THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

December 2023

MODULE 3.03 – TRANSFER PRICING OPTION

ADVANCED INTERNATIONAL TAXATION (THEMATIC)

TIME ALLOWED – 3¼ HOURS

This exam paper has **three** parts: **Part A**, **Part B** and **Part C**.

You need to answer **five** questions in total. You will **not** receive marks for any additional answers.

You must answer:

- **Both** questions in **Part A** (25 marks each)
- **One** question from **Part B** (20 marks)
- **Two** questions from **Part C** (15 marks each)

Further instructions

- All workings should be made in appropriate monetary currency, unless otherwise stated. Any monetary calculations should be made to the nearest whole unit of currency. Any necessary time apportionments in your calculations should be made to the nearest whole month.
- You must provide appropriate line breaks between each question, and clearly indicate the start of each new question using the formatting tools available.
- Marks may be allocated for clarity of presentation of your answers.
- The time you spend answering questions should correspond broadly to the number of marks available for that question. You should therefore aim to spend approximately half of your time answering Part A, and the other half answering questions in Parts B and C.
- There is no separate reading time, so you can start typing your answers as soon as the exam begins. However, we recommend that you set aside some time to thoroughly read each question and plan each of your answers.
- **Although references and short quotes from the OECD Transfer Pricing Guidelines can be included in your answer, you will not receive any marks for copying directly from the OECD Transfer Pricing Guidelines.**

PART A

You are required to answer BOTH questions from this Part.

1. Agriculture Tracking Systems Ltd (ATS) is a multinational group of companies involved in the manufacture, distribution and sale of GPS tracking products for the agricultural sector.

The ultimate parent entity, AgTracker Ltd (ATL), is domiciled in Country A. ATL conducts research and development, creating new tracking systems for various applications to the agricultural sector as well as improvements in the design of various tracking systems. It employs a number of highly skilled technical staff, including qualified electronic engineers and those possessing information technology-related qualifications. ATL has the legal ownership of all of ATS's intellectual property.

AgTracker Manco (ATM) is a wholly owned subsidiary of ATL, domiciled in Country B. ATM is responsible for the manufacturing of all of ATS's products, utilising the design information and intellectual property of ATL. ATM pays a royalty to ATL for the use of know-how in the manufacturing process for the products. ATM sells finished products to AgTracker Distribution Co 1 (ATDCo1) and AgTracker Distribution Co 2 (ATDCo2).

ATDCo1 is domiciled in Country C, and purchases finished goods from ATM which it distributes to end customers in the Country C market. ATDCo1 pays a royalty to ATL for use of the intellectual property attached to the products it sells to end customers.

ATDCo2 is domiciled in Country D, and purchases finished goods from ATM which it distributes to end customers in Country D. ATDCo2 pays a royalty to ATL for use of the intellectual property attached to the products it sells to end customers.

Each distributor has an office, and employs staff involved in activities including administration, procurement, marketing and sales. Given the highly technical nature of the products and their applications, marketing and sales staff need to possess strong technical knowledge and communicate this to potential customers in the agricultural sector.

You are required to:

1) Delineate the transactions between associated entities within the ATS group. (10)

2) Perform a functional analysis of the ATS group and characterise the entities. (10)

3) Provide a critical analysis regarding which transfer pricing methods may be applied to the associated transactions within the ATS group. (5)

Total (25)

2. Ocean Fresh Ltd (the Ocean Fresh Group) is a multinational group of companies which specialises in the end-to-end procurement and sale of tuna products. The group's ultimate parent company, Tuna Headco, is domiciled in Yellowfinland, which has a headline corporate tax rate of 30%.

Tuna Headco owns significant assets to undertake the processing of tuna for cans, whole tuna and tuna fillets. This includes the cleaning, gutting and cutting of the fish by employees of Tuna Headco, as well as machines for packaging.

Employees of Tuna Headco assist with the moving of the packaged fish into trucks for distribution. A procurement department within Tuna Headco manage the purchasing of the raw tuna from a wholly owned subsidiary, Tuna Sub 1. Tuna Headco performs research and development (R&D) activities, and has recently developed a new automated cutting machine to improve the efficiency, cost and timeliness of the operations; the R&D was conducted as part of a contract research and development arrangement with Tuna Sub 4.

Tuna Sub 1 is domiciled in Country W, which has a headline corporate tax rate of 17%. Tuna Sub 1 owns several large fishing boats and employs crews to catch the tuna within the territorial waters of Country V. Tuna Sub 1 has employees and a warehouse in Country V to store fishing nets and other associated products. It also owns a number of trucks and a large crane, which its employees use to transfer the tuna from its boats and deliver it to Tuna Headco's facility.

Continued

2. Continuation

Tuna Sub 2 is a wholly owned subsidiary of Tuna Headco and is domiciled in Country X, which has a headline corporate tax rate of 15%. Tuna Sub 2 is a distribution company that purchases the tuna products processed by Tuna Headco and delivers them to independent customers in Country V and various other jurisdictions. Tuna Sub 2 invoices the customers and receives payment, while the physical products are transported to the customers via independent companies using boats operating from Country V.

Tuna Sub 3 is a wholly owned subsidiary of Tuna Headco and is domiciled in Country Y, which has a headline corporate tax rate of 9%. Tuna Sub 3 is a distribution company that purchases the tuna products processed by Tuna Headco and delivers them to independent customers in Country V and various other jurisdictions. Tuna Sub 3 invoices the customers and receives payment, while the physical products are transported to the customers via independent companies using boats operating from Country V.

Tuna Sub 4 is a wholly owned subsidiary of Tuna Headco and is domiciled in Country Z, which has a headline corporate tax rate of 10%. Tuna Sub 4 is an intellectual property holding company that has legal ownership of all intellectual property for the Ocean Fresh Group, including the recently patented machinery process developed and used by Tuna Headco. As stipulated in the contract manufacturing agreement with Tuna Headco, Tuna Headco performs contract research and development for a reimbursement of cost plus 5% and does not receive any legal ownership of intellectual property that is successfully registered. Tuna Sub 4 has a preferential tax agreement with the tax administration of Country Z, granting Tuna Sub 4 an exemption from corporate income tax on the basis of its legal ownership of intellectual property.

You are required to:

1) **Provide advice on any transfer pricing risks or issues that a tax authority may raise when conducting a review of the Ocean Fresh Group.** (10)

2) **Discuss any comparability issues that may arise through the application of transfer pricing methods for the Ocean Fresh Group.** (10)

3) **Raise any specific issues in relation to intellectual property and the concept of development, enhancement, maintenance, protection and exploitation of intangibles (DEMPE).** (5)

Total (25)

PART B

You are required to answer ONE question from this Part.

3. The Smith Group is a multinational group of companies incorporated in Albinea.

The group has directed a number of its senior managers from Albinea to Reedland to negotiate and sign a material contract for $200 million with a well-known corporation incorporated in Reedland. The resulting contract involved the upgrade and installation of the latest transmission technology for mobile telephone coverage. The work is expected to take between six and seven months to complete, and is expected to make a profit of $50 million for the Smith Group.

The group resources the project by flying specialist employees from Albinea to Reedland on a fly-in fly-out basis, given the specialist nature of the project. The group has not established a permanent office in Reedland and relies on its seconded workers to undertake the work. The contract is project managed from the group's head office in Albinea.

You are required to:

1) **Advise on whether the Smith Group should have a permanent establishment in Reedland. You should consider and reference the relevant article(s) of the OECD or United Nations Model Tax Convention in supporting your answer.** (15)

2) **Explain whether you believe the profits derived by Smith Group in relation to the project should be taxed for transfer pricing purposes.** (5)

Total (20)

4. The Casuarina Group is a multinational group of companies whose ultimate parent entity, HT Corp., is headquartered and domiciled in Country A, which has a headline corporation tax rate of 25%. The primary business operation of HT Corp. is the manufacture and distribution of a range of building products.

The Casuarina Group has built a successful brand, associating its products with high quality, and devotes a significant amount of expenditure to research and development activities. HT Corp. maintains legal ownership of the key intellectual property of the Casuarina Group, including brand names, trademarks and manufacturing know-how. HT Corp. also undertakes manufacturing in Country A.

Following the appointment of a new board of directors, the Casuarina Group has undertaken a global business restructure of its operations with the goal of generating operational efficiencies and cost reductions in order to increase shareholder profits. This has resulted in the following key changes:

- The creation of a new regional manufacturing plant operated by Manufacturing Corp. in Country B. This is in addition to the existing plant maintained in Country A by HT Corp.
- The transfer of all intellectual property from HT Corp. to IP Corp. in Country C. In consideration for the transfer of the intellectual property amongst associated enterprises, a valuation was undertaken by the head of taxation of Casuarina Group. IP Corp. has a small team of employees maintaining and protecting the intellectual property.
- A material loan between associates, with funds provided by HT Corp. to Manufacturing Corp., which is interest-free for a twelve-month period.
- The transfer of the research and development function from HT Corp. to IP Corp.
- HT Corp. pays a royalty, based on 5% of sales, for use of the intellectual property legally owned by IP Corp.

The corporate tax rate in Country B is 15%, and in Country C is 10%.

You are required to discuss the implications of the restructure from a transfer pricing perspective. You should consider changes in functions, assets and risks of the entities concerned within the group, along with characterisation, in relation to the arm's length principle. (20)

PART C

You are required to answer TWO questions from this Part.

5. The Sapuppo Group has subsidiary companies in many countries. You have recently been appointed by the senior management team as the group tax adviser.

   You are required to:

   1) Advise the senior management team on key recent developments in transfer pricing specific to e-commerce. (7)

   2) Advise on how the Sapuppo Group should seek to minimise the likelihood of a future transfer pricing audit. (8)

   Total (15)

6. **You are required to advise on the following:**

   1) The most likely transactions or arrangements for which a multinational enterprise may enter into a 'cost contribution arrangement'. (6)

   2) When an enterprise will meet the criteria for having a 'permanent establishment', and how the arm's length principle will apply. (9)

   Total (15)

7. **You are required to answer the following questions as a chief financial officer:**

   1) How do the thin capitalisation rules impact upon transfer pricing? (5)

   2) Do you regard a company which has made losses in the last three years as being at higher risk of an examination or audit from the tax authority in which it undertakes its operations? Explain your answer with reasoning. (5)

   3) Provide your view on whether country-by-country reporting is likely to be a useful source of information for tax administrations. (5)

   Total (15)

8. **You are required to:**

   1) Outline the key transfer pricing issues associated with applying the arm's length principle to intra-group services. (8)

   2) Discuss the advantages and challenges involved with safe harbours from a transfer pricing perspective. (7)

   Total (15)

9. **Discuss what you regard as the most significant and impactful worldwide changes in transfer pricing since 2015. You should reflect on the OECD/G20 Base Erosion and Profit Shifting Project, and discuss the benefits and challenges for both tax administrations and taxpayers.** (15)