Answer-to-Question-_1_

**Part 1**

Two enterprises are Associated enterprises are with respect to each other if one of the enterprises meets the conditions of Article 9 of the OECT MTC, sub paragraphs 1a or 1b with respect to the other enterprise. In this answer, the transactions between associated enterprises within Beach Group shall be delineated as follows:

**Beach Plc**

Provides management and technical services to all Beach Group Entities including IT, Admin, treasure, insurance and marketing support.

Sells Beach-branded Products to group entities - namely Creek Pty Ltd, Canal Pte Ltd, Aqueduct Ltd

Purchases goods from Canal Pte Ltd under a written contacts

R&D is performed by Canal Pte Ltd under the director of Beach Plc (who owns IP)

Procurement activities for Beach PLC is undertaken by Canal Pte Ltd

Obtains Logistics and transportation services from Canal Pte Ltd

**Creek Pty Ltd**

Obtains management and technical services from Beach Plc including IT, Admin, treasure, insurance and marketing support.

Purchases beach-branded products from Beach Plc

Obtains Logistics and transportation services from Canal Pte Ltd

**Canal Pte Ltd**

Obtains management and technical services from Beach Plc including IT, Admin, treasure, insurance and marketing support.

Sells goods to Beach Plc under a written contacts

Purchases beach-branded products from Beach Plc

R&D is performed by Canal Pte Ltd under the director of Beach Plc (who owns IP)

Procurement activities for Beach PLC is undertaken by Canal Pte Ltd

Provides order fulfilment services services from Aqueduct Inc.

Performs Logistics and transportation services to group entities namely, Beach Plc, Creek Pty Ltd, River Ltd

**River Ltd**

Obtains management and technical services from Beach Plc including IT, Admin, treasure, insurance and marketing support.

Obtains Logistics and transportation services from Canal Pte Ltd

**Aqueduct Inc.**

Obtains management and technical services from Beach Plc including IT, Admin, treasure, insurance and marketing support.

Obtains Logistics and transportation services from Canal Pte Ltd

Obtains order fulfilment services services from Canal Pte Ltd

Purchases beach-branded products from Beach Plc

**<u>Part 2</u>**

A functional analysis is aimed at identifying the economically significant activities and responsibilities undertaken, assets used or contributed and risks assumed by the parties to the transactions.

As outlined in Section D.1 of the TPG, identifying the commercial or financial relations is of utmost importance whereby the following points should be noted as outlined in D1.33-1.41:
1) Identify CFR between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations in order that the controlled transaction is accurately delineated and compare the conditions and the economically relevant circumstances of the controlled transaction as accurately delineated with the conditions and the economically

relevant circumstances of the comparable transactions between independent enterprises.

2) Understanding of the industry, sector, markets, products, supply chain

3) Other options realistically available

It is important that the global value chain is understood as well as the contractual terms of the transactions and its underlying substance to see if this is in line with the terms of the contact.

Furthermore, in order to perform an effective functional analysis, one should take the time to obtain a group structure as well as the organisational roles of employees both at an operational and strategic level in order to understand these matters and even conduct interviews with personal.

Furthermore, when performing a functions analysis an understanding of the documentation in line with Chapter 5 of the TPG is useful.

| Company | Functions | Assets | Risks | Characterisation |
|---|---|---|---|---|
| Beach PLC | Ultimate parent entity involving strategic decisions and overview<br><br>IP rights holder | IP<br>PPE<br>Offices<br>Staff | Market Risk<br>Warranty Risk<br>Financing, credit risk<br>Investment Risk<br>Obsolescence Risk<br>Insurance Claim Liability | IP Owner<br><br>Distributor and Retailer<br><br>Centralised Group Services Provided |

| | | | | |
|---|---|---|---|---|
| | Management and Technical Services<br><br>Distributor & Retailer | | Risk<br>Inventory Risk<br>Foreign Exchange risk (assumption) | |
| Creek Pty Ltd | Demand Planning<br>Distribution and Marketing | Warehouse<br>Staff | Market Risk<br>Warranty Risk<br>Obsolescence Risk | Distributor |
| Canal Pte Ltd | Undertakes R&D<br>Procurement<br>Demand Planning<br>Logistics/transport<br>Distributions and marketing | Warehouse<br>PPE<br>Office for procurement activities<br>Staff | Market Risk<br>Warranty Risk<br>Obsolescence Risk<br>Investment in R&D risk | Procurer<br><br>Contract Manufacturer<br><br>Distributor |
| River Ltd | Distribution and Marketing | Warehouse<br>PPE<br>Offices<br>Staff | Market Risk<br>Warranty Risk<br>Obsolescence Risk | Distributor |
| Aqueduct Inc. | Online sales | Website<br>Staff | Website security risk (leak of personal customer data)<br>Competition Risk<br>Market Risk | Online retailer |

Answer-to-Question-2

**Part 1**

In selecting the most appropriate transfer pricing method, reference to Chapter 2 of the TPG is made whereby the traditional transactional methods and the transactional profit methods are listed.

**Comparable uncontrolled price method** - compares the price charged for property/services transferred in a controlled transaction to the price charged in a comparable uncontrolled transaction in comparable circumstances.

This is regarded as the most direct and reliable way to apply the arm’s length principle and is most appropriate to commodities or financial transactions but required very similar functionality.

Within Beach Group, the CUP may be the most appropriate method in order to apply an Arms length price to the sale of finished products by Beach PLC to group entities. Here there is the opportunity for apply an internal CUP whereby the price of goods soled by Beach PLC to Creek Pty Ltd, Canal Pte Ltd, Aqueduct Ltd respectively are compared. Furthermore, there is the opportunity for an external CUP when comparing tho the price Beach Plc sells its products to independent retailers. Another external CUP that may be applied is the price that River Ltd sells goods to independent retailers however this may not be the best comparable given that the goods are not entirely identical to those produced and sold by Beach Plc.

**Resale Price Method** - Begins with the price at which a product has been purchased from an associated enterprise is resold to an independent enterprise. This price is then reduced by an appropriate gross margin on this price representing the amount out of which the reseller would seek to cover its selling and other operating expenses and in light of the functions performed, make an appropriate profit. What is left after subtracting the gross margin can be regarded, after adjustment for other costs associated with the purchase of the product, as an AL price for the original transfer of property between the associated enterprise's.

This method is probably most useful where it is applied to marketing operations.

Fewer Adjustments are normally needed to accounts for product differences than under the CUP method because minor product differences are less likely to have as material an effect on profits margins as they do on price.

This resale price method may be applied to the goods which are purchased by Beach Plc from Canal Pte Ltd and resold to group entities as well as independent retailers. Given the limited input made by Beach Plc to these goods, it may be appropriate to determine a resale price based on both internal comparables and external comparables.

**Cost Plus Method** - begins with the costs incurred by the supplier of property (or services) in a controlled transaction. An appropriate cost plus mark-up is then added to this cost, to make an appropriate profit in light of the functions performed and market conditions. What is arrived at after adding the cost plus mark up to the above costs may be regarded as an arm's length price of the original controlled transaction.

This method is usually useful where semi-finished goods are sold between associated parties, where associated parties have concluded joint facility agreements or ling term buy and supply arrangements or where the controlled transaction is the provision of services.

This method may be appropriate for:
1) The R&D services which are provided by Canal Pte Ltd to Beach plc
2) Logistics and transportation services provided by Canal Pte Ltd to group entities.
3) Fulfilment order services provided by Canal Pte Ltd to Aqueduct Inc
4) Goods manufactured by Canal Pte Ltd and sold to Beach Plc
5) The management and technical services provided by Beach Plc to group entities. Kindly note that these services may fall under the definition of low-value services as defined in D1.7.45 of Chapter 7.In these situations the same mark up shall be utilised for all low value adding services irrespective of the category of services equal to 5% of the relevant cost as outlined in section 2.4. No benchmarking is required

**Transactional Net Margin Method** - examines the net profit relative to an appropriate base (costs, sales, assets) that a taxpayer realised from a controlled transaction. Thus, operating in a similar manner to cost plus and resale price methods.

TNMM is unlikely to be reliable if each party to a transaction makes unique and valuable contributions. However, it is less affected by transactional differences than is the case with CUP whereby the Net Profit indicator is also more tolerant to some functional differences. That being said, the NPI can be influences by some factors that would either not have an effect or have a less substantial or direct effect on price or gross margins between independent parties.

The TNMM may be applied with respect to those entities performing distribution and marketing activities of goods purchased from Beach Plc and sold to independent customers/retailers. In order to do so an appropriate NPI is required whereby perhaps an EBIT/Sales when compared to distribution/marketing costs. A ratio of between 2-10% may be expected however this would need to be determined.

**Transactional Profit Split Method** - Identifies the profits to be split from the controlled transactions and then splits them between the associated enterprises on an economically valid basis that approximated the division of profits that would have been agreed at arms length. Based on the information provided, it is understood that Canal Pte does not own any rights to the IP, should it have, perhaps the TPSM would have been applied in proportion to the R&D services performed in connection to the IP however in the absence of this, it is seen that the TPSM is not an appropriate method to apply to arrive at an arms length price for any group transactions.

**Part 2**

Reference to D1.36 Chapter 1 TPG is made whereby the economically relevant characteristics or comparability factors that need to be identified in the commercial or financial relations between the associated enterprises in order to accurately delineate the actual transaction can be broadly categorised as follows:
1) Contactual Terms
2) Functions performed, assets used, risks assumed and circumstances of the transactions, and industry practices.
3) Characteristics of the property transferred or services provided
4) Economic circumstances of the parties and marked in which the parties operate
5) Business Strategies

Sources of comparability data may included:
1) Internal Comparable
2) External Comparable and sources of information
3) Databases
4) Foreign Source of non-domestic comparable
5) Use of non-transactional third party data

Potential Comparables identified:
1) Internal Comparables between Beach Plc goods sold to associated enterprises namely Creek Pty Ltd, Canal Pte Ltd, Aqueduct Ltd
2) External Comparables between Beach Plc goods sold to independent retailers and other group entities goods sold to independent retailers.
3) External Comparables between Beach Plc goods sold to individual customers and Aqueduct goods sold to individual customers online.
4) External Comparables River Ltd goods sold to independent retailers and other group entities selling to independent retailers recognising the fact that the goods sold by River are not identical to those Beach-branded products sold
5) Outsourced fees/quotes for management and technical services as well as R&D services.
6) River ltd cost of purchases of goods when compared to the cost of manufactured goods made by Canal Pte Ltd sold to Beach Plc

**Part 3**

From the limited information provided, the following material concerns in the application of the Arm’s length principle have been identified:
1) Is an arms length price or simplified mark-up (if applicable) being provided to the management and technical services to group entities by beach group?
2) Is Canal Pte Ltd being remunerated for its R&D services? Here it is understood that Beach Plc retain the IP ownership and thus derive any profits from it. Any services provided by group members with respect to DEMPE should be remunerated appropriately.
3) Is an appropriate Arms length price being charged by Canal Pte to group entities for logistics and transportation activities and furthermore is an appropriate Arms length price being charged by Canal Pte to Aqueduct Inc for fulfilment of orders?
4)There is a significant difference between the tax rates in Canal Pte and Aqueduct compared to other group entities:

a) This may create the risk that Aqueduct is being used in order to shift profits to a lower tax jurisdiction without the

necessary functions being performed there. This is also highlighted by the fact that the net profit to sales margins for Aqueduct are extremely high when compared to other group entities - this is further supported by the high net profit as % of total assets ratio and low staff employed.
b) Canal Pte is the manufacturer of the group and thus it may be the case that being in a lower tax jurisdiction results in a desire to overstate the price for manufactured products, not at Arms length.

5) The lower net profit margins on sales and assets in Beach Plc may indicate that an appropriate arms length price for the use of IP to group entities is not being charged, whereby it was described that this group invested heavily in its brand and it the main reason for its success and thus group members should be charged an appropriate arms length price for such use of IP and the benefits derived.

Answer-to-Question-4

**Part 1**

It is not specified whether there is a double taxation treaty between Hydrovista and Altrum however the purpose of answering the question, it is being assumed that a tax treaty in line with the OECD MTC is in place.

Reference to Article 5 of the OECD MTC whereby article 5(1) outlines the meaning of a permanent establishment as a fixed place of business through which the business of an enterprise is wholly or partly carried on.

Article 5(2) provides examples such as:

1) Place of management
2) Branch
3) Office
4) Factory
5) Workshop
6) Mine, an oil or gas well, a quarry of any other place of extractions of natural resources

While it is not indicated whether any of the above examples shall be present in Altrum, it is possible that should the construction take place for a period of over 12 months this shall fall within the scope of Article 5(3) as a PE whereby the building site or construction or installation project lasts more than twelve months. Furthermore, it is also possible that there is an office available to the company representatives in Altrum however this is not indicated in the text.

Furthermore, Article 5(4) contemplated situations of a preparatory or auxiliary character whereby a PE shall not apply however it is understood that this is not relevant to the case at hand.

Furthermore, it is outlined that financing & key decisions are taken by directors/personnel of SPL in Hydrovista and any representatives in Altrum require pre-approval of any decisions. Furthermore, this indicated that no enterprises/persons in Altrum may be regarded as creating a PE for the purposes of Article 5(5) or 5(6).

Furthermore, there may come into play the anti-fragmentation anti-abuse clause mentioned in article 5(8) of the OECD MTC with respect to the associated companies conducting a range of activities in Altrum.

**Part 2**

Article 7(1) of the OECD states that profits of an enterprise of a CS shall be taxable only in that state unless the enterprise caries on business in the other CS through a PE situated therein. If the latter is carried out, the profits that are attributable to the PE in the accordance with Paragraph 2 of Article 7 may be taxed in that other state.

Consideration should be made to the OECD report on the Attribution of Profits to Permanent Establishment and the 2010 version of this report whereby multiple examples/issued where tackled particularly with respect to Article 5(5),5(6) and 5(8) of the OECD MTC.

That being said, when attributing profits or losses to an potential PE’s, one should apply the authorised OECD approach whereby the profits attributable to the PE should be the profits that one might be expected to make if it were a separate and independent enterprise engaged in the same or similar activities under the same conditions, taking into account the functions performed, assets used and risks assumed by the enterprise thought the permanent establishment and through the other parts of the enterprise.

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Answer-to-Question-5

The Transfer Pricing Guidance on Financial Transactions issued by the OECD in 2020 particularly highlighted the key transfer pricing issues associated with intra group financial transactions. Some key issues are mentioned below:

1) Determination of whether a purported loan should be regarded as a loan - whereby one is not only to determine the appropriate rate of interest to apply to a intragroup loan but must also determine if the 'loan' may indeed be classified as a loan or rather should be classified otherwise, such a a contribution to equity capital.

2) Any TPG guidance or material issued by the OECD does not seek to prevent countries from imposing measures to address debt/equity funds under their domestic legislation. That being said discrepancies may arise between domestic rules when compared to the Application of the commentary to Article 9 with respect to the classification of the loan.

3) For transfer pricing purposes, accurately identify the commercial or financial relations may not always be the easiest to undertake due to difference in amounts/types of financing, capital intensity levels, short-term cash balances needs, regulated vs unregulated industries, etc.

4) It may be the case that realistic alternatives are not available and independent enterprise might not realistically be ready to provide financing or insurance services to such intragroup entities and thus comparables may be hard to find. Furthermore, it could be that with respect to certain groups, there would be no information of similar transactions in the past.

5) One must take a close look at the contractual terms of the transaction and see if the conduct of the parties reflect the facts and circumstances. It is not enough to have an agreement in place but rather this needs to be an agreement than is just for both the lender's and borrower's perspectives as an independent party would certainly aim to ensure that their interest are protected and the conditions of the agreement are upheld.

6) In delineating a transaction, one must see if the lender is indeed exercising control over the risks associated with the loan or if it does not have the financial capacity to assume the risks

thereof (or rather is it another party that is assuming these risks?)

7) Absence of credit rating of an MNE or MNE group or past information available with respect to credit ratings which do not reflect present reality.

8) Issues with deciding on how long a balance should be treated as part of the cash pool before it could potentially be treated as something else, example a term loan.

9) Difficulties may arise with respect to hedging if the contract instrument is entered into by the treasury entity or another MNE group entity, which the result that the positions are not matched within the same entity.

10) Practical issues with respect to estimating the risk-free rate of return.

Answer-to-Question-9

**Part 1**

Reference to Chapter 4 of the TPG is made whereby a safe harbour as defined as a provision that applies to a defined category of taxpayers or transactions and that relieves eligible taxpayers from certain obligation's otherwise imposed by a juridisction's general transfer pricing rules.

An overview of the benefits of TP safe harbour are:

1) that simplified compliance as well as reduced compliance costs shall apply for eligible taxpayers when they are determining/documenting their appropriate conditions for qualifying controlled transactions
2) enhanced certainty for taxpayers since their qualifying transactions shall be accepted by the tax administrations
3) allows tax administrations to redirect their resources, particularly skilled workers training on the topic away from the lower risk transactions/examinations which would fall within the PT Safe Harbour regime.

The advantages can be summarised as providing compliance relief, certainty and administrative simplicity.

That being said, TP safe harbours also come with their issues (and perhaps this is why the initial feedback on safe harbours issued in 1995 was of a negative perceptions) - some issues include:

1) Implementation may lead to taxable income being reported that is not in accordances with ALP
2) May increase risk of double taxation or double non-taxation when this is unilaterally adopted.
3) Potentially open avenues for inappropriate tax planning
4) May raise issues of equity and uniformity.

Should Safe Harbours be adopted by tax administration, I would personally be in support of this however this is based on the understanding that the following points are kept in mind in line with E5 of the TPG:

1) Jurisdictions adopting safe harbours have the willingness to modify outcomes in MAP to limit potential risk of DT

2) Use of bilateral or multilateral safe harbours rather than unilateral safe harbours are adopted

**Part 2**

It is understood that here the MNE has two options being:
1) Seek to have a corresponding adjustment in terms of Paragraph 2 of Article 9 whereby just as the taxable income in one jurisdiction was increased, the corresponding effect is done whereby the taxable income in the other affected jurisdiction is decreased. This may still result in increase overall taxation for the MNE group as profits may be rewritten and increased in a higher tax juridisction than previously declared. That being said, a corresponding adjustment would at least eliminate the risk of double taxation in both jurisdictions.

2) Seek to initiate Mutual Agreement Proceeding in line with Article 35 of the OECD MTC. This is likely to be the preferred route by the MNE given that the question stated that the MNE did not agree with the outcome of the audit. In this manner, the MNE would seek for both Contracting States to arrive at their conclusions and find an acceptable outcome for both CSs. This path of seeking to initiate MAP may also be an options should a corresponding adjustment in terms of Para 2 of Article 9 is not provided by the other CS.