Case Study Finland - Proposed Solution

IOTA Case Study Workshop on Transfer Pricing Challenges in Advance Pricing Agreements

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Sami Laaksonen

First Reaction (Questions 1-2)

- Covered Transaction 1 (loan): It could be argued that independent parties would have agreed different terms and conditions on Covered Transaction 1. Third party financier could demand for example around 5% or even higher interest rate → is 0,05% interest rate arm's length?

- Covered Transaction 2 (routine manufacturing services): Benchmark study indicating an inter-quartile range of net cost plus from 1,5% to 4,7% with median of 2,9% is typical for contract manufacturers. BX should be compensated only for its routine manufacturing services, as it only controls the risk that it fails to deliver its services to the principal. It seems to be that B Corporation is performing all the control functions and assuming the economically significant risks of the business.

→ Do not base your position on first impression. You should always accurately delineate the actual transaction.

Other information (Question 3)

- There are usually a lot of information presented in APA requests, but you could always ask for more. In order to have a complete understanding of the covered transactions and the business you could send several detailed questionnaires to the taxpayer (and after that yet another round of detailed questionnaire).
- The experience of the Finnish Competent Authority (CA) is that it could be burdensome for all the parties involved to ask information not directly linked to the covered transactions.
- For example, in this case information on distribution activities is not relevant to analyze the covered transactions. As a principal B Corporation is responsible for all the functions and risks, so it doesn't make any difference to the covered transactions in what way B Corporation is pricing the distribution transactions with other group entities.
- Nevertheless, you should always call for relevant information concerning the case.

Approach (Question 4)

- OECD Transfer Pricing Guidelines are based on transactional approach. In principle the analysis should be done on transaction-by-transaction basis.
- However, in this case Finnish CA would prefer combining the evaluation of the transactions. Finnish CA would not accept the 0,05% interest rate as arm’s length as such but would accept the transactions as arm’s length in viewing both transactions in their totality.

  → BX should not bear the interest on intra-group loan, because B Corporation is controlling the investment risk. Whether the investment is funded by equity or debt, B Corporation should cover the expenses. B Corporation should bear the downside consequences, if the factory investment fails, but at the same time should be entitled to receive the upside benefits.

  → Even if the arm's length interest rate could be considered higher (for example 5% - 10%), B Corporation should compensate the same amount within the manufacturing service fee or other compensation resulting in around similar profit before tax for BX as in the taxpayers' transactions.

Position (Question 5)

- Finnish CA could agree on taxpayers' conclusion that the overall compensation on intra-group loan and the contract manufacturing operations is at arm's length.