Risks: Operational, obsolescence, market, financial, manufacturing, bad debt, IP/research and development, inventory.</p> <p>Characterisation: Fully-fledged manufacturer with a sales and marketing/distribution function and intellectual property holder.</p>	<p>Functions: Sales and marketing, human resource management, procurement, administration, strategic management.</p> <p>Assets: Staff, offices, warehouses.</p> <p>Risks: market, operational.</p> <p>Characterisation: Services provider/hub with a strategic management function.</p>
Flipper Sub 1 Country B	<p>Functions: Procurement, distribution, sales and marketing.</p> <p>Assets: Warehouses, staff, inventory, offices.</p> <p>Risks: Inventory, market, financial, operational, inventory.</p> <p>Characterisation: Fully-fledged distributor with a sales and marketing function.</p>	No change. Royalties now paid to Flipper Sub 3 with an increase in the percentage.
Flipper Sub 2 Country C	<p>Functions: Procurement, distribution.</p> <p>Assets: Warehouses, staff, inventory, offices.</p> <p>Risks: Inventory, market, financial, operational, inventory.</p> <p>Characterisation: Fully-fledged distributor.</p>	No change. Royalties now paid to Flipper Sub 3 with an increase in the percentage.
Flipper Sub 3 Country E	N/A	<p>Functions: Intellectual property holder, research and development.</p> <p>Assets: Offices, plant and equipment, staff.</p> <p>Risks: Market, financial, operational, research and development.</p> <p>Characterisation: Intellectual property holder with a research and development function.</p>
Flipper Sub 4 Country F	N/A	<p>Functions: Manufacturing and production, warehousing, procurement, distribution.</p>

Assets: Plant and equipment, inventory, staff, offices, warehouses.

Risks: Operational, obsolescence, market, financial, manufacturing, bad debt, inventory.

Characterisation: Fully-fledged manufacturer.

Candidates may raise transfer pricing risks such as:

- Commercial and economic rationale for entering into business restructure by all entities having regard to the arm's length principle.
- Is the transfer of intellectual property at arm's length? What is the commercial rationale for the transfer?
- Valuation issue in relation to the arm's length compensation for transfer of intellectual property.
- Economic versus legal ownership of IP and DEMPE functions.
- Arm's length nature of the royalties paid associated with intellectual property.
- What are the contractual terms between the parties (pre and post restructure)?
- Is the economic substance in line with the reallocation of risks?
- Potential for buy-out payments and loss of profit-making potential.
- What options were realistically available for all entities involved in the business restructure?
- Profit shifting to lower tax jurisdictions with a decline in profitability in higher tax jurisdictions.
- Potential anti-avoidance.

Question 4

Part 1

Candidates may reference the OECD Model Tax Convention on Income and Capital (2017), Article 5 – Permanent Establishment.

The term permanent establishment means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

A permanent establishment specifically includes:

- A place of management,
- A branch,
- An office,
- A factory,
- A workshop,
- A mine, oil or gas well, quarry or other place of extraction of natural resources, and
- A building suite or a constructional or installation project if the period exceeds 12 months.

Article 5(4) stipulates that a permanent establishment shall be deemed not to include:

- Facilities for storage, display or delivery of merchandise.
- Maintaining goods or merchandise for the purpose of storage, display or delivery.
- Fixed place solely for purchasing goods or merchandise or for collection of information, or
- Activities of a preparatory or auxiliary nature.

The facts applicable to Salinity Pty Ltd (SPL) will relate to the relevant permanent establishment article in any Double Taxation Agreement (treaty) between Hydrovista and Altrum.

A dependent agent permanent establishment may be created in line with Article 5(5) given decision makers (directors) of SPL sign contracts relevant to the construction project conducted in Altrum. In addition, strategic decision making is undertaken by SPL.

The project being undertaken by SPL (desalination plant construction) in Altrum may give rise to a permanent establishment - Article 5(3) – if it is a project lasting more than 12 months.

Candidates may contend that SPL has a fixed place of business permanent establishment in Altrum through the operation of an office. The place of management may also be conducted in Altrum for running the project - Article 5 (1 & 2).

Candidates may identify that the project activities are being split up between different associated companies of SPL. Also, staff employed by SPL are completing work in Altrum for short periods of time. This may indicate that separate activities relate to a holistic project and therefore a permanent establishment.

Candidates may highlight that the anti-fragmentation rules, noting Article 5(4), may apply to the SPL. Staff employed by SPL undertake work in Altrum on a short-term basis for two months at a time. This may result in the overall combination of activities carried out in Altrum resulting in a permanent establishment for SPL.

A services permanent establishment may also exist, having regard to the staff employed by SPL, performing work in Altrum.

It could be argued that Article 5(4) does not apply to the project activities in Altrum.

Part 2

Candidates may take the permanent establishment application further to apply Article 7 (business profits) of the OECD Model Tax Convention (2017) which would have implications for the attribution of potential profits to a permanent establishment.

Reference is made to the OECD Guidance on Attribution of Profits to Permanent Establishments (2017). The analysis of the examples included in the Report is governed by the authorised OECD approach contained in the 2010 version of Article 7. The key principle across the examples is that the profits attributable to a PE are those that the PE would have derived if it were a separate and independent enterprise having regard to the functions, assets and risks.

PART C

Question 5

Financial transactions between associated entities within an MNE should have regard to the arm's length principle and identify the commercial and financial relations (refer to guidance at Chapter I, D.1 of the OECD TPG).

Emphasis is placed on the accurate delineation of the transaction as a framework for assessing the arm's length nature of intra-group financial transactions. This includes an examination of each financial transaction in terms of the functions, assets, and risks of each associated enterprise involved in the transaction.

Candidates may refer to the OECD TPG, Chapter X - Transfer pricing aspects of financial transactions.

Candidates should list key transfer pricing risks/issues in relation to intra-group financial transactions.

- Whether a purported loan should be treated as a loan.
- Identification of the commercial and financial relations.
- The economically relevant characteristics of actual financial transactions.
- Treasury function.
- Intra-group loans (lender and borrowers' perspective, credit ratings, group membership, covenants, guarantees, fees and charges, cost of funds – arm's length interest rate, arm's length conditions).
- Cash pooling (arm's length price).
- Hedging (examination of risks).
- Financial guarantees (economic benefits, group membership, financial capacity of guarantor, arm's length price).
- Captive insurance (assumption of risk, arm's length price).
- Risk-free and risk-adjusted rates of return.
- Thin capitalisation.

Better candidates will cite relevant case law to support their discussion around the risks highlighted.

Question 6

Part 1

Candidates could highlight some key areas including:

- Conducting a full functional analysis for all entities within the multinational group and characterisation.
- Documenting the pre and post group structure and ownership with functions, assets and risks.
- Consider the commercial rationale and all commercial and financial relations within the group through the change/restructure.
- Review of all inter-company agreements from an arm's length perspective.
- Any movement of intellectual property.
- A full transfer pricing analysis must be documented to justify the arm's length nature of the arrangements between related parties.
- Consideration of the arm's length nature of all transactions for each jurisdiction.

Part 2

Considerations of a transfer pricing audit:

From the tax administration's perspective:

- A clear audit plan should be presented to the taxpayer at an initial meeting and set mutual expectations.
- Identification of the risk hypothesis from a transfer pricing perspective.
- Identification of organisational charts to identify the key staff to schedule and conduct functional interviews across the functions of business.
- Presentation of clear, targeted and relevant information requests.
- Evidence gathering ('litigation ready').
- Request Country by Country reporting documentation.
- Understanding of the holistic global group structure.
- Understanding of all related party dealings.
- Gather all inter-company agreements.
- Use of exchange of information with other jurisdictions.
- Approach with the taxpayer is contingent on taxpayer behaviour and level of engagement during the audit.
- Consider use of formal access powers under domestic legislation.

From the client/adviser's perspective:

- Engage early and in a timely manner throughout the course of the audit.
- Involve all appropriate staff within the global organisation and an advisor.
- Record keeping including Country by Country reporting documentation and all other transfer pricing documentation is critical.
- Clearly align operational businesses with transfer pricing mechanisms/outcomes articulated.
- Provide complete, accurate and timely responses to information requests.
- Ensure all documentation aligns with the transfer pricing outcomes.
- Use of OECD TPGs and domestic TP legislation in each jurisdiction for entities operating globally within the group.

Question 7

Part 1

Candidates may make reference to the OECD TPG, Chapter VI – Special considerations for intangibles. Some key areas that may be raised include:

- DEPME (development, enhancement, maintenance, protection and exploitation) is a key concept introduced by the OECD TPG in recent years in relation to IP.
- Economic versus legal ownership is critical.
- Performance of a functional and comparability analysis to identify intangibles and the associated risks, contractual arrangements and actual conduct of the parties.
- Identify intangibles, establish the ownership of the intangibles and look at how they are valued, assess the contribution of the intangibles to value creation within the MNE group, and decide which group members contributed to the value of the intangible.
- The appropriate TP method should then be established to allocate the profit between the related parties.
- The determination of an arm's length value for intangible assets is generally complex and is facing increasing scrutiny in transactions involving the use or transfer of intellectual property between associates. The valuation of IP and the resulting arm's length royalty or transfer price requires a correct delineation of the arm's length principle outlined in the OECD TPG.
- Marketing intangibles such as trademarks, trade names, or customer lists can be created by marketing activities and increase the sales of a product or a service for an MNE.
- In cases where the IP development activity was outsourced to an associate under a contract R&D arrangement, the arm's length compensation for such contract R&D services must be established. The OECD TPG indicate that the functions performed by contract R&D providers, including any risk mitigation or DEMPE functions, should be appropriately compensated via a service arrangement (i.e. usually cost plus) and should not impact the valuation of the IP.
- While it may not be necessary for the IP owner to perform all DEMPE risk control activities itself for it to be recognised as the economic owner of the IP, it is essential that the IP owner undertakes meaningful risk control functions for the specific economically significant risks relating to the IP it owns, as well as having the financial capacity to bear financially significant risks.

Candidates may discuss models available in relation to exploitation of intangibles. This may include the establishment of a principal within a structure/group that is the legal and economic owner of the intellectual property that licenses the use of the intellectual property to other entities to exploit through the sale of goods or provision of services whom pay a royalty in return. Other models may include variations to the structure whereby the legal or economic owner may be with other entities within the group.

Part 2

Candidates may reference the OECD's work since BEPS Action 1 in relation to taxation of the digital economy. A key issue with digital platforms such as Amazon, ebay, etc. is the concept of profits not reported in the jurisdiction where the income is derived (customer sales) with no physical presence relative to value creation.

In the digital economy, value is not created in isolation by a company for the benefit of the customer but, in fact, is created as a consequence of the constant flow of information between the company and the customer. Value creation, therefore, is no longer a static eventuality at the end of a value chain but rather a result of dynamic interaction within a digital ecosystem of shops and networks. This therefore presents fundamental transfer pricing issues in terms of the FAR, value creation and attribution of profits.

Better candidates may mention the OECD's two-pillar solution as well as the imposition by some jurisdictions previously, such as the UK, of a digital services tax. Essentially attempting to ensure that profits are taxed in a territory even in absence of a physical presence there, i.e. a digital presence. This reflects a link between where digital profits are made and where they are taxed.

Benefits to tax administrations that embrace the changes to the taxation of e-commerce models may include:

- Increased revenue base / reduce the tax gap.
- Minimise the risk of double taxation.
- Broader policy advantages.
- Increase international co-operation.
- Reputation and alignment with OECD best practice.
- Integration with IT and big data as well as AI in the tax system.
- Improvement of tax compliance risk management.

Question 8

Part 1

On 19 February 2024, the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) published their report on Pillar One - Amount B.

Refer to <https://www.oecd.org/tax/beps/pillar-one-amount-b-21ea168b-en.htm>

In its Statement of October 2021, the OECD/G20 Inclusive Framework on BEPS agreed to simplify and streamline the application of the arm's length principle to in-country baseline marketing and distribution activities, with a focus on the needs of low-capacity jurisdictions. In July 2023, the Inclusive Framework agreed to publish a final Amount B report, content from which would be incorporated into the TPG by January 2024 with due consideration given to both the needs of low-capacity jurisdictions, and the interdependence of Amount B with the signing and entry into force of the Multilateral Convention to Implement Amount A of Pillar One.

The simplified and streamlined approach draws from the general principles outlined in the TPG and is proposed to be incorporated into the TPG as an Annex to Chapter IV. Notably, nothing in the guidance should be construed as a basis to interpret the application of the general principles in the remainder of the TPG with respect to any transactions, nor should this guidance be interpreted as revising those principles. It is proposed that jurisdictions will have the ability to choose to apply the simplified and streamlined approach for in-scope transactions of tested parties in their jurisdictions for fiscal years commencing on or after 1 January 2025.

Jurisdictions can choose to apply the simplified and streamlined approach to the qualifying transactions of their in-scope tested parties according to the options articulated in Section 2. Similar to other elective approaches in the TPG, the outcome determined under the simplified and streamlined approach by a jurisdiction that has chosen to apply the simplified and streamlined approach to qualifying transactions of its in-scope tested party is non-binding on the counter-party jurisdiction where the associated enterprise that is a party to the controlled transaction is located.

However, subject to their domestic legislations and administrative practices, members of the Inclusive Framework commit to respect the outcome determined under the simplified and streamlined approach to in-scope transactions where such approach is applied by a low-capacity jurisdiction and to take all reasonable steps to relieve potential double taxation that may arise from the application of the simplified and streamlined approach by a low-capacity jurisdiction where there is a bilateral tax treaty in effect between the relevant jurisdictions.

The Inclusive Framework will continue to work on the implementation of this commitment in 2024, including through the development of competent authority agreements that could be used within the context of bilateral tax treaty relationships, taking into consideration the dual objective of bilateral tax treaties to avoid double taxation, as well as to prevent double non-taxation. The Inclusive Framework will agree on the design elements and on the list of low-capacity jurisdictions within scope of this commitment by consensus in 2024. The Inclusive Framework will agree on the list of low-capacity jurisdictions.

In summary:

- Transfer pricing disputes with respect to baseline marketing and distribution arrangements may involve administrative challenges for tax administrations, especially of low-capacity jurisdictions, and result in a compliance burden for taxpayers.
- Disputes may arise in relation to the accurate delineation of the arrangement or with respect to the pricing considerations of marketing and distribution arrangements, focusing on areas such as the selection of the transfer pricing method, the appropriateness of the benchmarking analysis or, where necessary, how to make appropriate comparability adjustments.
- The simplified and streamlined approach seeks to approximate an arm's length outcome for in-scope baseline marketing and distribution arrangements.
- It seeks to facilitate compliance, prevent transfer pricing disputes from arising and help resolve those that do arise in a more efficient manner.
- Therefore, for in scope arrangements, this measure should assist preventative disputes for jurisdictions which apply the approach.

Part 2

Chapter IV of the TPG addresses Administrative approaches to resolving and avoiding transfer pricing disputes.

Paragraph 4.143 defines an advance pricing arrangement (APA) as an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria (e.g. methods, comparables and appropriate adjustments, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a

fixed period of time. An APA is formally initiated by a taxpayer and requires negotiations between the taxpayer, one or more associated enterprises, and one or more tax administrations.

Generally, a bilateral APA is preferred over a unilateral APA. However, this will depend on a number of factors such as:

- Whether the jurisdictions in which the multinational enterprise operates have treaties,
- Whether transactions are material,
- The appetite of risk of the taxpayer,
- The number and complexity of transactions between associated enterprises,
- If safe harbours may apply, and
- Whether the jurisdictions offer APAs.
- Paragraph 4.156 supports that bilateral or multilateral APAs reduce or eliminate the likelihood of double tax.

Question 9

Part 1

Transfer pricing is complex and resource intensive for both taxpayers and tax administrations alike. Safe harbours are generally seen as positive as they provide taxpayers certainty and allow the efficient allocation of resources by tax administrations.

A safe harbour in the context of transfer pricing 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 country's general transfer pricing rules.

Chapter IV: Administrative approaches to avoidance and resolving transfer pricing disputes in the TPG addresses Safe harbours should be referenced by candidates.

A number of jurisdictions have adopted safe harbour rules which have generally been applied to smaller taxpayers and/or less complex transactions. It is generally perceived that the benefits outweigh the concerns.

However, when safe harbours are adopted on a bilateral or multilateral basis this is favoured over a unilateral basis. Candidates should advise whether they support safe harbours with appropriate reasons to support their decision.

E.3 of the TPG addresses the benefits of safe harbours which can be summarised as:

- Simplifying and reducing compliance.
- Providing certainty.
- More efficient use of resources for tax administrations.

E.4 of the TPG addresses the concerns of safe harbours which can be summarised as:

- May not be in accordance with the arm's length principle.
- May increase double tax when adopted unilaterally.
- May open avenue for tax planning.
- May raise issues of equality and uniformity.

Candidates may provide appropriate examples of safe harbours which tax administrations have in place. Further, a better candidates may reference Pillar One - Amount B (in-country baseline marketing and distribution activities) being similar to a safe harbour.

Part 2

The MNE group has the following options available to them to consider following audit tax adjustments made by a tax administration in the course of an audit:

- Option to object or appeal the audit adjustments from a unilateral perspective. As the MNE group has been subject to a transfer pricing adjustment, which they disagree with they have a number of options available to consider. The MNE group may consider that the tax administration has not interpreted or applied the law correctly. Usually there is a period in which the MNE group will need to lodge their written amendment. An objection or appeal is usually undertaken prior to litigation.
- Option to litigate or challenge the tax administrations amended assessments in a court of law in the jurisdiction which made the adjustments. It should be noted that litigating against the tax administration's decision can often be resource intensive and time consuming.
- Consider approach the tax administration to enter into settlement negotiations to resolve the dispute from a domestic or unilateral perspective. This can take into account the chances of success and costs of litigating the matter.
- Apply for Mutual Agreement Procedure (MAP) to resolve treaty related tax disputes. This is dependent on the jurisdiction/s having a treaty with the associated enterprise. MAP provides for a bilateral mechanism for competent authorities of tax administrations to seek to resolve the dispute.