VERO SKATT

Case Study Finland

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Application for Bilateral Advance Pricing Agreement

- **B Corporation**, a Finnish parent company of B Group, and it's wholly owned subsidiary **BX** located in X Country have requested a bilateral APA between Finland and X Country in September 2023 covering two transactions for tax years from 2025 to 2029.
- BX is a newly established limited liability company in X Country, where B Group haven't had any other subsidiaries or any prior activity.
- B Group develops and manufactures premium products. B Group manufacturing plants are currently in Finland and USA. To increase supply of its products B Corporation decided to invest in a new greenfield factory in X Country. Total value of the investment is estimated to be 650 MEUR. Construction will be completed in late 2024.
- B Corporation is financing BX through 195 MEUR equity and 455 MEUR loan.

Covered Transactions

- Covered Transaction 1:
- B Corporation grants BX an intercompany revolving loan facility in an aggregate amount of 455 MEUR. The interest rate is zero point zero five (0.05) per cent per annum for the entire loan period. Maturity date of the loan is December 2033.

- Covered Transaction 2:
- BX's sale of products to B Corporation. BX operates as a low-risk contract manufacturer for B Corporation, performing production activity strictly under B Corporation's instruction. The products manufactured by BX are sold to B Corporation under an arm's length compensation of Net Cost Plus 3,5%.

Functional Analysis

- **B Corporation** is the principal entity responsible for strategic direction of BX’s manufacturing operations. B Corporation performs B Groups’ research and development, owns the intangibles and makes all the important decisions related to the intangibles. In Addition, B Corporation performs the operations planning process, manages the supply chain, allocates the production capacity to the manufacturing units, determines the third-party pricing principles and allocates products to markets. Altogether, B Corporation controls all the significant risks of the business.

- **BX** operates as a low-risk contract manufacturer for products based on the models, specifications, guidance, quality, and supervision of B Corporation. BX sells the manufactured products to B Corporation. BX is expected to develop and maintain manufacturing related competences and processes using skilled workforce. BX owns the factory, production machinery, warehouse facilities and raw materials. The factory will operate using the state-of-the-art technology. BX does not bear any relevant risks in its operations.

Economic Analysis by the Taxpayers

- Covered Transaction 1:
- The applicants had performed a loan interest rate benchmark analysis. The fixed rate of final six loan instruments varies from 4,063% to 5,338% with a median of 4,438%. After several adjustments an applicable range between 0,001% and 1,902% was established. Based on the analyses, 0,05% interest rate appears to result in arm's length overall profitability when aligning the result with an indicative profitability calculation for BX.

- Covered Transaction 2:
- A benchmark comparability analysis was performed using TP Catalyst of Bureau van Dijk. The analysis produced a minimum and a maximum range of three-year weighted average NCPs between 0,4% and 9,2% as well as an inter-quartile range between 1,5% and 4,7% with a median of 2,9% → Net Cost Plus 3,5% was considered at arm's length.

BX Profitability Estimation

BX high-level P&L summary											
MEUR	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Operating revenues	0,7	13,0	124,5	218,3	268,8	274,2	272,4	272,5	278,8	273,0	273,4
Production costs	0,0	6,7	66,2	159,2	207,1	212,1	210,3	210,2	210,0	209,8	209,7
Other costs	0,7	5,8	12,2	13,5	14,0	13,5	13,3	13,3	13,3	13,3	13,3
Depreciations	0,0	0,0	41,8	38,1	38,7	39,2	39,5	39,8	40,2	40,6	41,1
Total costs & depreciations	0,7	12,5	120,2	210,9	259,8	264,9	263,2	263,3	263,6	263,8	264,1
EBIT	0,0	0,4	4,2	7,4	9,1	9,3	9,2	9,2	9,2	9,2	9,2
% of sales		3,1	3,4	3,4	3,4	3,4	3,4	3,4	3,4	3,4	3,4
Loan interest costs	0,2	0,2	0,2	0,2	0,2	0,2	0,1	0,1	0,1	0,1	0,1
Net working capital costs	0,0	0,0	4,3	4,3	7,3	7,9	7,8	8,0	8,3	8,6	9,1
Profit before tax	-0,2	0,2	-0,3	2,9	1,6	1,2	1,2	1,1	0,8	0,5	0,1

Assumptions

- 3,5% contract manufacturing mark-up on total costs and depreciations
- Investment with 70% share of debt and 30% equity
- 0,05% annually paid interest rate
- Loan repayments are assumed to be according to the depreciation schedule
- Net working capital is financed through intra-group loan from another group entity

Questions

1) What is your first reaction to the 0,05% interest rate of the Covered Transaction 1? Have you seen similar interest rates?

2) What is your first reaction to the contract manufacturing compensation of the Covered Transaction 2? Have you seen similar level of compensations for contract manufacturing?

3) B Corporation sells the products to markets, but there is no further information on distribution activities. Would you send a lengthy questionnaire to the taxpayer where you would ask more information about distribution, or would you consider that you are able to discuss the APA without distribution information?

4) In what way would you approach the case? Would you evaluate the case on a transaction-by-transaction basis, or would you combine the evaluation of both transactions?

5) What would be your position to sign the APA?