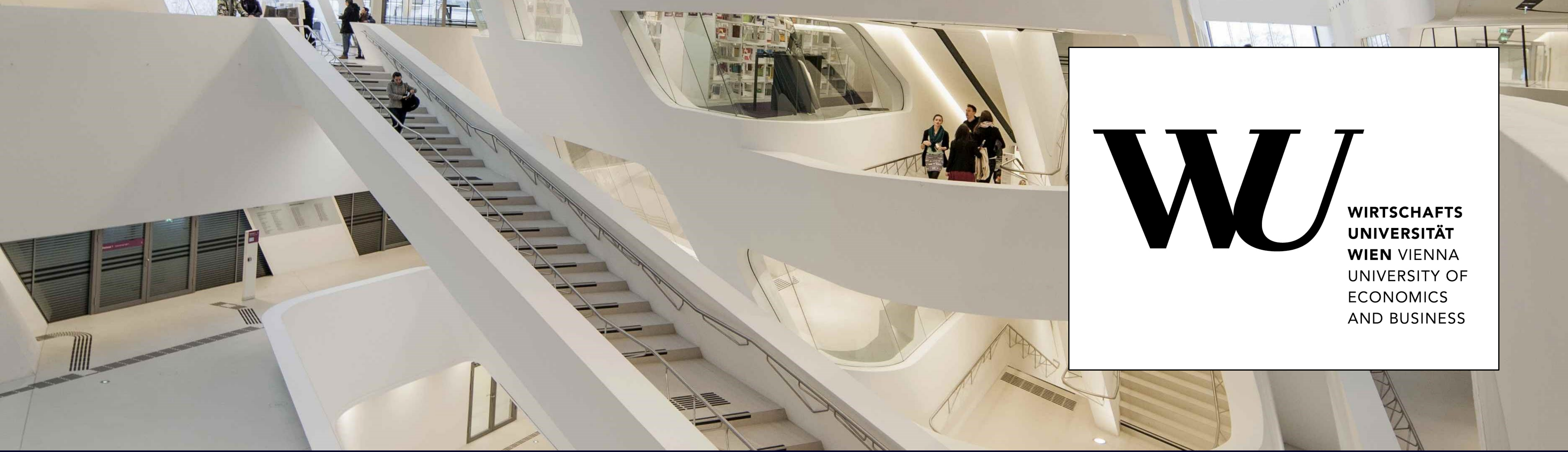

Workshop Instructions: Practical Application of Transfer Pricing Risk Management and Compliance

Dr. Sven Bremer, Head of Group Transfer Pricing

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Case Study 1 – M-Group

Institute for Austrian and International Tax Law Vienna
WU Transfer Pricing Center

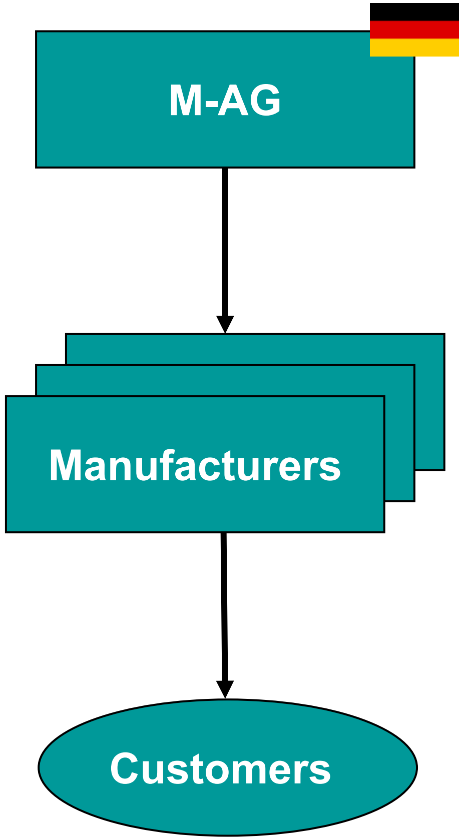
Facts

M-AG owns all relevant intangibles (product and process intangibles) of M-Group and is solely responsible for R&D activities. M-AG does not manufacture by itself, but charges royalties to various subsidiaries manufacturing the products and selling directly to third party customers within their country. The uniform royalty rate for all license manufactures is set at 3% of revenue.

All customer contracts are negotiated centrally by M-AG. The OPMs earned by the license manufactures range between -3% (M France SAS) and +20% (M China Ltd.). Central marketing and other costs including the costs related to the negotiation of customer contracts are charged to the licensees via a cost allocation mechanism.

Tasks

1) Elaborate on potential TP issues in a German tax audit.



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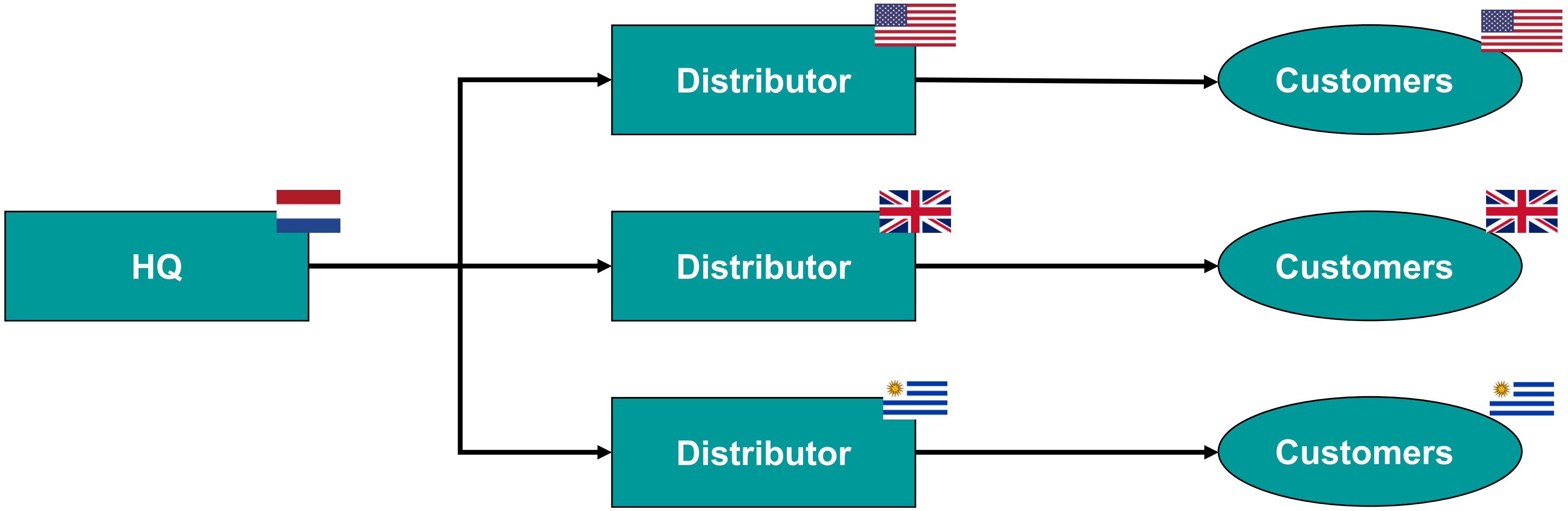
Case Study 2 – Toys4Kids
Setup

The group company „Toys4Kids“ (T4K S.A.S.) is a multinational enterprise with headquarter (entrepreneurial function) in France developing, producing and selling high tech kids’ toys and computer games all over the world. The distribution function is mainly performed by the regional companies in the relevant countries. Other functions and transactions, such as contract R&D, contract manufacturing, financing, services, royalties, delegations etc., shall not be subject to the following case studies.



Case Study 2 – Toys4Kids
Part 1

Institute for Austrian and International Tax Law Vienna
WU Transfer Pricing Center

Facts

T4K S.A.S. performed a European benchmark study for its product sales from France to UK. The British subsidiary (T4K plc) imports the goods from T4K S.A.S. and distributes them locally. T4K plc is characterized as a routine distributor. It has introduced two new products into the British market assuming all of the additional marketing expenses that have doubled due to the market introduction. The total marketing expenses amount to 8T€. Please assume that approx. 3/4 of the additional marketing expenses for the new products only incurred during the introduction in FY2023. In addition, the following information is available:

Income Statement T4K plc	FY2023
Revenue	100T€
COGS	-80T€
SG&A	-18T€
Operating Profit	2T€
OM	2.0%

IQR Distributor BM	OM
Lower Quartile	4.3%
Median	5.4%
Upper Quartile	6.8%

Tasks

1) What could be the argumentation of the company's tax team in case the British tax auditors challenge the results of the British subsidiary being below the LQ of the European benchmark range for comparable distributing companies, assuming that the transfer prices were at arm's length.
2) What could be potential reasons for routine companies being outside (either below the LQ or above the UQ) the IQR?
3) Please perform a quantitative justification showing that the reason for the FY2023 original margin being outside of the IQR is not related to transfer pricing.

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Case Study 2 – Toys4Kids
Part 2

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Facts

T4K Inc. both sells products to local customers and provides services regarding software installation, maintenance, warranty, support for big amusement halls and parks. Therefore, T4K Inc. purchases the finished goods and spare parts from the French headquarter. The French entity develops and owns all relevant IP. The US entity shall be characterized as routine-function. Whereas the French entity with entrepreneurial profile shows moderate profits, the US routine entity earns high profits out of the integrated service business. The product transfer prices allow only limited compensation due to various reasons, e.g. limited transaction volume, order back log. The French tax authorities want to adjust the income of the French company based on the high margins earned by the US entity. They argue that the entrepreneurial entity delivering the products that allow subsequent highly profitable services should also benefit from the high profits resulting from the integrated service business in the US.

Negotiations between the French entity and the French tax authorities remained without result. The tax authorities still uphold their adjustment. However, the final tax audit report has not been issued.

Tasks

1) Please discuss what options T4K S.A.S. can revert to in order to resolve the imminent double taxation. What could be possible measures to avoid a similar situation in future? How do circumstances change when the French entity faces a similar situation with deliveries to subsidiaries within a) Europe and b) Uruguay?

Case Study 3 – Widget Group

Facts

WidgetCo is the global headquarter of Widget Group incorporated in country A and is engaged in the development and sale of high-quality widgets. It is also the legal and economic owner of the group's IP and can be considered the sole entrepreneurial entity in the group for transfer pricing purposes. WidgetCo has access to external debt facilities in country A and uses them from time to time for intra-group financing purposes.

Furthermore, WidgetCo centralizes certain key group functions such as HR, IT, Legal, Tax, Accounting, and Finance. Certain costs incurred in the provision of such services are directly charged to group subsidiaries. Finally, the group has two subsidiaries in countries B and C:

- LiMa, in country B, is the group's license manufacturing entity. It pays WidgetCo a 3% royalty for the right to use the group's IP (i.e. technology, processes, and know-how) to manufacture widgets, which it sells exclusively to DistCo in country C.
- DistCo is the group's limited-risk distribution entity in country C which purchases widgets from LiMa in country B to sell to end customers worldwide.

Tasks

1) Please outline some transfer pricing considerations for WidgetCo in country A.
2) LiMa in country B is expecting to incur a significant capital expenditure in the upcoming fiscal year in anticipation of manufacturing a new line of widgets. It has been agreed that WidgetCo will provide a EUR 6.5 million loan to LiMa to fund this expansion.
   a) How could WidgetCo's external debt be advantageous in terms of pricing the intra-group loan?
   b) What are other key considerations for the borrower (LiMa) when determining an arm's length interest rate?
   c) What could be further tax considerations/risks in country B for LiMa? For example, would it be okay for LiMa to make a loss in a given fiscal year?
   d) Can you think of any transfer pricing risks in country A that might arise under this license manufacturing arrangement?

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