



THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

Specimen Examination Paper

PAPER III

PRINCIPLES OF CORPORATE AND INTERNATIONAL TAXATION

F - TRANSFER PRICING OPTION

TIME ALLOWED - 3 HOURS

- You should answer any **FOUR** out of seven questions including at least one question from each Part.
- Each question will carry equal marks.
- Start each answer on a fresh sheet.
- All workings should be made to the nearest month and appropriate monetary currency, unless the question requires otherwise.
- Marks are specifically allocated for good presentation.

PART A

Background information common to Questions 1, 2 and 3 (each of these three questions can be answered independently)

The Fashionclothes Cie is an Austrian company active in the design, manufacturing and distribution of clothes in Austria. In this industry it is important to be able to constantly renew the catalogue and propose new clothes for sale. One key strength of the Fashionclothes Cie is to release a new range of products every three weeks, so that customers will be interested in visiting the retail stores and buying Fashionclothes products on a regular basis.

Since 2005, the Fashionclothes Cie has sold its products in Poland through an unrelated distributor, the Polishdistri Company. The Polishdistri Company purchases the products from the Fashionclothes Cie and sells them in twelve well located retail stores in Poland. The agreement between the Fashionclothes Cie and the Polishdistri Company requires that every three weeks, the Fashionclothes Cie will buy back any inventory that remains unsold by the Polishdistri Company and that the latter will purchase products from the new catalogue.

In 2009, the Fashionclothes Cie acquires 100% of the shares in the Polishdistri Company. The distribution agreement remains unchanged.

Also, in 2009 the Fashionclothes Cie creates a new subsidiary in India, the Fashionclothes Manuf. Ltd. The Fashionclothes Manuf. Ltd now manufactures part of the Fashionclothes products (the rest are manufactured in Austria). The Fashionclothes Manuf. Ltd manufactures according to the designs and instructions of its parent company, using fabrics that are selected by the parent company. This makes it possible for the Fashionclothes Cie to derive significant location savings, as the manufacturing costs are significantly lower in India than in Austria. Once manufactured, the products are shipped by the Fashionclothes Manuf. Ltd to the Fashionclothes Cie for resale, either in the Austrian market (i.e. directly to end-user customers) or in Poland through the Polishdistri Company.

1. You are required to:

- 1) Create a functional analysis of the three entities of the group at the end of 2009, on the basis of information available to you (you can present the result of the analysis in a table). You should also identify significant missing information that should be asked before a transfer pricing conclusion can be drawn. (15)
- 2) List the controlled transactions that should be analysed in a transfer pricing analysis of the group. (5)
- 3) List the uncontrolled transactions that should be considered as potential comparables (irrespective of whether or not at the end they will be regarded as reliable comparables for the group's controlled transactions). (5)

Total (25)

2. 1) You are required to list the five comparability factors that the OECD considers as relevant to determine whether controlled and uncontrolled transactions are comparable. (5)

With respect to the sales of products by the Fashionclothes Cie to the Polishdistri Company:

- 2) Based on the information available, is it possible to apply the Comparable Uncontrolled Price method to determine the arm's length character of this transaction? Please justify your response. You should in particular analyse the relevance of the sales of products by the Fashionclothes Cie to the Polishdistri Company in 2008, and of the sales of products by the Fashionclothes Cie to the Austrian market. (10)
- 3) What other transfer pricing method(s) would you suggest for this transaction? You should explain your choice and also comment on the availability of comparables to apply the method(s) selected. (10)

Total (25)

3. 1) With respect to the manufacturing of products by Fashionclothes Manuf. Ltd: What transfer pricing method(s) would you suggest for this transaction? You are required to explain your choice. (10)

- 2) The case study indicates that, as from 2009, part of the manufacturing that was done in Austria is now done in India, thus allowing the Fashionclothes Cie to derive significant location savings.

You are required to give a definition of location savings.

(5)

- 3) From a transfer pricing perspective, do you think that the location savings derived by the Fashionclothes Cie should be partially allocated to the Fashionclothes Manuf. Ltd, and if so how? Please justify your response. (10)

Total (25)

PART B

4. **You are required to:**
- 1) **Explain what “economic double taxation” and “juridical double taxation” are and how they relate to transfer pricing.** (8)
 - 2) **Discuss the treaty mechanisms available to eliminate double taxation that may result from a transfer pricing adjustment.** (17)

5. The arm’s length principle is found in Article 9 of the OECD Model Tax Convention in relation to commercial and financial transactions between associated enterprises. It is also found in Article 7 of the OECD Model Tax Convention in relation to the attribution of profits to permanent establishments.

OECD guidance to apply the arm’s length principle between associated enterprises is found in the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations. OECD guidance to apply the arm’s length principle to the attribution of profits to permanent establishments is found in the Report on the Attribution of Profits to Permanent Establishments (versions 2008 and 2010). The latter describes the “Authorised OECD Approach for attributing profits to permanent establishments” (the “AOA”).

You are required to discuss the general structure of the AOA, its similarities with and differences from the application of the arm’s length principle between associated enterprises. (25)

6. Taxpayer is a member of a multinational enterprise group. It borrows £10million from its foreign parent company in order to fund the acquisition of a new subsidiary.

The tax authorities examine the loan transaction and the deductibility in the hands of Taxpayer of the interest charges paid to its parent company.

- 1) **What are the main issues to be discussed in relation to the deductibility of interest paid by Taxpayer?** (10)
- 2) **For each of the issues identified, you should discuss whether the arm’s length principle is relevant and can assist in finding a response.** (15)

Total (25)

7. **What is the significance of "intangibles" for transfer pricing purposes, and what are the key transfer pricing issues that arise in relation to intangibles?** (25)