CASE STUDY 2

FINLAND

Case submitter

Tiia Granfors

Finnish Tax Administration

Telephone: +358408200845

Email: tiia.granfors@vero.fi

Proposed solution

Based on the analysis of functions, assets and risks (FAR analysis) of XZeusFin Oy, made during the MLC and national tax audit, XZeusFin operates as a fully-fledged entity in the field of providing customers with technology solutions. XZeusFin owns valuable intangibles: customer relationships and educated consultant personnel, which is the key to success in this kind of line of business. The group's brand is owned by XZS in Ireland, but XZeusFin makes local marketing efforts and owns a local "brand". For the contract R&D services, which only cover a small percentage (1 %) of XZeusFin's revenues, XZeusFin acts as a limited-risk service provider.

According to the FAR analysis made during the tax audit, XZS Ltd in Ireland is the global IP company and performs DEMPE functions concerning the XZeus Group's Brand and Technology Assets. XZS owns, invests in, bears the risks of, and manages XZeus Group's Brand and Technology Assets. However, XZS Ltd is highly dependent on operating entities which perform contract R&D services to maintain and enhance the value of brand and technology assets. XZS is also depends on the local operating companies to perform sales and marketing activities with end customers. XZS itself does not act as a customer-facing entity.

IPLA transaction:

As a result of the tax audit performed by the Finnish Tax Administration (FTA), tax auditors deemed that, based on the arm's length principle, royalties should be paid by XZeusFin to XZS for the use of the Group's IP.

However, the FTA deemed in the final tax audit report that the CUP method, instead of TNMM (or a hybrid of the two methods), is the best applicable TP method for the royalties paid by XZeusFin to XZS. TNMM was rejected because XZeusFin is a fully-fledged entrepreneurial company owning valuable intangibles. In addition, applying TNMM in the way that the company had applied, led to a steady minimum routine profit (4,55 % of total external revenues) level year after year at a company level, including all the intra-group transactions, which in FTA's view was not at arm's length for a fully-fledged entrepreneur company. Profit split method could have been applicable too in the case. After examining the company's benchmark study for comparable license agreements, tax auditors deemed that the CUP royalty rate should be 5 % of external net revenues based on three comparable license agreements. Altogether, 10 license agreements were rejected as not being comparable due to being too old (license agreements that were more than 13 years old) or due to differences in how the royalty was determined.

IPSA transaction:

In the final tax audit report, FTA accepted the compensation, 7 % mark-up on total costs under IPSA, to be at arm's length.