DEMYSTIFYING TRANSFER PRICING-APPENDIX

tgs ROMANIA

HELLENIC-ROMANIAN BILATERAL CHAMBER OF COMMERCE

MOORE

Example 1 – Freight Forwarding Services – Characteristics:

a) Organisation of transport:

- Processing of Orders received in order to organise road, air and sea transport of goods for Service Recipient through Carriers (third party transportation providers);
- Analysis of the Service Provider's needs presented in the Order and selection of the most appropriate logistic solutions; and
- Coordinating the course of transport of goods through on-going cooperation with Carriers.

b) Administrative and office services:

- Administrative handling of invoices issued by Carriers;
- Scanning services, entering documents such as invoices issued by Carriers subcontractors into the IT and accounting system,
- Personal delivery of invoices to speed up document circulation and payment processing.

A. Comparable Uncontrolled Price Method ("CUP method")

- Compares:
  - **the price charged for property or services transferred in a controlled transaction to**
  - **the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances.**
- If comparable data were available in the following conditions:
  - **Two non-related companies** involved in a comparable transaction (**Ext-CUP**)
  - related Co. (provider) **provides** comparable services to non-related Co's **(Int-CUP)**
  - related Co. (receiver) **receives** comparable services from non-related Co's **(Int-CUP)**
- External Price Comparison (Ext-CUP): the terms of the transactions are generally confidential => no public data on the prices of similar transactions
- Internal Price Comparison (Int-CUP): high degree of comparability of the services and operation of the businesses involved.
- **Providing / not providing significant services in value terms to at least 5 independent companies (the minimum number required so the method can be applied)**

B. Resale Price Method (“RPM”)

- begins with the **price** at which a product that has been **purchased from an associated enterprise is resold to an independent enterprise**.
- This price (the resale price) is then reduced by an **appropriate gross margin** on this price (the “resale price margin”)
- after subtracting the gross margin and after adjustment for other costs associated with the purchase of the product (e.g. customs duties) => **an arm’s length price** for the original transfer of property between the associated enterprises.
- Method is most useful applied to **marketing operations**.
- Our case - provision of services and not purchase and resale of goods, the resale price method is not applicable

C. Cost Plus Method ("CPM")

- **costs incurred by the supplier of property or services in a controlled transaction for property transferred or services provided to an associated purchaser**.
- **an appropriate cost plus mark-up** is then added => an arm's length price of the original controlled transaction.
- method is most useful where:
  - semi-finished goods are sold between associated parties,
  - associated parties have concluded joint facility agreements or long-term buy-and-supply arrangements, or
  - the controlled transaction is the provision of services
- as a Principal, apart from the direct costs of transportation, there are additional other costs in connection with the service: **selling and administration expenses**
- **The profitability in connection with the transaction does not appear in Gross Margin**

D. Profit Split Method ("PSM")

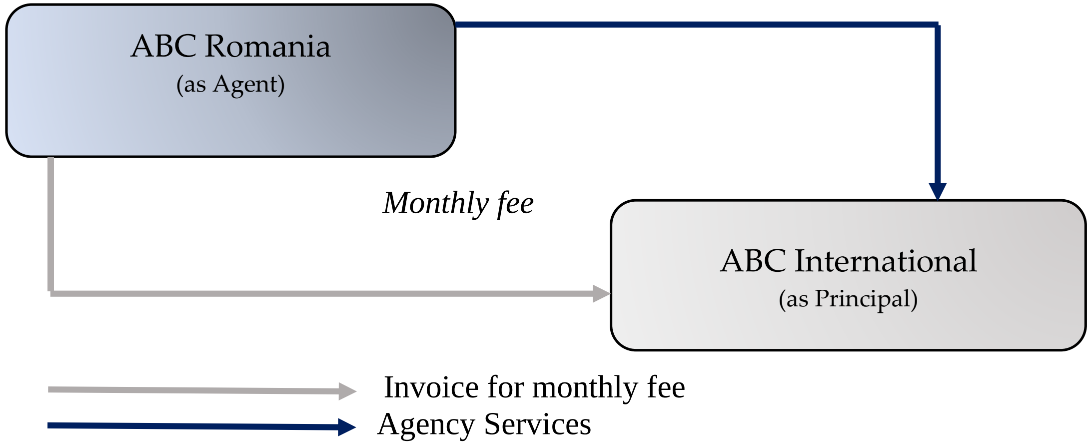
- For **transactions involving highly interactive activities** that cannot be separated, as well as to transactions between affiliates each of which contributes with **significant intangible assets.**

E. Transactional Net Margin Method ("TNMM")

- examines the **net profit margin** from a controlled transaction
- TNMM does not require extremely detailed information on the transaction price or gross profit margin. In addition, comparability standards are less stringent under TNMM than any other method proposed in the OECD guidelines.
- The net margin is determined by subtracting from the **income earned** as a result of the transaction the **costs incurred**, including general administrative expenses (proportionally).
- **Due to the lack of reliable data** from other similar transactions and because the **calculation of the net profit margin takes into account the selling and administrative costs,** the TNMM method was chosen as the most appropriate method for the financial analysis of the transaction.

Agent Services:

Principal is paying to the Agent a monthly fee depending of the actual operating costs incurred in respect of these services by the Agent and the number of processed orders in favor of the Principal.



- **Selected method:** Ext-TNMM;
- The range of the estimated monthly fee for agency services calculated based on the actual operating costs incurred in respect of these services by the Agent plus a margin (**mark-up on the operating costs**) estimated to satisfy the arm’s length principle ranges between LOWER and UPPER quarters.
- Due to the specialization of services provided, it would be safer from the tax perspective to choose a margin on the operating costs incurred in respect of these services by the Agent **around the median quartile**. Notwithstanding, a lower margin would also be acceptable but this will require more justification and supporting documentation in the transfer pricing file.

A. Information on the group:

- the **organizational, legal and operational structure** of the group, the geographical location of the component entities specifying the shareholdings at the level of the group, during the period;
- overview of the **group's activities**, its **business strategy**, including the **changes in the business strategy** within the period;
- description of any **transfer pricing policy** at the level of the group;
- general **description of transactions** carried out between related parties;
- general **description of functions performed, risks assumed and assets employed** in the transactions carried out between related parties (functional analysis), including the **changes in the functional profile** of the entities within the group, during the period;

A. Information on the group (cont'd):

- **functions performed, risks assumed and assets employed**, at the level of the group, that **contribute significantly and definitive** to the **value-adding processes undertaken**, taking into consideration each entity part of the group;
- description of **owners of intangibles** and **property rights** pertaining, within the group (patent, license, trade name, brand, logo, knowhow, etc.);
- transfer pricing policy regarding **financial arrangements** (intra-group financing services);
- **any business restructuring;**
- **research and development activities** within the group;
- **advance pricing arrangements** entered into by the taxpayer/payer or by other entities part of the group, except for those issued by the National Agency for Tax Administration.

B. Information on the taxpayer/payer:

- **organizational, legal and operational structure** of the taxpayer/payer (a list of its related parties, including their permanent establishments and identification data), the **geographical location** of the related parties, specifying **the direct and indirect affiliation** relations of the taxpayer/payer, during the period for which the transfer pricing documentation file has been prepared, highlighting the occurred changes;
- **activities performed** by the taxpayer/payer, business strategy, including **any changes** within the business strategy during the period;
- **transactions** carried out between each related party as well as the context surrounding them;
- **transfer pricing policy** established at the level of the taxpayer/payer;
- implementation procedure when applying the transfer pricing methodology for the transactions carried out between the taxpayer/payer and its related parties;
- **research and development activities** at the level of the taxpayer/payer;

B. Information on the taxpayer/payer (cont'd):

- transfer pricing **policy** regarding the **intra-group financing** services of the taxpayer/payer with related parties, along with the presentation of financing agreements concluded both with related parties and independent lenders;
- **agreements** concluded between the taxpayer/payer and its related parties, regarding cost contribution arrangements;
- **intra-group transactions** consisting in provision of services, detailing the allocation keys, if the case, describing the services which have a significant and definitive contribution to the value-adding processes undertaken;
- **main outlets** for tangible goods delivery/services provision of the taxpayer/payer with its related parties;
- **transactions related to any business restructuring** that involve the taxpayer/payer, during the period;

B. Information on the taxpayer/payer (cont'd):

- detailed description of the transactions carried out with related parties:
  - a) **flow of transactions**;
  - b) **invoicing flow**;
  - c) **amount of transactions** carried out with the related party/parties;
  - d) **amount of payments/receipts** associated with each transaction performed by the taxpayer/payer with each related party.

B. Information on the taxpayer/payer (cont'd):

- **functional analysis and comparability analysis:**
  a) **characteristics of tangible and intangible goods or services**, including the financing services subject to the transaction/transactions with related parties;
  b) **specific business strategies** (e.g. market penetration strategies, extraordinary events, etc.);
  c) **functions performed, risks assumed and assets employed** by the taxpayer/payer and by the related party/parties within the transaction(s) carried out;
  d) **contractual terms of the transaction(s)**, with attached copies of the contracts/agreements acting as legal framework of the transaction(s) carried out with related parties;
  e) **particular economic circumstances of the transaction(s)**;

B. Information on the taxpayer/payer (cont'd):

f) **comparability analysis**: information regarding the **external or internal comparable transactions** (search strategy for comparable companies and of the information sources, values of the financial indicators used, possible comparability adjustments that were made, comparable entities list as well as the list of rejected entities with the rejection reasons, etc.).

g) **critical assumptions** for establishing the transfer pricing policy;

h) **reasons for using a multiannual or annual analysis of data**;

- **method used** for determining the transfer prices for each transaction and validation of the selection criteria; and the rationale for the selection of the tested party;
- **unilateral or bilateral/multilateral advance pricing agreements**, related to the transaction(s) carried out, for which the National Agency for Tax Administration does not take part;
- **other relevant information**.

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