

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2025

MODULE 3.03 – TRANSFER PRICING OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Part 1

In responding to this question, candidates should specify the transactions between associated or related entities within the Sapupo Group.

NewvaniaCo

- Provides services including marketing, human resources, information technology, finance, legal and taxation to OldvaniaCo, PalmariaCo and ArchipeliaCo.
- Licences intellectual property to PalmariaCo in relation to manufacturing.
- Provision of \$100 million funds over 5-year loan term to OldvaniaCo, and associated receipt of interest income.
- Provision of \$400 million of funds over 10-year loan term to NewvaniaCo, and associated receipt of interest income.
- PalmariaCo manufactures goods on behalf of NewvaniaCo (assumed to be a contract manufacturer).
- Purchases finished goods manufactured by PalmariaCo (contracted to manufacture).

OldvaniaCo

- Receipt of services for marketing, human resources, information technology, finance, legal and taxation from NewvaniaCo.
- Purchase of finished goods from PalmariaCo (assumed contractually to be from NewvaniaCo).
- Receipt of \$100 million of debt funding on 5-year term from NewvaniaCo, and associated capital and interest obligation.

PalmariaCo

- Receipt of services for marketing, human resources, information technology, finance, legal and taxation from NewvaniaCo.
- Undertakes manufacturing of goods on contract basis for NewvaniaCo.
- Provision of manufacturing know-how/intellectual property from NewvaniaCo.
- Receipt of \$400 million of debt funding on 10-year from NewvaniaCo, and associated capital and interest obligation.

ArchipeliaCo

- Receipt of services for marketing, human resources, information technology, finance, legal and taxation from NewvaniaCo.

Based on the facts available, it is uncertain if there are further transactions between ArchipeliaCo and associated parties. For example, it is uncertain if ArchipeliaCo sources online applications on behalf of another group member (such as NewvaniaCo) or it undertakes this activity in its own capacity (noting that ArchipeliaCo returns income in its financial accounts). Further, it is possible that there may be a transaction between ArchipeliaCo and NewvaniaCo for the provision of meeting customers at NewvaniaCo's office premises. Refer to the response to Question 2 (3) for further consideration of this issue.

Part 2

The OECD 2022 Transfer Pricing Guidelines (TPG) define a functional analysis 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.”

Candidates should refer to the OECD 2022 TPG, in particular, D1.2 which sets out the steps to undertake a functional analysis.

It is acknowledged that limited information is available to candidates, as set out from a summary of the Country by Country report. However, based on the information available, a functional analysis is factually specific and should include the following key information in relation to the Sapupo Group:

NewvaniaCo

Functions

- Development, enhancement, maintenance, protection and exploitation of intellectual property
- Provision of administrative and associated services (including marketing, human resources, information technology, finance, legal and taxation) to associated enterprise
- Treasury
- Sales and marketing activities
- Distribution/wholesaling
- Retailing operations
- Logistics and warehousing

Assets

- Intellectual property (i.e. brand names, trademarks, patents, manufacturing know how, store design/layouts)
- Human capital (i.e. employees)
- Office equipment
- Motor vehicles
- Assets used in retail (cash register, cabinets, TVs, etc.)
- Cash/Funds

Risks

- Market
- Product liability (warranty)
- Inventory/obsolescence
- Bad debt

OldvaniaCo

Functions

- Sales and marketing activities
- Distribution/wholesaling
- Retailing operations
- Logistics and warehousing

Assets

- Human capital
- Assets used in retail (cash register, cabinets, TVs, etc.)

Risks

- Inventory/obsolescence
- Market
- Foreign exchange
- Bad debt

PalmariaCo

Functions

- Manufacturing (contract basis)
- Procurement of products for manufacturing
- Retailing operations
- Distribution/wholesaling

Assets

- Human capital
- Land, building and manufacturing plant and equipment
- Assets used in retail (cash register, cabinets, TVs, etc.)

Risks

- Inventory
- Market
- Equipment failure
- Employee injury
- Foreign exchange

- Bad debt

ArchipeliaCo

Functions

- Sourcing of applications for phones

Assets

- Human capital
- Office equipment

Risks

- Foreign exchange

Part 3

As limited information is available in the facts provided, additional information would be required to finalise a functional analysis to include in a transfer pricing documentation. A functional analysis is a method of finding and organising facts about a business in terms of its functions, assets and risk in order to identify how these are divided up between the associated enterprises in the transactions under consideration. To conduct a comprehensive functional analysis, it is necessary to gather information from numerous sources.

Only high-level information is available, which has been sourced from the Country by Country report. However, to prepare transfer pricing documentation, additional information would need to be sourced.

Candidates may identify a range of facts which would need to be clarified. As outlined in relation to 1) regarding ArchipeliaCo, there would likely need to be some clarity in relation to the entering of contracts for application developers and the role by both NewvaniaCo and ArchipeliaCo. Further, limited details are provided with respect to the loans between associated parties. For example, Chapter X: Financial relations of the 2022 OECD 2022 TPG supports that additional information would be required in relation to characteristics of the financial instruments, economic circumstances and credit ratings. This includes why a fixed interest rate was applied between NewvaniaCo and PalmariaCo.

Additional information may be sourced from undertaking interviews with key personnel, obtaining contracts between associated enterprises to obtain in-depth information, obtaining financial reports, loan agreements, transfer pricing documentation, staff/personnel organisational charts and requesting responses to request for information.

Part 4

The broad requirement for determining appropriate pricing is to apply the method or methods which achieve the outcome that best approximates the arm's length price.

Candidates should provide relevant references to Chapter II of the OECD TPG 2022 to support their response.

The OECD TPG 2022 recognise five different transfer pricing methods:

- Comparable Uncontrolled Price (CUP)
- Cost Plus (CP)
- Resale Minus (RM)
- Transactional Net Margin Method (TNMM)
- Transactional Profit Split Method (PSM)

Based on the information available, the most appropriate transfer pricing method for the respective transactions are set out below:

Cost plus

The cost-plus method begins with the costs incurred by the supplier of property or services in a controlled transaction for property transferred or services provided to a related purchaser. An appropriate arm's length cost-plus mark-up is then added to this cost to make an appropriate profit considering the functions performed and the market conditions. What is arrived at after adding the arm's length cost-plus mark-up to the above costs may be regarded as an arm's length price of the original controlled transaction.

For example, this method can be applied if:

- semi-finished goods that are subject to additional manufacturing or assembly are sold between associated parties;
- associated parties have concluded joint facility agreements or long-term buy-and-supply arrangements; and
- the controlled transaction is the provision of services.

Further analysis can be undertaken by reviewing the cost plus mark-up of the supplier in the controlled transaction. This is done by referencing the cost plus mark-up that the same supplier earns in comparable uncontrolled transactions. The cost plus mark-up that would have been earned in comparable transactions by an independent enterprise may serve as guidance.

In relation to intra-group services, Chapter VII of the OECD 2022 TPG has application. In respect to the centralised services provided by NewvaniaCo to other associated parties, these may satisfy the requirement of low value-adding intra group services. Paragraph 7.61 of the OECD 2022 TPG provides that a mark-up of cost plus 5% should be applied.

Based on the facts available, the cost plus method could be potentially applied to:

- the services provided by NewvaniaCo to associated enterprises, consisting of marketing, human resources, information technology, finance, legal and taxation; and
- contract manufacturing by PalmariaCo for NewvaniaCo (markup on costs).

Transactional net margin

The transactional net margin pricing method is based on comparisons made at the net profit level between the taxpayer and independent parties in relation to a comparable transaction or dealing. It examines the net profit margin relative to an appropriate base (for example, costs, sales or assets) that a taxpayer realises from a controlled transaction.

Comparisons at the net profit level can be made on a single transaction or in relation to some aggregation of dealings between associated enterprises.

Based on the facts available, this method could be applied to:

- distribution and retail activities (potentially the profit level indicator should be Earnings Before Interest and Tax (EBIT) to Sales); and
- marketing, human resources, information technology, finance, legal and taxation services to OldvaniaCo, PalmariaCo and ArchipeliaCo.

As OldvaniaCo and PalmariaCo both undertake retail and distribution activities, with all product sourced from an associated party (NewvaniaCo), potentially these business operations should be segregated and benchmarked separately. However, in practice, this will depend on how the accounts are prepared and the business is managed. I.e. potentially there would be a different margin for retail and wholesale activity.

Comparable Uncontrolled Price (CUP)

Chapter X: Financial relations at paragraphs 10.89 to 10.95 of the OECD 2022 TPG suggest that the CUP method should be applied to determine an arm's length price in respect of interest rates on loans based on consideration of the credit rating of the borrower, taking into account all of the terms and conditions of the loan and comparability factors. There is a widespread market for lending of money between independent parties, which is generally publicly available. Both internal and external CUPs should be considered.

Therefore, based on the facts available, the CUP method could be applied to:

- NewvaniaCo providing \$100 million funds over 5-year loan term to OldvaniaCo; and
- NewvaniaCo providing \$400 million of funds over 10-year loan term to NewvaniaCo.

Based on the facts available, it is unlikely that the Resale Minus or Profit Split Method would be applied to the Sapupo Group.

Question 2

Part 1

As part of a functional analysis, the associated entities should be characterised. Candidates should refer to the OECD 2022 TPG, Chapter I, D.1.2.

In relation to the Sapupo group, based on the information available, it would be reasonable to characterise the associated entities as:

NewvaniaCo

- Entrepreneur as intellectual property owner
- Service provider to associated entities

OldvaniaCo

- Distributor and retailer

PalmariaCo

- Contract manufacturer
- Distributor and retailer

ArchipeliaCo

- Provider of consulting, vetting and procurement services

Further information would need to be obtained in relation to ArchipeliaCo in order to form a definite characterisation. The sole business of ArchipeliaCo is the sourcing of third party applications.

Part 2

The arm's length principle is premised on transactions between associated enterprises to approximate the prices that would have arisen in the open market or between independent parties in similar circumstances.

Therefore, the expectation is that entities in a multinational group are unlikely to all earn or target the same economic outcome. However, this would depend on the functions, assets and risks of each entity. For example, entities undertaking distribution functions might expect to broadly target or earn similar margins, but this would likely vary depending on the economically relevant characteristics or comparability factors. The application of a transfer pricing method and comparability analysis may also result in different economic outcomes. It is imperative to undertake a comparability analysis to identify a range of economic outcomes an independent company would make based on similar characteristics to the tested party.

For example, an entity which has ownership of intellectual property will likely have the capacity to receive higher margins (or potentially losses in some circumstances) due to its ability to exploit such an asset. However, the entity which owns intellectual property would incur expenses in developing, enhancing, maintaining, protecting and exploiting (such as research and development, marketing costs, litigating those who may infringe, etc.)

In the case of Sapupo Group, the expectation would be that NewvaniaCo would earn higher margins if the group was profitable overall, due to having economic and legal ownership of the group's intellectual property and undertaking higher value functions.

Part 3

A comparability analysis is crucial to verify that ArchipeliaCo's high reported profitability is consistent with the arm's length principle, given its limited activities and substance. It ensures that income is aligned with value creation and helps defend Sapupo Group's transfer pricing policies against potential tax scrutiny.

The relevance of such an analysis is particularly high for ArchipeliaCo for the following reasons:

The nature of ArchipeliaCo's activities raises transfer pricing questions

The strategic direction, final approval of contracts, and control of IP and business model rest with NewvaniaCo as the parent. ArchipeliaCo has limited functions, assets, and risks — only 100 employees, no tangible product sales,

and operates from leased offices. This suggests that ArchipeliaCo may be a limited-risk service provider or intermediary, not the true economic owner of the app distribution business.

Testing whether profit allocation reflects functions, assets and risks

A comparability analysis compares ArchipeliaCo's functional profile to that of independent comparables performing similar intermediary or agency services. It helps to establish if ArchipeliaCo's profit level is commensurate with its routine functions, or whether excessive profits are being booked in ArchipeliaCo (possibly due to its low-tax jurisdiction). This is essential to ensure that profits align with value creation, consistent with the OECD TPG.

Determining the appropriate transfer pricing method

A comparability analysis informs which method is most appropriate. Without a comparability analysis, it's impossible to justify the choice of method or the arm's length return.

Managing tax risk and supporting documentation

Given ArchipeliaCo's very high profitability (42% margin) in a low-tax jurisdiction, tax authorities in Newvania are likely to scrutinise whether income has been shifted artificially. A thorough comparability analysis provides evidence to demonstrate that the intercompany arrangements are arm's length, and can help to minimise the likelihood of transfer pricing adjustments or double taxation.

Ensuring consistency with value creation

The OECD BEPS framework emphasises that profits must follow economic substance. ArchipeliaCo's limited substance contrasts with its disproportionately high profits. A comparability analysis would clarify whether its return reflects real contributions, or whether a greater share of app-related profit should be attributed to NewvaniaCo, which owns the IP, bears the strategic risks and makes the key commercial decisions.

Part 4

Based on the facts available, the tax administration of Newvania may potentially raise a number risk or potential issues.

Sapupo Group derives 20% of its sales from third party online applications, which it loads onto its mobile phones. Given the nature of the business, this may be intrinsically linked to the business model of the group, which is the sale of mobile phones. ArchipeliaCo's only business activity for its 100 employees is the sourcing of third party online applications and returning the sales from independent customers. As its employees often travel to Newvania to presumably consult and seek approval regarding entering into contracts with third party developers in NewvaniaCo's premises, there may be a possibility that ArchipeliaCo is a service provider to NewvaniaCo. A comparability analysis would likely need to be undertaken to test the functional characterisation of the entity. For example, it is possible that ArchipeliaCo is utilising NewvaniaCo personnel/premises and possibly intellectual property, without any form of arm's length payment.

Further information would need to be obtained in order to form this view, but if this was the case, it may not be appropriate for ArchipeliaCo to return sales with customers if they do not have the capacity to enter into contracts with customers. Further, no details are provided regarding how the sales to mobile phone customers are undertaken and the role of associated entities in the group. It is uncertain if ArchipeliaCo has the experience to and capacity to undertake. For example, there may be a case that NewvaniaCo is habitually concluding contracts in relation to the contracts with online application developers, given the meetings with independent parties are taking place at the premises of the head office. Employees of NewvaniaCo may attend these meetings and make the key decisions (i.e. a representative of ArchipeliaCo may only sign the contract). This may result in ArchipeliaCo having a permanent establishment in Newvania (this will depend on the whether a treaty exists and the respective Articles) and claim taxing rights (or a portion of).

Candidates may also note the 5% tax rate in Archipelia and may assert that the arrangement may be driven by seeking to minimise corporate tax (some candidates may also reference the application of Pillar Two if Archipelia hasn't implemented a domestic minimum tax, another jurisdiction may be entitled to top up tax).

OldvaniaCo derives the same net operating margin as NewvaniaCo in relation to the operation of their retail outlets. Although sales are to independent end users, the purchase of finished goods/mobile phones are wholly sourced from an associated party. Based on the application of the arm's length principle, the expectation would be that NewvaniaCo would earn a higher margin, given it retains legal ownership of intellectual property and should be compensated for this investment.

In relation to the contract manufacturing operations undertaken by PalmariaCo under on behalf of NewvaniaCo, consideration would need to be given whether the net operating margin of 3% is arm's length. Although a cost-plus transfer pricing method is likely to be appropriate, as PalmariaCo borrowed \$400 million to construct the manufacturing operations, the financing costs would likely need to be incorporated into the cost base, to ensure that PalmariaCo earns an appropriate margin after incorporating all costs. However, this is less likely to be a concern or risk from the perspective of the tax administration of Newvania.

Other risks which candidates may identify include the loaning of funds by NewvaniaCo to OldvaniaCo (including whether the 9% interest rate is arm's length and whether an independent party would enter into a fixed interest rate loan) and the loaning of funds by NewvaniaCo to PalmariaCo (including whether 3% margin in excess of NewvaniaCo's cost of funds is an appropriate margin).

Candidates may also validly raise further potential risks or issues, in addition to those set out above.

It is noted that the response is based on a preliminary risk assessment, given limited facts are available. Further information would need to be obtained and analysis undertaken.

PART B

Question 3

Part 1

AI Connect, tax resident of Fastria, has not registered a company, branch or permanent establishment in Greshia. The economic activity in terms of the implementation of a software project by AI Connect would raise a permanent establishment risk.

Candidates should make reference to article 5 (Permanent Establishment), and commentaries, of the OECD Model Tax Convention on Income and Capital (2017).

The facts applicable to AI Connect should be applied in relation to the Article 5 of the OECD Model Tax Convention (2017).

A functional analysis should be conducted that identifies the economically significant activities and responsibilities undertaken, assets used or contributed, and risks assumed by the parties to the transactions. Each entity should be characterised following identification of the functions, assets and risks of the entities (OECD Transfer Pricing Guidelines 2022, Chapter 1, D.1.2). Industry knowledge is another important element in understanding the business and global value chain. A functional analysis should identify the economically significant activities and responsibilities undertaken, assets used or contributed, and risks assumed by the parties to the transactions.

Candidates may argue that AI Connect has a fixed place of business permanent establishment in Greshia through the operation of a potential office, branch, factory or workshop; this would be evidenced through functions, assets and risks relevant to the operation of the project. The place of management may also be conducted in Greshia given the existence of key staff including the SSE, operations managers, software engineers, delivery lead, project manager; Article 5(1 & 2).

The software implementation project (artificial intelligence software) being undertaken by AI Connect in Greshia may give rise to a permanent establishment having regard to Article 5(3); a project lasting more than 12 months.

A dependent agent permanent establishment may be created with reference to Article 5(5) as the key decision makers of AI Connect negotiated and signed contracts relevant to the project conducted in Greshia.

A services permanent establishment may to be considered, applicable to the staff employed by AI Connect performing work in Greshia.

Transfer pricing risk in relation to intellectual property would also need to be considered. The facts mention that the code development was conducted in Greshia and the legal registration of the associated intellectual property for the system that was implemented was in Fastria. This raises an issue as to economic versus legal intellectual property.

Part 2

Article 7 (business profits) of the OECD Model Tax Convention (2017) would have implications for the attribution of potential profits to a permanent establishment of NG Headco in Country Z.

Candidates should reference the OECD Guidance on Attribution of Profits to Permanent Establishments (2017).

The Additional Guidance on the Attribution of Profits to Permanent Establishments, BEPS Action 7 (2018) particularly notes attribution commentary in relation to Article 5(4), 5(5) and 5(6). The analysis of the examples included in the report is governed by the authorised OECD approach (AOA). 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 (including the economic contribution towards intellectual property development). Therefore, all of the activities being conducted by AI Connect in Greshia would need to be considered when allocating associated profit/loss.

Question 4

Reference is made to the OECD TPG Guidelines (2022), Chapter IX – Transfer pricing aspects of business restructurings.

Each entity concerned should be characterised following identification of the functions, assets and risks of the entities pre and post restructuring. Consideration should be given to the commercial rationale of the business restructure itself and the arm's length principle.

Candidates should provide consideration of the impact of the changes to functions, assets and risks of the entities for Nutrition Corp by examining the pre and post business restructuring. They will raise that the commercial or financial relations between the associated enterprises involved in the business restructuring and the conditions and economically relevant circumstances attaching to those relations would be identified so that the controlled transactions are accurately delineated. Reference is made to sections D.1 of Chapter 1 of the OECD TPG Guidelines (2022).

Candidates may identify that functional interviews should 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. This examination should involve gaining an understanding of the changes to functions, assets and risks as a result of the restructuring.

Candidates may note that the selection and application of a transfer pricing method to post-restructuring controlled transactions must derive from the analysis of the economically relevant characteristics of the controlled transactions as accurately delineated. This includes an understanding of the functions, assets and risks involved in the post-restructuring and what party performs, uses or assumes them. (Reference is made to Part II: Remuneration of post-restructuring controlled transactions) of the OECD TPG Guidelines (2022).

Pre Restructure

Nutrition Corp

Functions

- Manufacturing
- Procurement (raw materials)
- Logistics
- Sales/marketing
- Distribution
- Research and development
- Support services (accounting, legal, HR)

Assets

- Intellectual property
- Plant & equipment
- Warehouses
- Offices
- Staff

Risks

- Manufacturing risk
- Inventory risk
- Warranty risk
- Market risk
- Research and development risk
- Intellectual property risk

Characterisation

- Fully-fledged manufacturer

Associated enterprises

Functions

- Distribution
- Sales/marketing

Assets

- Warehouse
- Staff

Risks

- Market risk

Characterisation

- Distributors with a sales and marketing function

Post Restructure

Nutrition Corp

Functions

- Financing (lender)
- Potentially sales/marketing

Assets

- Potentially staff

Risks

- Financing risk
- Credit risk

Characterisation

- Holding entity with a financing function (intra-group)

Nutrition Sub A

Functions

- Manufacturing
- Procurement (raw materials)
- Logistics
- Research and development

Assets

- Plant & equipment
- Warehouses
- Staff

Risks

- Manufacturing risk
- Inventory risk
- Warranty risk
- Market risk
- Research and development risk

Characterisation

- Fully-fledged manufacturer

Nutrition Sub B

Functions

- Support services (accounting, legal, HR)

Assets

- Offices
- Staff

Risks

- Limited market risk

Characterisation

- Services provider

Nutrition Sub C

Functions

- Strategy development
- Supplier selection
- Research and development

Assets

- Intellectual property

Risks

- Intellectual property risk

Characterisation

- Intellectual property holding company

In terms of the implications/risks of the business restructure, candidates may highlight the following having regard to the facts:

- Following an examination of the functions, assets and risks of each entity in the group and confirmation of characterisation relative to the purported business restructure.
- Have there been any changes to the application of the transfer pricing methods and do those put in place reflect substantive operations of the business?
- Transfer of intellectual property from Nutrition Corp to Nutrition Sub C:
 - Has there been a legal and economic transfer of intellectual property?
 - Which entities are involved in the development, enhancement, maintenance, protection and exploitation of intangibles (DEMPE) functions and has there been any change economically?
 - Has there been an arm's length compensation for the transfer of assets and risk?
 - Has the transfer of intellectual property arm's length?
 - Valuation issue in relation to the arm's length compensation for transfer of intellectual property.
- Loan between associated enterprises – Nutrition Corp and Nutrition Sub B:
 - Are the terms and conditions of the loan arm's length?
 - Commercial purpose of the loan?
 - Which entity manages and controls the risks associated with the provision of the loan and monitoring the collectability of the loan?
- Shift of manufacturing operations and research and development function through the creation of a new associated enterprise, Nutrition Sub A in a country with a lower headline corporate income tax rate. Change to the related party purchases and sales transactions:
 - What are the contractual terms between the parties (pre and post business restructure)?
 - Examination of budgets, forecasts and projections relating to financial performance pre and post restructure.
 - Has there been documentation that demonstrates the decision making process to reallocate risk (including the details the consequence of the profit potential of significant risk allocation)? Is the economic substance in line with the reallocation of risks?
 - Have there been any buy-out/exit payments?
 - Consideration of loss of profit making potential.
 - Commercial and economic rationale for entering into business restructure having regard to the arm's length principle.
 - What options were realistically available for all entities involved in the business restructure?
 - The legal form of the transaction relative to the economic reality of the transaction.
 - Does it make business and economic sense for the associated enterprises?
 - Have the associated enterprises protected their own economic interests?
- Royalty payment by all of the associated enterprises:
 - Establish the extent to which it would be payable at arm's length. This involves looking at the benefit the entities paying the royalty gain from the rights received for the royalty.

- Was a royalty previously paid to Nutrition Corp by the associated enterprises.
- Shift of provision of services function:
 - Are the services necessary from the perspective of the recipient?
 - Would an arm's length party have paid for the service?
 - Are the services duplicative?
 - Are there any charges for stewardship or shareholder costs?
 - Can the entities substantiate that the services were actually provided?
 - Examination of cost bases, allocation keys and arm's length nature of the mark-up.
- Potential 'treaty shopping' with regard to the commercial rationale for loan between Nutrition Corp and Nutrition Sub B in terms of structuring for a reduction in interest withholding tax payable.

PART C

Question 5

Candidates could note that 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, section D.1, of the OECD TPG (2022). 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.

Reference is made to Chapter X: Transfer pricing aspects of financial transactions of the OECD TPG Guidelines (2022) and the OECD's Transfer Pricing Guidance on Financial Transactions (Inclusive Framework on BEPS: Actions 4, 8-10).

Some key transfer pricing risks in relation to financial transactions include:

- Intra-group loans (lender and borrower's 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.

Consideration has to be given to the commercial reality and economically relevant characteristics of actual financial transactions.

Candidates are required to provide relevant case law.

Question 6Part 1

Reference is made to the Chapter VII: Special considerations for intra-group services of the OECD TPG Guidelines (2022).

Candidates may present issues in relation to the proposal including:

- Determining whether intra-group services have been rendered.
 - Benefits test.
 - Shareholder activities.
 - Duplication.
 - Incidental benefits.
 - Centralised services (Section B.1.5):
The activities that are centralised depend on the kind of business and on the organisation structure of the group, but in general they may include administrative services such as planning, co-ordination, budgetary control, financial advice, accounting, auditing, legal, factoring, computer services, financial services, production buying, distribution and marketing, recruitment and training.
 - Form of the remuneration.
- Determining the arm's length charge.
 - Once it is determined that an intra-group service has been rendered, it is necessary to determine whether the amount of the charge, if any, is in accordance with the arm's length principle.
 - Identifying actual arrangements for charging for intra-group services – direct and indirect methods.
 - Form of compensation.
 - Calculating the arm's length compensation.
 - Methods:
Often application of guidelines in Chapters I, II and III of the OECD TPG (2022) lead to use of the CUP or a cost-based method (cost plus method or cost-based TNMM) for pricing intra-group service.
 - Considerations on including a profit element.
- Low value-adding intra-group services.
 - Definition – supportive in nature, not part of the core business of the MNE group, do not require the use of unique and valuable intangibles nor lead to the creation of them, do not involve the assumption or control nor creation of substantial or significant risk by the service provider.
 - Section D.2: Simplified determination of arm's length charges for low value-adding intra-group services.
- Documentation and reporting.
 - Categories of low value-adding intra-group services provided, benefits, allocation keys, mark-up applied.
 - Written contracts or agreements.
 - Documentation and calculations for the cost pool and mark-up applied.
 - Calculations of allocation keys.
- Levying of withholding tax on charges for low value-adding intra-group services.

Part 2

Reference is made to Chapter IV: Administrative approaches to avoiding and resolving transfer pricing disputes, section E: Safe Harbours, of the OECD TPG (2022).

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. A safe harbour substitutes simpler obligations for those under the general transfer pricing regime and can allow taxpayers to establish transfer prices in a specific way.

Benefits of safe harbours:

- Simplifying compliance and reducing compliance costs for eligible taxpayers in determining and documenting appropriate conditions for qualifying controlled transactions.

- Property designed safe harbours may significantly ease compliance burdens by eliminating data collection and associated documentation requirements in exchange for the taxpayer pricing, qualifying transactions within the parameters set by the safe harbour.
- Providing certainty to eligible taxpayers that the price charged or paid on qualifying controlled transactions will be accepted by the tax administrations that have adopted the safe harbour within a limited audit or without an audit beyond ensuring the taxpayer has met the eligibility conditions of, and complied with, the safe harbour provisions.
 - The tax administration would accept, with limited or no scrutiny, transfer prices within the safe harbour parameters.
 - Taxpayers could be provided with relevant parameters which would provide a transfer price deemed appropriate by the tax administration for the qualifying transaction.
- Permitting tax administrators to redirect their administrative resources from the examination of lower risk transactions to examinations of more complex or higher risk transactions.
 - Once eligibility for the safe harbour has been established, qualifying taxpayers would require minimal examination with respect to the transfer prices of controlled transactions qualifying for the safe harbour. This would enable tax administrations to secure tax revenues in low risk situations with a limited commitment of administrative resources and to concentrate their efforts on the examination of more complex or higher risk transactions and taxpayers. A safe harbour may also increase the level of compliance among small taxpayers that may otherwise believe their transfer pricing practices will escape scrutiny.

Disadvantages/concerns over safe harbours:

- The implementation of a safe harbour in a given jurisdiction may lead to taxable income being reported that is not in accordance with the arm's length principle.
 - Safe harbours involve a trade-off between strict compliance with the arm's length principle and administrability.
- May increase the risk of double taxation when adopted unilaterally.
 - If a tax administration sets safe harbour parameters at levels either above or below arm's length prices in order to increase reported profits in its jurisdiction, it may induce taxpayers to modify the prices that they would otherwise have charged or paid to controlled parties, in order to avoid transfer pricing scrutiny in the safe harbour jurisdiction.
 - Reference is made to The Annex I to Chapter IV of the OECD TPG (2022).
- Potentially open avenues for inappropriate tax planning.
 - May provide enterprises an incentive to modify their transfer prices in order to shift taxable income to other jurisdictions as well as entering into artificial arrangements for the purpose of exploiting the safe harbours.
- May raise issues of equity and uniformity.
 - Creation of two distinct sets of rules in the transfer pricing area.
 - Insufficiently precise criteria could result in similar taxpayers receiving different tax treatment.

Candidates may also mention points raised in Section E.5: Recommendations on use of safe harbours of Chapter IV of the TPG (2022).

Question 7

Candidates may reference the following documents:

- Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 – 2015 final reports.
- Guidance on transfer pricing aspects of intangibles (OECD/G20 BEPS Project, Action 8, 2014 deliverable).
- Chapter VI: Special considerations for intangibles (OECD TPG Guidelines, 2022).

Candidates may reference the following with some example/key areas in relation to the evolution of transfer pricing with regard to intangible property, whilst not exhaustive, provided as follows:

- Identification of intangibles.
- Categories of intangibles.
- Ownership of intangibles and transactions involving the development, enhancement, maintenance, protection and exploitation of intangibles ('DEMPE').
- Intangible ownership and contractual terms relating to intangibles.
- Functions, assets and risks related to intangibles.
- Identifying and determining the prices and other conditions for the controlled transactions.
- Application of the foregoing principles in specific fact patterns.
- Transactions involving the use or transfer of intangibles.
- Issues included in Section D of Chapter VI in the OECD TPG (2022).

Question 8Part 1

Candidates should reference relevant sections of Annex II to Chapter IV of the OECD 2022 TPG to support their response.

Whether Surfland Ltd requests an Advance Pricing Arrangement (APA) will depend on whether the tax administrations of San Louie and Cheetland offer an APA program, as not all tax administrations offer such a product to provide tax certainty. There will be a number of factors which may dictate whether Surfland considers an APA including for example (on the assumption that an APA is available):

- Materiality of transactions between the associated enterprises of San Louie and Cheetland
- Monetary cost of APA (some tax administrations charge taxpayers a fee)
- Whether there is a risk of compliance activity being undertaken by the tax administrations of San Louie and Cheetland if an APA is not entered into i.e. one of the tax administrations may have previously raised concerns with transfer pricing
- If safe harbours are available to apply in relation to the transactions between associates which may apply certainty and minimise risk
- Whether Surfland has capability and human resources (either internal or advisors) to assist with the APA process
- Risk appetite of Surfland Ltd, and
- Whether the business of Surfland Ltd is likely to change and the transactions between associates of San Louie and Cheetland are expected to materially increase in the future.

As Surfland Ltd plans to list their securities on a worldwide stock exchange, it is recommended that the taxpayer proceeds with an APA as this will mitigate risk and provide it with increased certainty regarding future transfer pricing outcomes.

Part 2

Some advantages of entering into an APA include:

- Certainty of transfer pricing outcomes for future years for both taxpayer and tax administrations (for example generally up to 5 years) in relation to transfer pricing outcomes
- Improved corporate governance for the taxpayer, and
- Can lead to improved relationships with cooperation with tax administrations.

Some disadvantages of entering into an APA include:

- Monetary cost (in relation to possible fees charged by tax administration and the cost of advisors)
- Could be a resource intensive process with the effort required to prepare documentation to supply to tax administration and enter into negotiations (depending on complexity of transactions) and ongoing requirements to submit reports confirming compliance through the duration of APA, and
- Could lead to more thorough investigations of the appropriateness of transfer pricing outcomes, including review of tax returns of previous years i.e. rollback period of APA.

Part 3

The main subject areas including in an APA are generally standard. However, there will be some variances depending on whether the APA is unilateral or bilateral in nature.

For example, the main subject headings you would expect to find in an APA may include:

- Names of parties to APA (taxpayers and tax administrations)
- The timeframe in which the APA will operate (a standard timeframe can be 5 years)
- The functions, the assets utilised, and risks undertaken by each of the parties to the transactions (if material changes could be subject to critical assumptions), including the course of action should a possible breach of critical assumption occur
- The agreed transfer pricing methodology which applies to test the financial outcomes (i.e. there may be a range of possible outcomes or a single return required)
- The assumptions upon which the APA is made, and
- Yearly reporting requirements for the taxpayer to supply documentation to confirm compliance with APA terms on a yearly basis (e.g. supply of annual reports, calculations to apply agreed transfer pricing methodology, confirmation no breach of critical assumptions, etc.)

Part 4

The OECD BEPS Project Action Item 14 addressed more effective dispute resolution. One of the best practice recommendations was that tax administrations implement bilateral APA programs.

Therefore, the BEPS project should have resulted in APA's becoming more widely available to taxpayers if jurisdictions implement the best practice. However, whether a tax administration can offer a bilateral APA will depend on the number of Treaties the jurisdiction has entered into as this will be limited to those jurisdictions.

Part 5

The main consideration of whether Surfland Ltd should enter into a unilateral or bilateral APA depends on whether the jurisdictions of San Louie and Cheetaland:

- If both tax administrations offer an APA program, and
- Whether a Treaty or Double Tax Agreement has been executed between San Louie and Cheetaland.

Question 9

The OECD's Inclusive Framework on BEPS has been continuously working to develop a two-pillar solution to help address the tax challenges arising from the digitalisation of the economy.

Pillar One, Amount A targets the largest and most profitable multinational (MNE) groups. It will require in scope MNEs to pay tax in the locations where their customers and users are located based on a formulaic approach to allocate a percentage of profits between each jurisdiction.

Pillar Two, commonly referred to as global minimum tax is designed to ensure that large MNE's pay a minimum level of tax of 15% on the income arising in each jurisdiction where they operate.

Pillar One, Amount B provides for a simplified and streamlined approach to the application of the arm's length principle (transfer pricing) to in-country baseline marketing and distribution activities, with a particular focus on the needs of low-capacity jurisdictions.

The OECD's Inclusive Framework have published guidance on "Special considerations for baseline distribution activities" which has been incorporated into the OECD 2022 Transfer Pricing Guidelines as Annex to Chapter IV. The OECD has indicated that purpose of the simplified and streamlined approach is to enhance and to relieve compliance burdens for taxpayers and tax administrations alike.

In designing Amount B, the OECD has incorporated feedback from business, tax practitioner's, academics, industry groups and other stakeholders.

Each jurisdiction has the choice regarding whether they apply the simplified and streamline approach to qualifying transactions of eligible baseline distributors. The guidance sets out the characteristics of in-scope distributors, which cannot, for example, assume certain economically significant risks or own unique and valuable intangible property. Further, certain activities may exclude a distributor from the scope, such as the distribution of commodities or digital goods. The guidelines provide a pricing framework whereby a three-step process determines a return on sales for in-scope distributors. Guidance also includes requirements for documentation, transitional issues and tax certainty considerations. In summary, if implemented by a jurisdiction in which an MNE operates, and the MNE is in scope and chooses to apply it, it will over-ride the other transfer pricing methodologies in the OECD Transfer Pricing Guidelines.

The OECD is undertaking further work to agree the list of jurisdictions within scope of the political commitment on Amount B (given it is likely to be optional whether a tax administration elects to adopt the measure. The political commitment recognises that subject to their domestic legislation and administrative practices, members of the Inclusive Framework will commit to respect the outcome determined under Amount B to in-scope transactions where such an approach is applied by a covered jurisdiction and to take all reasonable steps to relieve potential double taxation that may arise from its application where there is a bilateral treaty in effect. It is still not certain which jurisdictions will make a political commitment to implement the measure and the OECD continues to undertake further work. If Amount B has application between two jurisdictions which have a Treaty, it should result in less disputes and more certainty for tax administrations and taxpayers alike due to its simplified and streamlined nature (one of the intended key benefits).

There have also been delays in the finalisation of its implementation, with the OECD seemingly prioritising Pillar Two over Pillar One. For example, there has been some media speculation that some jurisdictions may not implement Amount B unless Amount A is finalised. Further, some jurisdictions have raised reservations to certain aspects of the measure.