Day 2, Session 4

Workshop: Transactional Profit Methods

Case Study – Telecommunication Company

Solutions

1.a. What could be the initial trigger to challenge Company A on merits?

- Distribution of losses due to change in TP Methods (business model)

1.b. Have the transactions been accurately delineated and recognised under both pre- and post-conversion scenarios?

- Pre-conversion – Most likely yes based on given facts

- Post-conversion:

  - Company A along with other TSA consists of approx. 90 legal entities with approx. 4000 possible unique bilateral transactions. It is unclear whether the actual transaction is structured as a services cost-sharing arrangement or whether there is a joint-performance of functions towards integrated services
  - Have transactions been aggregated even before being accurately delineated?
  - Considerations for the 5 factors including contracts and FAR.

2. Selection of the most appropriate TP method:

   a. Pre-conversion

- TNMM adopted by Company A is the most appropriate method?
- Criteria and rationale for selection of TNMM?
- Comment on the selection of tested party, and selection of PLI?

- Narrow business activity (low value adding service), minimal complexity/IP, (if) comparables can be identified.
- Company A tested party is fine
- TNMM – OP/OC

b. Post-conversion

Is PSM the most appropriate TP method or could TNMM be more appropriate? - Criteria and rationale

- *TNMM argument:*
  - AB Group's operations may not be as fully integrated as asserted by the taxpayer
  - No unique or valuable intangible created
  - TNMM could provide more reliable results

- *PSM argument:*
  - AB Group's operations are fully integrated
  - Unique or valuable intangible is AB Business Model itself
  - PSM could provide more reliable results since all parties jointly perform the functions that cannot be separated

3. Application of the most appropriate TP method

a. Post-conversion

- Is the aggregation of profits and use of 8% "uplift" appropriate?
  - In general yes. However, whether 8% denotes C+ returns or TNMM (OP/TC) is unclear. The term "uplift" is undefined

- If PSM were to be accepted, discuss the specific problems in the design of the mechanism as per the TPA contract:
  - Is the weighting of 1/3rd for the three functional parts in Step C1 appropriate?

    - Arbitrary unless based on appropriate comparable information, rationale or value chain analysis. Equal weighting of functional parts for all 90 subsidiaries including Company B (HQ) may not make economic sense – differences in wage rates and economic indicators etc.

  - "Contributions" under step C2 determined appropriately?

    - Arbitrary unless based on appropriate comparable information and analysis were made.
    - The use of certain cost items could be subjective and not in line with PSM

  - Does AB Group's methodology and Company A's implementation resemble revenue sharing model/ formulary apportionment (FA)? What is the difference between FA and PSM?

    - Since PSM is not established to be carried out at a transactional level, and since it appears that it could be applied to the business as a whole/ aggregation without delineation, there is a risk of mis-application
    - However, unlike FA that may seek to allocated consolidated profits of group as a whole, the current model under the TSA, although imperfect only pertains to B2B business and doesn't include B2C business in its base.
    - Comment on differences between PSM and FA – specific to transactions vs. global profits

- If TNMM were to be the most appropriate method for the post-conversion scenario, discuss criteria and rationale

  - Comprehensive info. is necessary for application of PSM. Accurate financial and qualitative information across 90 countries may not be available. I such cases, TNMM could be more suitable.
  - TNMM may have been avoided by the tax payer to shield the loss position of subsidiaries. A corroborated TNMM analysis in addition to PSM could be possible.
  - Reliable comparables necessary

4. What are the steps that could be taken to refine the application of PSM in the above case?

- What is the role of value chain analysis and process mapping in the above situation? Discuss with regard to specific criteria such as DEMPE functions and RACI Model for contribution analysis.

  - 8% uplifit aligned with routine returns
  - Value Chain Mapping and RACI could provide better weightage to the apportionments of 1/3rd weightage
  - Revisit the steps for comparable information and alignment with what third parties would have chosen

- What are the risks deviations between budgeted PSM (*ex-ante*) and actual PSM outcome *(ex-post)*? How to mitigate them?

  - Countries may have % thresholds on permissible deviations. In certain cases this could be upto 50%. However an internal policy and assumption should be demonstrated to the tax auditors for bona fide treatment.

5. Does the fact that PSM was accepted in few countries automatically resolve the case for Company A in Austria?

  - The degree of vertical integration between HQ and few subsidiaries may vary. The nature of transactions and the 5 characteristics for accurate delineation and recognition requires consideration.
  - Although PSM is typically applied in a globally interconnected way, the separate entity principle ensures that each country views PSM from the respective local entity perspective.