

Question 1

1. Application of the arm's length principle is generally based on a comparison of the conditions in controlled transaction with the conditions in transaction between independent enterprises.

Risk is inherent in commercial activities. Business undertake commercial activities because they seek opportunities to make profits, based on the connection of higher risk - high reward.

1. Identify economically significant risk with specificity

Regarding the activities carried out between X and Y, the main risk is related to the provision of the R&D services.

According to the information provided the company X assumes development risk (a risk identified as economically significant).

2. Contractual assumption risk

Company X, hires company Y as a provider of R&D services with low risk assumed. We only know that the decision regarding the R&D activities are made by X, the risk related to the results of the research are also assumed by X and that X will hold title of the resulting intangibles.

Regarding the contractual terms it would be useful to know information regarding the pricing, the terms of the contracts, the pricing methodology.

3. Functional analysis in relation to the risk:

Company X:

Functions:

- ° developing of new products
- ° assesses the progress for product development
- ° controls the development of the product
- ° financing function (i.e. acts as the global treasury entity)

Risk:

- ° any risk related to R&D
- ° product liability risk
- ° financing risk

Assets:

- ° intangibles related to the results of the R&D activities
- ° office equipment?

Company Y:

Functions:

- ° provision of custom R&D services
- ° day to day activities

Risk:

- ° related to the provision of the r&d activities competently

Assets:

- ° office equipment?
- ° we assume that also the company has a laboratory and r&d equipment?

4. Interpreting steps 1-3

According to steps 1-3, the company X which bears all the risk related to the R&D activities also has the capacity to assume the risk (i.e. company X acts as the group's global treasure entity, with the capacity to assume any risk should the research fail).

5. Allocation of risk

As mentioned in the functional analysis above:

- ° company X is assuming high risk related to the R&D (e.g. decision maker, financing);
- ° company Y is assuming low risk, regarding day to day activities for the provision of this services.

6. Pricing of transaction

Based on the allocation of risk made at the step 4, the company X should pay Company Y for the provision of the R&D services a fee best on a cost plus methodologies (maybe with a mark-up between 7% to 10%).

2. The relocation of Chief Scientist from company X to Y, will impact the allocation of risk between the companies because he has the ability to decide if the evolution of the research is going in the right direction.

We do not have enough information but assuming that his report will be further analysed by company X and after that the decision will be made, this will not impact the allocation of risk.

If his transfer will imply the possibility for Company Y to make her own decision related to the R&D, this will change the allocation of risks.

Question 2

1. Homeco a 3rd party from Germany will acquire the product line related to home products that belongs to the Beautyco. Also, the deal include the sale of F CO (the small production facility from France).

We do not have enough information regarding the contractual terms under which the transaction will take place, but assuming that is between two independent parties (Homeco & Beautyco)it should be at arm's length.

Taking in consideration that the parties for the asset purchase agreement are HQ CO and Homeco, Beautyco should receive a fair allocation from the value of the sale.

The allocation should be made based on the specific assets that are transferred to Homeco. For example, there should be established prices for:

- » marketing assets (customer relationship, sales people)
- » intangibles (product rights & product names)
- » F CO (the price of acquisition for this company).

The other subsidiaries from the group should not receive a remuneration related to this sale:

- » the companies that were in engaged in selling the home products will acquire the products from Homeco (according to the text, we assume that they negotiated some purchase conditions)
- » for the other companies (for example M Co - the production facility for aloe vera) there will be no impact related to this sale.

2. Not allocating any amounts to its subsidiaries will probably, in case of tax audit will probably trigger adjustments. In the Italy, where HQ Co is located, there is a big chance that the tax authorities agree with higher revenues. But for the other subsidiaries (for example Beautyco), the lack of a revenue after selling an entire product line with marketing assets and intangibles will definitely mean adjustments.

3. Beautyco Group is a group that growth both organically and through acquisitions from independent parties. We assume that at the group level there is a transfer pricing policy regarding the acquisition of other business.

Also, we assume that this sale was made based on management, financial and marketing analysis related to the evolution of this line.

Question 4

1. This case is related to the provision of guarantee fees by GE Canada to GE US, both companies belonging to the same group.

GE Canada provided guarantee fees in order for GE US to obtain a better financing option.

The tax authorities from US mentioned that this guarantee should not be provided because GE US already had the same advantage because it was part of the GE group (i.e. the incidental benefit) and rejected the deduction of the fee. The Court disagreed and the company received the deduction.

In order to sustain the results of the case study, the paragraph 7.13 from OECD and also the BEPS quote below sustain that the provision of guarantees that impact the credit rating of the company should be considered as service.

According to *BEPS Action 10 (discussion draft, 3 November 2014), Chapter VII, para. B1. 4.*: "An associated enterprise should not be considered to receive an intra-group service when it obtains incidental benefits attributable solely to its being part of a larger concern, and not to pay any specific activity being performed. For example, no service would be received where an associated enterprise by reason of its affiliation alone" has a credit-rating higher than it would if it were unaffiliated, **but an intra-group service would usually exist where the higher rating due to a guarantee by another group member**".

2. Generally in MNE there is a practice that some activities are realized at a centralised level, related to group synergies. For example:

» the existence of a company that will provide headquarter activities for all the members of the group (i.e. a group service centre); these activities could include: management, HR, IT support, etc.

» there is also the case of the existence of companies engaged in the centralised purchase of raw materials, or R&D services.

Usually, depending on the activities engaged by the companies from the group, these types of services are usually allocated to them.

There are also some cases where an intra-group service is performed by a group member such as shareholder or coordinating centre that relates only to some members but incidentally provides benefits to another group member. The incidental benefits would not cause these other group members to be treated as receiving an intra-group service because the activities producing the benefits would not be ones for which an independent enterprise ordinarily would be willing to pay.

Question 5

1. Related party transaction during:

a. 2007 - 2010

- acquisition of products (i.e. cars) from DMG by Titan;
- provision of marketing services by DMG India office;
- acquisition of products (i.e. cars) from DMG by Telangana Industries group;

b. 2010 - 2013

- licensing of ip rights by DMG for the benefit of Titan;
- distribution of cars (i.e. Micron A) by TD;
- sale of cars in India?

c. 2013 - onwards

- acquisition of products (i.e. cars) from DMG by Titan;
- distribution of cars by DMG and TD;
- provision of head office services by DMG to Titan;
- loan acquisition by Titan from DMG.

2. Functional analysis

DMG

Functions:

- design, manufacture and distribution of cars
- marketing function (admired marketing campaigns, unified design language)
- engineering
- finance function
- HQ functions (management, HR)

Risk:

- market risk (if the products remain unsold it will buy them back from Titan);
- financial risk;
- we do not have many information regarding the production but we assume that it has: product liability risk, inventory risk, quality risk, foreign exchange risk.

Assets:

- patents
- money
- manufacturing equipment?
- marketing know how?
- office equipment?

TITAN

Functions:

- assembling imported foreign car models
- design, manufacture and distribution of Micron A
- local management?

Risk:

- market risk, product liability risk, r&d risk, inventory risk (for the Micron A), foreign exchange risk.

Assets:

- manufacturing equipment?
- office equipment?

TD

Functions:

- distribution of Micron A
- local management?

Risk:

- we do not have enough information regarding TD's activities but suppose that TD is assuming the transportation risk, market risk;

Assets:

- office equipment?

Question 9

1. Application of the arm's length principle is generally based on a comparison of the conditions in controlled transaction with the conditions in transaction between independent enterprises.

The five comparability factors are:

- characteristics of property or services;
- contractual terms;
- functional analysis;
- economic circumstances;
- business strategies.

a. Characteristics of property or services

The differences in the characteristics of property or services, often are translated in their value on the market (e.g. for tangible property the physical feature, quality, for services the nature and extent of the services).

Example: In order to compare the prices between the Acquisitions of two watches: one is super basic, a normal watch and the other one has the ability to show you the date is water resistant. We cannot assume that this products are comparable and to agree that the prices for both watches should be the same,

b. Contractual terms - usually in contracts there are defined the responsibilities, risk and benefits divided between the parties.

Example: If we have a controlled transaction based on a licensed agreement for the exploitation of ip rights and the transfer pricing method used is CUP, information on key contractual terms of uncontrolled licences, such as duration, geographic area, exclusivity can be critical.

c. Functional analysis - is a fact finding process in which we identify the functions performed, risk assumed and assets used by a company.

Example: Imagine we have: (i) a chocolate contract manufacturer and (ii) a fully- fledged manufacturer of chocolate. Based on the functional analysis we will be able to identify that these company are not comparable.

D. Economic circumstances - AL prices may be different across different markets even for the same transaction. Also, the geographic market and the existence of a cycle (economic, business, business cycle) can affect the comparability.

Example: Selling luxury machine in Las Vegas is less comparable to sell luxury machine in Romania, the prices may be different, the potential clients and probably the relation request - offer.

E. Business strategies: this could include innovation, new product development, degree of diversification, risk aversion, assessment of political changes, and input of existing and planned labour law.

Example: we have a company that is a producer of smart watches and the R&D activities are significant. When searching comparable we will try to adjust our search taking in consideration this aspect also.

2. The CUP method is the only method that compares prices. When applying internal CUP, we compare a transaction between two associated enterprises (A and B) with the transaction between company A and an independent party.

When trying to apply CUP is always important to check the compatibility with the 5 factors and when it is the case to make adjustments.

An example from a legal study is the one of the Dell, under which the tax auditor rejected their internal comparable used in the economic analysis of transaction based on reasons related to comparability (such as: the comparable used were too old or existed discounts).

These 5 comparability factors can influence the price and therefore, in order to compare a controlled transaction with an uncontrolled transaction it is important to understand these factors. Depending on the level of comparability the analysis will be more accurate.