

Case Study III:

Central Entrepreneur and Distribution Companies under Transfer Pricing Aspects

Modul 3

Facts:

Techco Austria Ges.m.b.H., a producer of technical equipment, manufactures and sells different kinds of products. Manufacturing takes place at the parent company's factory in Austria. Techco Austria owns all product related intangibles and controls the entire production process and all relevant intangibles needed in the production process.

Since many years the group is heavily investing in a new product line (mainly by spending R+D), the new product is expected to sell with high volumes in the future.

Corporate strategy and other headquarter functions are undertaken by the parent in Austria as the company operates as a **central entrepreneur**.

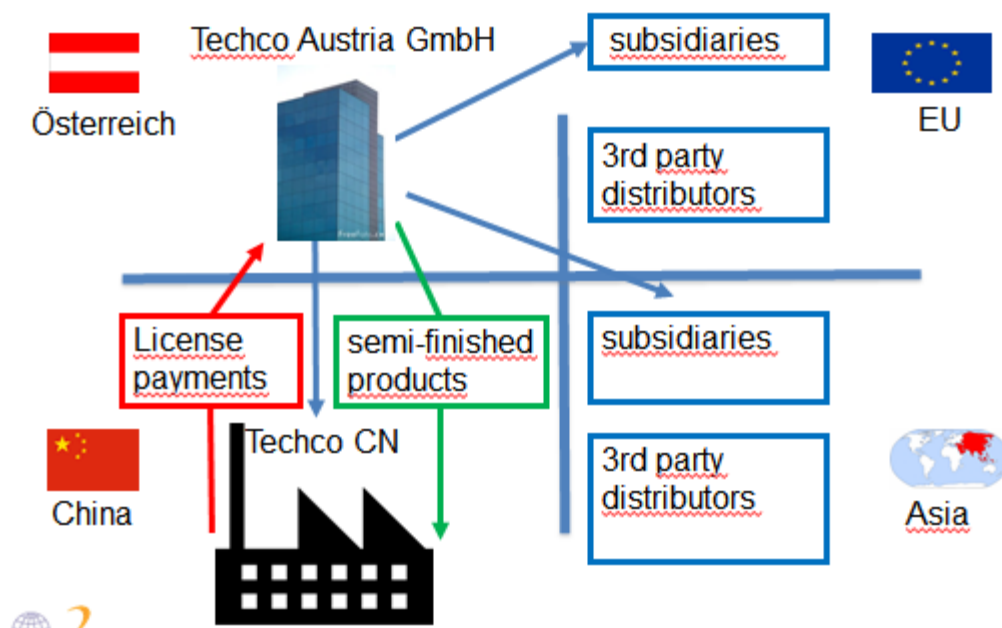
The products of Techco Austria are sold via its subsidiaries in many EU countries (e.g. Germany, Italy, Spain), but also in Asia. Techco has also some unrelated distributors for its products.

Techco subs located in the EU and Asia serve as "distributors" of Techco Austria's products in their local markets. The distributors typically employ skilled sales people. They also provide professional advice as well as other pre- and after-sales services to their customers, but they carry limited risks with regard to the product sales.

Techco CN is a subsidiary of Techco Austria located in China that manufactures and sells appliances for the **local market**. It makes use of Techco Austria's product and production technology which is licensed from the parent company at a license rate of 5% of turnover. The Chinese company was established in 2008. Main success factors have been the growing Chinese market, the advanced technology of Techco's products and the expertise of Techco CN's salesforce. Techco CN sources semi-finished

products from Techco Austria for which it compensates its parent company with a pricing at full cost plus 5% mark-up. Techco CN carries the risks linked to its business.

The following graph illustrates the facts.



The questions:

Techco Austria is confronted with a tax audit in Austria which, as it turned out, put a particular focus on the group's transfer pricing policy.

Please comment in this context the following questions:

1. Which entities/companies in the Techno Group are under the functional analysis "entrepreneurs", which are so-called "routine providers" (such as limited risk distributors, contract manufactures etc.)?
Please list the various types of companies under these groupings.
2. Which **TP method** can in view of the functional analysis be used to define the Transfer Prices between **Techco Austria** and the **distribution Subs** in the EU and ASIA?

What would be the typical **TP methods** to be used towards a subsidiary acting as **commissionaire**, as **low-risk distributor** (LRD) or as **fully-fledged distributor**?

3. What **TP method** is typically to be used for the sale of **semi-finished products** here to the sub in CN?
4. Why does Techco Austria concluded a **license arrangement** with the **CN sub** and how to define the **royalty rate** (which TP methods)?
5. As Techco Austria has **ongoing losses** while the sales subs outside enjoy positive "stable" results:
 - a. Does that mean that the group's transfer price policy is not arm's length?
 - b. What could be the reasons that losses have to be accepted and TP prices as applied as well? Please look at the functions of the various entities, especially routine activities versus the central entrepreneur.

Literature:

- Skript Modul 3
- VRP Richtlinien 2010 insbesondere Tz 5-7; 12-16;20-49; 50-62:72-73;
- CTPA Transfer Pricing Methods, July 2010
<http://www.oecd.org/ctp/transfer-pricing/45765701.pdf>
- **Rosar, Werner/Stradinger, Theresa**, Verrechnungspreismethoden und deren Anwendung in der Praxis im Überblick, in: Bernegger/Rosar/Rosenberger, Handbuch der Verrechnungspreise, Linde Verlag Wien 2012, S. 59 ff
- OECD TPG Chapter VII
- **Plott, Christoph**, Auswirkungen der Vertriebsstruktur-Möglichkeiten und Grenzen der Gestaltung, in: Bernegger/Rosar/Rosenberger, Handbuch der Verrechnungspreise, Linde Verlag Wien 2012, S.271 ff
- **Steiner, Gerhard**, Funktionsanalyse, in TPI 2017, S. 34 f