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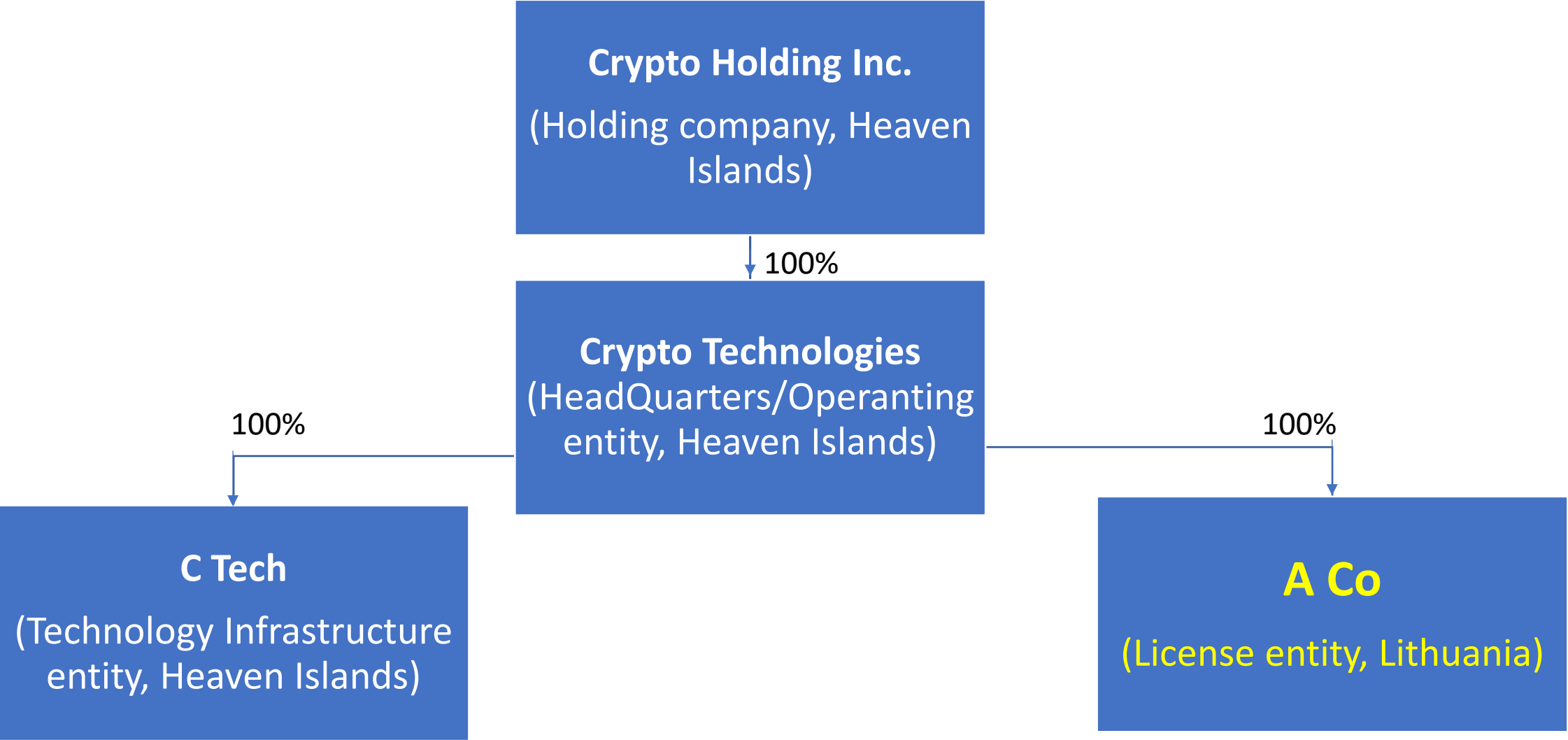
APA APPLICATION REGARDING INTRAGROUP TRANSACTIONS IN THE CRYPTOCURRENCY BUSINESS

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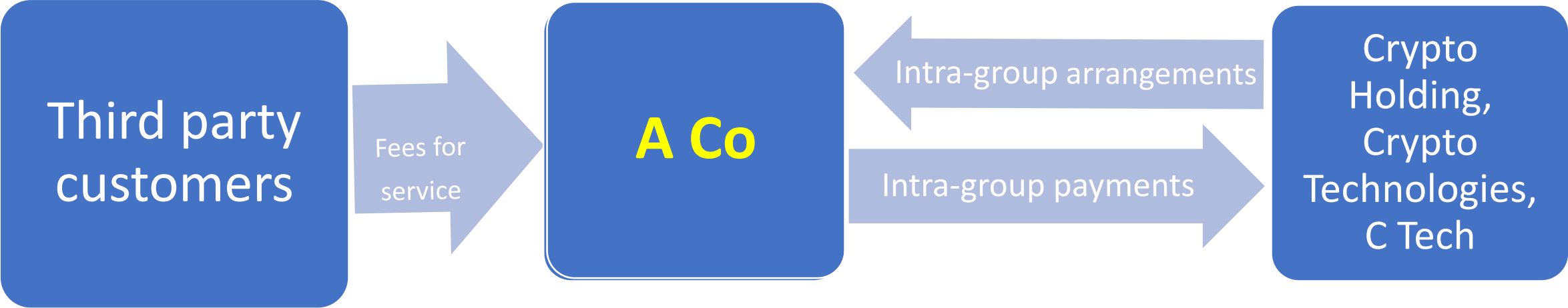
State Tax Inspectorate under the Ministry of Finance of the Republic of Lithuania

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CASE STUDY: CRYPTO GROUP'S ORGANIZATIONAL STRUCTURE / ENTITIES INVOLVED



Group's sales income stream in relation to transactions under review



FUNCTIONAL ANALYSIS

Functions	A Co (LT)	Crypto Technologies	C TECH	C HOLDING
Strategic management	-	√	√ (limited)	√ (limited)
Sales	-	√	-	-
Marketing and branding	-	√	-	-
Software management	-	-	√	-
Back-office activities:				
Finance management	-	√	-	-
Human Resources	-	√	-	-
Customer support services	-	√ (customer)	√ (IT)	-
Regulatory and compliance	√	√	-	-
Risks				
Market risk	-	√	-	-
Operational risk	-	√ (banking)	√ (IT)	-
Currency exchange risk	-	√	-	-
Registration loss risk	√ (direct)	√ (indirect)	-	-
Compliance risk	√	√	-	-
Assets				
Tangible assets:				
Routine business assets	√	√	√	√
Intangible assets:				
Software	-	-	√	-
Brand	-	√	-	-
Client relationships	√ (contracts)	√ (relationships)	-	-
Regulatory registration	√	-	-	-

Value chain analysis. Rationale of weights assigned

High weight - very important activities which are unique and highly valuable providing competitive advantage: Strategic management, Software, Client relationships.

Medium weight - necessary and important activities but do not lead to a significant competitive advantage: Brand, Regulatory registration.

Low weight - routine and not unique activities: Compliance, Back-office administration.



TP METHOD

Taking into account the circumstances of the intra-group transactions (integrated business and unique and valuable assets), **the residual profit split method** is chosen to estimate the remuneration for the parties.

Combined consolidated financial results (profit/loss) are used.

In applying the residual profit split method, **a two stage analysis** is performed.



APPLICATION OF THE PS METHOD I

Step 1. Each participant is allocated an arm's length remuneration for its non-unique contribution in relation to the controlled transactions (the compliance and back office functions).

The TNMM, using a PLI of full cost mark-up (FCMU), will be applied as the appropriate method to establish arm's length remuneration for the Group's non-unique controlled transactions and to calculate the residual profit for splitting.

Group's consolidated financial results	FY 2022
a. Sales revenue	\$ 72,086,748
b. Profit before tax	\$ 55,272,597

Allocating remuneration for non-unique contributions	A Co	Crypto Technologies
c. Costs of routine functions:	\$ 628,530	\$ 941,748
• <i>Compliance activities</i>	\$ 628,530	\$ 140,948
• <i>Finance support</i>	-	\$ 664,411
• <i>Human Resources</i>	-	\$ 136,389
d. Remuneration for routine functions:		
1. Compliance costs + 17% based on benchmarking study	\$ 106,850	\$ 64,001
2. Finance/HR costs + 5% based on LVAS guidance		
e. Residual profit after deducting remuneration for routine functions (b - d)	\$ 55,101,746	

APPLICATION OF THE PS METHOD II

Step 2. Any residual profit (or loss) remaining after the first stage division would be allocated among the parties based on an analysis of the unique contributions made by each transaction party (other remaining activities). The functional and value chain analysis is used for the identification of the functions performed, recourses employed, risk assumed by the entities. The weight to each value driver is allocated for the identification the importance of each factor and its contribution to the business.

Allocating remuneration to software and brand value drivers

	Crypto Technologies	C Tech
f. Remuneration attributable to software (30% of revenue)	-	\$ 21,626,024
g. Remuneration attributable to brand (5% of revenue)	\$ 3,604,337	-
h. Relevant costs	\$ 1,887,712	\$ 5,557,697
i. Residual profit attributable (f - h and g - h)	\$ 1,716,626	\$ 16,068,328
j. Residual profit attributable over total residual profit (%)	3.12	29.16
k. Residual profit after deducting remuneration for software and brand value drivers (e - f - g)	\$ 37,316,792	
<i>f. Weight for software estimated with reference to benchmarking study results for comparable software (IQR from 15% to 40%, median 25%) and reference to value chain analysis and comparison to other significant value drivers (i.e. value estimated to similar to the value of strategic management and client relationships)</i>		
<i>g. Weight for brand estimated with reference to benchmarking study results for comparable brands (IQR from 1.35% to 7.25%, median 4.5%)</i>		
<i>h. Eliminated relevant costs which the attributed remuneration is intended to compensate</i>		
<i>j. Estimated % of attributed profit over total residual profit (required for consistency of weightings in both steps 2.1 and 2.2)</i>		

APPLICATION OF THE PS METHOD III

Steps 2.1 & 2.2

Allocating weights to value drivers for remuneration						
Value Drivers	Parties				Weights (% of total residual profit)	Gross weight
	A Co	Crypto Technologies	C Tech	Crypto Holding		
2.1. Benchmarked						
1. <i>Software (incl. know-how)</i> (C Tech)	0%	0%	100%	0%	29%	91%
2. <i>Brand</i> (Crypto Technologies)	0%	100%	0%	0%	3%	9%
Total	0,0%	9.4%	90.6%	0,0%	32%	100
2.2. Not benchmarked						
3. <i>Strategic management*</i>	0%	58%	10%	31%	32,5%	48%
4. <i>Regulatory registration</i> (A Co & Crypto Technologies)	75%	25%	0%	0%	3%	4%
5. <i>Client relationships</i> (Crypto Technologies)	0%	100%	0%	0%	32,5%	48%
Total	3.3%	76.8%	4.9%	15,0%	68%	100%

* Allocated among entities based on proportions of top management team's expenses within each entity in the Group.

APA REQUEST I

A Co requests the Lithuanian Tax Authorities to approve the TP methodology for the intra-group arrangement with „Crypto Group” entities, in particular to:

Apply the profit split method, including:

Step 1 - allocation of remuneration for routine activities to be set on cost plus mark-up basis as follows:

1. Compliance activities performed by Group entities to be remunerated on a cost plus mark-up basis. Mark-up to be within the arm's length range of 8.61% and 34.97%.
2. Back-office activities performed by Group entities (incl. human resources, finance) to be remunerated on a cost plus 5% mark-up basis.

APA REQUEST II

Step 2 – allocation of remuneration (i.e. split of residual profit) for non-routine activities to be set as follows:

- 1. Software** – 29% of residual profit allocated to “C Tech”.
- 2. Brand** - 3% of residual profit allocated to “Crypto Technologies”.
- 3. Strategic management** - 32.5% of residual profit. The allocated total remuneration should be split among “Crypto Technologies”, “C Tech” and “Crypto Holding” proportionally according to the incurred strategic management costs by each Group entity in a particular year.
- 4. Regulatory registration** - 3% of residual profit. Allocated to A Co (receiving 75%) and “Crypto Technologies” (receiving 25%).
- 5. Client relationships** - 32.5% of residual profit allocated to “Crypto Technologies”.

ISSUES AND THE CHALLENGES ENCOUNTERED WHILE DEALING WITH THE CASE

ISSUES AND THE CHALLENGES I

- Most of the Group's companies are established in tax heaven ("Heaven Islands");
- Volatility of the Group's activities - the foreign company related to The Group performed the same activities as the A Co until June 2022. Following the tightening of legal regulations in Country X, this activity was moved to Lithuania, but the A Co has registered the activity of the virtual currency exchange operator only since 2023-03-24, i.e. A Co (and The Group) operated for some time without mandatory registration;

ISSUES AND THE CHALLENGES II

- A Co does not have a bank account in Lithuania;
- A Co has only two employees;
- Uncertainty regarding the value chain - specifically the allocation of profits among group companies - has raised concerns;
- Doubts about the validity of the Group companies' contributions, mutual transactions, and the integrity of the transactions;
- Uncertainty about the uniqueness and value of the intangible assets used.

QUESTIONS OR ISSUES RELATING TO THE CASE ADDRESSED FOR GROUP DISCUSSION

- 1. Are the specified circumstances sufficient to apply the profit split method? If not, what other evidence is missing? What other transfer pricing method could be applied to these transactions?**
- 2. How would you (your tax administration) assess such an APA request given the provided information, or what would be your perspective on it?**

