

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2024

MODULE 3.03 – TRANSFER PRICING OPTION

ADVANCED INTERNATIONAL TAXATION (THEMATIC)

TIME ALLOWED – 3½ HOURS

This exam paper has **three** parts: **Part A**, **Part B** and **Part C**.

You need to answer **five** questions in total. You will **not** receive marks for any additional answers.

You must answer:

- **Both** questions in **Part A** (25 marks each)
- **One** question from **Part B** (20 marks)
- **Two** questions from **Part C** (15 marks each)

Further instructions

- All workings should be made in appropriate monetary currency, unless otherwise stated. Any monetary calculations should be made to the nearest whole unit of currency. Any necessary time apportionments in your calculations should be made to the nearest whole month.
- You must provide appropriate line breaks between each question, and clearly indicate the start of each new question using the formatting tools available.
- Marks may be allocated for clarity of presentation of your answers.
- The time you spend answering questions should correspond broadly to the number of marks available for that question. You should therefore aim to spend approximately half of your time answering Part A, and the other half answering questions in Parts B and C.
- There is no separate reading time, so you can start typing your answers as soon as the exam begins. However, we recommend that you set aside some time to thoroughly read each question and plan each of your answers.
- **Although references and short quotes from the OECD Transfer Pricing Guidelines can be included in your answer, you will not receive any marks for copying directly from the OECD Transfer Pricing Guidelines.**

PART A

You are required to answer BOTH questions from this Part.

The following facts apply to both Questions 1 and 2.

Beach Group was incorporated in 1955 and its shares are listed on the London Stock Exchange. Beach Group operates as a multinational group, through a number of wholly owned subsidiary companies which are domiciled in the main jurisdictions in which it sells its products. Its primary business is the design, manufacture and distribution of sports equipment. The ultimate parent entity (UPE) of Beach Group is located in the United Kingdom.

Beach Group owns intellectual property (IP), including licences, trademarks, copyrights and manufacturing know-how. Beach Group is considered one of the worldwide market leaders in the swimming pool pump industry and, as a result, is able to sell its products at premium price points in all markets in which it sells. Beach Group has gone to substantial effort over the last decade in undertaking research and development (R&D) activities, in order to make use of the most recent technology in its products.

Beach Group has centralised certain functions amongst its group members, including treasury, procurement, logistics, R&D and certain services.

You have been provided with the following information from Beach Group's Country by Country Report (CbCR), which was lodged with the UK tax authority, HMRC, for the year ending 31 December 2023. The information includes a summary of the key entities within Beach Group, with each listed entity operating in a different jurisdiction:

<u>Entity</u>	<u>Summary of business extracted from CbCR</u>
Beach plc	<p>UPE of Beach Group, which owns all IP. Provides management and technical services to all Beach Group entities. Such services include information technology, general administration, treasury, insurance and marketing support.</p> <p>Sells Beach-branded products to independent retailers in the UK and to group entities.</p> <p>Operates two retail outlets in the UK as 'flagship' stores, with sales to independent individual customers in the UK.</p>
Creek Pty Ltd	<p>Sells Beach-branded products to independent retailers located in Australia, New Zealand and the South Pacific region.</p> <p>Undertakes distribution and marketing activities.</p> <p>Located in Australia.</p>
Canal Pte Ltd	<p>Undertakes R&D under the direction of Beach plc.</p> <p>Undertakes manufacturing of Beach-branded products under a written contract for Beach plc.</p> <p>Undertakes procurement activities for Beach plc by sourcing inputs required from independent parties in the manufacturing process. The commercial reason is that Canal Pte Ltd is located in close proximity to suppliers.</p> <p>Performs logistics and transportation activities for group entities.</p> <p>Sells Beach-branded products to independent retailers in Asia. Undertakes distribution and marketing activities.</p> <p>Located in Singapore.</p>
River Ltd	<p>Sells pool pumps for which Beach Group does not own the IP. Goods are sourced from unrelated manufacturers.</p> <p>Sales are made to independent retailers in jurisdictions in which Beach products are not sold.</p> <p>Undertakes distribution and marketing activities.</p> <p>Located in the United States.</p>
Aqueduct Inc.	<p>Sells Beach-branded products through an online platform in jurisdictions in which Beach products are not sold by a retailer.</p> <p>Canal Pte Ltd fulfils the orders by dispatching goods to Aqueduct Inc.'s customers, most of whom are individuals.</p> <p>Located in the Seychelles.</p>

<u>Entity</u>	<u>Income tax rate</u>	<u>Net profit to sales margin</u>	<u>Net profit as % of total assets</u>	<u>Sales to independent customers (£)</u>	<u>Sales to group entities (£)</u>	<u>Number of employees</u>
Beach plc	27%	2.5%	1.5%	500 million	140 million	2,000
Creek Pty Ltd	30%	5%	7%	100 million	0	1,000
Canal Pte Ltd	15%	20%	18%	40 million	0	100
River Ltd	25%	11%	150%	250 million	0	100
Aqueduct Inc.	15%	50%	550%	75 million	0	15

1. **You are required to complete the following activities, with references as relevant to the appropriate Transfer Pricing Guidelines.**

- 1) Delineate the transactions between the associated enterprises within Beach Group. (10)
- 2) Perform a functional analysis of Beach Group, and characterise each entity. (15)

Total (25)

2. **You are required to:**

- 1) Advise, with reasoning, on the most appropriate transfer pricing methodology that should apply to each transaction between the associated Beach Group enterprises. (10)
- 2) Advise on the potential sources of comparability data, based on the facts provided, and identify any potential comparables. (10)
- 3) Identify any material concerns in relation to Beach Group, in the application of the arm's length principle. (5)

Total (25)

PART B

You are required to answer ONE question from this Part.

3. The Flipper Group is a multinational group of companies that manufactures and distributes scuba diving and snorkelling equipment. Its branded equipment has a global reputation for high quality.

Flipper Ltd is the ultimate parent entity of the Flipper Group, tax resident in Country A with a headline corporate tax rate of 30%. It owns a facility for the manufacture of all of the group's products, including snorkelling masks, snorkel, flippers, fins, scuba regulators, tanks and wetsuits. Flipper Ltd legally owns all intellectual property (IP) including brand names, designs and patents, and conducts research and development (R&D) activities in the same facility as the manufacturing. It distributes manufactured products to associated and independent distributors in Country A, and owns a chain of retail stores in Country A for sale to end customers. In addition, it performs a marketing and sales function in both Country A and Country C.

Flipper Sub 1 is a wholly owned subsidiary of Flipper Ltd, and is tax resident in Country B with a headline corporate tax rate of 15%. It purchases products manufactured by Flipper Ltd and sells them to retail stores that are independent of the Flipper Group, as well as independent online customers. It pays a royalty of 5% of sales to Flipper Ltd for the use of IP. It also performs sales and marketing in Country B.

Flipper Sub 2 is a wholly owned subsidiary of Flipper Ltd, tax resident in Country C with a headline corporate tax rate of 15%. It purchases products manufactured by Flipper Ltd and sells them to retail stores that are independent of the Flipper Group, as well as independent online customers. It pays a royalty of 5% of sales to Flipper Ltd for the use of IP. It receives sales and marketing support from Flipper Ltd.

Deep Dive Pty Ltd is a company independent of the Flipper Group in Country D, with a corporate headline tax rate of 25%.

As part of a recent value chain transformation proposed by the group's global transfer pricing manager, the following changes have been proposed for the Flipper Group:

- 1) All IP legally owned by Flipper Ltd will be transferred to a newly created company, Flipper Sub 3, tax resident in Country E with a headline corporate tax rate of 10%. The R&D activities will also be transferred from Flipper Ltd to Flipper Sub 3.
- 2) The royalty payments by Flipper Sub 1 and Flipper Sub 2 are to be paid to Flipper Sub 3 rather than to Flipper Ltd, and will increase to 7% of sales.
- 3) The manufacturing function will be transferred to a newly created entity, Flipper Sub 4, tax resident in Country F with a headline corporate tax rate of 17%.
- 4) Flipper Ltd will now perform sales and marketing for all Flipper Group subsidiaries, as well as human resources, procurement and administration activities. In addition, it will perform a strategic management and guidance role for all associated enterprises within the Flipper Group.

You are required to discuss the transfer pricing implications and risks of the changes proposed for the Flipper Group. You should consider functions, assets and risks for the companies within the group as part of your analysis. (20)

4. Salinity Pty Ltd (SPL) is privately-owned company, tax resident in Hydrovista. The directors of SPL travelled on numerous occasions to Altrum, to negotiate the construction of a desalination plant there with the government of Altrum. As part of the negotiation process, SPL was required to submit an application including a detailed business plan.

Following the successful conclusion of negotiations, the directors of SPL signed the overarching contract in Hydrovista and provided an electronic version to the government of Altrum.

SPL has obtained financing for the project from an external financial institution in Hydrovista, personally guaranteed by the directors. SPL has appointed both independent and associated companies to conduct a range of activities, including planning, engineering, design, procurement, logistics, construction and environmental work.

SPL has assigned three company representatives and a project manager to work in Altrum. They will be required to work closely with various government bodies within Altrum, to obtain the necessary approvals. In addition, SPL plans to employ approximately 50 staff from the Republic of Novatech as labour, to be assigned to the construction of the desalination plant. These staff will be rotated and will leave Altrum every two months.

The directors of SPL will only be involved in the project to the extent that the company representatives in Altrum require approval of additional financing or key decisions, or direction on significant issues that may be encountered. A potential environmental issue has been identified, and is expected to require input from SPL's directors in its resolution with the Altrum government.

- 1) You are required to discuss any permanent establishment (PE) issues that may arise, based on the facts provided.** (15)
- 2) What consideration would you give to the attribution of profits and/or losses to any potential PEs?** (5)

Total (20)

PART C

You are required to answer TWO questions from this Part.

5. What are the key transfer pricing issues associated with intragroup financial transactions? (15)

6. You are required to answer the following questions:

- 1) The tax manager of a manufacturing and distribution company, which has recently expanded its business model (including the establishment of operations and transactions with associated enterprises) offshore has approached you as a transfer pricing adviser.

You are asked to provide a brief, outlining the key areas of risk that the company needs to consider and manage from a transfer pricing perspective. (7)

- 2) What do you consider to be the important aspects in conducting a transfer pricing audit, from both the perspective of a tax administration and that of a tax adviser or client. (8)

Total (15)

7. You are required to answer the following questions:

- 1) The global tax manager of a multinational group of companies is giving consideration to moving intellectual property (IP) within the group.

As a transfer pricing adviser, provide an outline of the key considerations from a risk management perspective, with regard to changes in the treatment of IP in recent years within an OECD context. (8)

- 2) Provide your view on the benefits, to tax administrations, of changes to the taxation of e-commerce business models, as proposed and implemented by the OECD. (7)

Total (15)

8. You are the international tax adviser for a multinational group of companies, which has recently decided to enter into an Advance Pricing Arrangement (APA). The chief financial officer (CFO) has approached you for strategic tax advice.

You are required to:

- 1) Advise on the extent to which you expect the OECD's Pillar One, Amount B initiative, if implemented, to reduce the incidence of tax disputes. (8)

- 2) Advise the CFO on whether the group's APA should be bilateral or unilateral, including your reasoning. (7)

Total (15)

- 9.

- 1) You are required to explain, with supporting reasons, whether you support the adoption of transfer pricing safe harbours by tax administrations. In your response you should outline what sort of issues may arise in the context of the international tax landscape (i.e. from a bilateral and multilateral perspective, rather than domestically or unilaterally). (8)

- 2) A multinational group was recently subject to a transfer pricing audit, which resulted in material adjustments by the tax administration to increase the income tax payable. The multinational group disagrees with the outcome of the audit.

What advice would you provide to the multinational group, regarding the possible next courses of action and the associated considerations? (7)

Total (15)