

This answer key provides some key themes to the case studies. There will undoubtedly be other issues to consider.

Case Study I – Manufacturing

a. A high-level overview of all potential tax risks

- TP - There are a lot of related party transactions for which the arm's length price will need to be established. Control of risk will be a key component of understanding the functions, assets, and risks of the business. There is also a risk that tax authorities may look dimly on the dated TP Documentation and the lack of formal agreements for the IT services
- PE - Perhaps not a huge risk, based on the limited facts. The group operate primarily through subsidiaries and therefore a risk of a Contracting State asserting a PE is diminished. If there are States in which the X group does not have a subsidiary, but either has a fixed place of business, or, a dependent agent, that State may assert that there is a PE. The information on the storage of products in a warehouse in the UK may have raised suspicions of there being a UK PE of X Finland, but Article 5(4) of the OECD MTC would likely exempt this from being a PE.
- WHT - The franchise fee may be a payment for use of the X group's intellectual property. If so, the relevant double taxation treaty may prescribe that the payee State withholds tax for payments of royalties.
- Digital tax - Some States may have unilateral measures for taxing digital companies. It is not clear whether any of these activities would be caught, but it may be something that the X group wish to consider.
- Exit Charge - There is talk of setting up a new Italian subsidiary to undertake R&D. A functional analysis would show whether the R&D function in Finland moves to Italy.
- Pillar 1 & 2 - A future consideration?

b. Transfer Pricing transactions

1. The French subsidiary is a distributor in France. It is currently loss-making. A full functions, assets, and risks analysis would need to be undertaken to ascertain whether the French entity should be exposed to losses.
2. The sale of products from X TopCo UK to subsidiaries. **(Distribution)**
3. The sale of products from the regional master distributors (Ger, US, HK) to subsidiaries in their respective jurisdictions. **(Distribution)**
4. Payment to Finland for their R&D – is this a key driver of business success? **(development)**
5. Payment to Finland for their **manufacturing**.
6. Payment to X India for IT services.
7. Use of 'brand'.

To note; retailing to third parties, purchasing manufactured goods from third parties, payments to third party contract designers in Italy, and the actual franchise fee paid by independent persons will likely not be caught by Transfer Pricing legislation as they are uncontrolled transactions.

i. What type of TP method you would adopt for the selected transactions?

1. If the French subsidiary is only distributing products, perhaps it should not be exposed to downside risk. It could be the decisions of the group to do business in France. As the French subsidiary is a distributor, perhaps a method such as 'resale minus' may be appropriate.
2. Again, the 'resale minus' method may be appropriate. It will be important to understand what functions the distributor performs. If the X TopCo manages distribution policies for the global group, that function may be deserving of a routine reward, perhaps a 'cost-plus'/'TNMM'.
3. Similar to '2' – resale-minus? Could look at profitability of 'standalone' X Japan?
4. It would need to be established whether the R&D was key to the success of the business. If so, perhaps the R&D function in Finland should be entitled to the residual profits, after rewarding routine functions (manufacturing, distribution, etc.). It would be necessary to understand who controls the risk – Finland, or, the main trading company, X TopCo UK?
5. Manufacturing may be rewarded with a routine return – perhaps a benchmarked cost-plus.
6. Cost+25% seems high. Do all entities benefit from these services? An adequate benchmarking study should be completed.
7. Who owns the brand? If X TopCo UK, the other subsidiaries may pay a royalty fee to X TopCo UK for the use of the brand. This may be based on a benchmarked % of sales. It would be important to note that the 'brand' seemingly has less value in France. Therefore, at arm's length, an independent company in France may not pay for the 'X' brand.

ii. What type of comparability factors you would deem important in this case?

Look to Chapter III of the OECD 2022 TPG that details the nine-step process when performing a comparability analysis.

- Ensure that the comparables are at the same stage of the business cycle and are of similar scale.
- In this case, we have some potential 'internal' comparables, where the group sell to third parties. What prices do the group do this at and could this be used as a comparable for the controlled transactions?

c. What type of information is likely to be required by the tax authorities and what information would you consider not necessary to disclose?

The answer to this largely depends on the requirements of each tax authority. For example, in the UK, HMRC requires taxpayers to self-assess their tax returns and have supporting documents available, should HMRC enquire. Other tax authorities may prescribe that supporting documentation is submitted to the tax authority at the same time as the self-assessment.

Most States require the filing of CbCR master and local files. The UK introduced a Master File and Local File requirement for accounting periods beginning after 1 April 2023.

From the limited information provided, it would be prudent for the X group to update their TP Documentation and look to formalise some intercompany transactions.

Tax authorities would not normally require sensitive information that divulged specific customer names (unless the tax authority deemed this was essential to their function), so X group would likely not need to divulge a list of all their customers.

d. What type of APA would you look for (unilateral/bilateral/multilateral)?

To get the greatest amount of legal certainty, the X group would request a multilateral APA with all their subsidiaries that have intercompany transactions.

But, drawbacks of this approach:

- This would take a lot of time. To get a lot of tax authorities all to agree a methodology will take a lot of negotiation between the tax authorities. There could be time and language differences to overcome.
- Some States may not have a functioning APA Programme.
- Some States may have an APA Programme but may be inexperienced in dealing with APAs.
- Some States may charge a fee to be in their APA Programme.
- There may not be a treaty in place between all States.

As such, it would be prudent for the X group to work out where their material-controlled transaction flows are and where they deemed there to be an audit risk.

If they deemed that UK and the hubs in US, Germany, and HK were the material transaction flows and that there was a risk of audit in some of those States, they may wish to file for a quadrilateral APA with those States. One potential difficulty would be that there is no US-HK Double Tax Treaty. As such, a trilateral between UK, US, Germany, or, UK, Germany, HK, may be preferable. This would still leave the non-covered State open to audit.

The group may then decide to apply the same TPM to other, non-covered, entities in other jurisdictions. If those other jurisdictions opened an enquiry, that Contracting State may take some comfort that there has been an APA agreed by US, Germany, UK, for example.

A unilateral APA would likely not be worth pursuing. If one State were to unilaterally agree to give an APA, all other States could still enquire, If the other State(s) did enquire and raise an assessment, the taxpayer may end up in MAP with the State that gave them the unilateral APA. The case study mentions a previous unilateral APA in India. The group could consider reigniting this APA but in the form of a bilateral APA to increase certainty.

e. What would an APA Agreement look like?

Taxpayer Information

Covered Transactions

Legal Effect

Term

Transfer Pricing Methodology

Critical Assumptions

Annual Reporting Requirements

Revocation Terms

Signatories

HMRC publishes a sample agreement in their APA Statement of Practice, [here](#).

Case Study II – Financial Services

a. Business opportunities for the bank are in large measure generated by 3 senior staff in London.

Unless these London based functions were actually accepting risk, they would not constitute KERT functions. If it was found that the EC just rubber-stamped everything that the London staff did, it would be persuasive to the argument that, in substance, the London based staff were the risk-takers on behalf of the bank. If the facts and circumstances supported that, the London based staff may constitute a KERT function.

b. One of the very senior Frankfurt bankers in German bank has considerable interaction with the EC, and in particular often discusses individual proposals to make sure they are within the group-wide risk limits that are applied across the group.

This, on the face of it, sounds more akin to strategy setting. If so, this will likely not be a KERT, as described in Part II of the OECD 2010 Report on Attribution of Profits to Permanent Establishments. If a functional and factual analysis shows that these senior Frankfurt personnel are in fact actively accepting risk, then they may be KERT functions.

c. The groups are interested in an APA.

i. In which countries are KERT functions being carried on? To what country or countries should the loan assets therefore be attributed?

From the limited information available, it looks as if the KERT functions are primarily in Paris. If it was established that the German senior staff were actively making decisions, or that the EC was just rubber-stamping proposals that had actively been decided by the CRO team (in London), then the KERTs may be in Germany or London, respectively. Following the 2010 Report, assets should be attributed to the location of the KERT functions.

ii. How would your answer change if (1) you later found out that the CEO had always dialled in to the EC meeting (and expressed his views on concluding the loans under discussion) when on holiday in his holiday home in Spain?

This may lead to there being a Spanish Permanent Establishment and there being a KERT in Spain. There could be a scenario where the KERTs were split between Spain and France. Again, this is subject to ensuring that the London based CRO team are not actively making decisions and the EC just rubber stamps those decisions.

d. Assume a treaty is in place between the UK, France and Germany.

There would be a prospect of a trilateral APA. Based on the fact pattern presented, it is not clear whether there is a provision between the UK PE and Germany. As such, there may be two bilateral APAs:-

- An Article 9 APA between Germany and France, and,
- An Article 7 APA between the French HO and the UK PE.

e. What if Paris was a PE as well?

If the French Entity was a PE of the German Entity, it can be assumed that the London PE would be a PE of the German entity. Similar to above, a trilateral APA could be possible that discussed the attribution from the German HO to both the French and UK PE.

i. And what if there wasn't a Germany-France treaty?

If there was no Germany-France treaty, the taxpayer would be unable to do an Article 7 APA between Germany and France. The taxpayer could request that Germany and UK do an Article 7 APA and the taxpayer could then seek a unilateral APA in France that agreed with the methodology. The risk would be that the French Competent Authority did not agree.

Case Study III – Construction

Phase 1

Sets the scene.

Phase 2

XYZ (M) engages a number of technical experts from sister company XYZ (S).

The group should probably now be thinking about potential permanent establishment risk.

The services are marked-up by 40%. Is this benchmarked? Seems quite high.

Questions – 1

What risks do you see?

- *Country M unlikely to be happy about losses.*
- *Cost+40 seems high?*
- *Fee from Country F arms-length?*

If you were XYZ, what could you do to minimise/prevent disputes?

- *Up to date TP Documentation.*
- *Early engagement with tax authorities.*
- *Encourage simultaneous examination from countries M, F, and S.*
- *Explore potential for APA(s)?*

Phase 3 (1/3)

The tax audit in Country M ascertained that the key drivers of XYZ (M)'s success are ;

- Terms/pricing of contract with MNO Ltd.
- Control of group costs.

Who controls these risks and has the financial capacity to assume them?

Phase 3 (2/3)

The contract – This seems to be materially managed from F. The fact that it was signed by the Managing Director of XYZ (M) may lead to there being an argument that he had control over that risk. Despite the legal contract saying that the XYZ (M) director is legally controlling the risk, an accurate delineation of the transaction would likely show that the risk was being controlled by XYZ HQ (country F).

The costs – This risk seems to be managed by XYZ (S) – not XYZ (M)

Therefore, it appears that XYZ (M) does not control either of the main risks that lead to the success of its business.

Phase 3 (3/3)

Confirmation that XYZ (M) does not assume risks.

XYZ (M) could be better characterised as a routine service provider?

As well as XYZ (S) controlling the risks of monitoring the cost bases, XYZ (S) also has the financial capacity to bear said risks, which may infer that XYZ (M) does not.

Phase 4 (1/2)

Although XYZ (M) was legally assigned the entrepreneurial risks, an accurate delineation of the transaction shows that XYZ (M) did not control the risks. In fact, XYZ (H.Q.) and XYZ (S) controlled the risks and had the financial capacity to bear the risk. As such, the entrepreneurial profits/losses should be allocated to XYZ (H.Q.) and XYZ (S), with XYZ (M) being remunerated as a routine service provider that is not exposed to downside risk (losses).

Phase 4 (2/2)

The tax authority in M deemed that a mark-up on costs was the most appropriate transfer pricing methodology to remunerate XYZ (M) for its provision of services.

The lever to implement this is to reduce the payment made from XYZ (M) to XYZ (S).

Questions – 2

If you were XYZ, what would you do now?

- *If you had TP documentation, probably go back to your advisor and challenge(!)*
- *Consider domestic litigation.*
- *Mutual Agreement Procedure?*
 - o *Does the treaty have an arbitration clause?*